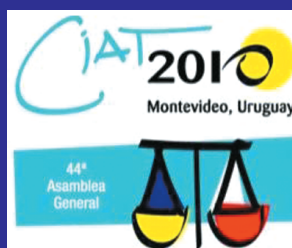




44th CIAT General Assembly

The Role of the Tax Administrations in the Global Crisis



Montevideo, Uruguay
April 12 to 15, 2010



**Inter-American Center of Tax Administrations – CIAT
Dirección General Impositiva – DGI**

44th CIAT GENERAL ASSEMBLY



**THE ROLE OF THE TAX ADMINISTRATIONS IN THE
GLOBAL CRISIS**

**Montevideo, Uruguay
April 12 to 15, 2010**



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Inter-American Center of Tax Administrations - CIAT
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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 38 countries: 29 countries from the Americas and 5 European countries as full members, and 4 countries as Associate Members: Czech Republic, Kenya and South Africa and India. 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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44th CIAT General Assembly

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INAUGURAL CONFERENCE

**THE IMPACT OF THE GLOBAL CRISIS: CHALLENGES AND
APPROPRIATE RESPONSES FROM THE TAX ADMINISTRATION**

Márcio F. Verdi
Executive Secretary
Inter-American Center of Tax Administrations
(CIAT)

Contents: 1. Introduction.- 2. The tax collection observatory.-3. What we already knew about tax matters in Latin America before the crisis.- 4. Taxes on income, profits and capital gains.- 5. VAT.- 6. Excise taxes.- 7. Other taxes.- 8. Some projections for 2010.

1. INTRODUCTION

Early last year, after nearly six months from the detonation of the international financial crisis and when the impact on the Latin American economies began to show, CIAT set out to analyze how this impact was reflecting in the tax collection of its member countries, with a view to providing a timely alert on the need to introduce policy and/or tax administration measures required to counteract the generalized loss of resources.

Short-term data were needfully required for this task. However, by then neither CIAT nor any other international body maintained consolidated data on monthly or quarterly collection as a result of the internationally accepted practice of reporting tax statistics annually, once the information was rendered final. So, a new database was required to be built with preliminary information.

2. THE TAX COLLECTION OBSERVATORY

If the principles of fiscal transparency had been respected, this task would have appeared fairly easy, for anyone with average training would have been able to consult the Internet or the relevant publications and obtained the short-term statistics required to perform this type of

analysis. The experience has shown us that greater efforts are needed in tax transparency policies in the fiscal field, particularly on a sub-national level and in respect of employer's contributions¹, as most countries fail to report this information properly. As a consequence, the work had to focus on the taxes managed by the Central Government (exclusive of employer's contributions).

The central governments of the 17 Latin American countries analyzed in this document (exclusive of Cuba, Venezuela and Haiti), either through their tax administrations or finance ministries, publicize short-term collection statistics of the taxes administered by them, under a cash basis accounting. The problems arise where several entities are in charge of collection, but the situation is fairly manageable. What is true, however, is that the information is usually presented before or after refunds are made, but not under both criteria, thus complicating the analysis on the impact from tax refunds.

On the other hand, the information available on a central government level varies as to the way the tax collection statistics are classified and recorded with respect to the internationally accepted methodology set forth in the IMF's Manual on Government Financial Statistics or that of the OECD. Concepts such as royalties are included as tax revenue, as are penalties too. How payment of tax debts is recorded, tax amnesties or fractioning or simplified systems are all topics for debate.

A proprietary classification was then required. Drawing on the project of the Tax Revenue Classification Manual developed in 2007 by a group of member countries, the CIAT considered it timely and a priority to generate a new manual to support the tax collection quarterly follow-up efforts.

In addition, unlike other bodies, CIAT's new collection statistics allocate collection to that level of government that has tax jurisdiction, regardless of whether such level of government is the one actually using these resources.

The tax collection is recorded on a conventional cash basis, considering not only cash payments but also payment in securities that the central government delivers to taxpayers, for example, in the case of tax refunds.

¹ *Or maybe we have not "googled" correctly.*

All the information is rendered preliminary until the country is able to report it as final. This normally occurs 1 or 2 years afterwards. However, when working mainly on variations and not on levels, the differences between the results of preliminary or final information are very little.

3. WHAT WE ALREADY KNEW ABOUT TAX MATTERS IN LATIN AMERICA BEFORE THE CRISIS

Two of the most recent analyses of the situation of tax revenues in Latin America are one conducted by the ECLAC in 2006 and another conducted by the OECD in LEO 2009. Both used ECLAC's annual data for the period 1990-2006, and both pointed out again at the conventional facts generally accepted by the international fiscal community regarding tax collection in Latin America.

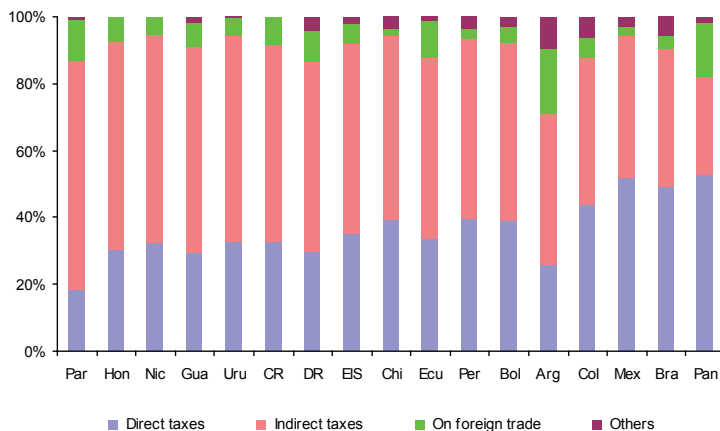
Some of the most known facts in Latin America regarding the taxes administered by the central governments (exclusive of employer's contributions) are:

Even the size of tax revenues is little. Although Latin America has shown some progress over the last decade, as a result of improved macroeconomic policies and the international economic situation, tax collection levels are still low compared to other countries of a similar size.

Besides the little size, the tax composition is too centered on indirect taxes. Latin America has followed the international trend towards expanding the value-added tax, and its taxable base has been expanded progressively as well, especially through the incorporation of services into such base. Its average rate has been increasing too. As for taxes on the consumption of goods and services (ISC, in Spanish), they have concentrated exclusively on products such as gasoline, tobacco and liquors.

Graph N° 1

Taxes administered by the Central Governments (exclusive of employer's contributions), 2008
Percentage share by tax type



Source: CIAT

Continued trend towards reducing taxes on foreign trade. This is evidenced in the signature of multilateral trade agreements. It shows the need to discuss probable ways to recover lost resources.

The redistributive effect of personal income taxes is very little. The weak redistributive effect of the fiscal systems in the region is one of the low level dimensions of tax collection.

The impact of the crisis on the collection of taxes administered by the central governments (excluding employer's contributions): recent evidence

The recent evidence on the impact of the crisis on the tax collection of Latin American countries has not been yet presented in an organized fashion by the international fiscal community. This paper represents a timely effort to fill that gap in respect of the taxes administered by the central governments (exclusive of employer's contributions).

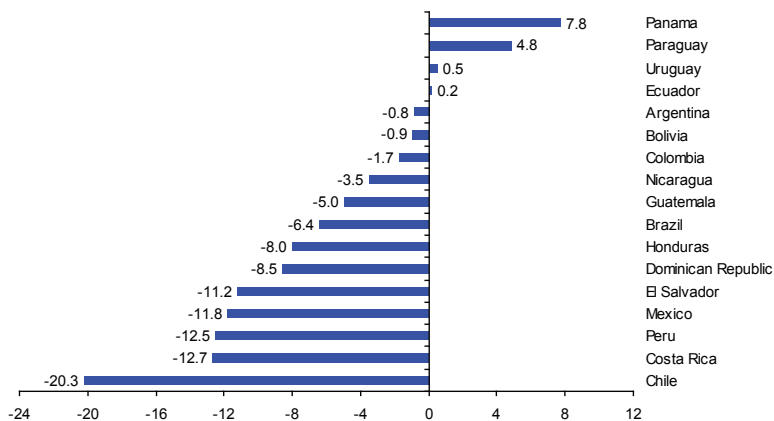
The first indicator used to measure the tax collection performance over one year is the percentage variation in actual terms experienced by it with respect to the preceding year. The CIAT's Observatory shows that

in 2009 the collection of taxes administered by the central governments (exclusive of employer's contributions) in Latin American countries has fallen by 7.5% on average², in real terms, with respect to 2008.

As expected, all countries have recorded falls, except for Panamá, Paraguay, Uruguay and Ecuador. In four countries of Central America (Nicaragua, El Salvador, Guatemala and Honduras), the Dominican Republic and Chile, tax collection has fallen in real terms for the second year. The negative trend has been observed in these countries since mid 2008 (most notably in Chile, where inter-annual variations were already negative), but there is no doubt that the impact of the crisis was fully observed in 2009.

Graph N° 2

Taxes administered by the central governments (exclusive of employer's contributions), 2009 (E)
Real inter-annual percentage variations



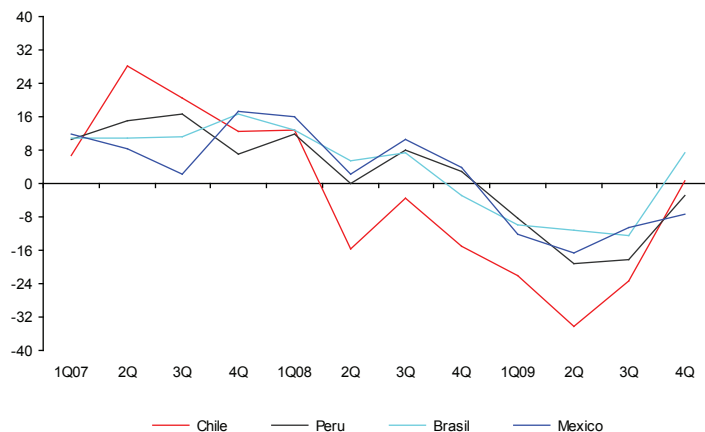
Source: CIAT

The global result is dominated by the falls in the tax collection of four of the six largest economies in the region (Mexico, Brazil, Peru and Chile). Upon removing the variations of these four countries, the fall would be only by 0.7%, in real terms, with respect to 2008.

² Weighted average. The same for all average calculations henceforth.

Graph N° 3

Taxes administered by the central governments (exclusive of employer's contributions), 2007-2009 (E)
 Real inter-annual percentage variations



Source: CIAT

Certainly, the main source of the falls has been the extended contraction of exports (as a result of the impact on exchange rates from the reduction in commodity prices) and its cascade effect on production, consumption and investments (including imports).

But they are also the consequence of the application of tax measures adopted as part of fiscal stimulus packages, such as:

Chile: i) provisory reduction in stamp taxes, ii) provisory reduction in monthly provisional payments made by companies based on their profits, iii) early refund of 2010's income tax to natural persons. These measures have supposedly had an annual impact of 300.435 millions from the reduction in PPM, 153.285 from early income tax advances and 500.231 million from stamp taxes.

Brazil: i) reduction in the IPI, mainly automobiles, construction materials, home appliances, capital goods, ii) reduction in IOF from 3% to 1.5% due to credit operations, iii) revision of charts of individuals' income taxes, which created lower tax bases (7.55% and 22.5%) favoring the middle class, iv) reduction in the COFINS rate for motorcycles. These measures resulted in an annual impact of 14,400 million *reais* (0.47 of the GDP). By 2008 the CPMF had already been eliminated.

Colombia: the stamp tax was reduced from 1.0% to 0.5%.

Argentina: the tax amnesty went not as well as the whitewash, but was able to collect some 1,300 millions in 2009 in the first one, and some 1,000 millions in the second one (the tax and social security amnesties covered all tax and social security obligations due as of December 31 of 2007; the whitewash would allow reporting goods in the country or abroad and the entry in the country of funds maintained abroad by residents). The withholdings on wheat and corn exports were also reduced (cutting down export rights tax bases applicable to wheat from 28% today to 23%, and corn from 25% to 20%), by one additional percentage point for every million ton in excess of production over the average of the last years, and the withholdings on the exports of all fresh fruits and vegetables were cut down by 50%.

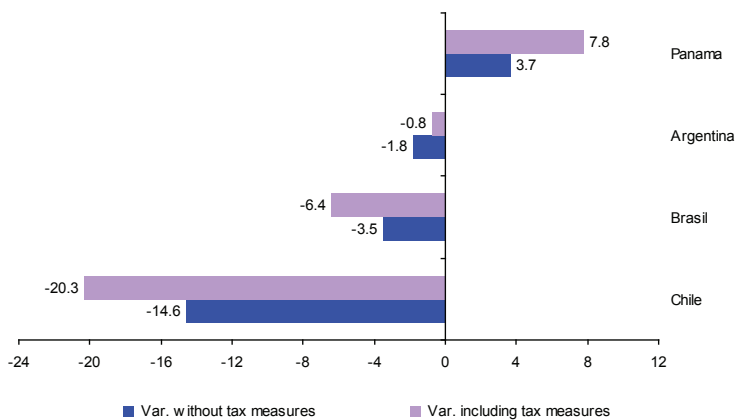
Panama: A tax amnesty was established for debts outstanding as of June 2009, with successful results, collecting nearly B/.129.4 million. The excise tax on cigarettes was raised (firstly from 32.5% to 50%, and then to 100% over the consumer sales price, with a top of 1.50 per pack).

Putting aside the positive or negative impact of these measures, the performance of some countries in 2009 changes, but the trend remains the same.

Graph N° 4

Taxes administered by the central governments (exclusive of employer's contributions), 2009 (E)

Real inter-annual percentage variations



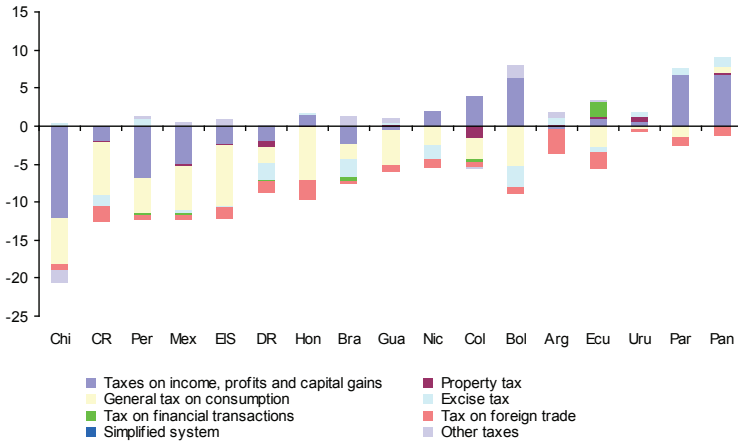
Source: CIAT

As stated previously, the tax composition in Latin America is excessively centered on indirect taxes. Therefore, it should not be surprising that the taxes that contributed the most to the fall in total collection (excluding employer's contributions) were the general taxes on consumption³, with the only exception of **Panama's** ITBMS, followed by income taxes, capital profits and gains; although it should be noted that, alternatively, in many countries this behavior was able to soften the fall in the global collection, as is the case of **Nicaragua, Honduras, Colombia, Uruguay** and mostly **Bolivia, Paraguay** and **Panama**. The fall in foreign trade taxes was also widespread and particularly important in **Ecuador, Honduras** and mainly **Argentina**, where rights over exports are charged; wealth taxes and taxes on financial transactions also recorded falls, except for a few cases, as is the case of **Ecuador's** tax on the exit of currencies.

Graph N° 5

Taxes administered by the central governments (exclusive of employer's contributions), 2009 (E)

Tax contribution to real inter-annual percentage variations
In percentage points



Source: CIAT

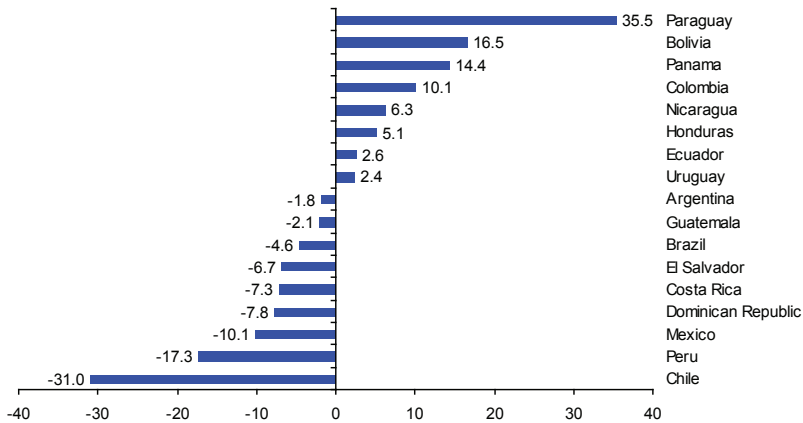
³ VAT in all analyzed countries - Brazil's ICMS is not included because it is a state tax.

4. TAXES ON INCOME, PROFITS AND CAPITAL GAINS

The tax on income, profits and capital gains fell by 5.7 on average, in real terms, with respect to 2008, with significant results in Bolivia and Paraguay.

Graph N° 6

Tax on income, profits and capital gains, 2009 (E) Real inter-annual percentage variation

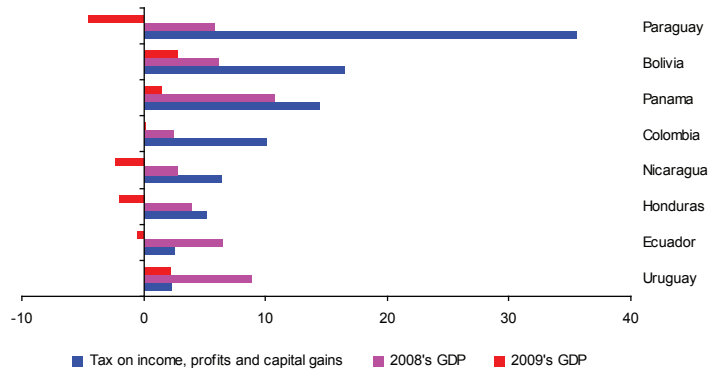


Source: CIA T

These taxes have normally an annual frequency and are less responsive to changes in the economic cycle because usually what is collected over one year is more the result of the performance in the previous year than the performance of the current year. As 2008 was a relatively good year (despite what happened in the second semester) for the group of countries recording positive growth rates (**Bolivia**, **Paraguay**, etc.), it may be argued that the impact on 2009's GDP from the widespread contraction of exports was lower in such countries. In particular, **Bolivia** and **Colombia** are strongly influenced by the results obtained in 2008 by YPFB and Ecopetrol.

Graph N° 7

2008's and 2009's GDP (E) and tax on income, profits and capital gains, 2009 (E)
 Real inter-annual percentage variations



Source: CIAT

In any case, the contraction of tax advances as a result of the fall in exports, where based on gross revenues, may have influenced more the collection results of the countries recording highest drops in the collection of the tax on income, profits and capital gains, which are in addition the countries most influencing the average results of Latin America. This is the case of commodity-dependent countries (**Peru and Chile**) and countries dependent on tourism, like **Costa Rica, Dominican Republic and Guatemala**.

Graph N° 8

Tax on income, profits and capital gains, 2009 (E), Exports in US\$ in 2009 and 2008's GDP

Real inter-annual percentage variations for the tax on income, profits and capital gains and 2008's GDP, and nominal variations for exports



Source: CIAT

It should be noted that many countries adopted measures for the tax on income, profits and capital gains as part of their fiscal stimulus program, as is the case of Chile, which temporarily cut down the monthly provisional payments made by companies based on their profits, and advanced 2010's income tax refunds to natural persons.

Furthermore, **Brazil** revised and reduced the charts relative to Individuals' income tax, and fixed lower tax bases (7.55% and 22.5%) that favored the middle class.

Finally, **Argentina** and **Panama** set forth tax amnesties for past due obligations, among which stand out those related to the tax on income, profits and capital gains.

As most countries do not apply taxes or assess income and capital gains very little, the collapse in the value of financial assets or profitability had little impact on the collection of the tax on income, profits and capital gains in 2009.

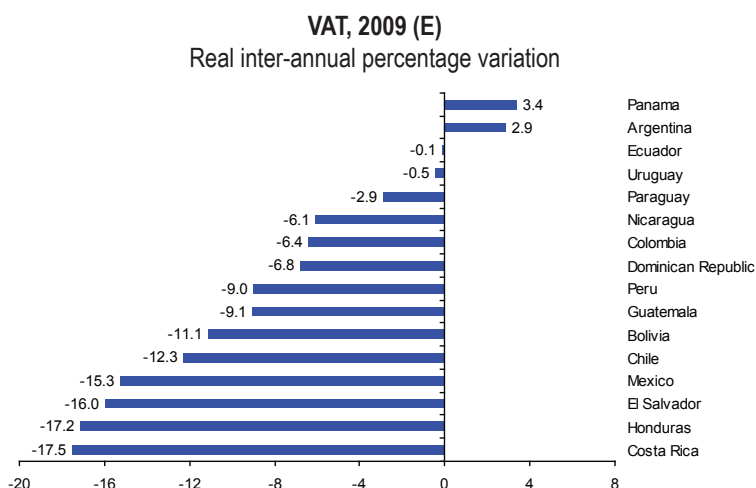
Making a breakdown by taxpayer or income type is not easy because the countries are not good at providing details of such information. A great many improvements are required in this sense; a Working Group is already in place at CIAT working on a project on this regard.

5. VAT

If we remove the tax on income, profits and capital gains from the total collection, we can see that the general taxes on consumption, which are very sensitive to economic cycles and are of great relevance for the total collection of the taxes administered by the central governments (excluding employer's contributions), were the main cause of the falls in 2009.

The Value-added Tax (VAT), with the only exception of Panama, dropped in all countries, reaching an average drop in Latin America of 9.3%, in real terms, with respect to 2008. The global result is dominated by a strong fall in Mexico, but also by a good performance of Argentina⁴.

Graph N° 9



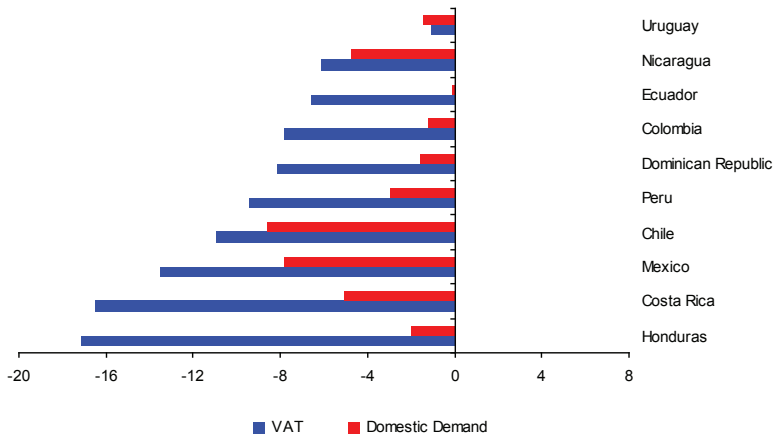
Source: CIAT

These results are tied directly to the drops in the domestic demand (which include the widespread contraction of imports, mainly capital goods and inputs).

⁴

Graph N° 10

VAT and domestic demand in selected countries, 2009 (E)
Real inter-annual percentage variation

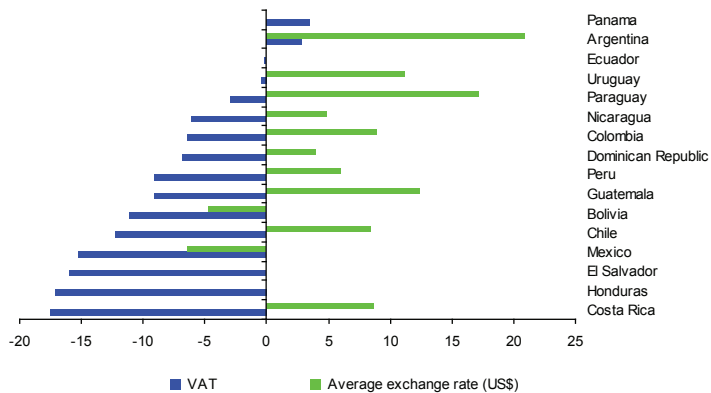


Source: CIAI

But since the fall in imports damaged the collection of import VAT severely, the degree of depreciation of some currencies may have also impacted the total fall in the VAT.

Graph N° 11

VAT and Exchange rate (US\$), 2009 (E)
Real inter-annual percentage variation for VAT and nominal variations in exchange rate



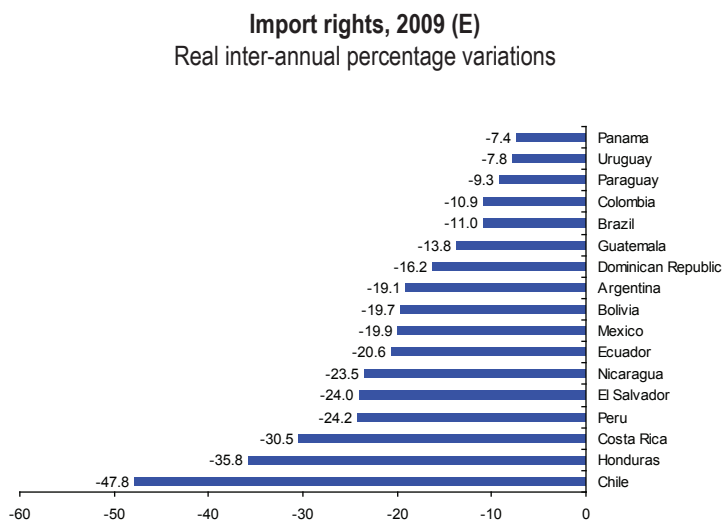
Source: CIAI

As for the VAT, the analyzed countries did not introduce significant measures as part of their fiscal stimulus programs. In any case, the tax amnesties in **Argentina and Panama** may have had some influence. Besides, despite there being not sufficient information to assert a generalization, some countries who manage a VAT-Product could have allowed the immediate deduction of the fiscal credit upon the acquisition of capital goods and hence provided some financial relief to taxpayers, which could have had an impact on collection.

Import rights

Although with decreasing importance in the total collection pie, except in **Panama, Paraguay and Ecuador**, import rights fell dramatically. Compared to 2008, the revenues from import rights in Latin America went down by 17.2% on average, in real terms. While countries such as **Chile, Honduras and Costa Rica** show falls in excess of 30%, the little share this tax has in the collection of such countries prevents it from being mainly attributable for the falls.

Graph N° 12

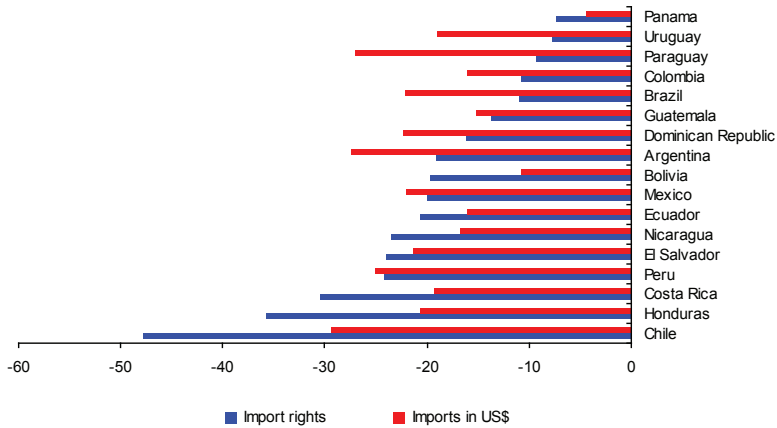


Source: CIAT

Without major variations in the nominal average tariffs, except for cases such as **Bolivia** (used cars) and **Ecuador**, the widespread contractions in imports, particularly of finished goods, were the main cause of the falls, since most capital goods are tariff-exempted.

Graph N° 13

Imports (US\$) and import rights, 2009 (E)
 Real inter-annual percentage variations and nominal variations in imports

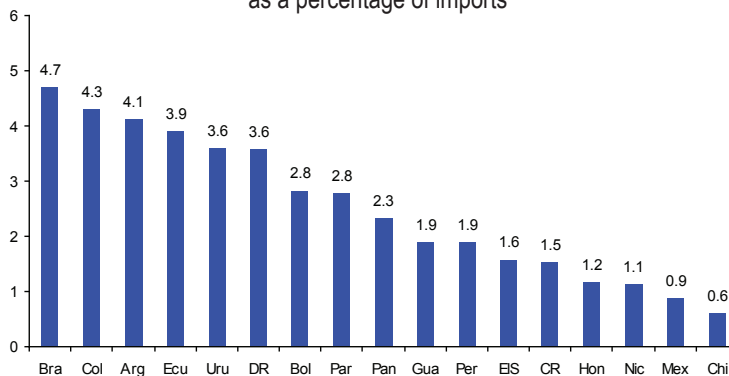


Source: CIAT

As a consequence of the widespread fall in imports, effective tariffs stood eventually at 3.1% on average for Latin America, not showing many changes in the per-country ranking of trade protection in the region.

Graph N° 14

Effective tariff, 2009 (E)
 as a percentage of imports

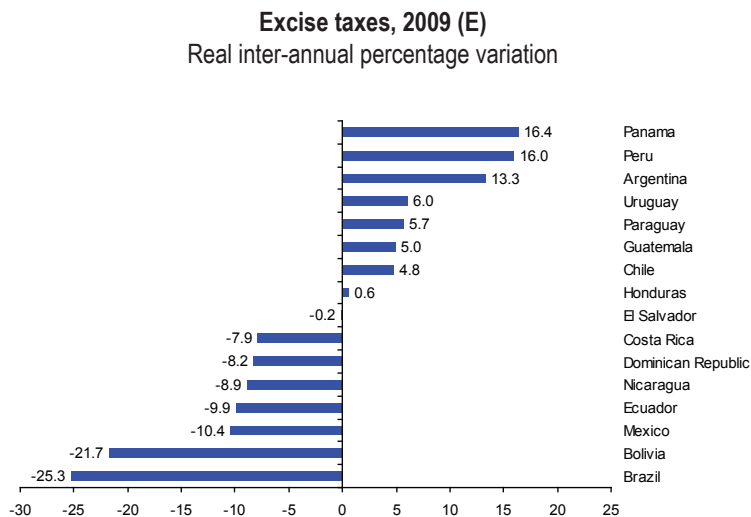


Source: CIAT

6. EXCISE TAXES

In Latin America, excise taxes fell on average by 10.8%, in real terms, with respect to 2008.

Graph N° 15



Source: CIAT

While this behavior is a reaction to the generalized contraction of the domestic demand, it also reflects the application of tax measures and, most of all, the impact from the recovery of fuel prices with respect to 2008 in many countries.

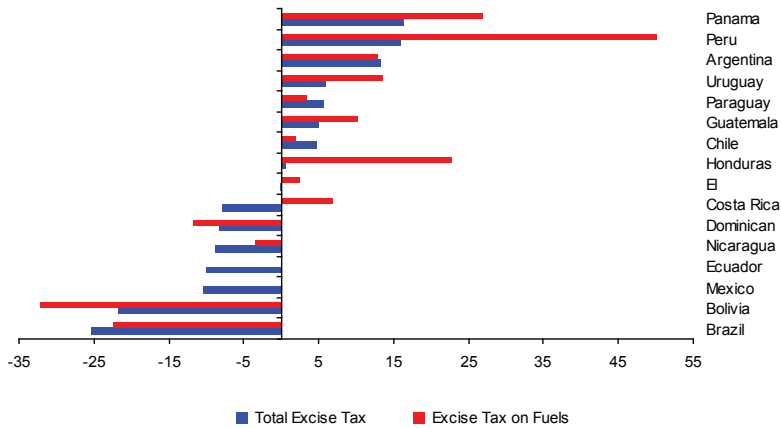
In the first case, it should be remembered that early this year, **Brazil** cut down the IPI, mainly on automobiles, construction materials, home appliances and capital goods. **Panama** also raised excise taxes on cigarettes (firstly from 32.5% to 50% and then to 100% over the consumer sales price, with a top of 1.50 per pack).

In the second case, **Panama, Peru and Argentina** phased out the subsidies on the price of fuel in 2008 and others left it to float freely.

Many reforms in excise taxes have become effective in 2010.

Graph N° 16

Total Excise Tax and Excise Tax on Fuels, 2009 (E)
Real inter-annual percentage variation



Source: CIAT

7. OTHER TAXES

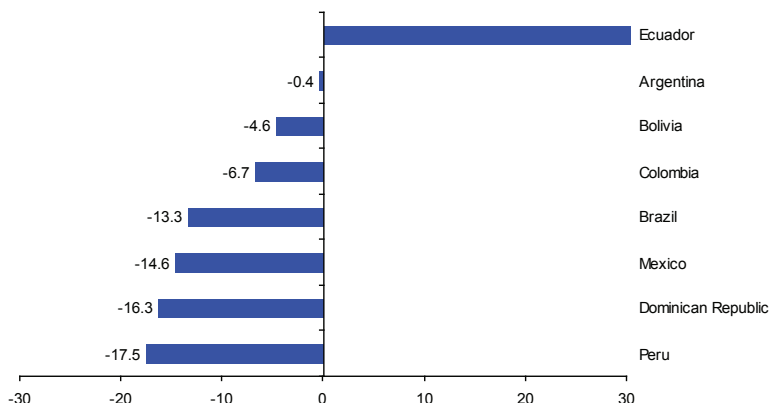
The crisis also affected the countries that levy taxes on financial transactions (exclusive of the taxes on juridical acts), observed in the contraction of the volume of operations in the financial system, except in the case of the tax on exit of currencies in Ecuador.

Once again, in the case of Brazil it should be remembered that there was a reduction in the OIF from 3% to 1.5% for credit operations, etc., as part of the fiscal stimulus package. The CPMF had already been abolished in 2008.

Graph N° 17

Taxes on financial transactions, 2009 (E)

Real inter-annual percentage variation



Source: CIAT

In countries taxing juridical acts, the application of measures as part of their fiscal stimulus programs had a strong impact, particularly in **Chile** and **Colombia**. In Chile there was a provisional reduction in stamp duties, while Colombia cut down the stamp duty tariff from 1.0% to 0.5%.

Among the countries taxing exports, the most important (or, rather, the only one) being **Argentina**, it should be remembered that the withholdings on wheat and corn exports were reduced (the tax base of export rights applied to corn was down from 28% to 23% and corn from 25% to 20%), as well as the withholding taxes on the export of all fresh fruits and vegetables.

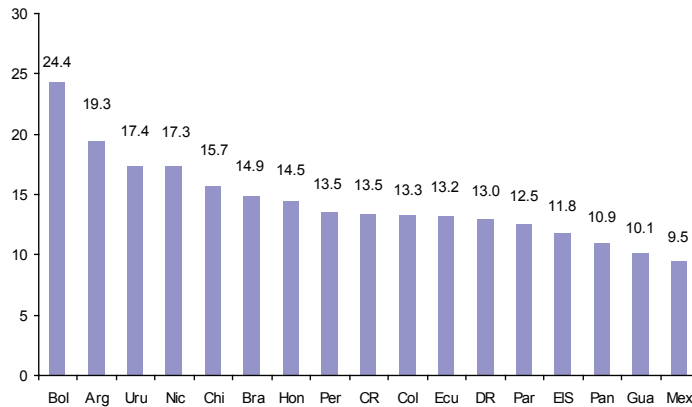
There is not much to be said about tax refunds in the absence of detailed information, as stated previously, which is expected to be improved with the above cited Working Group. On the one hand, it is concluded that the VAT on exporters went down, but on the other hand, the acceleration in refund procedures may have raised them. In Peru, the refund of import rights to exporters was increased from 5% to 8%.

8. SOME PROJECTIONS FOR 2010

The behavior of taxes led the fiscal pressure of the taxes administered by the central governments (excluding employer's contributions) in Latin America to 13.7%, on average, in 2009, without showing many changes in the per-country ranking of fiscal pressure in the region.

Graph N° 18

Taxes administered by the central governments (exclusive of employer's contributions) in Latin America, 2009 (E), as percentages of the GDP

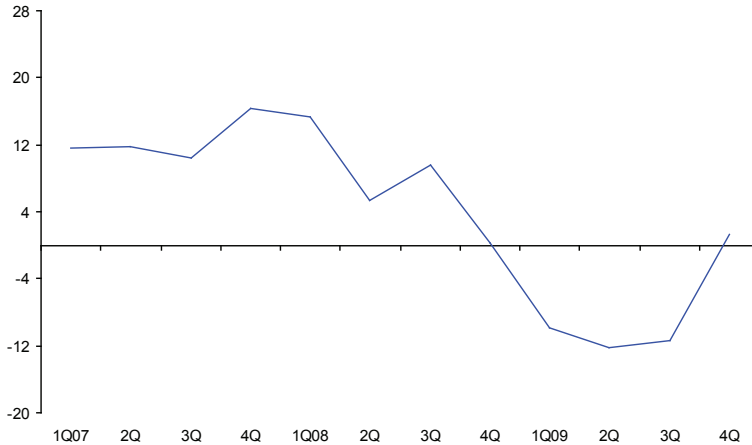


Source: CIA/T

Taking into account that the negative trend of tax collection has been phasing out since the third or fourth quarter of 2009 (statistical rebound) in the large economies that were most harmed this year, in the small economies that were most harmed this year and in middle-sized economies which showed the best performance in 2009, a better performance is expected for 2010, mostly in the case of the VAT, as the domestic demand recovers overall, and in the case of excise taxes, particularly the excise tax on fuels. In the case of the tax on income, profits and capital gains, the results are expected to be just middle favorable, especially in countries that showed better growth rates in 2009.

Graph N° 19

Taxes administered by the central governments (exclusive of employer's contributions) in Latin America, 2007-2009 (E)
Real inter-annual percentage variations



Source: CIAIT

Additionally, many new tax measures have been approved for 2010.

In the case of the VAT: i) Mexico raised the VAT base from 15% to 16% , and from 10% to 11% in the border zone; and ii) Panama expanded the taxable base of the ITBMS (including bank and financial service commissions, commissions paid to personal and real property brokers, professional services provided to persons domiciled abroad, fixed telephony for commercial use – the residential rate remains exempted), and could raise the overall rate of the ITBMS 5% to 8%.

In the case of the tax on income, profits and capital gains: **i) Ecuador** will tax the distribution of profits (fully integrated with the deduction of payments on company level), but this will have an impact in 2011, **ii) Panama** introduced withholdings as payment on account for the disposal of real property (3% of the disposal value, with the possibility of becoming a final withholding), and taxed the value of lands in condominium holding attached to above-and under-ground property, **iii) El Salvador** has introduced a 10%-income tax on the interest of saving deposits in excess of a threshold and on the first sale of real property in excess of a threshold, **iv) Nicaragua** has established a final 0.6%-withholding on the interest of deposits in the financial system, and extended the individual's income tax exemption trench, which will

result in collection losses in 2010, **v) Peru** has fully enforced the new dual taxation over individual's income, which will tax the income and capital gains by 5%, which had been exempted for two decades; **vi) in Mexico**, withholdings on salaries have increased in line with the provisional increase in the maximum marginal rate from 28% to 30%, **vii) in Ecuador**, the income tax advance that was effective has been transformed into a minimum tax, **viii) in Colombia**, the deduction from the gross income applicable to the purchase of production assets has been reduced from 40% to 30%, and certain benefits have been removed in duty-free zones, and the impact from the reduction in the income tax from 34% to 33% will be noted in 2009's fiscal year, **ix) in Mexico** the corporate tax rate has been raised provisionally from 28% to 30%, which will have an impact in 2011, **x) in Nicaragua**, the manner to determine the advances of corporate taxes (minimum payment) was modified, from 1% on assets to 1% on gross income; also, a final withholding of 0.6% has been fixed on the interest of the financial system's deposits; **xi) El Salvador** has introduced a 10%-Income tax on the interest of saving deposits in excess of a threshold; and **xii) Panama** has introduced changes in the companies that operate in the Colón Free-Trade Zone.

As for excise taxes: **i) Mexico** cut down the IESP on services provided through a public telecommunications network (except for Internet, public and rural telephony and interconnection services) by 1 percentage point (3% now); the IESP on beer has been reduced from 28% to 26.5%; the IESP on liquors over 20° GL was increased from 50% to 53%, the IESP on gambling and lottery was up from 20% to 30%, and the rate applicable on cultivated tobacco was raised (it is now 0.8 pesos per gram of tobacco or pack), **ii) El Salvador** has introduced changes in the excise taxes on liquors and tobacco; additional taxes have been introduced on calls made outside **El Salvador** as they are considered export goods. Hence, international incoming calls, which in 2008 were up 35% as a result of the \$0.04-tax per minute, will now have an additional payment of 13% on the cost of the minute. In this way, if the minute is \$0.12, it will now be increased by 13% of the VAT (\$0.0156) plus \$0.04 of the tax. If a Salvadorian located abroad speaks with their family for 30 minutes, they will pay \$3.60 for the 30 minutes, plus \$0.46 for the 13%-tax and \$1.20 for the \$0.04 tax per minute, which totals \$5.26, of which \$1.66 are taxes.

In the case of other taxes: **i) Ecuador** raised from 1% to 2% the tax on the exit of currencies, but the threshold is increased from 500 to 1000 dollars, **ii) in Colombia** the term of the Wealth Tax was extended to 0.6%, but a higher rate of 1.2% is fixed for net wealth in excess of 5 billion pesos, **iii) in Mexico**, the IDE rate was increased from 2%

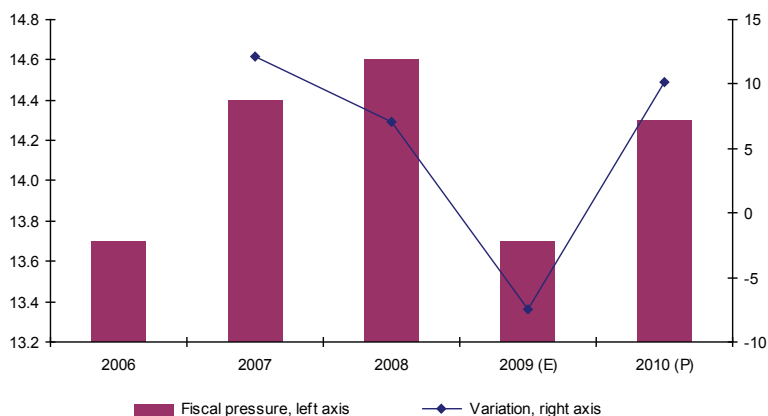
to 3% and the monthly threshold was reduced from the point where the 25,000 peso-withholding is applicable, to 15,000 pesos, and **iv) in Panama**, there is an outstanding balance of B/.70.6 million in payment settlements that expire on June 2010. Also, the maximum amount payable for the Notice of Operation tax has been raised from US\$ 40,000 to 60,000 (US\$ 50,000 in the Free-Trade Zone), at a rate of 2% over capital (1% on the Free-Trade Zone), and the real property tax was raised through a new calculation chart.

For all this, the collection of taxes administered by the central governments of Latin America (exclusive of employer's contributions) is expected to go up by 10,2% on average, in real terms, with respect to 2009, and will reach, on average, 14.3% of the GDP in 2010.

Graph N° 20

Taxes administered by the central governments (exclusive of employer's contributions) of Latin America, 2010 (P)

As percentages of the GDP and real inter-annual percentage variation



Source: CIAT

TOPIC 1

THE NON-FISCAL FUNCTIONS OF TAXATION AND THEIR IMPACT ON THE TAX ADMINISTRATION

Lecture

Topic 1

TRANSPARENCY AND ETHICS AS A CONDITION TO STRENGTHEN AND IMPROVE INSTITUTIONAL EFFECTIVENESS

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Canada Revenue Agency
(Canada)

Contents: Executive Summary.- 1. Introduction.- 1.1 Purpose of paper and scope.- 1.2 Ethics, accountability and transparency in Tax Administration.- 2. Promoting ethics within tax administrations.- 2.1 Ethics as the foundation of effective organizations.- 2.2 Human resources, training and Other measures to promote ethics in Tax Administrations.- 2.3 Public service ethics as an institutional attribute in Tax Administrations.- 3. Promoting accountability and transparency in Tax Administrations.- 3.1 Fundamental accountabilities of tax administrations.- 3.2 Demonstrating accountability.- 4. Compliance as an ethical issue.- 4.1 Taxpayers and their tax ethics.- 4.2 Responsible citizenship and corporate social responsibility.- 5. Conclusion

EXECUTIVE SUMMARY

One of the primary things that governments need tax administrations to be accountable for is a continuing and predictable flow of revenue. This is more important than ever in an era of economic volatility that strains economies and creates incentives for non-compliance among taxpayers. In order for tax administrations to effectively discharge their mandate, they need most taxpayers to be compliant—willingly compliant—because forced compliance is too costly to be effective. This paper explores transparency and ethics as a condition to strengthen and improve the institutional effectiveness of tax administrations.

A tax administration's ability to fulfill its role—that is, its institutional effectiveness—remains in part dependent on the basic inclination of citizens to comply with the rules of the tax system. Tax administrations foster taxpayers' willingness to comply by operating in accordance

with the principles of ethics, which orientate staff behaviours and organizational activities toward the public good, by being accountable for performance and means used, and by being transparent, making the activities of the tax administration visible. These attributes have universal appeal, and are recognized as fundamental to sound tax administration by a number of organizations, the Inter-American Center of Tax Administrations (CIAT) included. One effect of the global economic crisis has been a renewed public and political focus on these principles as critical elements of sound governance in any domain.

This paper describes a number of ways in which a tax administration can strengthen ethics in its organizational culture, and demonstrate accountability and transparency in both operations and the exercise of its mandate. The discussion begins by examining mechanisms and conditions that promote the proper conduct of tax administration staff, such as the presences of a robust framework of rules and accepted standards of behaviour, and sufficient human resources support to sustain a professional workforce.

At an organizational level, ethics manifests as fairness, and is demonstrated in the tax administration's application of tax laws and its treatment of taxpayers. With public expectations for accountability and transparency more relevant now than ever before, tax administrations can make use of proven techniques, perhaps most important among which is the periodic reporting to legislators and the public on actions, initiatives, performance and expenditures. This forthright disclosure of operations, coupled with external oversight, serves not only to ensure public accountability, but also to build public confidence. A number of examples from the Canada Revenue Agency (CRA) illustrate the application of these techniques.

As with tax administrations, the principles of ethics, accountability and transparency apply equally to taxpayers. The proper functioning of a self-assessment system, which by its nature leaves some opportunities for non-compliance open, requires that taxpayers put these principles into practice in the management of their tax affairs. True self-assessment assumes full disclosure of tax activities and practices, and is premised on taxpayers behaving ethically by paying their fair share of taxes as required under law. In this context, compliance is the ultimate taxpayer accountability.

As pressure mounts on tax administrations to more effectively combat harmful international tax planning and the abusive use of tax havens,

some tax administrations, including the CRA, are beginning to explore new and innovative ways to dampen the appetite of those that engage in such practices. Ethical appeals offer one such avenue. For example, shouldering a fair tax burden as set out in law is now being discussed in the context of good corporate governance.

Finally, this paper highlights the element of reciprocity in how tax administrations and taxpayers engage with each other, where tax administrations offer ethics and transparency in return for willing compliance and transparency on behalf of the public as taxpayers, with the two halves tied together by mutual accountability. Ultimately though, it is incumbent on the tax administration, with the balance of power at the centre of the tax system, to take the lead in setting and sustaining the right context for a mutually acceptable relationship by demonstrating ethics, accountability and transparency. In turn, taxpayers can rightfully be expected to reciprocate.

INTRODUCTION

Purpose of Paper and Scope

Recent world events have focused much political and public attention on the principles of ethics, accountability and transparency and their function in good governance and institutional effectiveness. This paper briefly explores the purpose and role of these principles, and their relevance within the specific context of tax administration. This paper is written largely from a Canadian tax perspective and primarily uses examples from the CRA to illustrate concepts and ideas. To assist readers in understanding this context, an overview of the Canadian tax system is provided in Appendix A.

1.2 Ethics, Accountability and Transparency in Tax Administration

1.2.1 Tax Administrations

The effectiveness of a tax administration in fulfilling its primary role to secure government revenues and protect the tax base is of utmost importance. A country's tax system plays a key role in supporting its citizens' quality of life, and tax administrations bear an enormous responsibility to ensure that tax is collected in order to finance public programs and services, and redistribute income. This is particularly true in the current era, where recent economic volatility has dampened government revenues and is expected to result in declining taxpayer

compliance. As the economy slowly recovers, tax revenues in many countries are expected to remain difficult to collect as economic pressures continue to make it difficult for individuals and businesses to meet their obligations. Tax administrations worldwide now recognize the need to focus on maximizing compliance in a difficult environment.

Tax administrations are not without the tools necessary to face this, or any other set of circumstances. Governments and tax administrations have evolved a number of methods to obtain compliance from the taxpaying population. Notwithstanding these methods, a tax administration's ability to fulfill its role—that is, its institutional effectiveness—remains in part dependent on the basic inclination of citizens to comply with the rules of the tax system. That taxpayers consent to transfer their resources to the state through taxation is not fully borne out of their legal obligation to support the tax system. Rather, it is widely thought that the intrinsic willingness of taxpayers to pay taxes¹ is a public expression of trust and confidence in the tax administration to be fair and diligent in the exercise of its mandate, and in the government as a whole to meet the needs of the citizens that it serves. In other words, citizens are more likely to consider tax compliance as reasonable and appropriate when institutions are seen as legitimate. Put conversely, Braithwaite argues that:

“In return for taxes, taxpayers should not only receive goods and services, but also sound governance that is respectful and protective of democratic principles and processes...If taxpayers offer compliance, the tax office, as part of government, should reciprocate with integrity.”²

While tax administrations, even governments, may aim to demonstrate integrity in the discharge of their duties, integrity is difficult to quantify without looking at the more tangible elements of integrity: ethics, accountability and transparency. Although much attention is now focused on these principles—or lack thereof—in the context of corporate conduct in the lead up to the global economic crisis, they are no less important for the public sector. In fact, all three have been identified as part of the founding principles of public administration.³

1 *The literature refers to this willingness as tax morale. See for example: Feld, Lars P. and Frey, Bruno 2. Deterrence and Tax Morale: How Tax Administrations and Taxpayers Interact (2002)*

2 *Braithwaite, Valerie. Tax System Integrity and Compliance: The Democratic Management of the Tax System (2003)*

3 *Armstrong, Ella. “Integrity, Transparency and Accountability in Public Administration: Recent Trends, Regional and International Developments and Emerging Issues.” UN Public Administration Programme (2005): 1-10*

Perhaps nowhere are these fundamental principles more important than for a tax administration. Sound administration, administrative oversight and the tangible elements of public sector integrity are key to effective tax administration.

Any meaningful discussion on the role of ethics, accountability and transparency in tax administration must first start with the obvious: what these terms mean in this context.

Ethics describe one's orientation relative to good or bad behaviours, where what is ethical aligns with the former and what is not, the latter. In the public domain, it is the public interest that defines what is good. For public servants, being ethical in one's professional capacity requires one's personal purpose to align with public service values. In practice, behaviour in the public domain must be governed by rules of conduct and sustained by organizational culture to ensure that as agents of government, public servants do not sacrifice the public good for private gain. Ethics can also be observed at the level of the collective. An ethical tax administration has an organizational character sufficiently orientated on the public interest, which endures despite leadership transitions and staff turnover. A tax administration's ethical stance is reflected in its policies, programs and relationships with citizen-taxpayers and other branches of government.

Accountability presumes a type of moral contract between the tax administration and the public. It describes a relationship based on the tax administration's obligation to demonstrate and take responsibility for performance—both the results achieved in light of citizen and stakeholder expectations, and the means used. In being accountable, public officials must subject themselves to whatever scrutiny is appropriate to their offices. For their part, citizens reciprocate by fulfilling their civic duties, of which tax compliance is fundamental.

Transparency makes the activities of the tax administration visible and is often considered the sustaining element of accountability. It implies disclosure of the full information required for collaboration, cooperation, collective decision making and verification.

These principles have universal appeal.⁴ Tax systems benefit from

⁴ *There is international acceptance of the positive nature of these principles. For instance, these principles are reflected in the CIAT Declaration on the Promotion of Ethics in Tax Administrations. Academically, recent research has studied why morality varies so much across cultures yet still shows so many similarities and recurrent themes. The University of Virginia's Moral Foundations theory proposed innate and universally available psychological systems as the foundation of "intuitive ethics", which in turn gives rise to the unique moralities we see*

demonstrations of these principles but suffer in their absence. Research shows that the way tax administrations interact with taxpayers impacts taxpayer behaviour.⁵ Taxpayers who believe that tax laws are created and administered arbitrarily and unfairly may compensate by decreasing their tax liability through illegitimate means.⁶ Further, taxpayers remit their taxes with the expectation of real civic benefits, however perceptions that 'their' money is being used in a wasteful or inappropriate manner may provide the moral justification to opt out of the system. Such actions are unlikely to be constrained by social norms if many taxpayers share similar views. Some even suggest that technical reforms can offer little to offset the impacts of a significant erosion of public confidence in a tax administration.⁷ It is of little surprise then that many tax administrations view maintaining the public's trust and confidence as fundamental to a self-assessment tax system, where high levels of participation with consent provides not only the basis for positive compliance outcomes, but also reduces the costs of administration and allows resources to be directed towards high-risk areas.

1.2.2 Taxpayers

Even though tax administrations play a central role in ensuring compliance with the legislation they administer, they are but one component of the tax system. It is the CRA's view, for example, that the tax system comprises the tax administration, taxpayers (businesses and individuals) who have obligations under the tax laws of the state, and the intermediaries who provide advice and assistance to taxpayers.⁸ While the integrity of public servants and tax administrations is one half of the discussion around transparency and ethics, the integrity of taxpayers (and the tax intermediaries who facilitate the arrangement of one's tax affairs) is the other half. Compliance is, of course, mandated by law. However taxpayer integrity is not particularly about the end result, but rather implies an acceptance of the correctness of being in

around the world: University of Virginia Moral Foundation website. <http://faculty.virginia.edu/haidtlab/mft/index.php>

5 Feld and Frey (2002)

6 Michael Wenzel has classified the concept of fairness in taxation as 1) the perceived fairness of outcomes (for example, tax burdens and tax-funded benefits), 2) fairness of procedures and treatment (for example, rights and respectful treatment), and 3) fairness of sanctions (for example, punishment and amnesties). Wenzel, Michael. *Tax Compliance and the Psychology of Justice: Mapping the Field*. Chapter 3, *Taxing Democracy*, Braithwaite, Valerie (Ed.) 2003.

7 Everest-Phillips, Max. *Business Tax as State-building in Developing Countries: Applying Governance Principles in Private Sector Development*. *International Journal of Regulation and Governance*, 8(2): 123-154

8 The CRA also sees a fourth element: the federal, provincial and territorial laws and regulations it administers.

compliance, with actions subsequently carried out as a result of that value decision, not because of the coercive power of rules.

As with tax administrations, the principles of ethics, accountability and transparency apply equally to taxpayers. Taxpayers' conceptions of what is right or wrong as manifested in their compliance decisions constitute their tax ethics. These influence the extent to which taxpayers willingly fulfil their tax obligations. In a self-assessment system that by its nature leaves some opportunities for non-compliance open, the tax ethics of individual taxpayers need to conform to broader responsibilities beyond one's pure self-interest. Because tax law locates the responsibility for determining one's tax liability with the taxpayer, compliance is the ultimate taxpayer accountability, reciprocating the obligation of tax administrations to account for performance. In the act of self-assessment, taxpayers demonstrate transparency in the disclosure of their activities and tax practices to the tax administration. At its simplest, transparency in managing one's tax affairs means the proper declaration of income and deductions in arriving at one's liability. At its highest level, it is an active interest by taxpayers in developing a relationship with the tax administration to ensure that the tax administration is aware of their current activities and tax practices.

Taxpayer behaviour is complex, however, and compliance postures can be influenced by a number of factors.⁹ Socio-psychological theories of compliance assume that factors such as moral and ethical preferences can lead taxpayers to follow through on their tax obligations, and more specifically, that certain ethical motivations set natural limits to the range of behaviours that some taxpayers will consider in managing their tax affairs.¹⁰

In other words, if taxpayers see compliance as an ethical issue with implications for self-image and reputation in light of values around honesty and social cohesion, for example, they will strive to meet their obligations regardless of the economic utility of non-compliance. Even from an economic analysis point of view, the desirability or demand for any outcome is based on underlying factors such as wants, needs, and values.

Therefore it is not surprising that studies have shown that the rate

⁹ *Considerable research has been done on factors influencing taxpayer compliance. This paper offers only a limited perspective.*

¹⁰ Roark, Stephen J. *The Influence of Ethical Attitudes on Taxpayer Compliance*. *National Tax Journal* (1994)

of compliance is higher when taxpayers have a strong belief that tax evasion is not ethical.¹¹ Certainly ethical considerations offer a possible explanation for some individual taxpayer behaviour; however discussions around organizational character suggest that similar considerations could also inform corporate decision-making. To improve compliance outcomes, it may be that tax administrations can complement efforts to foster trust and confidence by appealing to taxpayers' ethical values and promoting the concept of social duty.

2. PROMOTING ETHICS WITHIN TAX ADMINISTRATIONS

2.1 Ethics as the Foundation of Effective Organizations

The view that a revenue organization's obligation to protect the integrity of a tax system demands that employees be held to the highest standards of professional behaviour is one that is shared by many tax administrations and is enshrined in the CIAT Declaration on the Promotion of Ethics in Tax Administrations.¹² The decisions and conduct of revenue employees do affect people's lives and can—cumulatively over time— influence taxpayer behaviour. That employees be objective and impartial in carrying out their duties, seeing themselves and being seen by others as professionals, is essential. In this light, ethics in a tax administration is as much about transparency as professional values.

“Our success rests in large part on our professionalism and our integrity. Annually, we handle millions of transactions that have an impact on people and their opinions concerning us.”

Canada Revenue Agency
Annual Report to Parliament
2008-2009

Because public trust and confidence is more easily eroded than built, sustaining a culture of ethics in the workplace is important for all tax administrations. The management of risks then must reflect a tax administration's unique context, suggesting a continuum of management models that likely begins with behavioural controls set out in strict rules and enforced with meaningful sanctions, and evolves towards a model where ethical behaviour is widely accepted and commanded at least as much by internal social norms as rules.

¹¹ Ho, Daniel and Wong, Brossa. *Issues on compliance and ethics in taxation: what do we know?* *Journal of Financial Crime* (2008)

¹² *The Declaration on the Promotion of Ethics in Tax Administrations recognizes that the promotion of ethics must be at the heart of all policies of a tax administration.*

The practical benefits of proper conduct by taxation officials are well documented. New Zealand's Inland Revenue Department notes that its mature ethical culture allows 'previously constrained and tightly controlled services and products to become more streamlined, and more accessible and efficient for our [taxpayers].'¹³ In other words, a strong ethical culture in tax administrations creates opportunities for business improvement initiatives that otherwise would be ill-advised if not impossible. Moreover, if corruption thwarts the very purpose of taxation, by diverting payments made by taxpayers away from public accounts, then it's opposite—integrity—upholds it.

2.2 Human Resources, Training and Other Measures to Promote Ethics in Tax Administrations

Although administrative traditions vary according to historic and cultural context, there are universal expectations as to the way civil servants should fulfil their duties, namely with equity, probity and efficiency. Articulating standards of behaviour is fundamental for tax administrations. An ethical workforce has its foundation in a common understanding of the organizational values that are to guide the actions and decision-making of revenue staff of all levels, on a daily basis. Safeguarding the integrity of a tax administration requires a clear, consistent framework of rules and standards of behaviour that employees must adhere to or face meaningful sanctions. Conflict of interest regarding external business activities or investments, or the receipt of gifts and hospitality by public servants, are areas that require definition of what is permitted and what is not.

¹³ *New Zealand Internal Revenue Department. Internal Factors Influencing Inland Revenue's Integrity Framework. Twenty Seventh Annual Technical Conference of the Commonwealth Association of Tax Administrators (2006)*

CRA Tools to Foster Ethical Conduct

The CRA has four enduring values that guide employee conduct:

Integrity is the foundation of our administration. It means treating people fairly and applying the law fairly.

- **Professionalism** is the key to success in achieving our mission. It means being committed to the highest standards of achievement.
- **Respect** is the basis for our dealings with employees, colleagues, and clients. It means being sensitive and responsive to the rights of individuals.
- **Co-operation** is the foundation for meeting the challenges of the future. It means building partnerships and working together toward common goals.

The CRA has also consolidated all policies dealing with ethical issues into a single Code of Ethics and Conduct. The Code describes the expected standard of behaviour in areas such as conflict of interest, confidentiality and disclosure of information, contact with the public, safety and health, financial matters, harassment and discrimination, off-duty conduct and political activity. It spells out the possible disciplinary action if there is misconduct. New employees must consent to abide by the condition of the Code.

The Conflict of Interest Policy directs employees to act in a way that is neither damaging nor potentially damaging to the organization. The Policy asks employees to avoid situations that may lead to real or perceived conflicts of interest, or that a third party would perceive to be a conflict of interest.

The Gifts, Hospitality and Other Benefits Policy makes clear that an employee must decline any gifts, hospitality or other benefits that could influence his or her judgement or call into question the employees' integrity, or that of the CRA.

The Electronic Networks Policy emphasizes that computer systems, software, equipment, networks, Internet, Intranet and e-mail are intended for authorized business purposes. Personal use of these facilities is allowed only to the extent that it does not affect productivity, infringe CRA policies and/or impose a storage burden on CRA systems.

Orientation programs for new employees integrate discussions on values and ethics. The CRA Award of Excellence recognizes individuals or teams whose work and behaviour best reflect the CRA's mission, vision, and values.

Supporting a professional workforce is equally important. A tax administration can use a variety of techniques to limit opportunities for misconduct in the workplace, including rotating staff through different functions, controlling or restricting staff access to files or areas of work and segregating responsibilities among staff. However, moving towards a workforce where staffs self-regulate requires that employees be adequately compensated for their duties. Where remuneration is insufficient, employees may be tempted to engage in corrupt behaviour simply to 'make ends meet.'

The ability to engage highly skilled, professional staff is recognized by many governments around the world as an important shield against corruption and a cornerstone of a well-functioning, effective tax administration.

CRA Separate Employer Status and Human Resources Management

The CRA is a separate employer under Schedule I, Part II of the Public Service Staff Relations Act. The CRA is not subject to the appointment provisions of the Public Service Employment Act (PSEA) which governs the majority of the Canadian public service, but has its own appointment authority under the Canada Revenue Agency Act. Staffing in the CRA is conducted based on eight staffing principles: non-partisanship; representativeness, competency, fairness, transparency, efficiency, adaptability, and productiveness.

As a separate employer, CRA is responsible for its own labour relations, including collective bargaining. The CRA has also adopted a competency-based approach to human resources management. This approach was developed to address business needs by allowing the Agency to put the right people in the right jobs at the right time and according to their skills and abilities, as defined through competencies. Oversight of human resources rests with the Board of Management, which is accountable to Parliament through the Minister of National Revenue.

Strong ethical leadership sets the tone in any organization and inspires staff to follow suit. It is accepted as necessary for, and fundamental to, building and sustaining a culture of ethics in any organization. But ethical leadership is not only the responsibility of senior management. Rather, employees often relate most to their immediate supervisors, so ethical leadership must be present at all levels. Managers are at the forefront of effective staff management, with responsibility for employee performance, development and discipline, and therefore are critical in the pursuit of organizational objectives involving ethics. Having in place a well-trained middle management cadre recognizes the importance of a manager's role in supporting employees and fostering the desired behaviour.

CRA Management / Gestion Group

In 2002, the CRA implemented the Management/Gestion (MG) group for managerial jobs. This new classification group supports the Agency's goal of creating a management community that recognizes the importance of the manager's role as a focal point for employees. All new managers participate in the MG Learning Program, a three-week introductory management course that introduces participants to key concepts in leadership, financial management, and human resources. Values and ethics are common themes woven throughout the curriculum.

Additionally, performance agreements for both management and senior executives include a core commitment to demonstrate ethical values-based behaviour. Performance pay and movement through the salary range are impacted by the extent to which these commitments are met

Simple, transparent and efficient processes and operational procedures complement rules- or motivation-based approaches to ethics. Traditional procedures require personal accountability and hand-over mechanisms at all stages to clearly document an audit trail.

Automated transaction processing and electronic self-service options offer a partial solution, removing the need for revenue employees to interact directly with taxpayers. Of course, even with automation there will always be a need for audit trails and personal accountability.

Any framework for public service ethics is incomplete without a system of internal monitoring. Internal oversight mechanisms are crucial to ensure that operational policies are being followed and that performance standards are being met. An internal affairs division is an important body within any effective tax administration, with duties to conduct investigations into suspected fraudulent employee activity like theft of assets or revenues, conflict of interest, unauthorized access and disclosure of information, misuse of information technology systems, and improper handling of public complaints. To be effective, an internal affairs division must be regarded as complementing and supporting management.

It is equally important that staff can come forward and disclose serious wrongdoing with sufficient protection from reprisals, and that allegations will be handled objectively. Making a disclosure in good faith is in itself an ethical act and complements 'top-down' approaches to fostering ethical behaviour. More broadly, internal disclosure provisions enhance organizations' capacity to address these issues and provide concrete support for grounding organizational culture firmly in values and ethics.

Internal Disclosure at the CRA

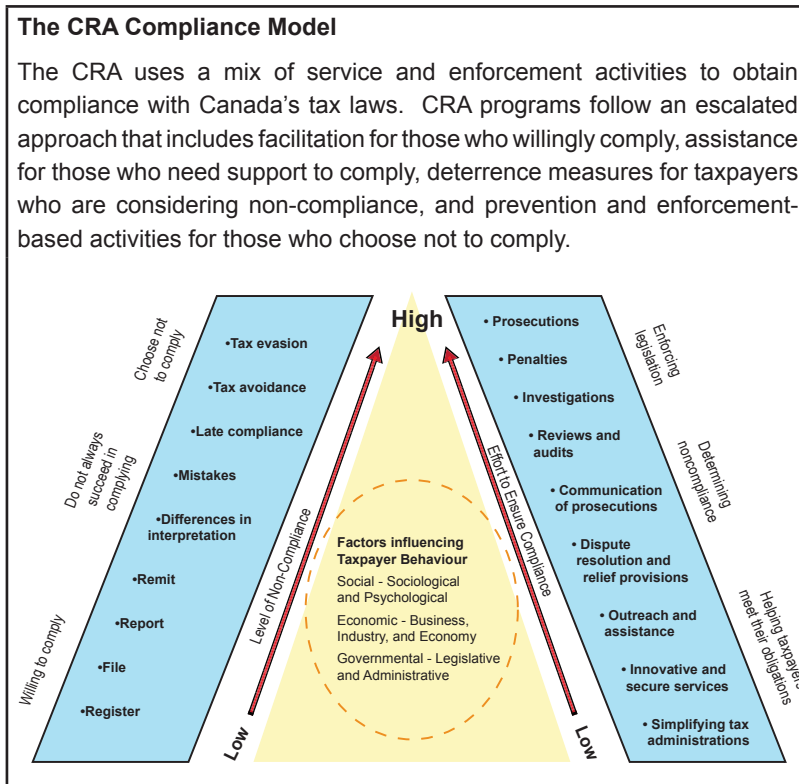
The CRA is subject to the Public Servants Disclosure Protection Act (PSDPA). The Agency's Internal Disclosures Office is responsible for coordinating the investigation of internal disclosures that fall within the definition of wrongdoing as described in the PSDPA. Employees have the choice to make a disclosure to their supervisor, to the Agency's designated Senior Officer for Internal Disclosure (who is also the head of the internal affairs unit), or directly to the federal Public Sector Integrity Commissioner.

The CRA encourages employees that feel that a serious wrongdoing could be taking place to come forward using the provisions in the Act and to feel protected in doing so. Supervisors that have received a report of wrongdoing from an employee must treat it as a protected disclosure and contact the Internal Disclosures Office for assistance as soon as possible. Aggregate details of internal disclosure activity are publically reported by Canada's Treasury Board Secretariat.

2.3 Public Service Ethics as an Institutional Attribute in Tax Administrations

If a tax administration as an entity can be said to have an ethical orientation, then fairness is at its heart. Intuitions about fairness are some of the most basic moral sentiments people have, and cannot be ignored in the realm of public administration. For tax administrations, fairness amounts to a delicate balance between upholding taxpayers' rights, both codified and intrinsic, and exercising its authority when warranted. The complexity of tax administration in the modern era requires that fairness be exercised in many domains.

Not only must the laws be fair, but so too must be the way in which they are enforced. In an ethical framework, the tax administration's powers of enforcement are balanced by a corresponding obligation for consistency in its application. A reasonable equilibrium can be achieved through a strategy of responsible enforcement, where enforcement responses are graduated based on the degree of non-compliance. Certainly, fairness in the enforcement of tax laws implies that tax administrations deal firmly with non-compliant taxpayers. However, fairness must also be evident to those taxpayers who are generally compliant. Excessively harsh treatment that is disproportionate to the seriousness of a contravention undermines perceptions of fairness and can turn the compliant into the non-compliant.



An impartial, transparent and accessible redress process that is open to all taxpayers provides an important check that tax laws are applied as intended. Avenues for formal and objective recourse in the event of a dispute over tax liability demonstrate a tax administration's commitment to fairness.

The CRA's Approach to Redress

The CRA provides an impartial and timely dispute resolution process that respects taxpayers' fundamental right to redress in their dealings with the CRA.

The taxpayer can file an objection with the CRA for an independent review of the facts and or interpretation of the law. Appeals officers who were not involved in the original decision will conduct a formal and impartial review. If the dispute is not resolved at this level, the taxpayer may take his or her case to the Tax Court of Canada, then to the Federal Court of Appeal, and in the final instance, to the Supreme Court of Canada.

The CRA's Approach to Redress cont...

In addition, taxpayer relief provisions give the CRA common-sense ways to help taxpayers that are unable to meet their tax obligations because of extraordinary circumstances beyond their control, including natural or human-made disasters, civil disturbances or disruptions in services, serious illness or accident, or serious emotional or mental distress due to circumstances such as a death in the immediate family. These provisions allow the CRA to be more flexible and responsive to taxpayers' circumstances when it is unreasonable or unfair to penalize them.

In a well-functioning tax system, taxpayers' obligations are reciprocated with recognized rights. Beyond the most basic right to pay no more or less in taxes than what is required by law, many jurisdictions currently consider the right to the protection and confidential treatment of taxpayer information as fundamental to self-assessment tax systems.

Privacy and confidentiality provisions in the administration of tax tend to be consistent with broadly held social values of the same nature, so at least in principle, they are a natural extension of citizens' broader rights. Notwithstanding these broader democratic rights, tax administrations have considerable power to intrude on taxpayer privacy, for example, in conducting audits and investigations. Taxpayer rights around privacy and confidentiality are a balance against this power, and are intended to safeguard against unnecessary intrusions and use of information for purposes other than those allowed by law.

As with any abuse of power, breaches of this nature can affect the legitimacy of the tax administration in the eyes of the public and thus undermine the tax system.

The CRA Taxpayer Bill of Rights

The Taxpayer Bill of Rights is a set of fifteen rights confirming that the CRA will serve taxpayers with a high degree of accuracy, professionalism, courteousness and fairness under clear and established rules. The Taxpayer Bill of Rights is intended to make it easier for taxpayers to understand what can be expected in their dealings with the CRA. The Bill of Rights also outlines five service commitments to small businesses.

The CRA has implemented a complaint resolution process to strengthen the Agency's ability to respond to service-related problems across all programs. Founded on the Taxpayer Bill of Rights, the CRA Service Complaints Program provides taxpayers with a formal resolution process for complaints about mistakes, undue delays, and other issues related to service.

See Appendix B for the complete listing of the Taxpayer Bill of Rights.

Taxpayers' needs and expectations should also be considered in the delivery of programs and services. Modern tax administrations recognize that these 'softer' rights need to be respected, such as the right to courteous and considerate treatment and timely service.

In a self-assessment system, taxpayers might also be said to have a right to clear and accessible tax rules and procedures. Given the active role taxpayers are obliged to play in the tax system, this right encourages compliance. In extreme cases, this can also help guard taxpayers from the manipulations of corrupt tax officials, who could otherwise use the lack of clear and accessible rules to their advantage.

3. PROMOTING ACCOUNTABILITY AND TRANSPARENCY IN TAX ADMINISTRATIONS

3.1 Fundamental Accountabilities of Tax Administrations

The delegation of powers from society to public authorities and institutions that is present in democratic societies means that citizens can rightly expect assurances that these powers are used effectively and prudently. The more precise act of delegation from political figures to public servants obligates leaders of all public sector institutions, tax administration included, to demonstrate results in the fulfillment of a given mandate and the wise use of resources. This expectation cannot be more relevant than it is now—even as the world economy slowly recovers, government resources will continue to be strained and citizens more than ever before will expect their tax dollars to be used in the best way possible.

A tax administration's most basic external accountability can be said to comprise two elements: the first, accountability for the securing of government revenues as measured ultimately through the collection of all taxes owed (program results), and the second, accountability for the sound administration and management of allocated resources necessary to execute its mandate (operational results). These two

accountabilities are inextricably linked, as operational results engender the effectiveness of a tax administration. There is also a third element: accountability for the means used to achieve operational and program objectives. Given tax administrations' wide range of powers and potential to significantly impact the circumstances of individual and business taxpayers, the importance of this basic accountability cannot be understated.

An expectation of accountability gives rise to its twin: the expectation of transparency. Transparency makes true accountability possible, and in its absence accountability becomes superficial. Transparency makes it difficult, if not impossible, for public servants to ignore their accountabilities around organizational performance or to avoid rendering an account of that same performance. Multilateral institutions and many governments now operate on the belief that public-sector decision-making should be visible and open to independent scrutiny in all manner of ways, and the current philosophy is that an increase in transparency leads to an increase in accountability. In most cases, this is probably true.¹⁴

Tax administrations whose operations are deeply founded in the public interest will naturally strive to perform in a manner consistent with public expectations. Perhaps the only caution in the quest for accountability and transparency in tax administrations is to avoid stifling over-bureaucratization to ensure accountabilities are met without fail. In fact, it has been noted that "accountability requires a culture where honest failure is not confused with criminal intent."¹⁵

3.2 Demonstrating Accountability

Accountability and transparency are universally accepted as cornerstones of maintaining the public's trust. Strong accountability systems are key components of good governance in general and even more so in the realm of tax administration.

Accountability presumes that there is a clearly articulated and communicated performance expectation that stems from the

¹⁴ In the article *The Proper Use of Transparency Instruments*, Caron and Hunt reflect on policy implications of transparency issues, arguing that naive use of transparency mechanisms can have unintended effects and can drive strategic behaviour in order to avoid required documentation. Contracting arrangements designed to circumvent disclosure requires are cited as an example. *Journal of Public Sector Management*, Volume 36, Issue 3, September 2006

¹⁵ Sears, Robin V. *The Old Accountability Shuffle*. *Policy Options*, June 2006

organizational mandate and objectives. At the organizational level, tax administrations are said to 'be accountable' for performance, however material accountabilities ultimately reside with the head of the tax administration. Without accountability, a tax administration is likely to underperform.

Executive accountability can also be considered the pinnacle of a hierarchy of accountabilities that cascade downward through management and staff based on the delegation of duties and authorities. Individuals become responsible for assigned tasks, and through delegation of authority, powers are divided and allocated to subordinates in order to achieve organizational results. Effective delegation requires:

clear roles, where authorities match accountabilities for specific results pursuant to assigned duties;
a strong commitment to organizational values, which enables tax administration staff to accept their accountabilities;
sufficient organizational capacity (infrastructure, tools, controls and management practices) and appropriate individual competencies (skills and knowledge) which equip staff to follow through on their duties to the best of their ability and assume accountabilities;
monitoring and learning mechanisms designed to improve effectiveness and to promote self-correction in support of the accountabilities; and
Consequences to compel staff to deliver on the results that they are accountable for.¹⁶

The literature describes "a very complex and rich set of tools [that] has been developed and implemented with an attempt to satisfy increasing demand for accountability and transparency."¹⁷ A tax administration's commitment to transparent management and accountability for results can be demonstrated in many ways. Most important among these is the periodic reporting of actions, initiatives, performance and expenditures to legislators and the public. This forthright disclosure of operations serves not only to ensure public accountability, but also to build public confidence. Statutory requirements for reporting and disclosure are common in modern tax administrations, and most are making use of the Internet to make a vast array of tax material accessible to the public. Independent offices of oversight and control also perform a critical monitoring and challenge function.

¹⁶ Adapted from the Canadian International Development Agency Accountability Framework.

¹⁷ *Ibid.*

Demonstrating Accountability and Transparency at the CRA**STATUTORY REQUIREMENTS AND INTERNAL MEASURES****Strategic Framework**

The CRA's strategic framework identifies performance measures to enable the CRA to measure and report on its progress in meeting its mandate, strategic outcomes and expected results for each of the program activities as identified in its program activity architecture. See Appendix C.

Corporate Business Plan / Summary of Corporate Business Plan / Report on Plans and Priorities

All three documents provide an overview of the CRA's main priorities over a three year period and are structured by strategic outcome, program activity and expected results.

Supporting information is also provided on human resource requirements, major capital projects and the net cost of CRA's programs. The Corporate Business Plan is produced for the Treasury Board of Canada pursuant to the statutory requirements of the Canada Revenue Agency Act. The Summary of the Corporate Business Plan and the Report on Plans and Priorities are tabled in Parliament, by the Minister of National Revenue and the President of the Treasury Board respectively. Both become public after tabling, and are made widely available to Canadians via the Internet.

Annual Report / Departmental Performance Report

The CRA Annual Report to Parliament is tabled in Parliament by the Minister of National Revenue, pursuant to the statutory requirements of the Canada Revenue Agency Act. It is produced concurrently with the Canada Revenue Agency Performance Report published by the Treasury Board of Canada Secretariat. Virtually identical, both provide a comprehensive report on the performance of the CRA for the previous fiscal year, and a rating of the CRA's achievements against the key targets and indicators set out in the Corporate Business Plan. Each contains an assessment of the fairness and reliability of the information contained in the report and an audit of the Agency's financial statements administered by the Auditor General of Canada.

Demonstrating Accountability and Transparency at the CRA

Service Standards

Service standards support results-based performance measurement and are reported on in the Annual Report, where they are subject to the scrutiny of the Auditor General regarding the reliability of the information presented. The CRA's inventory of service standards is designed to improve service to individual and business taxpayers as well as benefit recipients, and promote compliance with Canada's tax and benefits legislation. Service standards represent the CRA's public commitment to the level of service that taxpayers and benefit recipients can reasonably expect to encounter in areas of importance to them. For managers and employees, service standards help to increase understanding of service interactions from the service user's perspective, and represent a willingness to be accountable for the transparent reporting of performance.

Executive Cadre (EC) Performance Management Regime

The CRA Agency Management Committee (AMC) sets out priorities and accountabilities for Agency executives (some 600 individuals) for the year ahead. Each EC performance agreement establishes a personal accountability for, and alignment with, these priorities. Priorities are based on the Agency's planned deliverables, as well as the Government's longer-term and Public Service-wide objectives.

Executive performance agreements consolidate core program and management responsibilities, along with leadership and special commitments. The agreements include assessable performance measures that help in the evaluation of the individual's contribution to the achievement of Agency goals. Performance agreements are the foundation against which movement through the salary range and eligibility for performance pay is assessed annually. For the organization, the agreements contribute to better results management. As commitments to the achievement of Agency goals are cascaded throughout the Agency, shared accountabilities are identified and horizontal linkages are strengthened.

Demonstrating Accountability and Transparency at the CRA**Management Accountability Framework**

The CRA's management accountability framework describes the standards for good public service management as established by those with Agency governance oversight responsibilities. Structured around the key elements that collectively represent the management function like resources, personnel and risk, the framework provides the basis for annual evaluations of the Agency's management performance and practices. The results of this process enable the Agency's senior management to identify the management priorities needed to strengthen overall organizational performance.

Internal Audit and Program Evaluation

The CRA's internal audit and program evaluation functions support the achievement of the CRA's strategic goals by providing independent and objective information, advice, and assurance on the soundness of the Agency's operations. The results of the CRA's audits and evaluations are posted on the CRA website to promote public accountability and transparency.

Proactive Disclosure

As part of government-wide efforts to strengthen public sector management by enhancing transparency and oversight of public resources in the federal government, the CRA is required to publish on its website: travel and hospitality expenses for senior level officials; contracts over \$10,000 issued by or on behalf of the CRA; grants and contributions over \$25,000 awarded by the CRA; and the reclassification of positions.

By making this information readily available on departmental web sites, Canadians and Parliament are better able to hold the Government and public sector officials to account.

Demonstrating Accountability and Transparency at the CRA

Access to Information and Privacy

The Access to Information Act and the Privacy Act (known as the ATIP legislation) provide Canadian citizens, permanent residents or any persons present in Canada, with the legal right to obtain information in any form that is under the control of the federal government. This public right of access is subject to specific and limited exceptions and to an independent review of decisions on disclosure, and is balanced against the legitimate need to protect sensitive information and to permit the effective functioning of government. The Acts also recognize the right of government institutions to deny access to information affecting, for example, national security, commercial confidentiality, policy development, solicitor-client privilege and personal privacy. The Acts serve an essential democratic purpose by making government more open and transparent, and by promoting accountability through the participation by citizens in the decisions of government affecting them.

CRA Annual Corporate Survey

The Agency undertakes research on a regular basis to measure Canadians' experiences and satisfaction with the services and programs that the CRA provides. Since 2000, the CRA has been conducting an annual survey with national representative samples of Canadians to assess attitudes towards the Agency and satisfaction with aspects of specific programs.

EXTERNAL OVERSIGHT

Taxpayers' Ombudsman

The Taxpayers' Ombudsman is responsible for ensuring that the CRA respects the service rights outlined in the Taxpayer Bill of Rights and is mandated to: conduct impartial and independent reviews of service-related complaints; facilitate taxpayer access to assistance within the CRA; identify and review systemic and emerging service-related issues that have a negative impact on taxpayers; and provide advice to the Minister of National Revenue about service related matters in the CRA. The Taxpayers' Ombudsman operates at arms-length from the management of the CRA and reports directly to the Minister of National Revenue. Together with the Taxpayer Bill of Rights and the CRA – Service Complaints initiative, the Office of the Taxpayers' Ombudsman enhances the CRA's accountability and provides taxpayers served by the CRA with renewed assurance that they will be treated fairly, equitably and with respect.

Demonstrating Accountability and Transparency at the CRA**Office of the Auditor General of Canada**

In Canada, accountability is further buttressed by the Auditor General, who conducts independent audits of federal government operations and reports directly to Parliament. These audits cover not only a department or agency's management of its expenditures, but also its performance in providing "value for money" to Canadians.

4. COMPLIANCE AS AN ETHICAL ISSUE**4.1 Taxpayers and their Tax Ethics**

Because the effectiveness of a tax administration in fulfilling its mandate hinges in part on the basic willingness of taxpayers to comply, any discussion of institutional effectiveness is incomplete without considering the tax ethics of taxpayers. Meeting one's tax obligations can be seen as an ethical issue from multiple standpoints. Compliance is consistent with principles of duties under law and to society; it offers net benefits for the greatest number of people; and it responds to social expectations for fairness and equity. In this regard, to comply is to act ethically.

The simple equation of compliance and ethics is complicated somewhat by the fact that taxpayers have the right to minimize their tax burden within the bounds of the law. Taxpayers are entitled to undertake mitigation practices, such as taking advantage of credits, and effective tax planning consistent with the intent of the law. However, tax planning arrangements that are technically legal but contravene the object and spirit of the law cross the line between what is acceptable (and ethical) and what is not. Tax evasion, while clearly illegal, is also unethical. The current economic climate has raised the profile of compliance as an ethical issue. As Jeffrey Owens, Director of the Organization for Economic Cooperation and Development (OECD) Centre for Tax Policy and Administration, points out, "The threshold of tolerance for tax evasion has dropped to zero...governments need tax revenue and citizens need to be reassured that the tax burden is being fairly shared."¹⁸

¹⁸ Owens, Jeffrey. *Moving Towards Better Transparency and Exchange of Information on Tax Matters. Bulletin for International Taxation, November 2009*

Although instances of abusive tax avoidance and tax evasion can be found in all taxpayer segments, there is international consensus that large corporate taxpayers and high wealth individuals represent a significant risk for tax administrations.¹⁹ Differing from most taxpayers in terms of magnitude of tax liability, access to resources and financial flexibility, these taxpayers are not confined by domestic boundaries in the management of their tax affairs, and instead, can be described as 'global taxpayers.' In fact, the OECD describes a tax world where,

"...taxpayers' financial transactions take on an increasingly international flavour. International banking has become commonplace and it is no longer extraordinary for taxpayers to reside in one country, hold assets in another and have them managed from a third location. The proliferation of such financial relationships is a natural result of globalization, and may be motivated by tax concerns, commercial pressures or a variety of other considerations."²⁰

The international tax arena is one now characterized by globalized trade and financial systems, evolving multinational business structures and transactions, wide adoption of e-commerce and the presence of tax havens with strict bank secrecy laws. These conditions expand opportunities for taxpayers to engage in unethical tax minimization strategies, and at the same time, make the task of detecting and deterring non-compliance substantially more difficult for tax administrations.

The magnitude of global capital flight illustrates the impact of the compliance behaviour, and thus the related ethical stance, of people engaged in aggressive tax planning. Recent estimates put the value of individual and corporate assets held offshore in the trillions.²¹

No country is immune: In 2002, Canada's Auditor General reported that "tax arrangements for foreign affiliates have eroded Canadian tax revenues of hundreds of millions of dollars over the past ten years."²²

19 Organization for Economic Cooperation and Development. *Forum on Tax Administration. Study into the Role of Tax Intermediaries (2008) and Engaging High Net Worth Individuals on Tax Compliance (2009)*

20 Organization for Economic Cooperation and Development. *Tax Cooperation 2009: Towards a Level Playing Field (2009)*

21 In his remarks at the 2008 Conference on the Fight Against International Tax Evasion and Avoidance, OECD Secretary-General Angel Gurría noted that cited an estimate in the range of USD 5-7 trillion. Other estimates cite figures as high as USD 11 trillion.

22 Auditor General of Canada. 2002 December Report of the Auditor General of Canada, Chapter 11 – Other Audit Observations

Loss of potential tax revenues is particularly detrimental to developing or transitional countries needing to finance economic and social development programs. In considering global taxpayers, strong tax ethics can then be said to mean not only paying the right tax at the right time, but also in the right place.

4.2 Responsible Citizenship and Corporate Social Responsibility

In addressing the compliance challenges presented by cross-border transactions, appealing to the duties of responsible citizenship can complement the necessary actions of controlling and enforcing compliance. In essence an ethical appeal, responsible citizenship means that individuals and businesses appreciate their civic responsibility to pay tax, and know that it is their tax contribution that enables them to enjoy all the benefits, rights and privileges that their resident country provides. Tax administrations can explore ways to enhance existing programs and introduce new activities that will improve voluntary compliance by increasing awareness amongst taxpayers, both individual and business, that their cooperation is needed to protect the valuable services that they demand from a responsive government.

An interesting sub-set of the discussions on responsible citizenship and tax ethics centres on the emergent view that, for large businesses, shouldering a fair tax burden as set out in law is an element of corporate social responsibility (CSR), in the same way that environmental stewardship and responsible labour practices are currently perceived. CSR is typically defined as a corporation's commitment to a way of conducting business that takes into account the interests of all stakeholders, from shareholders and customers, to governments and society at large. A host of corporate failures and social activism has led to a business environment where increased corporate integrity and accountability are demanded.²³ The origins of the current economic situation have focused even more attention on responsible corporate behaviours—or lack thereof—and the recent provision of government bailout packages to corporations that shift income and assets overseas has only exacerbated these public sensitivities.

A precise definition of socially responsible tax behaviour is difficult to frame because the issue is a nuanced matter. However, a sense

²³ *Conference Board of Canada. (2008). The Trust Imperative: Taking Governance to the Next Level.*

of ethical and civic responsibility is thought to shape a corporation's orientation on CSR and that stance, if genuine, should inform all of its business decisions, including those taken to minimize tax liability.²⁴ The magnitude of a corporation's tax liability is influenced by a number of decisions over which it has control, such as where to locate operations, where to register assets/subsidiaries, how assets are priced when transferred between subsidiaries, and which tax credits to pursue. If tax is seen as a CSR issue, that position should come to bear in how a corporation conducts its affairs for tax purposes, the scope given to its tax practitioners, and in its self-assessment of what its fair tax obligation is, given the spirit of the law, and technicalities notwithstanding.

Calls on governments to create pressure on the business community to accept socially responsible tax practices, and to help foster an environment where aggressive tax planning is no longer acceptable,²⁵ show some very early indications of gaining traction with the tax administrations of some countries, Canada included. The recognition that tax payments are an important contribution to society, and the showcasing of tax paid in Canada are elements of CSR reports for a number of large corporations including some in the financial and energy sectors.

If ever widely adopted, tax-as-CSR would theoretically lessen the need for governments to address corporate non-compliance through continual and ever-more complex legislative amendments. CSR would instead guide conduct in the multitude of situations that rules fail to fully address. Reputation considerations offer one potential driver, that is, how corporations would approach tax if faced with mounting customer and investor pressure.

A starting point for the creation of such drivers, and a concept which is gaining prominence in the international tax administration community, seeks to link tax management with good corporate governance by engaging corporate boards in discussion of the financial and reputational risks of particular tax strategies. That tax strategies can impact a corporation's financial performance is well understood. What needs to be equally well embedded is that tax issues can affect a corporation's carefully nurtured and much valued reputation, and secondly, that a reputation for good governance and tax integrity will bring corporations tangible benefits in their dealing with revenue authorities.

²⁴ *Ibid.*

²⁵ *OECD Observer. Taxation in a Global Environment (2002).*

Promoting Compliance Among Individual and Corporate Taxpayers

The CRA believes that a sustainable tax system is one where taxpayers appreciate that paying tax is a civic responsibility that enables taxpayers to enjoy all the rights that accompany being a Canadian resident or business. The Agency is undertaking a number of efforts to ensure that taxpayers understand that their active participation in Canada's tax system is a necessary pre-condition. A comprehensive communications and outreach campaign targeting primarily individuals would be an example of these efforts.

The CRA's move to a risk-based approach for large corporate audits is another step. The Agency's level of engagement with corporations will be based on a range of factors, like compliance history and degree of transparency in dealings with the CRA. In brief, a risk-based approach means that corporations that demonstrate strong governance and a willingness to work with CRA on an open and transparent basis will be subject to less CRA scrutiny. Agency resources that are saved through reduced audits of low-risk businesses will be re-focused to address taxpayers that represent a higher risk to the CRA. The Agency will advise taxpayers as to how they are perceived in light of risk factors, and indicate the commensurate compliance approach.

5. CONCLUSION

There is without doubt an element of reciprocity in how tax administrations and taxpayers engage with each other. In the moral contract between a tax administration and the public, each are to offer integrity: ethics and transparency on behalf of the tax administration in return for willing compliance and transparency on behalf of the public as taxpayers, with the two halves tied together by mutual accountability. In this accord, the actions and behaviours of one affect the other. In essence, how a tax administration engages with taxpayers affects the behaviour of those taxpayers, and subsequently, taxpayer behaviour influences how tax administrations interact with them. For this reinforcing cycle to be positive, it is incumbent on the tax administration, with the balance of power at the centre of the tax system, to take the lead in setting and sustaining the right context for a mutually acceptable relationship by demonstrating ethics, accountability and transparency. In turn, taxpayers can rightfully be expected to reciprocate.

Recent events that devastated the global economic and financial system have made apparent the need for a renewed call for higher standards to safeguard against similar occurrences in the future. As part of these broad discussions, this paper has attempted to underscore the importance of ethics, accountability and transparency to a tax system and has used the CRA experience to demonstrate some of the ways in which a tax administration can implement these principles in the exercise of its mandate.

Recognizing that each tax administration operates within a unique landscape, efforts to strengthen capacity in any of these areas will naturally reflect the particular challenges and context of each revenue authority. Regardless of the strategies taken, however, the more important point is that commitment to these principles is just that—a commitment that must endure even as sensitivities to these issues diminish as economic recovery takes hold.

Appendix A – About the CRA

Canada is a large country that spans some 7,200 kilometres from east to west across six time zones. With a population of approximately 33 million people and a population density of 3.2/km², it is one of the least densely inhabited yet one of the most prosperous countries in the world.

Canada's tax system is based on voluntary compliance and self-assessment, which in Canada, is believed to be the most cost-effective way to administer taxes. Taxpayers are expected to determine what they owe under the law and then pay the correct amount of tax, without the CRA's intervention. This means that taxpayers are expected to register as required under the law, file their tax returns on time, report complete and accurate information to determine tax liability and pay all amounts when due. Non-compliance is the failure, for whatever reason, to meet any of these requirements.

The CRA is responsible for the administration of tax programs and the delivery of economic and social benefits on behalf of federal, provincial and territorial governments, and First Nations. In 2008-2009, the CRA collected more than \$366 billion²⁶ in taxes and other revenues, and issued over \$17 billion²⁷ in benefit payments to millions of families and individuals. Revenues come from three key sources:

²⁶ *Draft Annual Report to Parliament 2008-2009.*

²⁷ *Draft Annual Report to Parliament 2008-2009.*

income tax, excise taxes and duties, and GST/HST. In addition, the CRA administers a number of non-tax programs, such as delivery of Canada's national child care benefit and debt collection for various government programs.

As the principal tax administrator for the Government of Canada, our primary responsibility is to protect Canada's revenue base by ensuring compliance.

The CRA's mission is:

"...to administer tax, benefits, and related programs, and to ensure compliance on behalf of governments across Canada, thereby contributing to the ongoing economic and social well-being of Canadians."

The CRA's vision is to be:

"...the model for trusted tax and benefit administration, providing unparalleled service and value to its clients, and offering its employees outstanding career opportunities."

The CRA's **promise** is a commitment to:

"...contributing to the well-being of Canadians and the efficiency of government by delivering world-class tax and benefit administration that is responsive, effective, and trusted."

The CRA has a workforce of up to 45,000 permanent employees across Canada, and a term population that fluctuates to approximately 10,000 during peak tax-filing season.

The Agency operates out of 55 service sites across Canada, including 37 Tax Services Offices (TSOs), six Tax Centres (TCs), two combined TSOs and TCs, and 10 call centres.

Appendix B – Taxpayer Bill of Rights and Commitment to Small Business

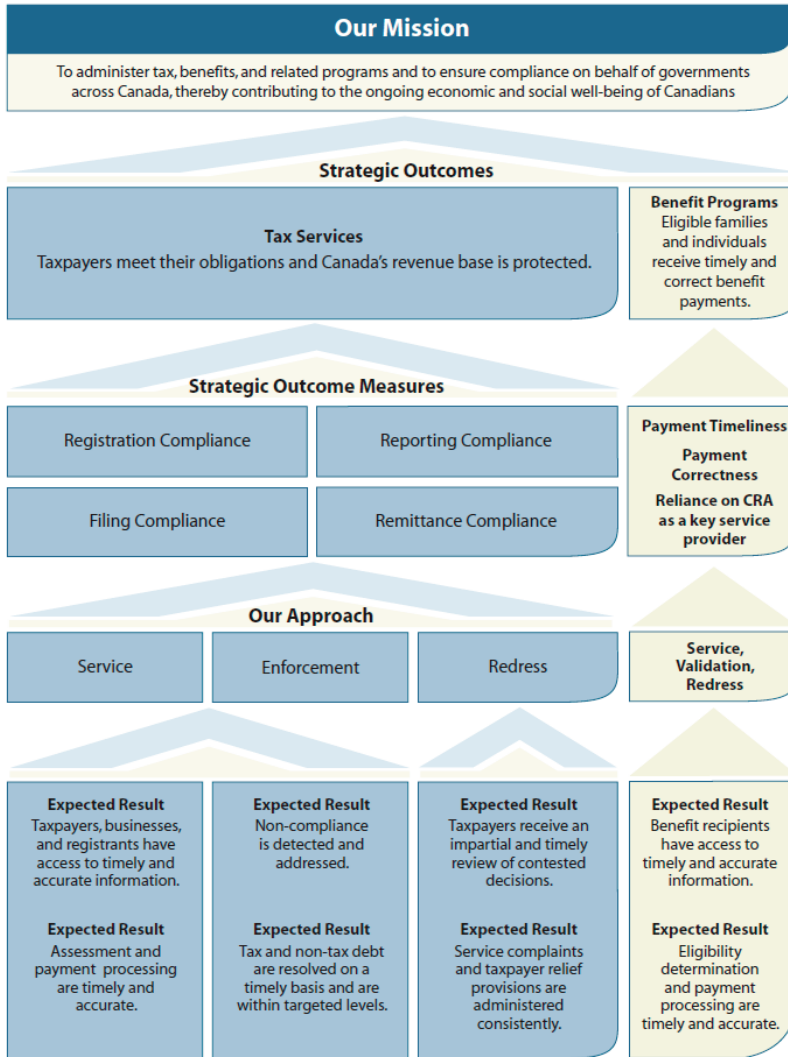
Taxpayer Bill of Rights

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 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.

Appendix C – CRA Strategic Framework



Case study

Topic 1.1

THE DEVELOPMENT AND STRENGTHENING OF THE CITIZENS' TRUST: THE ACCOUNTABILITY MECHANISMS IN THE TAX ADMINISTRATIONS

Germania Montás Yapur

DGII's General Assistant Director
(Dominican Republic)

Contents: Summary.- 1. Introduction.- 2. DGII's strategies to inform taxpayers and the society at large.- 3. To conclude

SUMMARY

Over the last years, the General Directorate of Internal Revenue (DGII, in Spanish) of the Dominican Republic has been developing an information program for taxpayers and the society at large, which is an integral part of the information that it publishes for accountability purposes. This document is concerned with the experiences obtained from the execution of such program, which have been the basis for its preparation.

The abovementioned program started in 2005 within the framework of the DGII's strategic planning, and its purpose is for citizens-taxpayers to be able to access the DGII's website for information, rather than asking for information.

This paper addresses the approach and the scope of the strategy intended for the development of an accountability culture, and considers the essential elements to achieve this paper's objectives, namely: what are the reasons to promote accountability; why it is important to promote it, how it relates with the officers' law and ethics and the importance of measuring citizens' perception of the DGII's performance by means of surveys.

Finally, the DGII's point of view is discussed, which believes that the promotion of accountability and citizens' information is part of its transparent management.

1. INTRODUCTION

Within the framework of the concepts of governance or corporate governance, the set of good accountability practices is usually identified with the English term “accountability”; however, the Latin American Center for Development Administration (CLAD, in Spanish) in the CLAD’s 2000 Scientific Council adopted the Spanish translation of such term as “responsabilización”. While this word may seem confusing, there are experts on the issue of accountability who have already adopted it in their studies.

In public entities, mainly those with a “technical” profile, whose performance is measured exclusively against quantitative goals achieved from operating efficiency and effectiveness, as is the case of the Tax Administrations, the practice of Accountability is formulated through two logics, as stated by IDB’s specialist Koldo Echebarría¹: One logic concerned with the strict performance of the regulations established for public management practice, and another logic that pursues the attainment of objectives and the presentation of results. Striking a balance between exercising a rule-centered public management and achieving the expected results stands as a big challenge for the institutions who want to incorporate accountability as an integral part of their work. Echebarría believes this situation is “a real dilemma that should be considered in any accountability strategy, which has proven particularly difficult in the case of State officers”.

Despite this dilemma, there is no doubt that accountability is an essential aspect in a reform process aimed at achieving a modern state. A modern state should have efficient and effective mechanisms so that their citizens may know what it is being done, how it is done and assess its performance.

Proper accountability is a key factor to achieve an adequate image of the Tax Administration, to the extent that it provides the citizens-taxpayers with the tools to assess performance and compliance with an organization responsible for administering laws.

While the Tax Administration enjoys the lawfulness deriving from the body of rules of each country’s public finances, we believe that its legitimacy is obtained from the ethic and responsible exercise of the authority conferred by the law upon the Tax Administration.

¹ See the article on *Managerial accountability and responsibility: institutions rather than instruments*, from CLAD’s book on *Public management accountability and assessment*.

The society's perception that the Tax Administration exercises its functions in accordance with the laws and the tax equity principle, reasonably and efficiently as to the administrative and financial areas, will definitely bring about a legitimacy that will facilitate the entity's operations.

The 2009 International Transparency Barometer reports on an increasing concern for corruptive practices inside the private and the public sectors. According to this document, more and more citizens perceive the private and the public sectors as corrupt; i.e., organizations and institutions at large.

The study shows that nearly 7% of the respondents have bribed the tax authorities around the world once. To gain the citizens' respect, the law enforcement authority should prove to be in compliance with the applicable laws. This entails a greater commitment from the tax authorities to showing society that they abide by the laws and the ethics.

This document will explain how the DGII has adopted accountability and citizens' information as part of its work; what mechanisms have been used to bring forward to the interested parties the information regarding the institution's performance.

2 DGII'S STRATEGIES TO INFORM TAXPAYERS AND THE SOCIETY AT LARGE

The DGII's Vision includes the commitment to being a credible and prestigious organization. The attributes of credibility and good reputation are cultivated through the observance of the laws, the ethical and unobjectionable professional conduct of its officers, the fulfillment of the undertakings and goals assumed by the organization as to the society and its accountability.

The taxpayers and the society at large will believe an organization is credible to the extent that their interaction with it meets their expectations, and based on the information at their disposal to give an opinion on its performance. This is why our vision is to:

"Become a prestigious and credible organization that uses policies, procedures and information systems that operate efficiently, staffed

by ethical and professionally unobjectionable people who abide by the norm of increasing tax collection steadily, reducing tax evasion and respecting taxpayers' rights".

For the DGII, accountability is part of its work. We believe that the organization's legitimacy has partly to do with its transparent practice. Even though the DGII as a public entity has its own institutional legitimacy, a power stemming from its own reason d'être, what is pursued is that the institution may gain greater legitimacy as a result of the manner it exercises such power.

Given the relevant role the DGII assigns to information, the Strategic Planning defines four objectives. Among them one stands out that relates to the topic of this paper: "To create efficient information mechanisms for taxpayers and the society at large".

Therefore, a citizen-taxpayer information scheme on the DGII's actions has been designed, and it is divided into four segments:

- **Administrative-financial performance.** It concerns the administration of the funds received by the DGII as an autonomous entity² to cover expenses and investments, and with relation to the compliance with the regulation on acquisitions.
- **Performance as a collection entity.** Its plan to achieve the collection goal and the results obtained.
- **Income and assets of its employees and officers.**
- **On taxpayers' obligations and how to fulfill them³.** It concerns the education strategy and the services provided by the DGII, which are covered by this document.

Accountability is regarded as part of good corporate governance practice. While it is a duty of tax administrations that the DGII should operate adequately, it is also a duty that citizens should know what the DGII does, how, and be able to assess it.

This decision goes beyond the legal reporting requirement ruled in the Dominican Republic by the General Act 200-04 of Free Access to Public Information, of July 28 of 2004.

² Section 14 of Act 227-06 provides that "The budget of the General Directorate of Internal Revenue will be two percent (2%) of the effective collection obtained each month from administered taxes".

³ This aspect will not be discussed in this document since we intend to focus on the information related to the DGII's performance.

This regulation provides wide powers to Dominican citizens regarding public information; in this sense, it establishes that all the persons are entitled to request and receive thorough information on any branch of the Dominican State and on all corporations and businesses having state participation.

The information referred to in the Law should be contained in the records and files of the public administration, which are documents kept in written, visual or sound means, or otherwise, which fulfill public purposes or objectives; and are provided as long as they do not affect the national security, the public order, the public health or moral, or the privacy rights or reputation rights of third parties. The law provides some limitations and exceptions as to the delivery of information where the secrecy imposed by the laws or judicial or administrative decisions cannot be violated in certain cases.

On the other hand, the Law establishes that state entities should have a permanent and updated information system regarding all their acts and activities, for which they should, in addition to their publication through the available means, computerize and incorporate such acts and activities into on-line communication systems or similar. So, they must bring in the publication of their respective webpages in order to facilitate the free access to the public with no need of a prior request, in accordance with the above cited Law.

Additionally, they are required to provide the information created or obtained by them or which is in their hands and under their control, and contained in written documents, photographs, recordings, magnetic or digital means or otherwise; including in such information, in the event it is the basis of any administrative decision, any type of financial documentation relative to the public budget or deriving from private financial institutions.

Alternatively, the Application Regulations of the Act 200-04 provide that the state entities and private law bodies receiving resources from the National Budget should create their respective Information Access Offices (OAIs, in Spanish) at which citizens may request the information authorized to them by the law.

Available information:

In this context, the DGII has set up information mechanisms where the citizen-taxpayer may obtain as much information as possible regarding

its management. We have a transparency portal as an integral part of the DGII's website (<http://www.dgii.gov.do/transparencia/Paginas/SeccionTransparencia.aspx>), which includes an on-line Public Information Access Office (OAI, in Spanish) and an OAI located in the DGII's main building, which is the channel whereby any citizen having no access to electronic means may obtain the information required from the institution⁴.

1) Accountability in the administrative-financial performance environment:

In this environment, one of the objectives is to prove compliance with the provisions of Act No 340-06 on the State's Purchases and Contracts of Goods, Services, Works and Concessions, and its amendments, and show the manner in which the DGII has expended and invested the resources received for collection purposes. The cited law provides the overall principles and rules governing public contracts, as related to the State's goods, works, services and concessions.

As an autonomous and decentralized body, the General Directorate of Internal Revenue is subject to the regulations provided for by the National System of Public Purchases and Contracts, established within the context of the Act 340-06 on Public Purchases and Contracts, and its amendments, the Regulation 490-07 and several resolutions issued by the System's Regulatory Body.

One of the principles governing the acts of the bodies covered by the System is the transparency and publicity principle. According to number 3 of Section 3 of the Act 340-06, the purpose is that "all stages of the public purchases and contracts contemplated in this act should be executed within a context of transparency based on the publicity and dissemination of the acts deriving from the application of this law. Contract procedures will be publicized through suitable means as per the requirements of each process. Any interested party will have free access to the administrative contract file and supplementary information. The use of information technology facilitates the community's access to the State's management on such matter".

Alternatively, Act No 227-06, which grants legal personality, functional, budgetary, administrative and technical autonomy and self-owned

⁴ *The DGII's limitations on the delivery of information are contained in a public document that is included in the OAI's transparency portal, called: GUIDE ON THE EXCEPTIONS AND LIMITATIONS IMPOSED BY THE GENERAL ACT ON FREE ACCESS TO PUBLIC INFORMATION No 200-04 APPLICABLE TO THE DELIVERY OF DGII'S INFORMATION.*

assets to the General Directorate of Internal Revenue (DGII), provides the obligation to publicize the financial statements audited by an external firm.

Regarding the issue of financial and administrative performance, the DGII has three types of information, all contained in the Transparency Section of our website:

a) Information on budgetary performance: In the DGII's Transparency Section, taxpayers may access:

- I. The Budgetary execution report. Contains staff and current expenses, as well as capital investment with recorded figures and the availability of the monthly and accumulated budget.
- II. Special projects: Is a detailed report on the main projects undertaken by the DGII, such as Fiscal Printers and Data Center, along with all the annexes supporting the execution thereof.
- III. Tax refunds: Presents outlays or payments made for different tax refund items, broken down by beneficiary, amount, date and item.

b) Information on the purchase and contract process. The Transparency Section shows the following information:

Required by the legislation:

- Public Tender Notices: inform to the citizens the diverse calls made for acquisition processes through the tender modality and the general purpose thereof.
- Bid Terms and Conditions: include the general and technical data on the goods or service being tendered.
- Questions and Answers: present the concerns brought forth by the interested bidders and the institution's opinions on such regard.

Not required by the legislation:

- Technical report: contains the assessment of the compliance with the evaluation criteria of the different technical and economic proposals submitted by bidders and the final recommendation issued by the Evaluation Committee.

- Record of adjudication: contains the final adjudication opinion issued by the Tender Committee, based on the information included in the Technical report and the considerations of its members as to the fulfillment of legal procedures and the institution's requirements.
- Winning offer: contains the full digitalized copy of the winning bidder's proposal.
- Non-winning offers: contains the full digitalized copies of the non-winning bidders' proposals.
- Letter of adjudication to the winning company: contains a full digitalized copy of the letter communicating bidder that they has won the bidding process.
- Letters to non-winning companies: contain a full digitalized copy of the letters communicating non-winning bidders that they have failed in the bid.
- External administrative audits: they present the reports or opinions of the audits performed to the DGII's purchase processes by well-known external auditors to verify the compliance with the provisions established by the effective legislation on state purchases and contracts.

c) DGII's financial information: This section shows:

- The Balance Sheet, which presents the financial position of the DGII, its assets, liabilities and shareholder's equity, each account with its properly detailed and identified annexes, cut off monthly and audited at year end by a certified external audit firm.
- Statement of revenue and expenditure: reflects the earned revenue (from budgetary allocation and its own revenues) minus expenditures or payments made, with a detail of each payment made to each beneficiary, along with the amount, date, payment item, etc.
- External financial audits: present the reports or opinions of external audits performed to the DGII's financial statements by external audit firms and the Chamber of Accounts.
- Cash in banks and banking reconciliation: is the availability of cash in bank accounts.
- The DGII as withholding agent: this report presents the DGII's compliance with the payment of taxes withheld from salaried workers, individuals, ITBIS [tax on the transfer of industrialized goods and services], etc.

2) Accountability in the environment of a collection entity:

In the DGII's website there is a Statistics Section that contains periodical bulletins and publications and especially an area devoted to showing the collection results by month and year, with respect to the budgetary estimation established in the national budget and the previous year. These reports include an analysis of each tax collected by the DGII, which is of great usefulness.

Additionally, there is an analysis of the sales behavior in respect of the VAT returns of taxpayers by economic sector. This information has become the primary input for the country's economic activity calculations.

The fact that the publication of this report is made with respect to the collection results as against the national budget's allocations, whether these are positive or negative, in the first week of each monthly, is a sign of the DGII's commitment to rendering accounts to the citizens.

Besides, a summary of the DGII's plan for the year can be consulted, as well as a document showing the alignment of the executed projects with the strategic objectives.

3) Accountability of income and assets of employees and officers:

In addition to the organization's information, the DGII's Transparency Section provides data relating to the officers and employees of the institution. The following can be consulted:

- The Staff payroll: provides a detail of the monthly payment received by each employee, identifying their name, position and salary.
- Income Tax Returns and the Assets Annex required from each senior officer (Director and Assistant Directors).

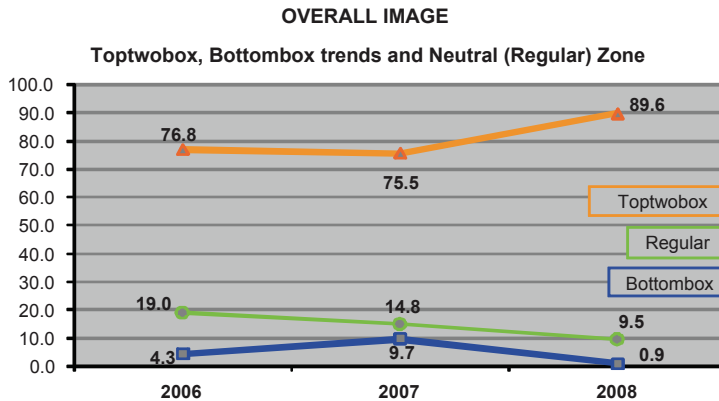
What is pursued through these data is that interested citizens may follow up officers' performance and be knowledgeable of such officers' income and lifestyles.

4) Taxpayer's perception of the DGII:

One way to measure the taxpayers' perception of the DGII's performance is by conducting surveys on a representative sample of taxpayers.

In this sense, the DGII has been conducting an image survey each year since 2006⁵, with external companies specialized on this issue. Below are the results of such surveys regarding the overall image, trust, credibility, transparency and ethical reputation. In each graph we show the so-called toptwobox results (the two best types of results: excellent and good), bottomtwobox (the two worst results: bad and very bad) and the neutral or regular zone.

From the graphs it is observed that in the last year the neutral or regular responses go down, while excellent and good responses go up.



⁵ The 2005 survey was conducted between October and December of that year by Gallup Dominicana, with a sample error of 5%. The 2006 survey was carried out by the DGII with a sample error of 5%, between September and October of 2006.

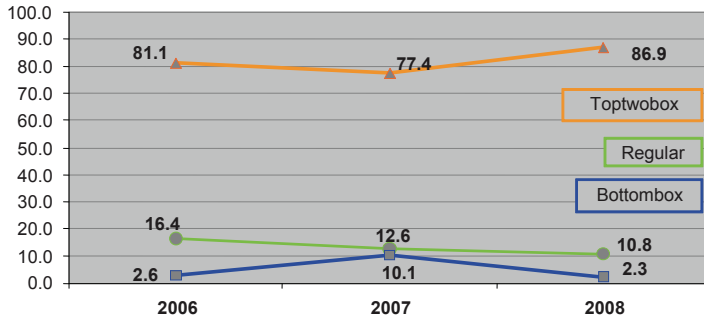
In 2007, the survey was conducted by Gallup Dominicana with a sample error of 4%, between May and July of that year.

In 2008, MKT Consulting conducted the survey with a sample error of 5%, between February and March of 2009.

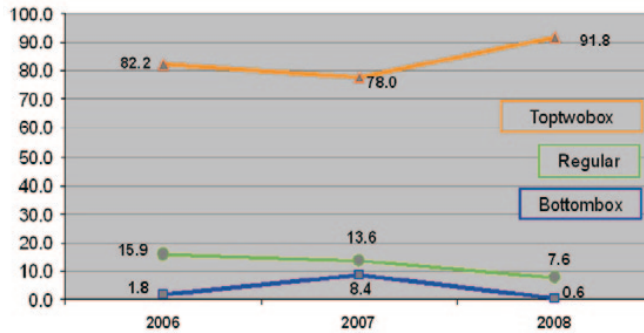
At this time, the firm Alpha Consulting is conducting a survey whose results will be shown in the May presentation.

CREDIBILITY

Toptwobox, Bottombox trends and Neutral (Regular) Zone



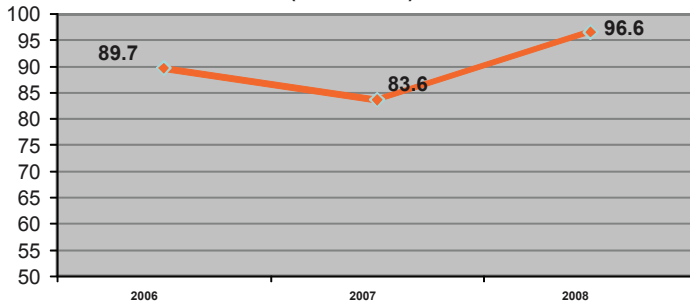
Tendencia Toptwobox, Bottombox y Zona Neutral (Regular)

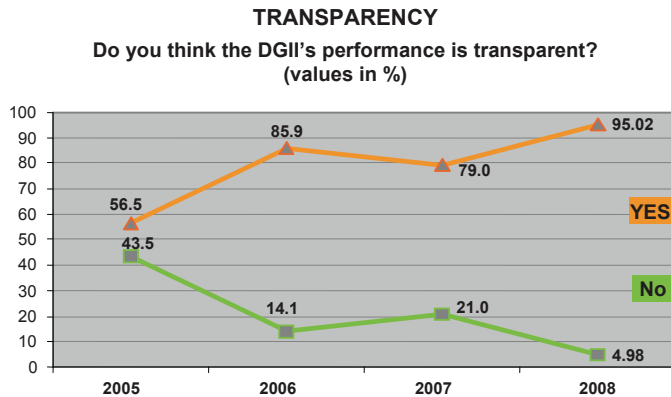


Inquired on whether they trusted the DGII and consider it a transparent institution, the respondents answered as follows:

TRUST

Level of trust on the DGII, positive answers (values in %)





One indicator on how the citizens perceive the DGII's performance regarding accountability is the publication by the non-governmental or non-partisan organization Participación Ciudadana (PC)⁶ of the Transparency ranking, conducted in November 2009.

This study is intended to determine the degree of applicability and/or compliance with the Law on Free Access to Information (Act 200-04) by Dominican public institutions.

More specifically, it is aimed at:

- Verifying the constitution of Information Access Offices (OAI) and the appointment of Information Access Responsible (RAI, in Spanish) at public institutions.
- Assessing the level of availability of official information on the webpages of public institutions, pursuant to Section 3 of the Act 200-04 and Section 7 of its regulations.
- Verifying the level of responsiveness of public institutions to the requests made by individuals, as well as of non-governmental institutions within the frame of the Act 200-04.
- Assessing the procedures implemented in the assessed public institutions, for the purposes of the application of the Act on Free Access to Information.
- Comparing the level of applicability of Act 200-04, among the diverse public institutions evaluated.

⁶ *Participación Ciudadana [citizens' engagement] defines itself as a civic, non-partisan movement that advocates, coordinates and links the social ambit with the public branches. It was constituted to promote the articulation inside the civil society and encourage the engagement of citizens with a view to achieving the political, institutional and democratic reforms required by the republic and a fair and balanced social development. It is the most prestigious and influential organization of this type in the Dominican Republic.*

The study evaluates the transparency information on websites and the OAI. From this result a grade by category is derived, which ranges from A (greater compliance) to F (worse compliance).

The Direct Observation Registration File used by the PC for the webpage study grouped the observations around the following points:

- Availability of official information on webpages
- Updated information on webpages
- Overall information on the institution
- Regulatory information
- Information on officers and employees
- Ongoing and updated information services

In the case of the OAI, the following is evaluated⁷:

Allocation of value by indicator			
No	Indicator	Relative value	Weighted value %
1	Availability of official information	100	50%
2	Response to information request	100	30%
3	OAI's structure and resources	100	10%
4	Information Access Responsible	100	10%

In this last study, the General Directorate of Internal Revenue was classified under the A category, which is indicative of an efficient application and/or compliance with Act 200-04 on Free Access to Public Information, with a score of 92.2 out of 100, placing itself among the best 10.

Of a total of 85 institutions evaluated, only eight, i.e., 9.4%, were classified under the A category.

TO CONCLUDE

Providing effective information mechanisms implying the timely publication of data on DGII's performance, in anticipation of the citizens-taxpayers' requests, has been our strategy in the area of accountability. The data is put at the disposal of society with a view that the perception of this organization should be based also on the analysis

⁷ *The official information is the information that can be accessed without any request.*

of the information on the performance of each one of the processes we execute: administrative management and tax management processes.

In this sense, we are content with the results obtained so far, which we have shown as deriving from the results of surveys and analyses conducted by civil society organizations.

CREATING AND BUILDING TRUST IN CITIZENS: THE TAX ADMINISTRATION REPORTING MECHANISMS

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Contents: Summary.- Introduction.- 1. The vectors for “accountability” towards citizens.- 1.1 The institutional vectors: The LOLF dynamics.- 1.2. Communications’ policy.- 1.3 Users’ relation policy: users’ committee.- 2. Performance report quality tools.-2.1 Performance management.- 2.2 Quality assurance mechanisms.- Annex

SUMMARY

The civil duty to pay taxes arises from tax administrations’ ongoing effort. Users must receive but also perceive a quality service. They shall be able to measure the administration’s performance based on a mechanism of public communication. The annual performance report presented in Parliament as well as the related external communication mechanisms stem from the organic law on financial acts (LOLF, as per the French acronym), and tend to meet the foregoing initiatives. In the last few years, an additional contribution has been the implementation of users’ committees, for professionals as well as individuals, at the national level as well as in each department.

Ultimately, the trust relation with citizens (except in the case of fraud) is based on the reliability of the information delivered to them, beyond the quality of service. This fundamental requirement to improve the image and credibility of the administration and taxpayer’s civic duty to pay taxes entails effective monitoring of actual performance. In turn, it is necessary to implement procedures that assure that the processes are undertaken in line with the sector’s norms (auditing, deontology, risk control).

INTRODUCTION

For citizens, although it constitutes a vital element of democracy, acceptance of taxes not always depends on an immediate awareness. Enforcing, sustaining and developing taxpayers' civil duty to pay taxes, their acceptance of taxes (or social contributions) entails, in addition to the control and punitive aspects, not only facilitating formalities, but also establishing and nourishing a positive relation between them and the Tax Administration, a virtuous circle.

The challenge is to strengthen the acceptance of taxes and its concrete translation into tax compliance, accurately documenting the performance of tax administrations. On the other hand, citizens expect a better service, even the best at the lowest cost. Thus, it is a matter of guaranteeing the quality of service, its traceability and endurance. At the internal Tax Administration level, we shall spur performance, facilitate the channeling of the income from productivity and oversee quality, not only in terms of service efficacy and professionalism, but also risk control and, consequently, the deontological dimension of quality.

Along these lines, after the merge between the General Tax Directorate and the General Public Accounts Directorate in April 2008, the General Public Finance Directorate is paying close attention to this issue, by virtue of the broadness of the the sector under its umbrella, in the tax, accounting, financial and economic spheres. In furthering the initiatives started by the two inherent directorates, it implements in-depth actions: on the one hand, with respect to the vectors that enable accountability towards citizens (1), and on the other, with respect to the tools that enable quality and truthfulness on the performance report and performance conditions (2).

1. THE VECTORS FOR “ACCOUNTABILITY” TOWARDS CITIZENS

Information shall be detailed and reliable; but in addition to being mandatory, it shall be communicated as best as possible to the public.

1.1. The Institutional Vectors: The LOLF Dynamics

1.1.1 The New LOLF Scope

The organic law relative to the Finance laws of 2001 (the LOLF, which was enacted in 2006 and mainly governing the accounting

sphere) requires Parliament to vote on and monitor programs that bring together the administrative actions.

This effort enhances clarity of the Tax Administration's activity for the authorities elected by popular will, with the assistance, if required, of the enforcement authorities such as the Court of Auditors.

Its purpose is to structure the Tax Administration's proceedings according to a performance and results' rationale, while the previous text of the law (the organic resolution of 1959) was centered chiefly on the means. Thus, the "LOLF" entailed a considerable innovation in providing a framework and recovering the Tax Administration's activity. Its scope is no longer limited to the chapters (implying in practice a certain degree of inaccuracy or opacity); Parliament and the Executive branch have envisioned it in terms of consistent programs that express strategic priorities, are detached from past compartments and, owing to their global nature, provide the grounds for Parliamentary control while making tax officials accountable. The question of "why" comes before the "how". Objective-based management and measurement of results are the core of the LOLF methodology, in order to attach an effective scope to the budgetary principles of universality, truthfulness and regularity. This requirement is made extensive to the certification of Government Accounts (articles 27 and 58 of the LOLF) by the Court of Auditors.

In global terms, the LOLF improves the quality of the information available for Parliament in its role of legislator and monitor, for government and officials in optimizing performance, for the rating agencies and investors and for citizens.

From the technical standpoint, the main counterpart for the greater responsibility delegated and better defined objectives are the asymmetric fungibility that grants flexibility in the use of credits while guaranteeing their appropriate use, but also the strict limitation of credit deferrals, which expresses the demand for more transparency in expenditure.

1.1.2 The Practical Implications of the LOLF for the DGFIP

Accountability regarding a program's execution requires Parliament to deliver information that is as truthful and complete as possible. A report is drafted to such purpose, which may be supplemented with hearings.

The DGFIP is responsible for the State tax and financial management program as well as the local public sector program, which entails over 8 billion Euros (other programs are included therein). Twenty performance indicators are involved in the program-monitoring effort. Its documentation is released on the first semester of N-1, when the allocation of public finances is discussed. In fact, it is worth highlighting that performance management is assessed under the framework of the multiannual budget 2009-2011. The Finance Bill for 2011 shall constitute the groundwork of a new multiannual budgetary cycle, and for new documentation on performance indicators.

This multiannual dimension deepens the LOLF contribution. It ensures growing continuity and consistency in the objectives and their fulfillment in the program implementation.

Under this framework, the annual performance report to Parliament sets forth, pursuant to the terms of the organic law (Article 54), the performance with regards to the objectives and the values pursued, as well as the related costs (it also provides for the credit transactions' grounds and the expenses incurred, as well as the expense authorization proceeding).

On the other hand, the DGFIP is strongly involved in the State accounts' certification process, as operator from the different ministries, as well as actor for its inherent proceedings (such as, revenue accounting).

1.1.3 Advantages and Disadvantages

The biggest advantage of this procedure is based on the methodological completeness effort with respect to the indicators' documentation (and the related objectives) and the results' analysis. Parliament relies on complete information and participates, through the informative debate, in the definition of objectives; it relies on a vision within the continuity of the priorities assigned to the program and their fulfillment: it may conduct an analysis in terms of efficacy and efficiency. The performance report is the starting point for a concrete dialog between Parliament and the DGFIP (parliamentary matters).

A practical disadvantage arises from the limitations that this procedure generates in drafting the indicators and objectives of the program operating budgets for the territorial services (departmental Directorates). Given the large number of indicators of the Annual Performance Program in the "Program Operating Budgets" (BOP, as

per the French acronym) (see Annex 1), the calendar is defined by the discussion in Parliament. Nevertheless, in the dialog between the central administration and the departmental Directorates (through the Director General delegates) it is worth allowing for timeframes that match the desired objectives and the attainable objectives at the time of defining them.

Additionally, we shall consider a **twofold limitation**: in order to guarantee clarity for legislators, the number of indicators to follow shall be reduced (this is the DGFIP approach for the 2010 program, reducing the number of indicators by 25%); on the other hand, such indicators shall be a cross-section of the Tax Administration activity (thus, the DGFIP, based on its current strategy, continues monitoring the local public accounts' quality indicator or the coverage rate of the credits requiring external tax controls).

Finally, the framework for the programs defined by the LOLF, like the multiannual budgetary allocation, are not exclusive to the annual budget discussion. Finance laws shall be amended if required, introducing hues and complicating the interpretation of results.

A current example drawn from the 2010 Finance law is the reform of the tax on professional practice that has hindered the fulfillment of the objective of notifying territorial authorities from their temporary bases.

1.2. Communications' Policy

- The information delivered to Parliament, no matter how complete and accurate, is aimed at citizens, and no longer exclusive as a communication for the "general public".

Therefore, the annual DGFIP activity report (summarizing the the program's annual performance report –RAP (as per the French acronym)-) is available for users at www.impots.gouv.fr. It may be also presented in the users' committees created in the departments (see item 1.3 hereunder).

In addition, the DGFIP performance is also explained and communicated to the public, since it is included in the Ministry's activity report.

Such reports constitute the opportunity of implementing **an external communication policy**, so that citizens may clearly perceive the performance report, its context and implications. Communication may

also originate within a Directorate or Ministry. In recent examples, the communication from the Ministry, which creates strong visibility, mainly referred to the results and the external tax policy, but also the State's real estate property policy.

From the organization's standpoint, the DGFIP relies on a communication department that reports to the Director General, for the information coming from a Directorate, and in the territorial sphere, reporting requirements from each head of department. In 2010, a specific initiative was launched to relate to the university world.

Beyond the strict communication of results, it is recommendable to **deliver a highly focused communication to different groups under the administration** of the tax, accounting and financial authority. The examples that do not strictly refer to tax statements, contribute in building trust and understanding relations. We may refer to the communication towards local elected authorities (whether they are renewed, for training purposes, or to present the DGFIP services, or even in the case of tax reforms that impact their budgets); massive communication regarding income tax statements (it is massive, but experience proved that it may be in series, through letters or e-mail), the use of the Internet whether to document information, or for Questions and Answers, and the involvement of professional tax proceedings, with intermediate agencies (accountants, certified institutions) and the insertion of messages on VAT statements.

The advantage of external communication efforts is to provide the target audiences with information, not only technical (this largely depends on all the formats: physical, telephone and electronic), but also the one providing a framework to understand the actions by the Tax Administration, and, just like any great organization that processes information, updated benchmarks that increasingly streamline the user-services relation. The user that trusts the Tax Administration requires fewer contacts therewith.

The limits for communication depend on three features:

- A complex and ever-evolving matter that entails reactivity;
- The public's difficulty in understanding, based on the fact that communication was focused on the technical details: communication does not replace reception, in general as well as specialized terms;
- The need for an appropriate balance between external and internal communication. The message that the Tax Administration delivers

to its users shall not contradict its internal values, but rather assert them. Communication shall be balanced and consistent.

The DGFIP 2009-2010 effort entails fine-tuning a strategic guidelines' document, with the active participation of over 7000 agents in theme-based workshops. It stands for a strong internal consistency and communication challenge, which shall be in line with external communication.

1.3. Users' Relation Policy: Users' Committee

1.3.1 A Space for a Specific Dialog

Since 2004, the Tax Administration has been implementing committees of users, professionals and individuals, at the national and departmental level. They are consultative bodies that seek to gather the concrete analyses of the users, with respect to the enforcement of the texts and the ways and means to improve the quality of the service rendered, based on documentary queries and working meetings. They link representatives from the different sectors of the administration with representative bodies. Meetings are scheduled every 6 months approximately. Their works refer to the results obtained by the administration (delivery of the activity report) and, from such starting point, the way to streamline the service rendered.

Such users' committees constitute an interesting innovation. On the one hand, they supplement the communication policy; and on the other, the action of lobbies, which may be exerted in the drafting of regulation through different channels.

The key advantage is to set forth a space for specific dialog, vis-à-vis law enforcement (forms, relation modalities, summaries, supporting explanations, etc.). What is perceived from the progress or the progress margins of the Tax Administration, such as the expectations by category of users, is set forth and processed without any issues, more precisely than through surveys (which are useful mostly on the qualitative mode with quality panels, for example, in terms of a form). It enables conveying and listening to practical messages.

At the same time, it guarantees the administration's openness towards society, and somehow the equivalent of an analysis with "customer" panels. The administration presents its methods and may receive the feedback and a critical opinion from the users who are still taxpayers

with an active role. Likewise, users become aware of such instances, which entail rights, of course, but also duties (fulfilling their obligations).

A tangible example of the mechanism's outcomes is available in the charter of Rights and Obligations for the Tax Administration's users of 2005, with the effective participation of the national committee of private users.

1.3.2. Limits in the Mechanism

Firstly, owing to the time restrictions and the heavy burden on IT that condition the enforcement of tax regulations, users' committees may only address a given number of issues, mainly, the main tax statements. Their frequency prevents them from focusing on the daily detail of the implementation mechanisms that tend to be very complex. The frequent evolution of the norm also hinders their subsequent assessment.

Beyond this functional limitation, experience has shown that it was easier to find representatives of professional users, mainly at the national level, than of private users. In effect, in the latter case the administration may either deal with associations that challenge the tax from the onset and are less interested in improving its enforcement (even though this is not the purpose of the users' committees), or rely on counterparts with insufficient representation (such as, a majority from the retirees associations, or social entities). At the departmental level, it sometimes seemed inappropriate to extend full powers to the users' committees. In fact, their ability to articulate practical proposals is still limited.

2. PERFORMANCE REPORT QUALITY TOOLS

Although it is vital to develop a regular, precise and reactive communication towards the administration's authorities and users, whether institutional or for the general public, in order to build a relation of trust it is equally important that such communication be based on undisputable elements (otherwise, it would lose credibility and become counterproductive).

To such purpose, it is important to rely on effective performance management, based on strong risk-control means.

2.1. Performance Management

2.1.1. Management Control

Performance management by the DGFIP in 2009-2010 is developing on different fronts: renewed management dialog principles have been set forth and applied, in line with an initiative regarding the tools for management control and a project on the redefinition of indicators. The details of this evolution may be found in Annex 2 hereto.

Overall, management control (and activity monitoring) is aimed at delegating responsibility on the officials at the territorial level or those from the specialized directorates (mainly, by means of the dialog with the Director General delegates) as well as, at the sub-departmental level, those responsible for the different operating services. It connects the network, while favoring the accurate analysis of deviations and creation of the appropriate corrective action plans.

2.1.2 The Hubs per Sector for the Visible Performance Progress

The certification dimension stands as the supplement for performance monitoring. The objectivity of the performance report is assured by the existence of external counterparts of the administration.

For the DGFIP, it is first a matter of certification for the purpose of collective participation, based on a dozen indicators (see Annex 3), which constitute the dimension of user service quality by 15% (which is in turn audited during the proceedings by the external parties, mainly under the form of “mystery” calls). It is conducted by an external body, the General Financial Inspection Office.

Then, it becomes a matter of certification of benchmarks per sector, such as, onsite customer assistance or the proceedings by a group of inspectors. Such specific quality standards provide the framework for good practices. They may be completed by the “rules of the trade” that define optimal processes (such as a tax audit report) in the specifically internal operation of the services.

The advantage of the certification is to determine an objective framework, traceable to a quality level for a specific sector, which if absent, would be blurry.

The disadvantage lies in the relative burden that monitoring the framework entails (in particular, for the heads of service) as well as, in terms of the quality of user service, in the need of attaching new dynamism to the actions that meet the objective pursued.

On another note, the DGFIP mediators in litigation cases, as well as the development of the administration's answer, constitute the progress factors in the sectors involved, but also prove to users the quality efforts implemented to their benefit.

2.2. Quality Assurance Mechanisms

The General Public Finance Directorate features proceedings and operations subject to audits by different external auditing agencies: the General Financial Inspection Office of the Court of Audits (as a control body as well as accounts and accountants' jurisdiction and also as public accounts' certification), public or private auditors that participate in the general review of public policies.

Firstly, it shall rely on internal quality controls, according to the following three areas:

- In terms of auditing (for internal purposes, without disregarding the external auditor role): this is the case via a national auditing committee, with a national auditors' Mission and departmental missions, the delegates of the Director General who fulfill a coordination mission in this respect;
- In terms of internal control, which called for the implementation of a risk control Mission, replicated in each department, and in charge of defining the functional organizational charts in detail and overseeing their compliance in each operating service, with regards to the sector pilots.

Pursuant to the international standards, at the national level such groups directly report to the Director General, and to the head of the territorial office, at the local level. Their dimension is strategic.

- Lastly, the DGFIP oversees the necessary monitoring, through an office devoted to the central administration, more specifically for a financial administration, in terms of deontology.

Conclusions/recommendation: 3 guidelines

The technical framework that CIAT defines emphasizes the improvement of the administration's image to strengthen their performance with citizens. Three guidelines may contribute in such respect:

Regular performance measurement

Honest citizens demand quality service. Defining objectives, monitoring compliance or analyzing deviations and correcting the path, knowing the related costs, contributes in the creation of awareness of the administration's answer to this demand. Quality only exists when measured, and measured continuously.

Internally, management control, auditing and internal control may be perceived as burdensome with regards to the operating demands, but nevertheless, they are still the guarantors and advocates of the sector's correct processes.

Is it necessary to go even further, in the final measurement of the quality perceived? Beyond the surveys, which are a contributing factor, shall we put increasingly more efforts in users' committees? and subsequently, how shall we rely on truly representative counterparts?

The financial administration, Caesar's wife

But, citizens' demand goes even further: upon managing revenue and confidential information, the financial administration shall be irreproachable: not only is it transparent (within the limits set forth by the law) in their objectives and efficiency, but also above suspicion. It shall be Caesar's wife. The issue entails several dimensions, including deontology and internal control. Service professionalism shall not be detached from strict ethics.

This deontological policy is tied to exemplary tax officials' behavior. How to translate it in practice?

Communication and pedagogy

The communication policy is a subtle matter. It could not be mistaken for publicity, even if, in practice, it falls under the general framework of government communication. On the basis of the topic under

discussion, it may not replace the information functions that depend on the reception. Its scope is general information.

¿Should we ban any attempt at pedagogy and education with the administration officials? Whether on the technical sphere to minimize the need for onsite assistance (with powerful tools like an updated Internet site or an effective telephone customer service), or in earlier stages, especially aimed at students – the seedbed of future citizens with the civil duty to pay taxes.

Annex 2 – The evolution of management control in the DGFIP

I. The unification of the performance management mechanism

The DGFIP pursues a triple objective, defined in its preliminary document on strategic approaches, disclosed in early July, 2009:

- Building a unified management method for the whole network, pursuing the performance, efficiency and accountability objectives, based on legacy mechanisms and procedures from the two merged directorates;
- Establishing new modalities for the management dialog at the inter-regional, departmental and sub-departmental level, based on a simplified and unified management tool, aimed at the heads in the different territories;
- Guiding the reflection upon performance measurement based on fewer and more pertinent indicators.

A. Reflection on the indicators

It is performed within the network and the dialog with the organizations representing officials and is based on a twofold assessment.

Firstly, the number of DGFIP indicators overall (over 250) is quite significant. Not all depend on the same record, some translate objectives, and others provide clarification. But nothing prevents us from thinking that they arise from a tendency towards settlement. Additionally, from a practical standpoint: is a consolidated number of too many indicators compatible with management focused on strategic priorities, in a context of challenges tied to the deep reformed implied by the merger and the consolidation of results, among which many have reached a high level already?

Secondly, the issue of the race towards indicators, or the excessive burden it would represent on the activity of the services, with potential consequences in terms of professional stress, was subject of debate. Consensus is being sought in this respect. It requires in-depth consideration.

If defining an organization's progress margin based on measurable objectives is deemed healthy, an effort to establish them according to series as the means to enhance and make performance definition more dynamic is also evident. Reviewing indicators, based on the analysis at the central administration level as well as field studies, is covered by this scope. It translates according to a reduction in the Program Operating Budget indicators (almost twenty) and a renewed articulation with the activity monitoring mechanism, as automated as possible and aimed at providing context elements if required.

The reflection on the indicators was conducted in depth, with consensus, tied to the preliminary work in workshops on the Strategic Guidelines' Document, relative to the sectors. In 2010 it shall be translated. It constitutes the background for performance dialog.

Thus, the procedure to apply the national indicators, defined in the fall of 2009, represents a significant stage. A list of almost twenty indicators supports the management dialog. They are based on the application of national indicators (mainly those in the PAP of programs N° 156, 200 and 201 in the PLF 2010). Fourteen of them come from the State and local public sector Tax and Financial Tax Management Program, 2 from the reimbursement and exemption programs, and the others from previous performance contracts.

In this panel of indicators, the sectors have defined targets, included in the inter-regional application. The Director General delegates (DDG, as per the French acronym) manage the local application on this basis in the framework of a dialog within the defined set so that the cycle may complete the last iteration with the central administration. The DGFIP subsequently considers such feedback. The DDGs then notify the indicators and the target heads of territorial offices.

These objectives are subject to DDG monitoring, in the course of the year, within the framework of the management dialog.

B. Performance dialog organization

The implementation of the new performance dialog mechanism is organized on the basis of the DDG. This pivot role is understood within the respect to the principle of subsidiarity and accountability at the operating level.

Thus, the performance dialog is established in two phases: within six months after the head of the territorial office takes office and, annually, based on a performance report. The head of the territorial office (or the inter-regional director for tax control (DIRCOFI)), who performs a diagnosis, is responsible for the initiative in each case. The delegate shall analyze this diagnosis and elaborate on it, during an interview, if required. The delegate's role falls under the framework of the departmental strategy, and does not intervene at the sub-departmental level.

In the case of the initial dialog, a report is drafted at the end of an interview, according to a format defined by the office of the central administration in charge of controlling performance and coordination (BP1A). Based on this synthesis of the organization and the results, leverages, hurdles and priorities to be defined, the delegate writes a preliminary charter of objectives: it is submitted to the central administration for the Director General's approval.

The charter of objectives determines the principles of the mission and the priorities of the head of the territorial office for his/her term. It is signed by the Director General, and integrates elements that deal with the evaluation of the head of the territorial office. This initial procedure replaces the final procedure, which applied in the former General Tax Directorate (former DGI) and results in a simplification of proceedings.

In the case of the annual performance report, the delegate analyzes the document drafted by the head of the territorial office – with an interview, if necessary – and then delivers it to the BP1A office, which communicates it to the sector's office. This information delivery process (more refined and improved in terms of analysis with respect to the DIGITEX or DESCARTES tools) seeks to contribute to the examination (crossed) of the sector's directorates on a given department's management.

Indeed, such principles may go beyond the sub-departmental management dialog, where certain practices prevailed. The unification

process of the tools for performance control shall finish, in the IT sphere, the unification conducted from this moment onwards in the methodological sphere.

This description of the management dialog mechanism is understood if we consider, in its content, the elements contributing to the wealth of shared diagnosis: the causal analysis of situations in retrospective, the evaluation of conditions and the context in which results are obtained, and the focus on the action hubs that have been most adapted.

II. Operation modalities of the unified performance dialog

A. The dialog between the DDG and the heads of the territorial offices

- From the delegations' standpoint, the dialog has been facilitated in terms of technical knowledge by the increasingly mixed nature of the groups, by assigning to the delegations Chief inspectors and inspectors who specialize in government administration. Given their educational role, the management control efforts (centered, based on their structure, on the performance reports in the course of the first semester, and conducted for the initial dialogs according to the dates featured for turnover in senior positions) are developed in an environment of increasing competition in multiple fields, which shall focus on a multi-skilled approach.

This osmosis is facilitated by the cross-sectional initiatives that delegations shall undertake, not only in terms of monitoring the hubs arising from the merger, but also to establish a monitoring process for the quarterly activity, as defined in the circular letter dated 2 October, 2008 and for the budgetary discussions or the suppression of jobs. As from 2010, the network or working groups' mutualization initiatives, as well as the oversight of audits, seek to enhance the dialog content and the relevance of the contribution in the mutualization on the action hubs.

- From the directorates' standpoint, the dialog is the opportunity to structure the activity based on the merger's dimension overall. This is especially true in the initial dialogs that coincide with the creation of the DRFIP or the DDFIP, which take on a truly managerial dimension for this reason, to make the senior team more consistent and homogenize the new management.

Beyond the managerial dimension, the creation of a DDFIP or DRFIP stands as an opportunity of reviewing the activity monitoring issue, as well as control staff and internal communication of results, acknowledgement factor and the action hubs. The pursuit of a harmonized format and the frequency is relevant to learning about a new dimension for directorates and mutually enhances know-how.

B. Performance dialog at the departmental level

- In the case of the directorates that have not been merged yet, the mission charter mechanism implements the formal application by the head of department of the strategic priorities in the implementation of their departmental management. Of course, the local priorities remained in the definition process, within the continuity of the previous results; the mission letter confers upon the departmental management a deeper field depth and confirms the sub-departmental dialog that had been sustained.
- In the increasingly frequent case of merged directorates in 2010 and in general, as from 2011, the departmental dialog constitutes the opportunity of assigning a single responsible party in its global framework, given the joint development by the cross-sectional center and the sector-based centers, since it is enforced upon the heads of service to express the new unity in the directorate and concretely translate the merger into the operating commitments.

In the merged directorates, 2010 is the year of a new management, which implements a more systematic dialog; the government administration sphere relies on a chapter on management issues and improvement hubs in addition to the application of the objectives defined. On the other hand, the tax management sphere features the simplification of procedures that could be inspired by the directorate/DDG mechanism (“incoming head of service” procedure followed by an annual simplified stage assessment).

Management tends to strengthen the network development role inherent in the directorate.

Annex 1

PAP 2010 Indicators

Program 156 – Tax and financial State and local public sector management (09/14/2009)

Objective 1 Completing the merger

- Indicator 1.1 Deploying the one-stop shopping window (from the user's standpoint).
- Indicator 1.2 Number of regional or departmental public finance directorates (from the user's standpoint).
- Indicator 1.3 Improvement of the services rendered to the territorial administrations (from the user's standpoint).

Objective 2 Favoring voluntary compliance with tax obligations (civil duty to pay taxes)

- Indicator 2.1 Part of the taxes filed or paid voluntarily to the DGFIP
 - 2.11 Rate of individual users who fulfill their tax filing obligation.
 - 2.12 Rate of collection of taxes on professional activities.
- Indicator 2.2 Gross rate of collection of taxes filed.

Objective 3 Facilitating taxation

- Indicator 3.1 Degree of effective implementation of the initiatives in the program "Facilitating taxation" (from the user's standpoint).
- Indicator 3.2 Degree of development of virtual procedures in the DGFIP (from the user's standpoint).
 - 3.21 Part of VAT collection, Corporate Income Tax- IS (as per the French acronym) and Payroll Tax -ISal- (as per the French acronym) paid by professional users who have adhered to a remote payment procedure.
 - 3.22 Number of remote tax statements - Tele Income Tax- IG (as per the French acronym).
 - 3.23 Rate of virtual payment of taxes on individuals (Income Tax-TH-Real Estate Tax).

Objective 4 Reinforcing the struggle against tax fraud and tax and fines' enforcement

- Indicator 4.1 Percentage of controls that punish the most serious types of fraud (from the taxpayer's standpoint).
- Indicator 4.2 DGFIP gross collection rate of duties and fines on external tax control credits for year N-2 (from the taxpayer's standpoint).
- Indicator 4.3 Rate of fines' payment (from the taxpayer's standpoint).

Objective 5 Controlling financial administrations' management costs

- Indicator 5.1 Rate of intervention on revenue and expenditure (from the taxpayer's standpoint).
 - 5.11 Rate of intervention on taxes (DGFIP).
 - 5.12 Rate of intervention on customs duties (DGDDI).
 - 5.13 Global rate of intervention on revenue (DGFIP – DGDDI).
 - 5.14 Rate of intervention on Government expenditure (DGFIP).
 - 5.15 Rate of intervention on the local public sector's expenditure (DGFIP).

TOPIC 1.1 (France)

Indicator 5.2 Annual evolution index of the global DGFIP productivity (from the taxpayer's standpoint).

Objective 6 Improving the quality of accounting procedures

Indicator 6.1 Rate of days-noncompliance verified on the State accounting records (from the user's standpoint).

Indicator 6.2 Rate of compiled data on the qualitative monitoring of local accounts (from the user's standpoint).

Objective 7 Reducing government expenditure terms of payment

Indicator 7.1 Government expenditure term of payment (from the taxpayer's standpoint).
 7.11 Government expenditure global term of payment.
 7.12 Term of payment for accountants of the local sector expenditure (Administrations under the Hélios application).

Objective 8 Strengthening the quality of the cooperation service for the local public sector

Indicator 8.1 Implementation of virtual procedures in the local public service.
 8.11 Coverage rate of virtual procedures in the local public sector.
 Indicator 8.2 Cooperation agreements with the most important Administrations and the local public businesses. (Rate of weighted coverage of the CSCF) (new)

Objective 9 Accelerating processing terms to optimize the quality of the service rendered to public officials in terms of retirement procedures

Indicator 9.1 Percentage of urgent retirement formalities processes within a two-month term. (from the user's standpoint)

Annex 1 Bis

INDICATORS (Updated as of 21 December 2009)	Presence in the BOP 2009 (Reminder)	National objective 2010
I. PAP 2010 Indicators		
Objective 2 : Favoring voluntary compliance with tax obligations (civil duty to pay taxes)		
2.1 Part of the taxes filed or paid voluntarily to the DGFIP.		
2.11 Rate of individual users who fulfill their tax filing obligation.	X	98%
2.12 Rate of collection of taxes on professional activities.		98%
2.2 Gross rate of collection of taxes filed.	X	98.40%
Objective 3 : Facilitating taxation		
3.1 Degree of effective implementation of the initiatives in the program "Facilitating taxation".	X	5
3.2 Degree of development of virtual procedures in the DGFIP.		
3.23 Rate of virtual payment of taxes on individuals (Income Tax-TH-Real Estate Tax).	X	55%

TOPIC 1.1 (France)

Objective 4 : Reinforcing the struggle against tax fraud and tax and fines' enforcement		
4.1 Percentage of controls that punish the most serious types of fraud.	X	18.50%
4.2 DGFIP gross collection rate of duties and fines on external tax control credits for year N-2.		43.50%
4.3 Rate of fines' payment. (rejected under the form of enforced collection of fines and punitive interest)	X	79% (39%)
Objective 6 : Improving the quality of accounting procedures		
6.1 Rate of days-noncompliance verified on the State accounting records.	X	20
6.2 IASQCL (not rejected on the BOP 2010, extended from the 2009 objective).	X	115 (objective 2009)
Objective 7 : Reducing government expenditure terms of payment		
7.1 Government expenditure term of payment.		
7.11 Government expenditure global term of payment.	X	28 days
7.12 Term of payment for accountants of the local sector expenditure (Administrations under the Hélios application).		7.5 days
Objective 8 : Strengthening the quality of the cooperation service for the local public sector		
8.1 Coverage rate of virtual procedures in the local public sector.	X	45%
8.2 Cooperation agreements with the most important Administrations and the local public businesses.		50%
II. Additional indicators in the BOP 2009		
Parts of the requests for VAT reimbursements and Corporate Income Tax refunds with a favorable or partially favorable response, within a term not exceeding 30 days.	X	80%
Rate of contentious claims regarding Income Tax and Residential Tax within a month's term.	X	95.90%
Increase rate in automatic Local Public Sector (SPL, as per the French acronym) payments (in amount or number).	X	8% (number) 7% (amount)
III. Other indicators issued by the CPP followed in 2009		
Rate of compliance within a month's term to provide an answer to the mandatory evaluation requirements for the France Domaine service (QSF3)		93.50%
Enforced collection rate.		55.75%
IV. Other indicators		
Coverage rate of the real estate transactions rate in N-2/N (H12R).		76%

Annex 3

PARTICIPATION INDICATORS 2009

Objectives	Objective 2009	2008 (reminder)	
		Results	Objectives
Effective implementation level for the commitments from the program "Tax Facilitation" of the DGFIP (common to both networks).	90% (PAP 2009)	90.93 %	90 %
Breakdown of the payment rate for tax on individuals. (Income Tax, Residential Tax, Real Estate Tax)	50% (PAP 2009)	50.15 %	49 %
Part of the VAT credit reimbursement requests and the IS refunds, with a favorable or partially favorable decision, within a term not exceeding 30 days.	80% (PAP 2009)	89.52 %	80 %
Contentious claims' rate in terms of Income Tax and Residential Tax in a one month term.	95.80% (PAP 2009)	96.16 %	94.1 %
Delivery of Real Estate Information within 10 days. ¹	100 % (BOP 2009)	99.98 %	100 %
Delay rate in the business annual income.	< 1 %	0.39 %	< 1 %
Record of private users who fulfill their income tax obligations.	98 % (PAP 2009)	98.20 %	98 %
Gross collection rate for the taxes filed as of 31/12/N+1.	98.35 % (PAP 2009)	98.52 %	97.9 %
Percentage of controls that punish the most serious frauds.	18 % (PAP 2009)	18.12 %	15 %
Rate of anomalous days on the State accounting records.	25 (PAP 2009)	33	35
Coverage scope of the CSCF (Convention on Accounting and Financial Service)	60%	57 %	50 %
Rate of increase in automatic payments in the SPL (Local Public Sector) (in amount or number)	5 % 5 % (BOP 2009)	15 % 22 %	+ 5 % + 5 %

¹ The objective is deemed fulfilled by 99.75 %.

Case study

Topic 1.2

THE TAX ADMINISTRATIONS AND TAXPAYER'S SOCIAL RESPONSIBILITY: STRATEGIES FOR COMBATING HARMFUL TAX PLANNING

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Contents: I. The Tax Administration-taxpayer relationship.- II. The spanish case: Forum of large companies. - III. Forum of fiscal advisors

I. THE TAX ADMINISTRATION-TAXPAYER RELATIONSHIP

The tax systems of developed countries are increasingly complex, as a reflection of the social, economic and financial reality in which they operate.

Tax administrations must perform their task in an environment characterized by the globalization of companies' performance, demographic changes, the international mobility of capital and labor factors, the constant innovations in corporate structures and the offer of financial products, the advancements in information technologies or the increasing concern for environmental issues. The concurrence of these factors calls for Tax Administrations to formulate new strategies in the field of both tax default prevention or control, and taxpayer information and assistance.

In light of such environment, the analysis should focus, on the one hand, on the position of taxpayers and how they approach the new economic situation; and on the other hand, the position of Tax Administrations to approach the new challenges described.

Factors Influencing Taxpayers

Over the last years, taxation has taken on an increasingly ethical, social and economic relevance. The issues of business management associated with tax matters have turned more complicated, risky and

changing. A corporate attitude that presupposes the assumption that the tax environment has a secondary role may fail to provide the company with the transparency required by these times of increased sensitivity to corporate social responsibility. In addition, the lack of tax revision systems may deprive entities of the access to benefits and incentives created by the tax authorities and shared by countries which design their tax systems to attract and retain the corporate investment. Therefore, the entities' tax and risk management policies should be as sophisticated, consistent and transparent as are the policies for the rest of the areas that involve multiple stakeholders, such as suppliers, clients or investors.

Historically, the tax departments of companies have been inclined to work isolately from both the advisors and the business units, and have on occasions not received the same importance as have other business areas. This implies that, in many companies, the fiscal risks are the target of attention only with relation to financial aspects.

The old barriers between the tax departments and the rest of the areas of a business are being toppled more by external influences than by internal actions. Regulations such as the US' Sarbanes-Oxley Act or the new compliance programs in different countries are compelling the change.

The companies may adopt two positions regarding the fiscal strategy vision:

- They may consider that the entity should act and provide services to the society, emphasizing compliance with the regulations and its contributions to the society.
- They may act exclusively for the sake of its stakeholders by reducing costs to a minimum within the legal boundaries (or on the borders of it) and perceiving taxation as a cost; in fact, as one of the main costs of the business.

To discuss the fiscal policy of choice, companies should ponder two main issues:

- How aggressive should the fiscal policy be?
- What is the acceptable level of risk it can assume?

In any case, whichever the adopted position may be, advisors should be aware that any tax planning that implies a forced interpretation of the regulation may create value for the stakeholders in the short term, but may destroy value in the long term upon damaging the entity's image in the eyes of interested third parties. This damage to its reputation may in turn lead to considerable damages in the economic results.

Hence, among the key factors that determine the decision-making processes of companies, as well as the interaction with the Tax Administrations, are the **Corporate Social Responsibility** and the **reputation risk**. Taxpayers, especially big-sized companies, have become very sensitive to the negative publicity related to a number of aspects, among them fiscal supervision. The Boards of Directors should assume that the current debates over good governance, corporate social responsibility and ethics suggest that the bet on a strict tax reduction policy, even within the legal boundaries, could have such effect on image that could lead to potential financial losses, loss of opportunities or even the failure of the company's strategies.

On the other hand, the companies should consider that fiscal risk management cannot be performed isolately from the supervising departments, but should rather climb up to the management layers which must make the necessary choices to increase transparency of financial reporting and become responsible for the relationship with the Tax Administration, facilitated by the incorporation of fiscal matters into the principles of Corporate Social Responsibility. The companies that have advanced most regarding responsibility matters have a formal structure and a perfectly designed fiscal risk management that are applied strictly and on a regular basis. This structure should be supplemented with the design of a periodical development evaluation system, the results of which should be known by the company's decision makers. All this allows the internal audit to perfectly identify the risks faced by the company, to prepare tools that facilitate decision making and provide the required information to the stakeholders (shareholders, clients, suppliers).

The Position of Tax Administrations: Risk Management and Cooperative Relationship

Broadly speaking, the strategic long-term objective of Tax Administrations is the promotion of taxpayers' voluntary compliance with their fiscal obligations through two lines of action: on the one hand, the provision of information and assistance services in order to cut down overhead costs tied to the performance of tax obligations;

and on the other hand, the detection and regularization of tax defaults by way of control actions.

In light of the great amount of work implied in the management of mass tax systems, the Tax Administrations have to make a rigorous allocation of resources to the diverse procedures and, in this scenario, risk management becomes an essential tool to allocate resources efficiently. To summarize the most relevant benefits, we could say that risk management provides tax administrations with:

- a structured base of strategic planning that comprises the allocation of resources;
- a process of identification of risks that affect the whole tax system;
- a compilation of evidence that allows determining the response to the risk; and
- a defensible criterion to manage taxpayers' compliance

Furthermore, risk management may also carry with it benefits to taxpayers, which implies not initiating unnecessary controls, minimizing compliance costs and generating greater certainty on their situation.

In any case, in order to make effective risk valuations, tax administrations need to have updated, apropos and reliable information. The valuation of risk implies that the tax administration has to consider, overall, the data available on each taxpayer and their different tax obligations, and draw on the compiled information in order to make an objective estimation of the risk. Besides, this valuation should make it possible for the Tax Administration to fix priorities or respond to taxpayer's conduct.

This new approach entails the construction of new relationship channels, bridging communication between the Tax administration and taxpayers, fostering relationships based on cooperation and trust; that is, establishing a **cooperative relationship**.

It is within the frame of risk management where the establishment of a **cooperative relationship**, based on the mutual confidence between taxpayers and tax administrations, can develop its full potential, in allowing, on the one hand, that tax administrations should identify "low-risk profile" taxpayers, and, on the other hand, that companies should cooperate in identifying the risks that affect taxation activities.

To be able to build a cooperative relationship as that previously described, tax administrations need to display, in their treatment of

taxpayers, their knowledge of the situation based on the understanding of the business world, their objectivity and technical strictness, proportionality, transparency and responsiveness.

As a consequence, the adoption of a cooperative relationship in the sense described above may carry with it important improvements in the **risk management** of tax administrations that organize their control activities in consideration of the existence of taxpayer groups that respond to a relationship of trust and cooperation.

II.- THE SPANISH CASE: FORUM OF LARGE COMPANIES

In an environment such as the one described so far, the State Agency of Tax Administrations is immersed in the process of developing a new form of relationship with Large Companies, a process which has consisted of two stages: the creation of a central unit as a single interlocutor with large taxpayers, and the implementation of a cooperative relationship.

The Central Delegation of Large Taxpayers

The Tax Fraud Prevention Plan of 2005 proposed, among its organizational and internal coordination and functional integration measures, the creation of a Central Delegation that would allow a coordinated control of large taxpayers, within the frame of a strong bet on the coordination and integration among the functional areas of the Tax administration, aimed at, in some cases, a greater integration between the inspection controls performed by the financial and tax inspection bodies, and the customs and special tax inspection in the case of taxpayers subject to the payment of such taxes, in order to avoid the performance of independent and uncoordinated actions. And, in other cases, the reinforcement of the coordination between liquidation and collection areas, so that control actions may be targeted from the very start at not only regularizing tax non-performance but also the effective collection of the debt bound to be liquidated.

So, the Central Delegation of Large Taxpayers was created as the single interlocutor with large-sized companies subscribed to it. This has brought about a change in organization and culture, upon overcoming the functional structure present in the rest of the organization and attaining a more direct relationship frame with large-sized companies.

The objective is to contribute with added value to the Tax Agency's actions. Hence, some functions are integrated which are in other delegations distributed along different bodies and divisions, as is the case of, for example, financial control and customs control, or the activity of liquidation and collection bodies.

The effects of the creation of the Central Delegation of Large Taxpayers since its creation to date may be discussed in light of the following figures:

- More than 3,200 taxpayers are enrolled. Nearly all of them are large economic groups (over 80%), and a minority is composed of individuals.
- It has a payroll of over 900 persons.
- It provides over 80 percent of the information records received by the Tax Agency.
- It contributes with over 40% of the annual collection.
- Their taxpayers' activities account for 39% of the GDP, outperforming the entire public sector.
- It has liquidated certificates of control actions for over 4,200 million euros.

Creation of the Forum of Large Companies

The opinion of large companies regarding the creation of the Central Delegation of Large Taxpayers has been very positive, for the centralization of an interlocutor has allowed greater simplification, clarity and professionalism in the relationship with the Tax Agency as well as a greater legal certainty.

In 2008, the AEAT conducted a survey to know the degree of satisfaction of large taxpayers regarding the task performed by the Central Delegation of Large Taxpayers. In general terms, the valuation was very positive, mostly regarding aspects related with the Management area (with an excellent reputation, high information technology, qualified and professional staff). Alternatively, the control procedures were questioned, mostly due to the existing legislation, the duration of procedures and the volume of information that taxpayers must provide.

In this state of things, the update of the Tax Fraud Prevention Plan conducted within the Tax Agency in 2008 implies a step forward in the relationship between the Tax Agency and large taxpayers, through

the implementation of a new type of **cooperative relationship** with a reduced number of large companies, in two phases:

1st PHASE. The creation of a discussion forum with taxpayers intended to discuss, through joint or sector meetings, the main problems arising from the relationship between large-sized companies and the Tax administration and the valuation of the extension of the cooperative relationship model.

2nd PHASE. The possible implantation of a special framework whereby the Tax administration would provide, in terms suitable to the needs of companies, a criterion regarding the tax consequences of business operations, in exchange for a total transparency of such operations, provided that companies that voluntarily abide by this special framework should offer any information required by the Tax administration to establish its criterion.

To apply the first of the proposals, the Forum of Large Companies was constituted on July 10 of 2009 as a cooperative relationship body between the AEAT and a total of 27 large Spanish companies, with a view to promoting a greater cooperation based on the principles of transparency and mutual trust, through the knowledge and sharing of problems that could arise in the application of the tax system.

The selection of companies that would participate in the Forum considered factors such as turnover volume, tax debt volume, the volume of information provided to the Tax administration, number of employees, activity sector and geographical distribution; choosing the companies considered representative and easily accessible for these purposes.

Among the represented economic sectors are:

- Automotion (2 entities).
- Integrated trade (1 entity).
- Construction (2 entities).
- Financial (4 entities).
- Insurance (2 entities).
- Large surfaces (3 entities).
- Transformation industry (1 entity).
- Electrical industry (1 entity).
- Textile industry (1 entity).
- Petroleum (2 entities).
- Communication (2 entities).

- Transportation (1 entity).
- Electronics (2 entities).
- Electricity (2 entities).
- Gas (1 entity).

The initial participation of a reduced group of companies should not be interpreted in any way as a sign of privilege to these participants with respect to the other taxpayers, because, in any case, the agreements adopted in the Forum will be applied generally to all affected taxpayers.

At the session of incorporation of the Forum of Large Companies, the Functional Rules of such forum were approved, which regulate, among others, the following matters:

- Regarding the Forum's functions, any matter proposed by any of the participants may be brought forth, which should be related to taxation and be of interest to all participants.

Among others, the following issues may be subject to knowledge and discussion at the Forum:

- a) Improvement of the relationship between the State Tax Administration and the companies, and the establishment of fluid communication channels. In particular:
 - Dissemination of the structure of tax application bodies and the practice of such application.
 - Suggestions for improvement of tax management.
 - Improvement of the current communication channels between the Tax administration and the companies, and the establishment of new ones.
 - Dissemination of specific interpretation criteria of the competent bodies (administrative, economic-administrative and judicial) that are of general concern.
- b) Simplification and facilitation of tax obligation compliance through the analysis of:
 - Possible improvements to be introduced in tax application procedures.
 - Tax control actions: duration, costs of assistance, etc.
 - Formal obligations with relation to the supervision of tax groups (Corporations and VAT), related operations, etc.
 - The criteria and the frequency for forwarding tax information to the Administration.

- The incorporation and modification of reporting and assistance software for fulfilling tax returns. Anticipated information on them.
 - The promotion of electronic billing.
 - The establishment of information channels that may generate greater security of corporate actions, minimizing litigation costs and penalty risks.
 - Taxation of certain operation that are of general concern.
- c) Study of regulation changes and how to adapt to them:
- Anticipated knowledge of regulation projects of general concern.
 - Proposals for changes in regulations of general concern.
- d) Evaluation of the internal actions of companies with regard to the tax system application:
- Spreading of tax management relevance in management education programs of companies.
 - Responsibility of the Boards of Directors as to task matters, as a sign of Corporate Social Responsibility.
 - Creation of a Code of good tax practices.
 - Possible improvements to be introduced in internal control procedures to detect and manage fiscal contingencies in companies.
- As to the Forum's functioning, the functional regulations establish Plenary work and Group work:
- a) The Plenary acts with the presence of the members of the Board of Directors of the companies or the members of the companies expressly appointed by the Board to represent them at the Forum, together with the Directors of the functional departments of the Tax Agency.

One of the main objectives of the Forum is that the maximum responsible for the companies have a direct participation in the supervision area, so their presence is required at the Forum's Plenary.

The Plenary meets under the direction of the Chairman of the Forum, a position that is exercised by the President of the Tax Agency.

The Plenary will hold regular meetings at least once every semester, and a special meeting called either by the President or at the request of the representatives of at least five of the member companies.

The decisions at the Plenary are always adopted by the consensus of the attendees and will be formalized in reports or recommendations regarding the issues transacted thereat, which shall have no binding legal effects.

- b) At the Working Groups, the representatives have a more technical profile regarding tax matters. The Forum's Plenary is the body authorized to agree to the creation or suppression of Working Groups, and will set forth their commitments, competences and functioning system.

Currently, there are three working groups operating:

- The preparation of a Code of Good Tax Practices
- The analysis and rationalization of Indirect Tax Burdens, and
- Transfer prices.

- c) The Forum has a Technical Secretariat headed by an officer of the AEAT. Also collaborating on a rotating basis with the Technical Secretariat are the representatives of member companies of the Forum who wish to do so.

Actions of the Forum of Large Companies

There are three Working Groups operating currently at the Forum of Large Companies: The preparation of a Code of Good Tax Practices, The analysis and rationalization of Indirect Tax Burdens and Transfer Prices.

These Working Groups held a first constitutional meeting by late July of 2009, and continue pursuing their commitments, despite the fact that the Forum may have already arrived at certain conclusions or have adopted certain decisions as a result of the work of the Groups.

Working Group on Transfer Prices

The work carried out by this group is intended to discuss the different matters relative to transfer prices, such as:

- Prior valuation agreements.
- Documentation to be presented within the context of transfer prices.
- Secondary adjustment and relationship with third-country jurisdictions.
- Penalty system.

So far, an agreement has been reached for the preparation of a series of criteria for AEAT's actions on different matters, in which preparation the experience contributed by the companies themselves will constitute key data.

Working Group on Analysis and Rationalization of Indirect Tax Burdens

The Spanish model of tax system application is based on an intensive use of information and new technologies. Notwithstanding the success of the model in terms of the implementation of a modern tax system apt to raise the necessary resources, the model implies a series of formal obligations that taxpayers must fulfill, with the resulting cost of physical and human resources. Nowadays, Tax Administrations, both on an internal and international level, are immersed in the process of reducing, as much as practically possible, the complexity of tax regulations and simplifying the formal obligations that fall upon taxpayers, while assuring the adequate compliance with tax regulations. In the process of transposing the European regulation¹, the Spanish Government has raised the objective of reducing the administrative burdens borne by taxpayers as a consequence of the national legislation, from 25% proposed by the European Commission, to 30% for 2012 (Agreement of the Council of Ministers of June 20, 2008).

Therefore, this Working Group allows obtaining information directly from taxpayers, thus facilitating decision making in the process of simplification of formal obligations.

¹ *Directive 2006/123/CE of the European Parliament and the Council, December 12 of 2006, relative to services in the local market.*

As for the conclusions, for example, one of the Working Group's proposals has been incorporated into a draft bill.

Besides other commitments, the AEAT is working with this Group to spread to other Public Administrations the matters that motivate a special concern to companies.

Working Group on the preparation of a Code of Good Tax Practices

One of the main projects discussed at the Forum of Large Companies is the approval of a Code of Good Tax Practices. The purpose of the Code is to encourage a reciprocal cooperative relationship between the Tax Agency and the companies that subscribe to it, a relationship based on the principles of transparency and mutual trust, which should lead to the development thereof under the principles of good faith and loyalty between the parties, which would result in an increase in the efficiency of the controls of the Tax Administration and reduce the legal uncertainty that companies could be exposed to and the amount of litigations arising between them.

On the other hand, the principles of good faith and legitimate trust that legally govern the functioning of Public Administrations gain special relevance within this taxation framework. Not only because of a greater strictness of the legislation, but also because the economic systems require from companies, and especially from those with an international component, an increased complexity of their operations.

And all the most when one of the two large lines of action of the Tax Agency, under its governing regulation, consists in the provision of information and taxpayers assistance services. In effect, a modern Tax Administration is required to stand closer to the companies, considering them both as main taxpayers and their valuable contribution as tax collaborators. This closeness should be characterized not only by a better and more detailed knowledge of taxpayers' actions, but also by procuring the maximum publicity and consistency of their interpretation criteria and actions. All things considered, it is this commitment of the Tax Administration which should provide taxpayers with the necessary legal certainty and allow a better and more effective compliance with tax obligations.

Hence, the main task of this Working Group is the formulation of a series of recommendations that sum up the measures or practices of good governance of corporations regarding tax matters, with relative and flexible character, allowing companies to adapt them to their own characteristics. Among the matters subject to debate are:

- The Board of Directors' actions regarding tax matters.
- The reduction by companies of significant fiscal risks.
- The transparency in the actions of companies and the Tax Agency.
- The cooperation in the fight against tax fraud.
- The establishment of a procedure for consultations with the Tax Agency.
- The increase in the information provided by companies.

III.- FORUM OF FISCAL ADVISORS

As stated at the beginning of this paper, the tax systems are becoming increasingly complex as a reflection of the social and economic reality in which they operate. In this environment, the task carried out by the fiscal advisors as offerors of tax planning mechanisms and assistants of taxpayers for the understanding and fulfillment of tax obligations should not go unnoticed. Therefore, Tax administrations must design coordinated and consistent relationships with taxpayers and fiscal advisors.

Under the Spanish model, the tax advisory services are provided by diverse professional entities with very different levels of services as well. So, between the large tax advisory firms and the individual advisor lies a whole universe of advisory formulas performed by experts (lawyers, economists, business agents, etc). It is sector with a high segmentation.

Among the diverse forms whereby the AEAT may intensify its relationship with fiscal advisors, one of them, of innovative character, is the creation of a Forum with representation of both parties, intended for the discussion of tax matters of general concern.

In order to be able to value the alternative relationships of the AEAT with the fiscal advisors, firstly the most representative interlocutors of the sector should be identified. For this purpose, we may classify the sector under two big groups: large tax advisory firms and the different entities representative of small and medium-sized advisory firms.

On ruling out large tax advisory companies, represented by the companies with highest turnover, the sector is composed of professionals of diverse origins and different corporates (from small or medium-sized companies, to individual advisors).

The best option seems to be a relationship with large advisory firms and the association of fiscal advisors existing in our country. A direct relationship with these associations, as well as with a representative of the profession (as recommended by the associations themselves) presupposes a significant representation of the sector. However, it should be noted that since these are not organizations such as the Professional Association, the membership of a fiscal advisory professional to any of the associations is purely voluntary, with the consequences that this has in the involvement of these professionals in future agreements.

Secondly, it is necessary to determine the objective of the Forum, both by the AEAT and the advisors' representatives.

Today, fiscal advisors are vital figures for the functioning of tax systems, helping taxpayers understand their tax obligations and fulfill them. In addition, in some cases they play a relevant role in large investment projects of multinational companies, so a fluent and stable relationship with them is of great importance to provide legal certainty to taxpayers and attract investments.

The cooperative relationships between tax administrations and fiscal advisors offer potential benefits to all parties involved and favor a better understanding by tax administrations of their work and their role in the economy.

The adoption of a cooperative relationship with fiscal advisors may bring about important improvements in **the risk management** of Tax administrations. Risk management has become an essential tool to detect risk taxpayers or behavior. Hence, the fiscal advisors themselves may provide information on behaviors or operations with fiscal risk, while the Administration will adapt its control actions taking into account the existence of taxpayer groups that are responsive to a relationship of trust and cooperation.

Likewise, it would be beneficial to the fiscal advisors to know certain criteria of the Administration's actions, for this will allow them to stand in a better position to give advice to companies.

The fiscal advisors, together with the tax advisory tasks, perform an important task as collaborators in the application of taxes. This brings about, among others, two relevant consequences: the adaptation to regulations changes in tax matters, which occur rapidly, and the obligation to assume the compliance with formal burdens implied in

the fulfillment of tax obligations, for which they should be the first interlocutors in the process of preparing development rules and concrete measures associated with these changes.

Regarding indirect tax burdens, the Spanish tax system application model is based on an intensive use of information and new technologies. Notwithstanding the success of the model in terms of the implementation of a modern tax system apt to raise the necessary resources, the model implies a series of formal obligations that taxpayers must fulfill, with the resulting cost of physical and human resources. However, and within the environment created by the European regulation and the Government's directives, the AEAT is immersed in the process of rationalization of the formal obligations that fall upon taxpayers, but assuring in all cases the control of the adequate compliance with the fiscal rules. In this process, the group of fiscal advisors should not be kept aside, because to a large extent, and through the mechanisms of social cooperation, it is them who, in many cases, maintain a direct relationship with the Tax administration on behalf of third parties.

Finally, the aspect of the fight against aggressive tax planning should not be disregarded, to which the Tax administration should respond. The maintenance of a cooperative relationship between the tax administrations and the fiscal advisors will allow the aggressive tax planning to be a less attractive option for taxpayers, and will reduce the demand thereof and, consequently, the offer of these products.

Therefore, within such frame, the Tax Agency has designed as one of its future projects in the short term the creation of a Forum of Fiscal Advisors, with the following guidelines:

- **Creation of a specific Forum of Fiscal Advisors** to discuss the main issues of interest in their relationship with the AEAT. A particular characteristic is the heterogeneity of the participants (small advisors and large advisory firms), so the Forum would function through Sections and Working Groups.

The territorial units will take part in this Forum by way of periodical meetings with fiscal advisors' associations of their territorial jurisdiction. At these meetings, the issues dealt with at the Forum will be informed and the territorial associations will be able to put issues for debate or make suggestions or comments on the issues discussed at the Forum.

- Among the **objectives of the Forum of Fiscal Advisors** is the pursuance of a better relationship between the AEAT and the fiscal advisors, and, specifically, an increased mutual knowledge between the parties, through the search of actions that facilitate the voluntary compliance of taxpayers and the transparency of the information, allowing for an improvement of the advisors' work as well as the facilitation of tax compliance. In addition, this Forum will make it possible to increase parties' interaction for the purposes of social collaboration tasks.

From its creation, two Sections were formed within the Forum having clearly differentiated tasks:

- Section on specific or especially complex issues.
- Section on operating issues.

On the one hand, as far as the work contents are concerned, the following proposals have been subject to consideration:

- Permanent information on issues discussed at the Forum of Large Companies, allowing for an interaction between both Forums, without duplication of Working Groups.
- Definition of the relationship frame between the AEAT and the fiscal advisors (regulation of responsibility, etc.).
- Analysis of formal tax obligations.
- Study and application of mechanisms for the communication of information and the registration of doubtful operations or operations performed exclusively for fiscal reasons.

- As for the **composition of the Forum of Fiscal Advisors**, it will be composed of as follows:
 - On behalf of the AEAT: members of the Tax Agency Directorate.
 - On behalf of the fiscal advisories:
 - The main fiscal advisory firms in Spain.
 - The remaining fiscal advisors, represented by business and professional associations:
- Despite the existence of meetings with the totality of the members of the National Forum of Fiscal Advisors, an important part of the work will be performed through the **Working Groups**. Each group will identify the problems and establish guidelines for the Groups' activities. The decisions will be made by the Plenary of the National Forum or, in the cases of delegation, by the relevant Working Group, in order to learn in more detail about the technical matters brought forth.

**THE TAX ADMINISTRATIONS AND THE TAXPAYER'S SOCIAL
RESPONSIBILITY: STRATEGIES FOR COMBATING HARMFUL
TAX PLANNING**

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Contents: Summary.- Introduction.- 1. Laying the groundwork.- 2. Combating harmful tax planning.- 3. Making compliance easier.- 4. Conclusion.- 5. Sources and citations

SUMMARY

During a time when many Federal agencies are experiencing budget cuts, the Internal Revenue Service (IRS) has seen a budget increase. Indeed, for FY 2010, the IRS actually received more funding than requested for its international tax compliance programs. Key to any kind of tax administration program expansion is high level support – at the national level as well as within the agency – and collaboration across the various functions within the tax administration.

For several years the IRS has enjoyed support for its international programs beginning with Commissioner Mark Everson and continuing with Commissioner Douglas Shulman. Many members of the U.S. Senate and House of Representatives have an interest in combating offshore tax evasion. Both Commissioner Shulman and Treasury Secretary Timothy Geithner testified before key Senate Committees to assure adequate funding. While addressing U.S. Senate Committees, Commissioner Shulman emphasized his belief that the majority of U.S. citizens voluntarily comply with the tax obligations. But he always cautions that, those who are paying their fair share want to see the IRS make sure that everyone else is paying their fair share, too.

Organizations need to be structured in a way that facilitates meeting their goals. Beginning in 2007 and continuing through 2009, the IRS has been consolidating its international compliance programs within the Large and Mid-Sized Business (LMSB) Division. It was also in 2007 that IRS launched a cross-functional team of executives focused on taking a collaborative approach to international tax administration. It was partly due to taking such an approach to the FY2010 budget that the IRS received more funding than requested.

2009 has been a landmark year for the IRS in combating international tax avoidance by hiding assets in offshore financial institutions. Work that started in 2008 (when nine countries around the world became interested in obtaining information about their citizens' accounts in Liechtenstein) culminated in 2009 when the U.S. signed a Tax Information Exchange Agreement (TIEA) with Liechtenstein. This TIEA, the first for Liechtenstein, went into force as of January 1, 2010.

The 2008 John Doe Summons issued to the Swiss Bank UBS came to fruition when the U.S. signed agreements with the Swiss Government and UBS in August 2009. Another John Doe Summons with First Data Corp. is in process and moving forward as a way to combat the use of offshore credit cards to evade tax.

Programs in support of improving voluntary compliance are the Voluntary Disclosure program and the Transfer Pricing Practice. The Voluntary Disclosure program gave taxpayers who were hiding income producing assets offshore the opportunity to voluntarily come forward and pay their taxes and penalties without fear of criminal prosecution. The Transfer Pricing Practice will result in increased levels of expertise within the IRS to more effectively deal with large scale international transactions.

INTRODUCTION: SCOPE/CONTENT

The Discussion of this paper has three parts: Laying the Groundwork, Combating Harmful Tax Planning and Making Compliance Easier.

- **Laying the Groundwork** covers the International Planning and Operations Council and how it takes a servicewide approach to international tax administration and budget formulation. It also covers testimony by the IRS Commissioner and the Treasury Secretary to gain the funding necessary for the Service's offshore compliance programs. Finally, there is a discussion of a multi-year consolidation of international compliance efforts within the IRS.

- **Combating Harmful Tax Planning** discusses the IRS' efforts to obtain taxpayer information from Liechtenstein, Swiss-Based UBS and First Data Corp. It also includes information about the successful Voluntary Compliance program which took place in 2009 and the creation of a Transfer Pricing Practice within the IRS.
- **Finally, Making Compliance Easier** makes reference to programs discussed in the paper prepared for the October 2009 CIAT Technical Conference. These are programs aimed at providing taxpayers with certainty sooner through increased transparency on the part of the taxpayer and the IRS.

DISCUSSION

1. LAYING THE GROUNDWORK

International Planning and Operations Council – a Servicewide Approach to International Tax Administration

Several years ago, Commissioner Mark Everson and other key executives looked across the Internal Revenue Service (IRS) and saw that international tax administration was not limited to the International organization in the Large and Mid-Sized Business Division (LMSB). It was, in fact, Servicewide: one operating division handled processing and customer service, another was responsible for international individuals and international small businesses and another for international pension arrangements and charities. In addition, Appeals, Criminal Investigation and Counsel – all separate organizations within the Internal Revenue Service (IRS) – each had responsibility for various aspects of international tax administration. Meanwhile, globalization was clearly on the rise — overseas travel, investment, shopping, employment and outsourcing are commonplace events today. The acceleration of globalization meant the IRS' tax administration operations had to be prepared to serve an expanded taxpayer base with cross-border transactions. It was evident the IRS needed a more coordinated approach to international tax administration.

To deal with this situation, Frank Ng, then Deputy Commissioner International in LMSB, created the International Planning and Operations Council (IPOC), composed of executives from each of the IRS business units (Wage and Investment, Small Business and Self Employed and Tax Exempt and Government Entities) along with executives from Appeals, Criminal Investigation and Counsel. At the January 23, 2007 launch of the IPOC, both he and LMSB Commissioner

Deborah Nolan spoke to Commissioner Everson's high level interest in international tax issues. The IPOC accepted the challenge to take a coordinated effort across the Service and developed a multiyear plan, the Servicewide Approach to International Tax Administration (Servicewide Approach). The thrust of the Servicewide Approach was to integrate and strengthen existing international expertise, programs and activities located in the various parts of the IRS. The members of the IPOC meet every other month. As expected, the active involvement of all IRS business units has made it easier to improve taxpayer assistance, enhance enforcement and modernize the organization to assure the achievement of international tax administration goals. The Servicewide approach, i.e., the unified plan, was an important first step in improving international tax administration and positioning IRS to meet the challenges of globalization.

After Barry B. Shott became the Deputy Commissioner International, he took the Council one step further. At the November 2007 meeting of the IPOC, he charged them to link their FY2010 international budget requests to specific goals in the Servicewide Approach. They were to be quite specific about why they needed the money, e.g., increased staff, equipment, computer programming. He formed a sub-team which met and identified four main areas of focus: increased staffing; training (new and experienced employees); information reporting, information processing, using information technology and taxpayer service. His goal was to institutionalize international within the IRS by embedding it in the budget. He urged Council members to describe, not just what was attractive, but what was deliverable and to clearly articulate what they wanted to do. Each operating division prepared its own budget but included a cross-functional reference back to the Servicewide Approach. This had the desired effect of making this new way of dealing with globalization more visible within the IRS. As they set to work, everyone knew this was a time when government budgets were likely to go down, not up.

By March, the Council sent to the IRS' Chief Financial Officer (CFO) a unified FY 2010 request for more than \$100,000,000 (\$100M) to fund 676 positions focused on international issues. This included hiring international examiners, economists, revenue agents and tax compliance officers with \$3,400,000 earmarked for training. It also included increasing focus on combating offshore activities; expanding Criminal Investigation's overseas presence; improving processing of information documents the Service receives; as well as funding for Appeals and Counsel to support increased activities in other parts of the IRS.

From the very beginning of his appointment in early 2008, Commissioner Shulman took a strong interest in international tax administration including providing additional funding for FY09. In November 2008, Deputy Commissioner International Barry B. Shott announced that during FY09, LMSB would hire 200 new employees for international issues: 40 International Examiners, 40 Economists and 20 Financial Products Specialists who came onboard beginning at the end of the 2nd quarter. These LMSB employees were to focus on corporate taxpayers in the area of transfer pricing and other international issues. At the same time, the Small Business Self Employed (SBSE) operating division got the OK to hire an additional 150 employees to focus on high income/high wealth individual taxpayers.

In April 2009 the IRS learned the President's budget request included the FY2010 international initiatives that all IRS offices had worked on. The final figure was actually more than requested – approximately \$126,000,000 (\$126M) budgeted instead of the \$100,000,000 (\$100M) requested. But with increased funding came increased expectations, i.e., there is an expectation of \$210,000,000,000 (\$210B) in additional revenue over 10 years. This will require legislative changes and non-traditional compliance work.

Senate Finance and Appropriations Committee Testimony

The IRS relies heavily on voluntary compliance but recognizes there are taxpayers who, not only do not willingly comply, they deliberately engage in tax planning designed to evade tax – harmful tax planning from a tax administration point of view. Beginning with his initial testimony at the January 29, 2008 Senate Finance Committee hearing on his nomination as Commissioner, Douglas Shulman set the tone for his tenure as IRS Commissioner when he said:

For taxpayers who pay their taxes willingly and on time, which is the great majority of Americans, there must be clear guidance, accessible education, and outstanding service. Our aim should be to make it as easy as possible for them to pay the correct amount of taxes in the most efficient and least burdensome manner possible. For taxpayers who intentionally evade paying their taxes, there must be rigorous enforcement programs.¹

At the July 24, 2008 U.S. Senate Finance Committee Hearing on **Tax Haven Financial Institutions: Their Formation and Administration of Offshore Entities and Accounts for Use by U.S. Clients,**

LMSB Commissioner Frank Ng testified about a variety of initiatives aimed at improving compliance and drew the Committee's attention to the Servicewide Approach he created to integrate the international perspective into IRS business division strategies and processes. When he summed up the international challenges faced by the Service, he laid the groundwork for a high level of support from the Senate and hinted at the need for a restructuring which took place in October 2009:

...there is no longer a bright line that can be drawn between international and domestic tax issues. With increasing globalization, virtually every large business return – as well as the returns of many small companies and even individuals – has international features due to the ease of cross-border transactions²

In June 2009, IRS Commissioner Shulman and Treasury Secretary Timothy Geithner testified before a panel of the Senate Appropriations Committee. He continued the idea expressed in his nomination hearings, i.e., honest taxpayers who pay their fair share of taxes want the government to take action against those who don't. He said:

The American people who play by the rules every day expect the IRS to pursue those taxpayers who do not pay their taxes, and we are vigorously enforcing the tax law. We are focusing on current enforcement initiatives, such as in the international arena, while seeking to evolve and innovate.³

Both urged a Senate appropriations panel to support President Obama's FY 2010 budget request to fund key tax priorities in FY10.

Recent Restructuring

For a number of years the IRS has been observing some unmistakable trends in the international tax arena, including significant increases in cross-border transactions, transfer pricing and foreign tax credit filings, the use of flow-through entities, and tremendous growth in the number of U.S. citizens and small businesses abroad and non-citizens working in the U.S. These trends require that the IRS strengthen its focus on international tax administration. The President, Treasury Secretary and IRS Commissioner each have underscored the urgency of stepping up our international tax compliance activities. In October 2009, the IRS launched the Large Business and International Expansion (LB&IE) initiative. Two key work streams within that initiative were:

- the High Wealth/High Income Industry in LMSB (with taxpayers in this group including individuals); and
- completing the task of bringing all of the Service's international compliance activities under one roof (foreign resident and international small business compliance).

High Wealth Industry

On October 7 and 8, 2008, Deputy Commissioner International, Barry B. Shott, hosted an international conference to discuss the movement of money and how that impacts tax administration. The invitations included all IRS operating divisions as well as external banking regulators, U.S. Government enforcement agencies (e.g., Department of Justice, FINCEN), Tax Executives Institute (TEI), major accounting firms, members of OECD Banking Intermediary Study Team, Treasury and others – about 95 participants altogether. The goal was to find out what externals were seeing that could affect international tax administration. Plans included a series of panel discussions including how high wealth individuals structure their finances (as corporations or as individuals). Day 1 was for internal/external stakeholders. Day 2 was only for internal stakeholders and included facilitated discussions of what they heard on Day 1. IRS learned that the behavior of high wealth individuals is more like corporate behavior than it is like individual behavior.

Concurrently, the IRS' Examination Enforcement Government Council (EEGC), another council with members from across the IRS, had been looking for a way to establish priorities for strategies around Abusive Tax Avoidance Transactions, the Earned Income Tax Credit, non-filers and the tax gap. This Council's High Income/High Wealth team conducted a review of cases that had come through the enforcement/exam pipeline to understand compliance risks. They looked at the taxpayer's entire enterprise, i.e., all entities related to a particular taxpayer instead of simply looking at the individual entity.

As part of the October 2009 restructuring IE, IRS brought SBSE's High Wealth/High Income (GWHI) initiative to LMSB as a new Industry to work alongside LMSB's existing five Industries. The strategies of this group include:

- Refine a risk assessment process for global high wealth enterprises;
- Establish a format for comprehensive case building;

- Conduct examinations of GHW individuals and related enterprises;
- Centralize IRS expertise on global high wealth compliance risk into a single organizational entity.

Foreign Resident and International Small Business Compliance

Late in 2007, IRS brought SBSE's Foreign Resident Compliance function to LMSB International. This represented a big change to LMSB's view of its taxpayer profile. No longer were LMSB's taxpayers limited to businesses with assets of \$10,000,000 or more. They also included:

- U.S. citizens residing overseas or in U.S. Territories;
- Lawful permanent residents (green card holders) in the U.S.;
- Small businesses maintaining books and records overseas;
- Non-resident aliens and foreign corporations in the U.S.;
- U.S. expatriates who gave up their citizenship;
- Individuals with tax treaty issues or other international features.

The October 2009 restructuring continued this effort by bringing into LMSB International additional SBSE international initiatives affecting individuals and small businesses:

- Abusive Tax Avoidance Transaction Offshore Field Groups and Headquarters;
- Offshore Compliance Initiative team; and
- Central Withholding Agreements (CWA) Group.

The target completion for the full integration of these functions is October 2010.

The goals are simple:

- Improve consistency of international and offshore compliance operations;
- Increase coverage of international and offshore compliance;
- Enhance customer service.

2. COMBATING HARMFUL TAX PLANNING

Liechtenstein

In mid-February 2008, a news story broke that attracted the attention of tax administrations around the world. The German government had received information on German citizens who were involved in a multi-billion-euro tax evasion scandal involving its citizens who were hiding assets in Liechtenstein banks.

By the end of February 2008, tax administrations in Australia, Canada, France, Italy, New Zealand, Sweden, United Kingdom, the U.S. others, all member countries of the OECD's Forum on Tax Administration (FTA), began working together concerning Liechtenstein accounts being used for tax avoidance and evasion. Within a few days of each other, news and press releases went out around the world:

Tax commissioners battle against tax evasion (Australia and UK)⁴

Agenzia Entrate ha ricevuto informazioni su italiani con depositi in Liechtenstein (Italy)⁵

Tax authorities work together to stop international tax evasion (NZ)⁶

IRS and Tax Treaty Partners Target Liechtenstein Accounts (US)⁷

In the U.S., the IRS began enforcement action involving more than 100 U.S. taxpayers to ensure proper income reporting and tax payment in connection with accounts in Liechtenstein. Some countries, such as New Zealand, offered penalty relief programs under their voluntary disclosure rules.⁸

By December 8, 2008 the U.S. and Liechtenstein had a signed Tax Information Exchange Agreement (TIEA). In October 2009, Liechtenstein and U.S. representatives met to discuss implementing legislation necessary to bring the TIEA into force as of January 1, 2010. This TIEA is Liechtenstein's first to enter into force and the only one in force for 2010. It will have effect for requests for information made for tax years beginning on or after January 1, 2009 for both civil and criminal tax matters.

UBS

On June 30, 2008, the U.S. Justice Department filed a petition for permission to issue a “John Doe Summons” to request information from Zurich Switzerland-based UBS about U.S. taxpayers who may be using Swiss bank accounts to evade federal income taxes. The next day a federal judge in Miami, Florida issued an order authorizing the IRS to request information from Zurich, Switzerland-based UBS AG about U.S. taxpayers who may be using Swiss bank accounts to evade federal income taxes. The IRS uses a John Doe summons to obtain information about possible tax fraud by people whose identities are unknown. Internal Revenue Manual (IRM) 25.5.7.1 defines this kind of summons as follows:

A John Doe Summons is any summons where the name of the taxpayer under investigation is unknown and therefore not specifically identified. A John Doe summons can only be served after approval by a Federal court. Therefore, the Service must never serve a “friendly” John Doe summons even though a prospective summoned party may request one as a condition to providing information to the Service. Serving a John Doe summons without court approval violates the statute and will jeopardize the investigation.⁹

The U.S. became interested in UBS, in part, because of a statement submitted to the court by former UBS banker Bradley Birkenfeld. Birkenfeld said UBS employees assisted wealthy U.S. clients in concealing their ownership of assets held offshore by creating sham entities and then filing IRS forms falsely claiming that the entities were the owners of the accounts. According to Birkenfeld’s court statement, UBS had approximately \$20 billion of assets under management in “undeclared” accounts for U.S. taxpayers.¹⁰

After filing the Summons, the U.S. and the Justice Department began discussions to seek cooperation of the Swiss government. On August 19, 2009, the Justice Department and the IRS announced that the agreement with the Swiss government has been finalized. As a result of the agreement, the United States will receive substantially all of the accounts of interest when it initiated the John Doe summons against UBS on June 30, 2008.

The agreement involved a number of simultaneous legal actions:

- The judicial enforcement of the John Doe summons was be dismissed in a way that left the underlying John Doe Summons in effect;
- Upon receiving the treaty request, the Swiss government directed UBS to notify account holders over the course of several months that their information was included in the I.R.S treaty request;
- Receipt of this notice did not by itself preclude the account holder from coming into the IRS under the Voluntary Disclosure Program, which ended Sept. 23, 2009.

In addition, the Swiss Government has agreed to review and process additional requests for information from other banks regarding their account holders to the extent that such a request is based on a pattern of facts and circumstances equivalent to those of the UBS case.

Finally, the agreement retained the U.S. Government's right, if the results are significantly lower than expected and other measures fail, to seek appropriate judicial remedies, including resuming actions to enforce the John Doe summons.¹¹

Right now the IRS is at the beginning stages of implementing the agreements with the Swiss Government and UBS. By the end of 2010, IRS expects to receive information about approximately 7,500 accounts.

Voluntary Disclosure Program

On March 26, 2009, the IRS announced a short-term program intended to provide a reduced penalty regime as well as immunity from prosecution if taxpayers met certain conditions. The program featured paying:

- Back-taxes and interest for six years;
- An accuracy or delinquency penalty on all six years;
- A penalty of 20 percent of the amount in the foreign bank accounts in the year with the highest aggregate account or asset value anytime in the past six years.

The driver for this program was a growing sense that a very significant number of persons with a U.S. filing, paying or reporting requirement were not declaring the existence of their off shore accounts nor were

they reporting the income from them. The program was designed to give taxpayers – and tax practitioners – certainty and consistency in how their case would be handled.¹²

Three guidance memos went out: how to handle offshore cases¹³; routing voluntary disclosures for action¹⁴; penalty framework to assure consistency¹⁵. The landing page of irs.gov featured a “rotating spotlight” to draw attention to the program and to an initial set of Frequently Asked Questions due to the high volume of questions IPOC members reported getting at conferences they attended.

Initially, the deadline was September 26, 2009 but, because many practitioners reported being overwhelmed with last-minute client requests to participate, IRS extended the deadline to October 15, 2009.

The Voluntary Disclosure program gave people a special chance to come in and get right with the government. Taxpayers took advantage of it in record numbers – more than 14,700 people who hadn’t been reporting offshore assets and income are coming back into compliance.

The unprecedented agreement with the Swiss authorities reached in August 2009 regarding UBS account holders – and the response to the special offshore voluntary disclosure program – together represent an historic milestone. They proved to the world – especially to account holders, promoters and banks – that the IRS is serious about:

- its international efforts;
- piercing the veil of bank secrecy; and
- carrying forward the momentum to address offshore tax evasion.

IRS is currently mining the 14,700 voluntary disclosures for information to identify financial institutions, advisors, and others who promoted or otherwise facilitated US persons hiding assets and income offshore and attempting to shirk their tax responsibilities at home.

The response to the voluntary disclosure program will have ramifications extending far beyond 2009. It will change the conversations that practitioners and tax return preparers will be having with many of their clients – especially during tax filing season. Those taxpayers who sought advice from advisors, but chose not to come forward in the voluntary disclosure program, will once again have to confront whether they come clean and properly report these accounts.¹⁶

First Data Corporation

On April 13, 2009, the Department of Justice asked a federal court in Denver to approve service of a John Doe summons on First Data Corporation for information to help the IRS identify merchants who use offshore accounts to evade their U.S. tax liabilities. The petition alleged that the merchants opened bank accounts in offshore jurisdictions and directed their payment card processor, in this instance First Data, to deposit the proceeds from their debit or credit card transactions directly into offshore accounts. With this summons, the Department of Justice ratcheted up the pressure on tax evaders by seeking the identities of merchants who attempt to hide their business income in offshore accounts.¹⁷ By April 15, 2009, a Colorado Court issued the summons.

In September 2009, First Data Corp. agreed to comply with a modified IRS summons seeking businesses that may be hiding income in offshore accounts. The modified summons reduced disclosure requirements.

Transfer Pricing Practice

Starting in the fall of 2008 and into 2009, a team from across the country, made up of domestic and international managers, field specialists, technical advisors, competent authority, field counsel, APA and LMSB International looked at ways to rethink IRS' approach to transfer pricing.

They developed a set of short and long term recommendations that were presented to LMSB leadership. The recommendations were grouped as:

- Organize to better support transfer pricing operations;
- Build a team of transfer pricing experts to improve issue development and resolution;
- Improve leverage of transfer pricing expertise;
- Incorporate transparency strategies and incentives to improve taxpayer compliance;
- Improve issue identification and case selection to focus on significant areas of non-compliance;
- Ensure field accountability through transfer pricing goals and measures.

The Service has already implemented some of these recommendations, including hiring additional specialists who will play a key role in transfer pricing exams, and establishing the Transfer Pricing Council in January 2009.

The Transfer Pricing Council is comprised of executives from LMSB and Chief Counsel, and focuses on coordination of transfer pricing strategies and policies. It is a forum for gathering and sharing information from key areas within IRS that deal with international transfer pricing matters. The Council meets every 4 to 6 weeks to address high-level issues, e.g., strategy, resource allocation, coordination, tools our employees require, gaps in guidance and forthcoming changes in law. The Council recommends guidelines to stakeholders for transfer pricing strategic decisions, resources, commitments and outcomes. The Council does not have case or issue control, nor does it get into the business of reviewing cases.

Right now, a team is working on the design and implementation planning for the Transfer Pricing Practice. This is to improve IRS' capability to strategically and systematically administer transfer pricing issues. The idea is to create a group of experts in the transfer pricing area who will coordinate the handling of issues that are most important to taxpayers and to the IRS, identify emerging issues and trends, and provide consistency in developing and resolving transfer pricing cases. This group will help examination personnel throughout the organization by providing technical expertise as needed, assist in the development of new risk assessment techniques to better identify the taxpayers and issues with the greatest risk, and develop examination best practices to ensure optimal resource allocation.

IRS' goal with the establishment of the Transfer Pricing Practice is to significantly improve how it addresses transfer pricing issues in the future, with a focus on interactions with taxpayers, development of issues, and consistent resolution.

3. MAKING COMPLIANCE EASIER

"Creation of Large Taxpayer Units and the Inclusion of Large Individual Taxpayers" prepared for the CIAT October 2009 Technical Conference included a discussion of programs IRS has implemented to make compliance easier:

LMSB's overall strategy depends on two things: currency (certainty sooner) and transparency, i.e., completing examinations in an efficient and timely manner, while reconciling the book-tax differences and risks. Today, IRS has an established foundation that will result in better service to large taxpayers and a greater ability to conduct its compliance responsibilities more effectively and in a timely manner. LMSB has identified challenges and has initiated several programs that foster transparency, currency, pre-filing compliance opportunities and improved efficiencies in issue and risk identification.¹⁸

One of the programs to assure certainty sooner is Fast Track Settlement. The Fast Track Settlement program (FTS) offers a customer-driven approach to resolving tax disputes at the earliest possible stage in the examination process. LMSB made this process permanent in 2003.

Another program is the Compliance Assurance Process (CAP) introduced in LMSB in 2005. CAP is a pre-filing compliance assurance process, focusing on issue identification and resolution through real-time taxpayer interaction. Under CAP, a taxpayer works cooperatively with LMSB Revenue Agents in a pre-filing environment to resolve issues of tax controversy and to determine the proper tax treatment of completed transactions.

When LMSB stood up in October 2000, the Pre-Filing Agreement program was a groundbreaking feature of IRS' new ways of doing business. This program encourages taxpayers to request consideration of an issue before the tax return is filed and thus, resolve potential disputes and controversy earlier in the examination process. The program reduces the cost and burden associated with the post-filing examination, provides a desired level of certainty regarding a transaction and makes better use of taxpayer and IRS resources.

4. CONCLUSION

The Internal Revenue Service has long relied on the voluntary compliance of taxpayers to fulfill its mission: "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."

The IRS has programs in place to make compliance easier for those taxpayers who want to comply. Many of those taxpayers also want

certainty sooner. The IRS is committed to offering taxpayers certainty sooner through increased transparency on the part of the IRS as well as on the part of the taxpayers.

These same taxpayers also want everyone to pay their fair share of tax. The programs to make compliance easier coupled with stepped up offshore enforcement efforts combine to build the foundations needed to improve voluntary compliance in support of the IRS mission.

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THE PROMOTION OF ETHICS IN THE TAX ADMINISTRATIONS: STRATEGIES AND PROGRAMS FOR THE PROMOTION OF ETHICS

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Contents: Introduction.- 1. Why and what is the reason why the tax administration must implement a strategy to promote ethics.- 2. CIAT's strategy for the promotion of ethics.- 3. The work of CIAT in the promotion of ethics in the tax administrations.- 4. Turning statements into action: implementing a program for the promotion of ethics.- 5. What follows. - 6 conclusions

INTRODUCTION

In 2003 CIAT, with the joint sponsorship of the Canada Revenue Agency and the participation of a group of expert officials of its member countries' Tax Administrations began the design and development of a set of tools designed to support the promotion of ethics in tax organizations as a means to prevent and anticipate actions that may affect the effectiveness thereof.

The works of the Group were not the first actions carried out by CIAT oriented towards complying with such purpose, because, previously, in the mid-1990s, the organization had incorporated this issue as a priority in its most important international meetings.

The case study will present the background and will mention the works that the Center has produced, and which have served as a reference for the development of the pilot carried out at the end of 2009 in Uruguay, with the support of EUROsociAL Taxation and mainly the authorities and officials of the General Tax Directorate of Uruguay.

This experience will be used in this document as one of the important backgrounds that will give place to future tasks that the organization

is going to deal with, not only as support, but as a starting point for similar pilots that are already on the agenda of some Member States and which have the technical support and collaboration of CIAT.

Finally, it should be clarified that a program for the Promotion of Ethics must be complemented by the required and fundamental actions from across the entire organization, such as disciplinary systems which must act effectively when irregular behaviors are detected.

1. WHY AND WHAT IS THE REASON WHY THE TAX ADMINISTRATION MUST IMPLEMENT A STRATEGY TO PROMOTE ETHICS

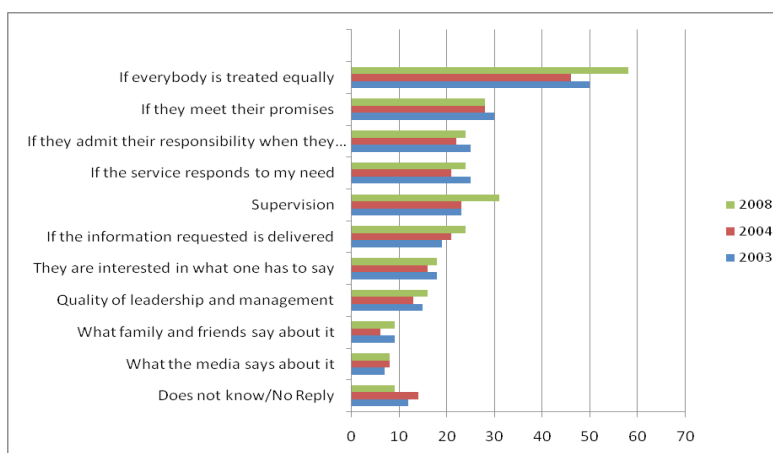
The Loss of Trust

By reference in Latin America the level of confidence in State organizations, and in Governments in general, has traditionally been low. While this may have increased from 2003 to 2008, as indicated in the Latin barometer-2008 report, it is evident that much work must be done to make credibility grow in public institutions and place itself at a satisfactory degree.

FACTORS DETERMINING TRUST IN PUBLIC INSTITUTIONS

LATIN AMERICA 2003 – 2008

Q. Which of the following factors on the card, do you consider are the most important to determine how much trust you have in public institutions? Mention up to three. Multiple choice answers: the total add over 100%

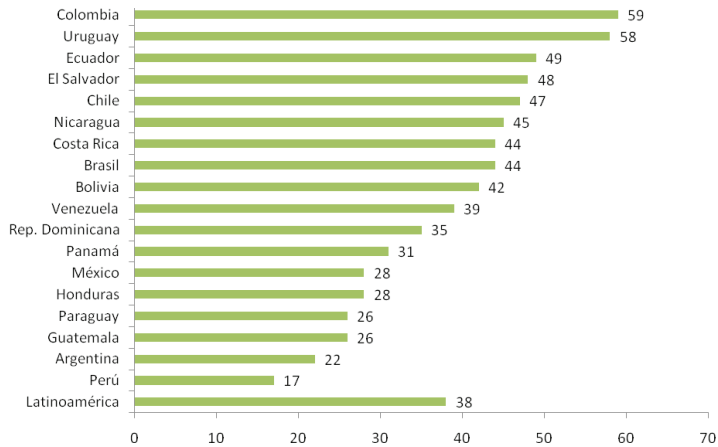


Source: Latin barometer 2001 – 2008

ADVANCES IN REDUCING CORRUPTION

LATIN AMERICA 2004 – 2008 / TOTAL BY COUNTRY 2008

Q. How much advance do you think has been made in the past 2 years in reducing corruption in State institutions? A lot, Some, Little, Nothing. “Here only “Much” and “Some.”

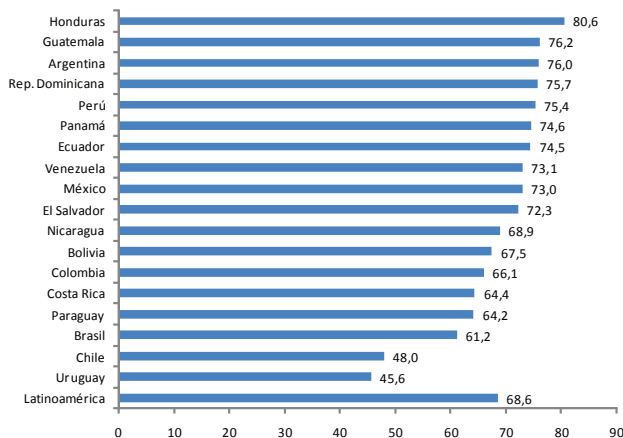


Source: Latin barometer 2001 – 2008

HOW MANY PUBLIC OFFICIALS ARE CORRUPT?

LATIN AMERICA 2001 – 2008 / TOTALS 2001 – 2008

Q. Imagine that the total public officials in the (country) are 100 and you had to say how many of those 100 you think are corrupt. How many would you say are corrupt? “Here just the “Average.”



Similarly the same happens in relation to progress in the reduction of corruption and the perception of the integrity of public officials, or by the direct or indirect knowledge of citizens that must interact with them.

However, we must be clear that in the corruption of organizations and public officials there are two facets: the one who offers and the one who accepts. This is where society must be an active part in the fight against corruption. On the other hand, it is not less true that the ineffectiveness and inefficiency of public administration facilitate, and in many cases pressure, the use of not so appropriate means to obtain a service or to comply with an obligation.

In adverse circumstances, the starting point is the creation of an atmosphere of trust which has been undermined or lost; the tax administrations are particularly sensitive because of the mission they comply with: ensure the correct collection of taxes through the efficient and effective management of the tax system adopted by the country.

The comments and ire of citizens are many when they often blame, their tax directorates, for embezzlement of income taxes when they, in turn, are under pressure to meet the tax duties and are heavily penalized when they do not.

While it may be true that there is a technical explanation on which are the skills, limitations and State organizations' powers, the conclusion it is that we cannot over complex or overload taxpayers in the fulfillment of their obligations and must recognize their rights and guarantee them. That is, we have to be effective in every sense and there are multiple budgets that must be met in order to recover or plant a climate of confidence in citizenship, although not involving the happy and pleasurable payment of taxes, but rather to do so with ease and justice.

The challenge of the organizations is to retrieve that credibility, and above all, keep it sound. Therefore, the strategy developed by CIAT and adopted in some cases by the Tax Administrations will be analyzed.

2. CIAT'S STRATEGY FOR THE PROMOTION OF ETHICS

Considering the reality stated in the previous section, the Promotion of Ethics has been and is a priority for the Inter-American Center of Tax Administrations as evidenced by its incorporation in the current 2007-2010 Strategic Plan as the draft plan to be approved during the

General Assembly of Montevideo, Uruguay, that will govern for the 2010-2013 period.

In **Directive No. 5**, the current plan establishes the following strategy: **Promote the development of key aspects for the strengthening of the tax administrations**, and in the same Strategic Initiative No. 5 C: **the Promotion of ethics and integrity of the officials of the tax, administration** as an important and concrete action for the implementation of the Strategy.

Also in the draft plan, Directive A: **Develop and disseminate information, studies, research and development of innovative and good practices to improve policy and tax administration**, and its initiative No. 5: **Implement tools for the promotion of ethics and integrity in the tax administrations**, gather the relevance that the issue represents for CIAT and place it in an operational perspective to put into operation and test the tools developed, recognizing that now the work of the Center should aim at the realization and practice of the instruments that are available, including updating and adjustment based on experiences lived.

For the development of this strategy CIAT has developed documents, models and tools that enable the deployment and implementation of the promotion of integrity in the Tax Administrations of its Member countries and which can be adopted by any organization with the necessary adjustments.

3. THE WORK OF CIAT IN THE PROMOTION OF ETHICS IN THE TAX ADMINISTRATIONS

There are a number of important milestones that mark the most significant advances attained by CIAT in the promotion of ethics in the Tax Administrations, including discussion of issues relating to the main international meetings of the Center: the General Assembly and the Technical Conference, up to the products designed by the working groups and the promotion of the Permanente Committee for the Promotion of Ethics as stated herein:

- **29th General Assembly, Lima (Peru) 1995, “Problems in the Struggle Against Corruption in the Tax Administration”**
- **30th General Assembly, Santo Domingo (Dominican Republic) 1996, “Impact of Modernization in the Tax Administration”,**

where the “**CHARTER DOCUMENT ON THE MINIMUM NECESSARY ATTRIBUTES FOR A SOUND AND EFFICIENT TAX ADMINISTRATION**,” which involves:

- To guarantee the **integrity and impartiality of a tax administration**, which requires:
 - a rigorous **Code of Conduct**
 - the absolute incompatibility of managerial and technical personnel
 - the existence of an Administrative Career Path.
 - **remuneration** in agreement to the market for similar technical qualification, duties and responsibilities
 - the **independence** of the tax administration to define policies and strategies in order to monitor compliance with fiscal obligations,
 - the Government must protect the **privacy and confidentiality** of the information provided by taxpayers
 - Guarantee **the continuity** of an appropriate tax administration, through:
 - technical and professional **meritocracy**
 - **labor stability** without anarchy or complicity
 - Strategic and operational **plans**
 - **availability** of human, financial and technological resources
 - **participation** of the tax administration in the drafting of the standards
 - **capacity and knowledge** to adapt programs, services and organizational structures
 - **development** of training plans
 - **authority** of officials but with accountability
 - Guarantee the **trust** of the taxpayers, through:
 - **The fair, reliable and transparent enforcement** of tax policies and laws, access, reliable service and taxpayers’ inquiries
 - **Fast processing** of taxpayers’ requests
 - **The creation of a taxpayer conscious** – Fiscal Education
 - **Respect of taxpayers’ rights**
- **37th General Assembly, Riviera Maya, Cancun (Mexico) 2003, “Strategies and Instruments for Increasing the Effectiveness and Efficiency of the Tax Administration”**
- **WORKING GROUP ON THE PROMOTION OF ETHICS IN THE TAX ADMINISTRATION**, which worked during 2003-2006, and

as sponsored by Canada and had the participation of Argentina, Brazil, Canada, Spain, Trinidad & Tobago, and CIAT's Executive Secretariat.

The main **products-tools** that the Working Group developed were:

- Compilation of **best practices**:
 - **Revelation of interests**, statement of situations that effectively or potentially may cause conflicts of interests
 - Emphases on the **communication, orientation and training** aspects, because in the case of ethical deviations it is not objective to transgress behavior standards due to ignorance or lack of preparation in its application in real situations
- The **Model Code of Conduct**, having clear and simple rules on the expected behavior

The **MODEL OF CODE OF CONDUCT OF THE CIAT** is an orientation and comparison paper for the development, review and/or improvement of the Code of Conduct of a Tax Administration.

CIAT's Code establishes a set of obligations and promotes "good" compliance. However, practical rules may require greater scope and detail pursuant to the characteristics of the organization and its environment.

The **overall objective** of CIAT's Code is to **provide a reference framework** to officials regarding expected behavior and **promote the importance of integrity** in a sound and effective tax administration.

The principles that it considers are:

1. Compliance with the law
2. Personal commitment
3. Relations with stakeholders
4. Relations with the public
5. Bribery
6. Gifts and hospitality
7. Conflict of interest
8. Public statements
9. Confidentiality and use of official information
10. Use of organizational resources
11. Government owned purchases by personnel

- 12. Working environment.
- 13. Behavior outside work

→ **The DECLARATION ON THE PROMOTION OF ETHICS IN THE TAX ADMINISTRATION,”** enacted by the **39th General Assembly, Buenos Aires (Argentina) 2005, “The Role of The Tax Administration in the Society.”** That includes the guarantees stipulated in the Charter of Minimum Attributes and establishes eight key aspects to be considered by the Tax Administrations in the promotion of ethics. These eight points are:

1. Leadership and Commitment

The primary responsibility in safeguarding and promoting integrity in the tax administration falls on the highest authority of the tax administration and senior management. They must adopt an important leadership role demonstrating a clear and unequivocal position on integrity and recognize that fighting corruption should be permanent throughout time.

2. Legal Framework

The laws, regulations, procedures and administrative guidelines must be clear, precise, public and easily accessible.

3. Equality

The tax regime must be fair and equitable. The laws, regulations and policies must be managed in a transparent manner.

The taxpayers are entitled to a high degree of certainty and consistency in their transactions with the tax administration. They are entitled the presumption of good faith; the fair enforcement of the law, to appeal decisions and to information protection and confidentiality.

Information given to taxpayers must be clear, precise, and easily accessible.

4. Information Technologies

The computerization of tax functions in addition to contributing to the efficiency and effectiveness of tax administration increases the ability to identify access and the illegal use of the tax information.

Information systems must strictly consider security rules to prevent the unauthorized manipulation of information.

5. Institutional Autonomy

Independence to define policies and strategies to control compliance with tax obligations by a strict application of the law without concessions, favors or interference from higher authorities or other members of the political power is required to ensure the integrity and impartiality of the tax administration.

6. Effective Control Mechanisms

The existence of strong allocation of responsibilities and accountability mechanisms, as well as internal and external control bodies are key elements for the good governance that contribute to the safeguarding of integrity in the tax administrations.

7. Codes of Conduct

A key element of any effective integrity program is the development, issuance and acceptance of a Code of Conduct that sets in clear and practical terms the behavior expected from tax officials.

A code of conduct can be an excellent tool for safeguarding and promoting integrity in the tax administration.

8. Management Practices in the Management of Human Resources

The implementation of effective policies and procedures for human resources management is a very important role in the promotion of ethics in the tax administration. The management of human resources that have proved useful in such practices includes the following:

- Fair, just and transparency selection and promotion procedures;
- Competitive remuneration levels;
- The existence of an administrative career path;
- Regulations that guarantee tax officials the exercise of their rights;
- Timely correction mechanisms in the event of inadmissible or inappropriate behaviors;

- Appointment, turnover and transfer practices of tax officials whenever appropriate;
 - Adequate training and professional improvement programs;
 - Performance evaluation system; and
 - Labor environment free of discrimination and harassment.
- The **SELF-ASSESSMENT GUIDE** which is useful to diagnose strengths and weaknesses in the Ethical infrastructure of a Tax Administration and which **objectives** are:
 - **identify** the key elements of a strategy of integrity in the Tax Administrations;
 - **diagnose** the organization's positioning;
 - **install** improvement processes since by knowing the initial situation and assess progress through permanent reviews;
 - **provide** practical methodology to help the directors of the Tax Administrations to evaluate the strategies and identify areas susceptible of improvement ;
 - **describes** practical and useful measures to develop a general integrity strategy.
 - The **phases** of the application of the Guide are:
 - **self-assessment** being adjusted to the particularities of each organization;
 - **identification** of strong points and improvement areas;
 - **selection** of critical areas of improvement;
 - **definition** of an execution plan and timetable;
 - periodical **review** of the level of progress and convenience of the established Plan.
 - Throughout this process CIAT plays an **important role** because it provides useful support to the Tax Administrations in the diagnosis and implementation of their ethics programs through:
 - the availability of **specialists** with skills in Management, Communications and Ethics Programs;
 - the **orientation** of the facilitators of the Tax Administrations and program directors;
 - the appointment of a **liaison official** at CIAT for constant communication and assess the program's preliminary implementation plan;
 - helping to locate specialists for the **external assistance** plan.

- **Organizational structure for the Management of a Program of Ethics**, description and examples of bodies for the management, control and leadership for the management of a Program on Ethics
 - **Communication and Training Strategy for the management of an Ethics Program**, promote among CIAT member countries the importance of ethics in the Tax Administration, the use of the tools and provide quality training and technical assistance to member countries
- **The Permanent Committee on Ethics and Tax Administration, formed in 2008**, is coordinated by Canada and has the initial participation of Argentina, Brazil, Chile, Spain, Netherlands, Panama, Dominican Republic, Trinidad & Tobago, and the Executive Secretariat of CIAT. Later Ecuador, Guatemala, Paraguay and the Bolivarian Republic of Venezuela, Sweden and South Africa joined the group.

The Committee is formed by representatives of the areas of Human Resources, Internal Audit and Management of the institutions of the participating countries and the objectives are:

- Implement the CIAT **Action Plan** for the strengthening of Ethics in the Tax Administrations,
- develop **strategies**, prepare **instruments** and provide **technical assistance** in the design and application of integrity programs.

The **mandates** of the Committee are:

- establish mechanisms to **exchange knowledge and experiences** among countries relating to the promotion of ethics in the tax administration
- compile, classify, systematize **innovative practices** applied in the promotion of ethics and complement the same with the development of new proposals
- perform **research and analysis** tasks to develop a conceptual framework

List of **projects of forums**:

- **Forum of Innovative Practices**, which by means of a template the delegates of the countries of the Committee may send

effectively implemented practices in their tax administrations. Two documents that are the outcome of the activities are available at CIAT's website: **Compendium of Innovative Practices and Compendium of web sites on Ethics**

- **Discussion Forum of Examples**, where you can discuss the examples provided or request additional information about them
- **Forum of Conflict of Interests**, which aims to gather information on the treatment of conflict of interest situations in the tax administrations.
- **Forum of Inquiries and Recommendations** on the use of tools and on matters relating to the activities of the Committee

4. TURNING STATEMENTS INTO ACTION: IMPLEMENTING A PROGRAM FOR THE PROMOTION OF ETHICS

Using the set of tools created in the Working Groups for the Promotion of Ethics as described in the preceding paragraph, CIAT began the application thereof through a pilot project with the collaboration of EUROsociAL, and the decisive and committed involvement of the authorities of the DGI of Uruguay and the support of the members of the Permanent Committee on Ethics.

This set of tools has as main reference the Self-Assessment Guide which, based on the eight fundamental aspects adopted in the Declaration for the Promotion of Ethics of CIAT, develops one by one in a series of questions, for the items established in the same. This guide is an excellent reference especially for those tax administrations that have not made similar processes and represents a good starting point for the implementation of tools that are more complex to apply when the highest level of organizational maturity is required.

The guide is a self-reflection examination to detect both strengths and sensitive aspects that must be the purpose of a review, improvement and adjustment of the design, implementation and monitoring of an improvement plan in the short, medium and long-term.

Based on CIAT's strategy, the experience of Uruguay and the feedback that emerged from this experience and others that are at a preliminary stage, we will be highlighting the most important aspects for the implementation of a program for the promotion of ethics, based on products developed by the Center.

Finally, with regard to the experience of the DGI of Uruguay it should be noted that the Self-Diagnostic Guide was previously adapted by the members of the Permanent Committee on Ethics using the EVAM1 model but following eight strategic points contained in the Self-Diagnostic Guide. In this manner the survey was simplified to facilitate its implementation and the pilot’s assessment. The most significant change was to gather in 4 fundamental axes 8 key points around of which these were lined up, as shown in the following table.

SELF-ASSESSMENT GUIDE	CIAT SELF-ASSESSMENT GUIDE
LEADERSHIP, ORIENTATION AND COMMITMENT AXIS	<ul style="list-style-type: none"> • LEADERSHIP AND COMMITMENT. • LEGAL FRAMEWORK. • EQUALITY. • INSTITUTIONAL AUTONOMY. • CODES OF CONDUCT.
MANAGEMENT AND PROCESSES AXIS	<ul style="list-style-type: none"> • LEGAL FRAMEWORK. • EQUALITY. • COMPUTERIZATION. • HUMAN RESOURCES MANAGEMENT PROCESSES.
PERSONS AND ALLIANCES MANAGEMENT AXIS	<ul style="list-style-type: none"> • HUMAN RESOURCES MANAGEMENT PROCESSES. • INSTITUTIONAL AUTONOMY. • CODES OF CONDUCT. • LEADERSHIP AND COMMITMENT.
SECURITY AND CONTROL AXIS	<ul style="list-style-type: none"> • COMPUTERIZATION • INSTITUTIONAL AUTONOMY. • EFFECTIVE CONTROL MECHANISMS. • RISK MANAGEMENT.

4.1. Key factors in the implementation of a project for the promotion of ethics:

The Political Decision of the authorities - the want to and be ready to do so:

Starting this self assessment process requires the commitment and decision at the highest level of the tax administration, without this, any intention to apply the tools designed is completely unproductive, if not impossible.

To make the decision to self-diagnose and accept the results with sufficient maturity as an organization to objectively construe these results, communicate them and determine the actions to follow is

1 EVAM: model used in the General Administration of the State in Spain, EVAM is the acronym for "Evaluation, Learning and Improvement."

an important condition to be able to start, develop, and complete the same.

This was the first condition that was fulfilled thoroughly by the DGI of Uruguay, whose authorities **accepted it and committed themselves** to the development, even without being affected by the vicissitudes of changes of authority due to Government changes. This decision was made by **thinking about the Organization** and the place where it was, seeing it as an **opportunity** and not a threat.

Similarly, once the decision was made, **constant, transparent, objective and permanent communication** with officials about the process (as done in the DGI), allows understanding from the beginning what is the relevance involved and the need for the cooperation of all stakeholders. This allows counteracting the negative and harmful information which may give rise to misinterpretation of the process, turning it into an element of discord, resistance and pessimism, instead of the added value that the process brings.

4.1.2. The Facilitators

To form the Group of people who will be responsible for the implementation of the guide is one of the crucial points. The choice about who, what levels, areas and how many, is one of the first issues to deal with. Understanding that CIAT tools are designed for the process to be done by the tax administration for the tax administration, group selection must follow some important parameters to be taken into account and will necessarily depend on features and conditions of the administration itself.

Some items to consider when carrying out this selection are:

- **The number** depends on the sample size, i.e. on how many officials will be surveyed, since the guide is extensive and most questions are not designed to have a simple answer

In the case of the DGI the original thought was on a group of five people from different areas and who did not have top-level management functions. However, later we saw the need to strengthen the group with two executive level staff members for better implementation of the methodology using group interviews and, in some cases, individual interviews to supplement evidence gathering.

- **The Profile of the Facilitators:** officials with excellent knowledge of the organization, professional performance, good relationship and communication with others, without calling into question their integrity and conduct, are required. Individuals that can understand the process and apply it efficiently getting the best of the respondents and participating active and proactively in the responses evaluation processes.

The selection of the Group of facilitators was one of the biggest hits of the Uruguayan experience.

- **Availability,** by the magnitude of the process, those who act as facilitators should have all the time availability and dedication to the process

4.1.3. The Team Coordinator

Guides and supports the team of facilitators, acts as liaison with the authorities to clarify and report on the development of the experience, addresses important questions and feeds back to the facilitators and directors on an ongoing basis. An executive level official is suggested, with a profile similar to the facilitators but with the capacity and authority for decision making, but also to reconcile and prepare the ground and provide a good environment to facilitate the welcome of the facilitators.

In some cases we think of internal control managers or directors as the appropriate individuals to take on this task; however, this will depend on how the area and your manager is perceived within the organization. In many cases these officials are seen more like police officers than support and this makes it difficult and places barriers to accept the process not only from an external perspective but also from the same manner in which they conceive the work to be done.

4.1.4. The Training of the Facilitators

Their preparation to understand the Guide or the adjusted EVAM model, as in the case of the DGI is fundamental to the success of the process. With this the project implementation phase for the promotion of ethics begins. CIAT, supported by more experienced members of the Permanent Committee on the Promotion of Ethics and other experts, is responsible for preparing the facilitators selected to familiarize them with the entire process and with the Guide so they

understand its scope, objectives, methodology and implementation and evaluation procedure.

During the training, facilitators analyze the survey and especially respond to the SWOT analysis on the internal and external conditioning factors that impact the Organization and are relevant for the promotion of ethics; identify strengths and weaknesses that should be included in the annual plans concerning part or those that, even when they are not in the scope of the tax administration, do affect it significantly and its advancement would require the involvement of other organizations or authorities.

In the case of the DGI one of the conclusions is that, while it is true that this training was very important and productive its duration must be extended from one to two weeks to ensure a higher level of content assimilation and to adjust the questions and process as emerging questions or suggestions due primarily to the fact that the degree of prior knowledge of the material by the facilitators is usually limited.

4.1.5. The development of the process, its follow-up and feedback

The process of implementation of the tool consists of several stages, which can be divided as follows:

- **Prior Stage:** reporting the process, conditions and profiles that facilitators' must meet to the authorities and where a probable implementation schedule is established.

In the case of the DGI, a preliminary meeting with the Uruguayan tax administration authorities and members of the Permanent Committee was held in July 2009 at the headquarters of CIAT's Executive Secretariat to present the pilot. This stage was important to understand the process and to select the facilitators and the team coordinator.

- **Stage One:** which contains:
 - **The training** of facilitators selected by the tax administration. This training is done by experts selected by the CIAT.
 - The establishment of an **Advisory or Ethics Committee:** the highest authorities must be part of this Committee, as well as

the coordinator of the team of facilitators and other officials that the Director-General or the highest authority of the organization considers important to incorporate. The Committee receives feedback information given by the team, sets guidelines, clarifies doubts and supports the work of the facilitators. It is important that the Committee meet at least once a week to track the process.

In the DGI the Ethics Committee was formed by the General Director of Revenue, the Director of Administration, the Director of IT and the General Internal Auditor.

- **The sample of respondents:** the Committee decides the group and the number of officials to survey and the methodology to carry out. In this case a recommendation is made to select a representative group of officials from each level and region to have an important number that brings the different points of view, according to responsibilities, areas of work and region, according to the structure of each administration.

In the case of the DGI, a decision was made to apply the survey to a group of middle management and operational level officials.

- **The adjustment of the survey and the process:** it is possible that as part of the training to the facilitators and resulting from the interaction and feedback that occurs with the Ethics Committee, there is a need to adjust some questions of the survey, the SWOT analysis and the process to apply the survey. This step is very important in order to harmonize questions, the SWOT analysis and establish the best way to proceed with later steps, according to the administration's capacity and objectives.

The DGI applied the guide adapted through the EVAM model, some questions were restated for the better understanding and the process was reformulated so that the first the strategic aspects stated in the SWOT matrix were analyzed and then the EVAM model was applied.

- **The preparation of the schedule of interviews:** once the sample is defined, the interviews plan indicating the days and hours for organizing the development thereof is prepared.

- **Phase two: Application of the Guide**

Once the aspects mentioned above are defined, the timetable for the application of the Guide is executed where it is important to introduce respondents to the objectives and procedures to follow in order to understand the importance and relevance of the experience. During this stage periodic meetings between the facilitators and the team coordinator are very important as well as the meeting with the Committee's Coordinator to report on the process and request support or information or additional feedback when required.

- **Phase Three: Evaluation**

Once the surveys were applied, they are evaluated by the Group of facilitators and the team coordinator, establishing common aspects that require a more detailed analysis, by complexity or doubts in responses, reaching an agreement on the results. This analysis is performed together with the evidence found by group facilitators, which allows contrasting and harmonizing answers. This phase ends with an evaluation report carried out by the facilitators, which identifies strengths and weaknesses in each of the axes and eight aspects and which is presented, discussed and agreed upon by the Coordinator and the Committee.

4.1.6. The development of the improvement plan and its incorporation into the Organization's Strategic and Operational Plan

Based on the evaluation report the points identified as weak as well as the strengths that are part of the activities that the organization must take in order to improve or strengthen their promotion of ethics, and increase levels of effectiveness and efficiency where the self-diagnostic has noted and giving sustainability and permanence to those who have shown to be functioning effectively are incorporated into the annual plan of the organization.

This would be the plan for the promotion of ethics of the tax administration and as with any plan it must include indicators that will make it possible to measure its compliance, as well as point out areas and people responsible for carrying it out successfully.

It is also possible that the report points out strategic aspects which should be restated or clarified in the strategic plan of the institution.

In the case of the DGI currently the development of the plan and the implementation timetable are underway.

4.1.7. Follow-up

Once the plan of ethics developed, the periodical assessment of compliance through indicators designed for its measurement is essential. Each responsible area must report advances or developments with respect thereto and propose adjustments to be carried out if accidental situations that may or will affect its development arise.

4.1.8. Review

The program for the promotion of ethics proposes that two years after the implementation of the self-assessment guide for the promotion of ethics a review of its evolution be performed through a similar process. In it you will see, within a reasonable period of time, the progress made with regard to the first diagnosis.

5. WHAT FOLLOWS

- The tools for the promotion of ethics: the Center will continue, through the Permanent Committee on the Promotion of Ethics and the corresponding areas of the Executive Secretariat, supporting its implementation in other tax administrations of the member countries which have already requested the same. At the same time and as part of the work of the Committee's tasks, they will be adjusted based on the experiences, strategies, mechanisms and tools in order to update and refine them, thus facilitating their understanding and application. This task will be carried out by the Permanent Committee during its next meeting in June of this year.

- The course on ethics and fiscal citizenship: understanding that the issue of the promotion of ethics has a highly important component, which is society, CIAT is already developing a course on ethics and fiscal citizenship to complement the tools designed for the working groups and the Permanent Committee.

The Center it is important to work on **raising the awareness of the individuals of a country on its commitment to and responsibility in building a democratic and just society through the undertaking of its tax duties, clarity in the existence and exercise of their rights**

and their role as guarantor and overseer of the proper execution of social spending². In a broad sense, without the involvement of society, both at the level of tax duties as watchdog for the fulfillment of the obligations of the State denouncing the irregularities, requiring effective accountability, and support efficiency and modernization of public institutions, it is very difficult to effectively promote of ethics and combat corruption.

It is important to raise the awareness of citizens and organizations on their commitment and responsibility for the effective implementation of the functions and objectives of public organizations and that the lack or failure to comply on their part can lead to or facilitate the lack of institutional transparency, affecting the credibility and confidence in these same organizations.

6. CONCLUSIONS

- The ineffectiveness of organizations promotes the lack of integrity in any organization whether public or private.
- Lack of integrity affects the credibility and confidence in organizations
- To promote institutional integrity and build trust the implementation of some conditions or key factors such as leadership, accountability, equity, the legal framework, the efficient management of human resources and partnerships with stakeholders as stated in the Declaration for the Promotion of Ethics of CIAT is important.
- Tools designed by CIAT for the promotion of ethics have proven to be important tools to improve the efficiency of the tax administrations as a way to promote ethics.
- The application self-diagnostic elements require a decision by the tax authorities at the highest level with full awareness of the importance of the process, its implications, consequences, duration and permanence.
- Good communication is a key factor in the application of the tools of CIAT because not only are the tax administrations the means of dissemination, but it ensures consistency and transparency in the content of the information.

² *“The building of tax citizenry as the basis for democratic governance,” Maria Raquel Ayala Doval, 4th Meeting of Networks, EUROsociAL, Salvador de Bahia, Brazil, June 2009.*

- The self-diagnostic guide is a critical piece in the detection of weak and strong points that a tax administration must work on to increase their levels of efficiency.
- The responsibility and commitment to undertake the process for the promotion of ethics using CIAT tools, are key factors for the success, an example of this is the DGI of Uruguay.
- The permanence and sustainability of the strategies for the promotion of ethics are the major challenges for the continuity of policies and strategies aimed at laying the foundations of faith in the institutions and Governments.

Case study

Topic 1.3

THE PROMOTION OF ETHICS IN THE TAX ADMINISTRATIONS: STRATEGIES AND PROGRAMS FOR THE PROMOTION OF ETHICS

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(Sweden)

Contents: Summary.- Introduction.- 1. Why is it important to promote ethics?.-2. Ethics and trust from a strategic point of view.- 3. experiences.- 4. Conclusions

Why should a tax administration focus on promoting ethics? How do issues concerning ethics and trust affect the outcome? In this paper you will find some experiences from The Swedish Tax Administration concerning these issues.

Summary

The Swedish Tax Administration aim to minimize the tax gap by increasing voluntary compliance. It is therefore important to have knowledge about the drivers that affects compliance and non-compliance. Trust is an important factor and ethics is mainly an issue of trust. In our view, promoting ethics contributes to create the best conditions for voluntary compliance.

Working with ethics and trust is about working with, and changing, the culture within the organization. In order to succeed with a culture change, the consequences must affect the whole organization, the goals, the way we measure the result, recruitment, employment policies etc.

A high level of transparency is something we think creates a good environment for high levels of trust. More or less unconditional rights for citizens to access information counteract abuse of government power and resources.

Understanding things from the taxpayers point of view is essential for improvement.

In 2004 we commissioned a study to learn more about the attitudes taxpayers perceive. The study showed three different attitudes (A, B, C) and how these affected trust. An attitude recognized by empathy and cooperation has the most positive effect on trust.

Another study concerning the change of trust after an audit showed that the most important reason for the change of trust was the tax administrations ability to listen and have a good dialogue. This was much more important than the size of the reassessment.

The studies have been used as the basis for communication activities and other actions within our organization.

To act in an ethical way is to respect the individual from his or her point of view. It's important to make it clear that acting in an ethical way is not about auditing or not, following the law or not, it's about how we do it.

INTRODUCTION

1. WHY IS IT IMPORTANT TO PROMOTE ETHICS?

Ethics is not an isolated issue that can exist on its own and it's mainly an issue of trust. The Swedish Tax Administration have a goal to minimize the tax gap by increasing voluntary compliance, but in order to succeed we need knowledge on taxpayers behaviour so we can prioritize the right actions. Our main focus is to get things right from the start.

In the past, we didn't have enough knowledge and instead we assumed that our actions would have the desired impact. We still have much to learn, and we think tax administrations have a lot to learn from each other because we more or less face the same challenges even if the conditions are different.

It is of course important to have knowledge in order to do the right things. To use audit resources to correct unintentional errors is expensive, instead we try to clarify information to the taxpayers, pre-populate tax-returns, take initiative to an early dialog etc.

When it comes to intentional evasion, we can see that there are many different factors that affect the behaviour. Some important factors are:

- Social norms
- Personal norms
- Opportunity
- Risk of detection
- Penalties
- Crises situations

We used to focus a lot on risk of detection and penalties, but now we can see that there is so much more that affects the taxpayer. It's important to have knowledge in order to do the right things but it's not enough. We also need a trustful relation with the taxpayers and carry out our activities in the right way. In order to get and maintain trust, promotion of issues concerning ethics is very important. The key question is of course, how an organization can deal with and improve within this area? A brief description is found below about how we handle these issues on a strategic level as well as some examples from studies we have done that underline the importance of a good taxpayer relation.

Ethics is a broad subject and the focus in this paper is on the relation between the taxpayer and the tax administration. The approach is more of promoting good ethics than handling serious unethical behaviour, even if this is an important part as well.

The global crises affect both citizens and authorities in many ways. The ability to understand taxpayers situation and relation with the tax administration helps us to prioritize the right actions.

2. ETHICS AND TRUST FROM A STRATEGIC POINT OF VIEW

The Swedish government model

The Swedish society has a long tradition of transparency and openness. The Freedom of Press Act is from 1766 and gives the citizens access to information from local and central governmental institutions. Most documents within authorities are accessible by any citizen as well as by the media. When someone asks to see these documents, authorities must provide them without delay and without asking about the purpose or who the person is. Of course, some information is not accessible in order to protect the personal

integrity of whom the information concerns. The possibility to access information is a very important citizen right in the Swedish society. The purpose is to counteract corruption and abuse of government resources. The opportunity is commonly used by the media to look into how authorities and politicians spend money (e.g. travel expenses). There is also legislation on how authorities should communicate with citizens. It should be done in a way they understand and citizens should be treated with respect. This is of course easier said than done but it underlines the importance of a good relation with the taxpayers.

Authorities are also very independent from the government in Sweden. As an example, it's not allowed for a minister to interfere in an ongoing case handled by an authority. The government provide resources and gives overall instructions to the authorities.

Ethics and trust on a strategic level within the Swedish Tax Agency

Trust is something that takes time to build but can be ruined over night, the consequences for us as a tax administration would be serious if the trust was ruined. Trust is built in many ways, most important is perhaps the experience people get when interacting with an officer but also what people read in the newspaper or hear from their friends and others.

In our opinion, working with ethics and trust is about working with, and changing, the culture. Therefore it's very important to realise that this takes time, and that it has to be dealt within all levels of the organization.

From a strategic point of view, we see trust as an essential factor for our organisation to succeed with our mission. A high level of trust is therefore a long-term goal for The Swedish Tax Administration, as well as good perceived treatment from our tax officers. It is, as described above, an important part of our compliance strategy. If we have a trustful relation, it's easier to solve things early, to interact with our taxpayers and to increase the possibilities to get it right from the start.

We are now more focused on the outcome of our activities than the output i.e. from number of audits, cases handled to the effects like perceived treatment, opinion about our audit activities in society etc. The way we measure have, as a consequence also shifted. Taxpayers perceived experience is much more important now as well as effects like less illicit work in a market segment.

When it comes to recruiting new staff we value social skills very high. It is important that the people who work for the Swedish Tax Administration have a good way of communicating and treating taxpayers. It's not enough that you can interpret the law; you must have the skill to do it in a way that ordinary people can understand.

In the employment policy it is stated that a high social skill is a very important condition in order to get a raise of the salary. On a strategic level we prioritize education and increased knowledge in order to be better in the taxpayers view.

We have a special board within the organization to handle serious unethical behaviour of our staff like unauthorized access of data, suspected corruption or Internet surfing on websites with pornographic or racist content. The consequences are usually a warning, deduction of salary, prosecution and dismiss from the job depending on the situation.

3. EXPERIENCES

The last years we have done a lot of qualitative studies in order to find out how we are perceived and the factors taxpayers think are important for a good and trustful relation with the Swedish Tax Administration. Some of them contain video interviews with taxpayers where they talk about their experience, treatment, thoughts etc concerning their situation and relation with us. We have used these surveys as an input for discussions with the staff in our organization and as an example, we can see that some of our staff are surprised over the strong feelings many taxpayers have concerning an interaction with an officer.

Two studies are described below and these studies have been very important for us in order to address the issue about trust and how we can affect the motivation to comply or non-comply. The surveys help us to understand our actions from a taxpayers point of view and the importance of treating people with respect.

Perceived attitudes

We are convinced that a trustful relation between the taxpayer and the tax administration is very important in order to create the best conditions for voluntary compliance. In 2004 we commissioned a study to learn more about this. The purpose of the study was to find out what attitudes we at the tax administration had and how these affect trust. It

was a very comprehensive study with 84 in-depth interviews and 500 telephone interviews.

We wanted to know if there were any differences between different groups of taxpayers. Therefore we divided taxpayers into small businesses, large businesses, people with foreign background, old people, young people etc. There were no difference between the groups, all perceived the same attitudes. The result was that the taxpayers met three different attitudes within the tax administration, these were called A, B and C. Note that it is no difference in how we interpret the law, we follow the law in the same way with all different attitudes, the difference is how we are perceived when we carry out the work.

The A-attitude

This attitude is cold and insensitive. The officer thinks most taxpayers are dishonest and will do everything to try to avoid paying taxes. He or she thinks people complain too much and know too little about taxes. He or she has an arrogant behaviour and wants to use his or her power.

The attitude can lead to the following reactions from the taxpayer:

- Insecurity
- Anger
- Feels disrespected
- Feels powerless
- Disappointed

This attitude has a strong negative effect on the trust in the tax administration.

The B-attitude

This attitude is recognized by impersonality. The taxpayer feels that he or she is like a tax return form or a case, not a person in the view of the tax administration. The officer treats the taxpayer as an object. The officer thinks all taxpayers should be treated in exactly the same way. Everybody should know the law but those who fail to fulfil their obligations must take their consequences.

The attitude can lead to the following reactions from the taxpayer:

- Not relaxed
- Insecurity
- He or she tries to show that he or she got knowledge
- He or she feels inferior
- Leaves the meeting without understanding what the officer meant or said.

The perceived attitude indicates a distance between the officer and the taxpayer and can as a consequence lead to a situation where the taxpayer won't ask questions because of the risk of feeling stupid. A typical statement from a taxpayer who perceives this attitude is: "We don't speak the same language".

This attitude has a negative effect on the trust in the tax administration.

The C-attitude

This attitude is recognized by empathy and cooperation.

The officer is helpful, human and wants to find a solution for the taxpayer.

He or she knows it is difficult for the taxpayer to understand legislation and therefore needs a helping hand. The officer thinks we are equals, most people are honest, and that the taxpayer is important. He treats the taxpayer with respect.

The attitude can lead to the following reactions from the taxpayer:

- Relaxed
- Feels that he or she can discuss the case
- Opens up and talks
- Optimistic
- "We can solve this together"

This attitude has a strong positive effect on the trust in the tax administration. Taxpayers also feel they can accept a negative answer in a better way if they are treated with this attitude.

How common are the different attitudes?

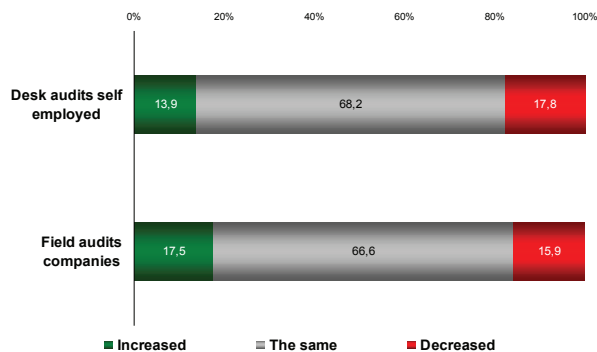
The most common attitude is the C-attitude. 60 percent of the Swedish taxpayers perceive that they meet this attitude, 50 percent state that they meet the B-attitude and 20 percent the A-attitude. A person can

perceive more than one attitude and that's the reason why the sum is not 100 percent. In connection with the survey concerning the taxpayers perceived attitudes, we commissioned a study to find out our staffs perception about how we are perceived. The result from this study showed the same relation between the different attitudes were C-attitude was the most common and A-attitude the most uncommon. However, there was a big difference concerning the perception of how common they are. Approximately 90 percent of the staff thought that taxpayers perceive them with the C-attitude and only 4 percent with the A-attitude.

Change of trust after an audit

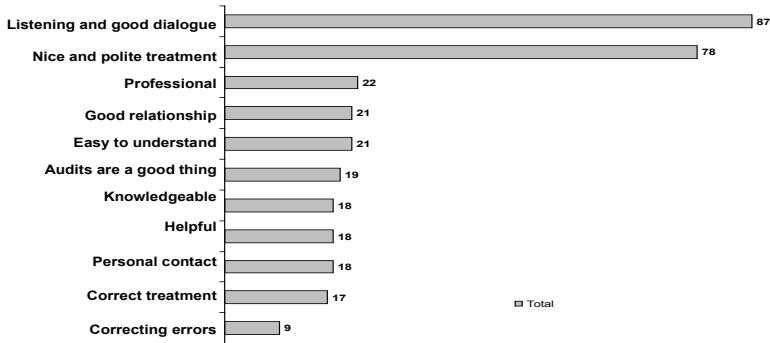
We wanted to see if the trust in the tax administration increased or decreased after an audit, and the reason for the change. Therefore we let a company do a study on audited businesses in different categories. The result shows a slightly more negative impact for desk audits compared to field audits when it comes to the change of trust.

Have your trust in the tax agency increased or decreased after the audit?



The most interesting question is however, why did the trust increase? This is what the survey shows as the most important reasons:

**Reasons for the change in trust
Why the trust has increased**

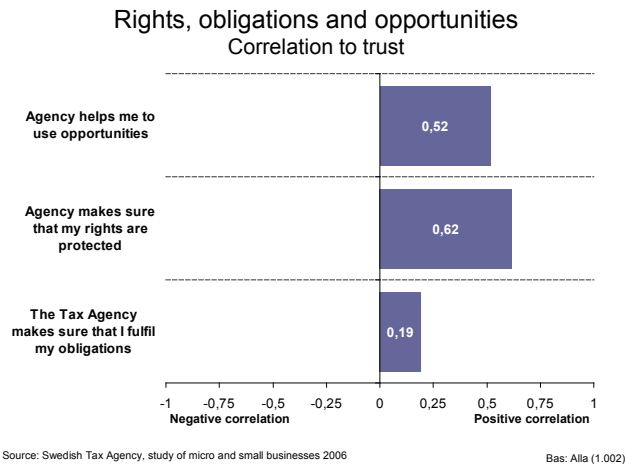


What most taxpayers stress as the most important factor for increased trust after an audit is the capability to listen and have a good dialog. Nice and polite treatment was also very important. Note that this was much more important than the size of the reassessment. When it comes to decreased trust, the result was almost the same. The most common explanation for reduced trust was the lack of the tax administrations ability to listen and have a good dialog; the taxpayer perceived that the auditor did not treat him or her with respect etc.

Procedural justice

An important concept here is procedural justice. It refers to how a tax administration handles its taxpayers. For a taxpayer it can be more important how the tax administration treat him than the actual monetary outcome of a case.

The perception of fairness is important in order to achieve high level of voluntary compliance. Fairness is correlated to trust in the tax administration which also is important in order to achieve compliance. The following diagram from another study concerning the micro and small businesses shows how the Swedish tax administrations behaviour is correlated to trust:



To create trust is it very important to protect the taxpayers right and to help the taxpayer use opportunities.

Implications of the results of the surveys

We could see a gap between the taxpayers view and our own insight concerning the attitude study. The result from the comprehensive study and the potential for improvement were important factors when we decided to communicate the survey in the whole organization and to prioritize activities to strengthen the relation with the taxpayers.

Working with issues concerning ethics and trust is to a high degree to work with the internal culture. One example of this is the way we talk about our taxpayers within the organization. Is it in a respectful and understanding way or not? Does our staff just see a case or the person with a case? The way we talk about our taxpayers will be reflected in our attitude and therefore in the way they perceive us. Therefore we think it's of great importance that we do not, even within the organization, talk in a negative way about our taxpayers.

To act in an ethical way is to respect the individual from his or her point of view. It's important to make it clear that acting in an ethical way is not about auditing or not, following the law or not, it's about how we do it. We are trying to show the taxpayer respect by writing with a more plain language and by better explaining the consequences for the taxpayers. The written language is very important because it reflects the attitude of the tax administration in a strong way. We want

to open up for questions and dialogue so we can solve things in an early stage but if the taxpayer feels distrusted or not respected the taxpayer will avoid communication or have negative feelings about the tax administration which will affect trust and the willingness to comply in the future.

Changing the internal culture towards more respectful treatment based on knowledge from taxpayers is not easy for everyone within the organization. Strong traditions of using bureaucratic language are not changed overnight but our insight of how taxpayers perceive it helps us underline the importance of a change.

We have trained our staff in order to strengthen the insight of how we are perceived. A very important factor has been the connection to the willingness to comply. By showing the connection to a good result, it's easier to get acceptance within the organization. Working with ethics and trust is not something we do in addition to the ordinary work; it's actually an important part of the usual work.

One of our actions was a group exercise where ethical dilemmas were described and six different suggested actions. The dilemmas reflected situations like when a colleague is arrogant and abuses a taxpayer, what do you do? The aim of the exercise was to use the knowledge from the surveys in a more practical way.

4. CONCLUSIONS

A high level of transparency is something we think creates a good environment for high levels of trust. More or less unconditional rights for citizens to access information counteract abuse of government power and resources.

When trying to create the best conditions for voluntary compliance, our surveys show that the relation with the taxpayers and their trust in the tax administration is of great importance. We have used this knowledge in order to communicate and discuss the treatment of taxpayers with our staff and this way of communicating has been successful, but changing the culture takes time.

By shifting the focus and looking more at the taxpayer's situation in relation to the tax administration, we have become more aware of how we can strengthen our insights and treat taxpayers in a way that will create the best conditions for a good result. The importance of perceived

procedural justice, if taxpayers feel we treat them in a respectful way, will have a great impact on trust and on future compliance.

In order to succeed with a culture change, the consequences must affect the whole organization, the goals, the way we measure the result, how we write to the taxpayers, recruitment, employment policies etc.

It's not good enough to use our resources to do the right things; we must also do them in the right way.

Even if we have done a lot of improvement concerning our insight, strategies and activities in order to promote a good taxpayer relation, we have still much to do. Our future strategy will continue to focus on how we can increase trust and get deeper understanding of tax payer's perception of the relation with us.

TOPIC 2

THE MEASUREMENT OF THE TAX GAP AND ITS IMPACT ON THE EFFICIENCY AND EFFECTIVENESS OF THE TAX ADMINISTRATION

Lecture

Topic 2

DEVELOPMENTS IN VAT COMPLIANCE MANAGEMENT IN SELECTED COUNTRIES

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Developments in VAT compliance management.- IV. Key observations,
findings and recommendations arising from the survey of selected
countries. - V. Annex*

PURPOSE

This information note has been prepared to assist member revenue bodies achieve improved compliance with their VAT systems by sharing knowledge of recent developments in selected countries.

BACKGROUND TO THE FORUM ON TAX ADMINISTRATION

The Forum on Tax Administration (FTA) was created by the Committee on Fiscal Affairs (CFA) in July 2002. Since then the FTA has grown to become a unique forum on tax administration for the heads of revenue bodies and their teams from OECD and selected non-OECD countries.

In 2009 participating countries developed the FTA vision setting out that... The FTA vision is to create a forum through which tax administrators can identify, discuss and influence relevant global trends and develop new ideas to enhance tax administration around the world.

This vision is underpinned by the FTA's key aim which is to...improve taxpayer services and tax compliance – by helping revenue bodies increase the efficiency, effectiveness and fairness of tax administration and reduce the costs of compliance.

To help carry out its mandate, the FTA's work is directly supported by two specialist Sub-groups—Compliance and Taxpayer Services—that each carry out a program of work agreed by member countries, and a number of more focused task groups.

The Compliance Sub-group's mandate, in broad terms, is to provide a forum for members to:

- periodically monitor and report on trends in compliance approaches, strategies and activities;
- consider and compare member compliance objectives, the strategies to achieve those objectives and the underlying behavioural compliance models and assumptions being used;
- consider and compare member compliance structures, systems and management, and staff skills and training; and
- develop and maintain papers describing good country practices as well as develop discussion papers on emerging trends and innovative approaches.

Since its inception, the Sub-group has focused its work on issues associated with improving the tax compliance of SME taxpayers. The Sub-group meets annually to review and discuss developments, to provide oversight and direction of its work program, and to provide a forum where members can exchange experiences and approaches for improving taxpayers' compliance.

Caveat

National revenue bodies face a varied environment within which to 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 administration may be neither practical nor desirable in a particular instance.

The documents forming the OECD tax guidance series 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.

DEVELOPMENTS IN VAT COMPLIANCE MANAGEMENT IN SELECTED COUNTRIES

SUMMARY

VAT is now a widespread and significant means of raising revenue, being used by 29 of the 30 OECD member countries. In 2006, it accounted for 18.8 percent on average of all tax revenues across OECD members, compared to 11.9 percent in 1965. In terms of percentage of GDP in 2006, it was roughly double that for the revenue collected from corporate profit taxes. Given population trends across OECD countries, projections of a declining work force and an ageing population, and the negative revenue impacts (especially in relation to corporate tax receipts) of the current global economic and financial crisis, Governments are likely to become even more dependent on consumption taxes. It follows, therefore, that any substantial leakage from the VAT revenue base will have a serious impact on Governments and their ability to balance budgets. Furthermore, perceptions of serious compliance issues with the VAT can only be expected to have a negative "knock-on" effect with taxpayers' compliance for other taxes.

This is the third report prepared by the Forum on this topic. Earlier reports produced in 2004 and 2005 both reflected concerns at indications of serious revenue losses across many countries, particularly among EU member countries, arising from criminal fraud and general non-compliance, and weaknesses in aspects of administration. On a positive note, the reports highlighted promising work being undertaken by the UK indirect revenue body (now part of Her Majesty's Revenue and Customs Department), based on efforts to establish a systematic risk management approach to both estimating the overall extent of these losses and their key components and developing and implementing strategies to counter their growth. It also referenced a variety of other measures introduced across different countries to counter the abuses being experienced. In making recommendations for further work, it emphasised the need to develop techniques for measuring losses, and strategies for countering them in ways which would not fundamentally undermine the taxes. It was agreed that the matter would be kept under review and a follow up report produced after around two years.

This report reviews developments in a small sample of volunteer countries (i.e. Australia, Austria, Canada, Ireland and the United Kingdom), particularly in relation to their overall risk management approach, as a primer for consideration of whether further work should be done by the Forum. It deliberately does not address members' activities to address fraud associated with EU intra-community transactions, as this matter is the focus of special efforts by the European Commission's Tax Directorate-General Taxation and Customs Union.

Although confined to a relatively few member countries, the survey has revealed a useful array of developments that build on the Forum's earlier work on VAT abuses and compliance risk management in general. The key observations and conclusions are as follows:

- Compared to the situation observed in 2004, there are clear indications of a maturing in the strategic approach to compliance risk management (e.g. increased attention to the development and use of top-down measures covering the major risk types, significantly increased use of better IT tools to detect compliance risks and assess their potential magnitude, more systemic risk treatment approaches).
- Survey responses indicated an improved or consistent pattern of VAT compliance for the countries concerned:
 - In the case of the UK, compliance trend and other data support a conclusion of substantially improved compliance over patterns of serious non-compliance observed in the early 2000's, of the order of around a 20 percent reduction in the estimated tax gap, and lend support to the value of its 'strategic approach' described in the Forum's previous reports;
 - In the case of Canada, indications of improved compliance were evident from its range of strategic outcome measures; and
 - For other surveyed countries, responses indicated that their VAT systems had generally performed in line with revenue projections and/or other indicators, suggesting a broadly consistent pattern of compliance.

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- Notwithstanding the observations of improved or consistent compliance and the measures implemented all revenue bodies continue to rank their VAT as a “high risk” area for their administration.
 - The use of random audits for risk profiling and overall compliance monitoring purposes figures in the compliance management approach of three of the five surveyed revenue bodies.
 - Revenue bodies are increasingly moving to detect and treat risks on a ‘whole of client’ basis, as opposed to a ‘tax by tax’ approach. Among other things, this is evident in the way IT systems are being designed and the way in which work processes (e.g. audit/ verification) are being conducted.
 - Given a number of ‘hard to treat’ compliance risk issues, there has been a fair resort to legislative responses over recent years; numerous efforts to simplify the laws thereby making it easier to comply and easing the burden on taxpayers were also noticeable.
 - Revenue bodies have evolved more systematic and specialised risk-based processes for validating the integrity of VAT registrations; three of the five surveyed bodies reported they have a systematic process using internal and/ or external data sources to identify businesses that should be, but are not, registered for the VAT.
 - Considerable attention is being given to strengthening case-based risk profiling systems but these require close monitoring and fairly regular updating to take account of changing patterns of compliance behaviours.
 - Deficiencies in the performance management information systems of a number of revenue bodies were apparent—there was a dearth of information concerning VAT refund claims and their processing, information on ‘VAT specific’ verification checks and their results and the value unpaid VAT debt could not be reported in two countries.

RECOMMENDATION

Revenue bodies, especially in those countries where there are indications of serious non-compliance, are encouraged to examine closely the findings of this study in order to identify opportunities to strengthen their administration of VAT compliance (and other taxes).

Revenue bodies are encouraged to put in place, if not already the practice, a comprehensive set of performance/output and outcome

measures to enable them to monitor key risk areas (e.g. VAT refund claims processing and VAT verification activities) and to gauge the impacts of their targeted risk treatments.

I. DEVELOPMENTS IN VAT COMPLIANCE MANAGEMENT IN SELECTED COUNTRIES BACKGROUND

1. This is the third Forum report on the topic of VAT compliance management.

The 2004 report

2. Following a request from the former Tax Administration Advisory Board in January 2003 for work on the increasing compliance problems arising with VATs, a survey of all member countries was carried out through the summer of 2003. A report on this work (see DAFFE/CFA(2004)13/CONF/REV2) summarised some preliminary findings and made proposals for further work, given a number of concerns.
3. The survey, which received a high rate of response from members reflecting their concerns in this area, provided indications of significant VAT revenue losses in terms of criminal fraud, general non-compliance and tax avoidance activity in many OECD countries. Analysis of the survey results suggested that losses in those countries were probably running in the order of at least 15% (and possibly much higher) of the potential tax base although, with a few notable exceptions, many OECD countries did not appear to have undertaken work to estimate aggregate losses or the key components of non-compliance. The report briefly noted potentially promising work carried out by the former UK Customs and Excise Department, as part of a systematic risk management approach to both estimating the overall extent of these losses and their key components and developing strategies to counter their growth. It also referenced a variety of other measures implemented across different countries to counter the abuses being experienced. In making recommendations for further work, it emphasised the need to develop techniques for measuring losses, and strategies for countering them in ways which would not fundamentally undermine the taxes.

The 2005 report

4. The follow-up report finalised in May 2005 (see CTP/CFA(2005)8REV) updated member country information and provided further details on approaches taken by member countries to reduce the incidence and impact of VAT abuses. These approaches were considered at the strategic, legislative and administrative levels.
5. The report described in some detail the strategic approach adopted by the UK revenue body, noted the significant improvement in compliance reported by the UK authorities, and provided further information on its VAT gap measurement methodology. The report also elaborated a number of practices identified by countries as assisting in reducing losses and went on to note that whatever approaches and practices were adopted some measurement of their impact should be a key component for application.
6. In order to assist member countries, the report made two recommendations. First, it encouraged revenue bodies, especially those with a significant VAT revenue leakage problem, to strengthen their VAT compliance improvement activities, drawing on the experiences and approaches of member countries. Second, that the matter be kept under review and a further report produced after around 2 years.

Other relevant reports

7. Since 2003, the FTA has produced a number of reports directly relevant to this topic.
 - The guidance note 'Managing and Improving Taxpayers Compliance' published in October 2004 described a strategic and systematic approach for managing and improving taxpayers' compliance. The purpose of this guidance note was to provide a framework for the application of modern compliance risk management principles to the management of tax compliance risks. It identified and discussed the general principles found in both the identification and treatment of compliance risks within a wide variety of taxation jurisdictions and provided information about the way in which treatment strategies influence the behaviour of small businesses in relation to their taxation obligations.

- The guidance note 'Monitoring Taxpayers' Compliance: A Practical Guide Based on Revenue Body Experience' published in June 2008 encouraged revenue bodies in member countries to improve their understanding of taxpayers' compliance and the effectiveness of their compliance improvement programs by developing a compliance monitoring framework (where one was not already in place). It suggested that such a framework should embody a range of measures and indicators for each of the major risk types for the major taxes administered by the revenue body, drawing on the ideas, approaches and practical examples provided in the note and other measures and indicators deemed useful by them. It also encouraged revenue bodies to document and publish their approaches (and where applicable, any related qualifications and limitations concerning the approaches adopted) and the results of their monitoring efforts in this area to promote greater dialogue, understanding and exchanges of experience among national revenue bodies.
8. Other bodies have also been active over the last three years in drawing attention to the significant difficulties in achieving effective administration of the VAT, for example:
- An EC communication in May 2006 ¹ called on members to develop a co-ordinated strategy to improve the fight against fiscal fraud and identified a number of areas for exploration, including improved risk management. In 2007, the EC Directorate-General of Taxation commissioned a study to provide estimates of VAT revenue leakage across all member countries. In December 2008, the EC outlined the elements of a co-ordinated strategy to improve the fight against VAT fraud in the EU, focussing largely on intra-community transactions. ²
 - In response to its concerns for VAT collection effectiveness, the Contact Committee of the Supreme Audit Institutions of the EU in December 2007 resolved that member states should be encouraged to produce top-down and bottom up estimates of aggregate VAT losses to check reliability and to allow international comparisons.

¹ See 'Communication from the Commission....to improve the fight against fiscal fraud' (COM(2006)254 final)

² See "Communication from the Commission....On a Co-ordinated strategy...." (COM(2008)807 final)

The IMF's Fiscal Affairs Department has released a number of special reports.³

This report

9. At the April 2008 meeting of the Forum's Compliance Subgroup, the Secretariat presented a proposal to delegates for work in the area of VAT compliance management. The Secretariat's proposal envisaged a study to gather information on key developments in VAT compliance management at the strategic and operational level. Special focus would be given to VAT refund controls, in particular to the use of advanced computerised risk profiling techniques, given their critical role in the detection of potentially fraudulent VAT refund claims. It accordingly proposed that to assist with the study a survey be conducted of a representative sample of countries that would be designed to gather information on aspects of VAT compliance risk management, drawing on the Sub-group's risk management model. The Secretariat noted that the intention to restrict the countries initially surveyed was made to minimise the amount of work entailed with the study, particularly for EU member countries, and to help expedite the work's overall completion. However, all countries would have an opportunity to contribute to a draft report prepared following the initial survey. Steps would be taken also to avoid overlap with the EC's work in this area and its particular focus on 'carousel/ missing trader' fraud and the associated need to improve the monitoring of intra-community transactions. Delegates gave in-principle agreement to the work and 6 countries (i.e. Australia, Austria, Canada, France, Ireland, and the United Kingdom) agreed to be involved in the initial survey phase. (France subsequently withdrew from this phase).

10. This report focuses on the findings of the initial survey, with emphasis given to identifying positive developments in the area of strategic and operational risk management. **It is not, nor is it intended to be, an evaluation of the performance of the participating revenue bodies.**

³ For example, see 'VAT Fraud and Evasion: What Do We Know, and What Can Be Done?' IMF Working Paper WP/07/31, February 2007 and 'VAT Refunds: A Review of Country Experience', IMF Working Paper WP05/218, November 2005.

II. VAT AND COMPLIANCE RISK MANAGEMENT

INTRODUCTION

11. As noted in prior reports, VAT is now a widespread and significant means of raising revenue, being used by 29 of the 30 OECD member countries. In 2006, VAT accounted for 18.8 percent on average of all tax revenues across OECD members, compared to 11.9 percent in 1965 and, in terms of percentage of GDP, was double that for revenue collected from corporate profit taxes (OECD (2008), Revenue Statistics 1965-2008, OECD, Paris, p81). Given population trends across OECD countries, projections of a declining work force and an ageing population, and the negative revenue impacts (especially in relation to corporate tax receipts) of the current global economic and financial crisis, governments are likely to become even more dependent on consumption taxes into the future. It follows, therefore, that any substantial leakage from the VAT revenue base will have a serious impact on governments and their ability to balance budgets. Furthermore, perceptions of serious compliance issues with a tax such as the VAT can only be expected to have a negative “knock-on” effect with taxpayers’ compliance in relation to other taxes.
12. The Forum’s last report on this topic—see ‘VAT Abuse: 2004 Report’ released by the CFA in May 2005 (hereafter referred to as ‘the 2004 report’)—provided indications of significant VAT revenue losses in terms of criminal fraud, general non-compliance and tax avoidance activity in many OECD countries. In response to these many and significant challenges, it encouraged revenue bodies to strengthen their VAT compliance improvement activities and provided details of the approaches taken by some countries to counter VAT abuses. These approaches were considered at the strategic, legislative and operational levels and the report drew particular attention to the strategic approach adopted by UK revenue authorities which had been successful in achieving improved compliance.
13. Drawing on the survey responses of volunteer revenue bodies, this note identifies further developments at the strategic, legislative and operational level in order to 1) assist member countries further develop their own approaches; and 2) guide members on any further examination on aspects of the topic that may be useful to members.

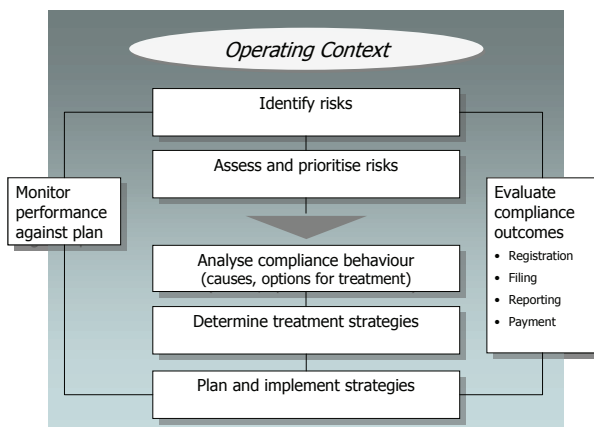
Compliance risk management

14. The Forum’s guidance note ‘Compliance Risk Management: Managing and Improving Tax Compliance’ published in 2004 described, and sought to promote, the concept of compliance risk management as an essential management tool for revenue bodies and gave a description of practical approaches that could be adopted by revenue bodies. The model of compliance risk management recommended, which draws on leading revenue body experience in this field, is depicted in Figure 1. Application of the model by revenue bodies **across each of the major taxes** administered as part of the normal management cycle is intended to answer the following critical questions:

- What are the major compliance risks to be addressed?
- Which groups/ segments of taxpayers do they apply to?
- How should these risks be treated to achieve the best possible outcome?
- What measures can be used to gauge whether the overall set of treatment strategies is achieving the intended outcomes?
- Which treatment strategies are having the intended result, which ones are not?

15. As will be evident, the model is essentially a ‘top-down’ strategic process designed to deliver gains in the form of sustained compliance improvement for individual revenue bodies and, in turn, additional revenues for the government and taxpaying community.

FIGURE 1. THE COMPLIANCE RISK MANAGEMENT PROCESS



16. A key element of the recommended approach to compliance risk management is a compliance monitoring framework which is intended to provide revenue bodies with a range of 'top-down' compliance measures and indicators to monitor and evaluate the impacts of its compliance activities at the aggregate level. These can be complemented by various 'bottom-up' measures and indicators derived in the course of evaluating the impact of specific risk treatments in targeted risk areas. The 2004 note gave only limited guidance as to the nature of specific measures and indicators that could be used at all levels. Further guidance was elaborated in a subsequent note published in June 2008- see 'Monitoring Taxpayers' Compliance: A Practical Guide Based on Revenue Body Experience.

Implications for administration of the VAT

17. The 2004 guidance noted emphasised a range of critical points in relation to each element of the overall risk management model. Those more relevant to this report are set out hereunder:

Identifying risks

- Risk can be identified using either top-down techniques such as macro-economic analysis or by bottom-up processes such as case-based risk assessment systems.
- A more complete understanding of risk will occur through taking a multi-level approach (e.g. strategic and operational) to risk identification and assessment.
- Risk identification processes that offer linkages to understanding the drivers of compliance behaviour offer the most effective leverage of intelligence.

Assessing and prioritizing risk

- Revenue bodies need a mechanism for objectively assessing the relative size of compliance risks in the context of organisational business priorities.
- Assessment and prioritisation needs to be firmly based upon objective evidence.
- A balanced approach to risk prioritisation may see some risks being addressed that may not represent today's highest revenue exposure.

Analysing compliance behaviour.

- Understanding compliance behaviour is more than guesswork: several factors are now supported by robust empirical research.
- Individual taxpayers adopt a range of motivational postures in their response to the demands of revenue authorities.

Determining treatment strategies

- Compliance programmes need to provide a graduated response to compliance behaviour—making it easy for those who want to comply and applying credible enforcement to those who don't.
- Treatment needs to address the underlying drivers of compliance behaviour.
- The most effective strategies are likely to be multi-faceted and systemic.

Evaluating the outcomes

- Success criteria and measurement indicators should be considered when choosing treatment strategies.
 - Qualitative measures add useful support to quantitative ones.
 - Treatment objectives must look beyond immediate outputs (e.g. audit results) to changing behaviour over time.
18. All of these points provide a framework for understanding and learning from the approaches of surveyed revenue bodies in relation to their administration of VAT, as described in the following sections. Readers seeking more information on aspects of the risk management model referenced in this note are directed to earlier FTA published materials on compliance risk management identified at paragraphs 14 and 17.

European Commission Study on the Incidence of VAT Fraud

19. At the time of completing this note, the European Commission's (EC) Directorate General Taxation and Customs Union was finalising a report on research it had commissioned in 2007 to provide estimates (and associated trends) of the incidence of overall VAT revenue leakage—the VAT tax gap—for all (then) 25 EU member countries (which includes 18 OECD member

countries and two others currently subject to OECD accession processes). The purpose of this research, which is part of a wider study into fraud that also includes corporate income taxation and excise duties, is to quantify and analyse the extent of tax fraud, thereby allowing an assessment of tax fraud and tax activities and their impact on the fiscal revenues of member states.⁴

20. While the detailed findings of this work are yet to be published, EC officials have indicated that, based on the preliminary findings of this work, the estimated VAT gaps for the 25 countries included in the study vary widely in their magnitude and for some countries the results are both disturbing and confronting (ranging up to around 30% of the estimated theoretical tax base).
21. While acknowledging the limitations of the top down VAT gap estimation methodology (ies), these findings point to the likelihood that, faced with serious levels of non-compliance, many countries may need to mount major efforts to revamp their overall risk management approaches.

III. Developments in VAT Compliance Management

22. This section draws on the information provided by participating revenue bodies. It outlines developments with; 1) their overall strategic approach; 2) compliance-related features of their VAT legislative framework; and 3) their VAT administration operations. It commences with some basic information on the VAT systems in place, providing context for their circumstances and associated administrative implications.

The surveyed countries- background information on their VAT systems

23. It is important to bear in mind that policy design features of VAT systems can have important implications for their administrability. For example, a VAT with a multiple rate structure and numerous exemptions is likely to facilitate non-compliance and will be more difficult for taxpayers to comply with and for the revenue body to administer than, say, a VAT with a single rate structure and few or no exemptions. Similarly, a VAT with a relatively low registration threshold is likely to have relatively greater workloads than one where the threshold is set at a realistic level.

⁴ See 'Specifications attached to tender... 'A Study to Quantify the Extent of Tax Fraud in the EU (25) Member States in the Field of VAT, Excise Duties and Corporate Income Taxation' (January 2007).

24. Tables 1 and 2 provide background information on the VAT systems of participating countries. They reveal some important differences to be kept in mind when appraising the developments described in this note:

- Standard rates of tax vary significantly across the surveyed countries (i.e. from 5 to 21 percent), as does the relative amount of revenue produced (expressed in terms of tax/GDP (%)), reflecting differences in the degree of reliance on the VAT as a source of revenue.
- There are large differences (i.e. by a factor of four) in the value of the VAT registration threshold—from the equivalent of around €18,000 to €72,000, measured at current exchange rates — which is likely to have significant implications for revenue body workloads, particularly the number of VAT returns where a refund is involved.
- There is significant divergence in the overall proportion of VAT refunds that must be refunded to taxpayers, resulting from a range of factors (e.g. the incidence of zero-rated exported goods and services and reduced rates) that impact to varying degrees across countries.
- As EU members Austria, Ireland and UK are impacted by the absence of border controls between EU member states, which is known to facilitate increased VAT fraud. Neither Australia nor Canada is impacted by an absence of border controls.

Table 1. Background information on VAT system

Country	Standard rate of VAT (%)	Reduced VAT rates (%)	VAT registration threshold	Businesses registered (millions)	EU members
Australia	10	0	\$A75,000	2.6	x
Austria	20	10, 12	€30,000	0.6	✓
Canada	5	0	\$C30,000	3.0	x
Ireland	21	0, 4.8, 13.5	€70,000 (G)/€35,000 (S)	0.29	✓
UK	17.5 /1	0, 5	£67,000	1.92	✓

Source: OECD Consumption Tax Trends 2008 and survey responses.

/1. Temporarily reduced to 15 percent for 2009.

Table 2 VAT revenue, refunds and revenue ratios (by fiscal years)

Country	VAT revenue /GDP (%) /1			VAT refunds/ VAT revenue (%)		VAT revenue ratio (%) /1,/2	
	2004	2005	2006	2006	2007	2003	2005
Australia	4.0	4.0	3.9	49	51	0.56	0.57
Austria	7.9	7.9	7.9	n.avail.		0.59	0.60
Canada	3.4	3.4	3.1	80	81	0.51	0.52
Ireland	7.4	7.7	7.9	25	25	0.62	0.68
UK	6.9	6.8	6.7	42	42	0.50	0.49
OECD	6.7	6.9	6.8	n.avail		0.57	0.58

/1. Sourced from OECD Revenue Statistics and Consumption Tax Trends.

/2. The VAT revenue ratio measures the gap between the revenues that would arise from a pure VAT system (where all consumption is taxed at the standard rate) and the amount of tax actually collected. It is therefore impacted by both policy design features and the tax that not uncollected as a result of taxpayers' non-compliance.

Overall strategic approach

Risk identification and assessment

25. The Forum's 2004 guidance note described the importance of revenue bodies having 'top down' and 'bottom-up' processes as part of an effective set of risk management arrangements. It emphasised that a more complete understanding of risk will occur if revenue bodies take a multi-level approach to risk identification and assessment.
26. A number of revenue body responses to this aspect of the survey were informative.
- As identified earlier in this note, the UK measures the totality of VAT risk through the use of its top-down VAT gap measurement methodology. However, it readily acknowledges that this top-down measure does not give information about specific types of non-compliance or the groups or segments of taxpayers responsible. As a result, it is looking to develop new approaches to provide this finer level detail, such as the recent introduction of a random audit program for smaller businesses to gather finer compliance detail, a survey approach for case workers of large businesses, and the use of data matching and network analysis technology to provide estimates of levels of serious attacks on the VAT system.

The UK emphasised that its approach to compliance risks is based on their materiality, and that its prime compliance objective is to reduce the VAT gap. As such, its identification of strategic risks is always in respect of their impact on the VAT gap. It utilises a number of tools and systems to monitor receipts and identify trends at an early stage and to ensure that an appropriate compliance response is actioned quickly. In order to build on this, it has recently set up specialist Futures Assessment and Tax and Duty Alerts teams to increase its awareness of potential risks/threats at the earliest possible stage.

The Futures Assessment team will provide HMRC with the foresight to successfully shape its future. The team will be responsible for assessing the plausible implications of potential future compliance risks, threats and opportunities for HMRC and likely future compliance developments which are at the margins of current thinking and planning. Techniques such as horizon scanning, environmental scanning, scenario planning, predictive analysis, divergent analysis and hypothesising will be used. Generating realistic future scenarios will allow for better informed decision making and more successful compliance strategies to be developed. The Futures Assessment Team will generally operate across the medium-long term, which can often (though not exclusively) be seen as the 3-10 year period.

The Tax and Duty Alert Team will be responsible for a number of HMRC analytical tools containing a range of HMRC data that can be used to identify indicators of emerging compliance risk and also to monitor factors such as trends and changes to trading patterns. The team will use tax and technical expertise to identify and evaluate emerging compliance risks, threats and issues and their impact as they occur and present decision makers with their findings. This will be done by providing Tax Alerts (summarising emerging compliance risks) and Tax and Duty Briefings (a more detailed product providing further information or answers following the delivery of a Tax Alert).

In order to improve its identification of compliance risks, HMRC is also looking to take a more holistic view of the risk of the taxpayer. To this effect, it is making increasing use of data/information from direct taxes and third party information sources to help inform its view of the risks posed by VAT taxpayers.

- Australia reported that it utilises a structured corporate-wide process for gathering information on actual and potential compliance risks that is described in Box 1. One outcome of this process is a prioritised list of key compliance risks.

Box 1. Australia—Strategic Approach for Identifying Compliance Risks

The ATO has a robust risk management framework to identify GST compliance risks.

Information is gathered as observations that are processed through the intelligence processes, assessed as risks and managed. The four-stage process used for Intelligence entails: 1) Direction and Coordination; 2) Collection; 3) Analysis and Production; and 4) Dissemination. This then feeds into the risk management processes: 1) Risk Identification and Assessment; 2) Treatment; and 3) Evaluation.

The information collection and subsequent intelligence processes stem from the identification of Key Intelligence Needs. Significant planning is undertaken to determine the sources of the information that's needed and how it is to be analysed. The information gathered is then analysed to determine any salient issues requiring further exploration. If these issues represent a threat to the GST system they are escalated through the decision making committees to register as a Matter of Concern (MOC) and stored centrally. The MOC is then further analysed to identify if a risk exists, the size of the risks, any relevant drivers and the methods being adopted to avoid GST. Generally a proposed risk mitigation strategy is developed if the risk represents a significant threat.

Once the risk has been identified and assessed it is tabled at the decision making forum for endorsement and prioritisation. This committee critically analyses the information being tabled, ensuring:

there is sufficient evidence to support decision making,

all GST product areas have been included and provided input into the future direction and methods to manage the risk.

Endorsed risks are recorded on the GST Risk Register. Risks are reviewed at least annually to reaffirm the risk rating and the treatment strategy. This includes any additional or altered strategies and any changes in the risk that might increase or decrease the size of the threat.

The ATO publishes an annual compliance program which details its focus risk areas (and for some, intended treatment strategies) for the coming fiscal period. Table 3 hereunder describes the specific GST compliance risks it has identified and publicised for attention in 2008-9.⁵ Performance against each of these risk areas is evaluated as part of an annual 'health of the system assessment' process.

⁵ *Some specific examples of compliance risks may be peculiar to an individual country because of unique policy design features.*

Table 3 Australia— GST/ VAT Compliance Risks

Taxpayer segment	Major compliance risks highlighted in compliance program
Large business (turnover over \$250mn)	<ul style="list-style-type: none"> ● GST risk management by businesses' internal business systems. ● A range of specific risks with real property transactions. ● Financial services and related GST issues. ● Ensuring correct GST treatment of international transactions.
Small / medium businesses (turnover of \$2mn-250mn)	<ul style="list-style-type: none"> ● Refund integrity ● Property transactions ● Financial supplies
Micro-businesses (turnover under \$2mn)	<ul style="list-style-type: none"> ● Filing returns ● Collecting tax debts ● Refund integrity ● Property transactions
Government bodies	<ul style="list-style-type: none"> ● Treatment of grants ● Property transactions ● Machinery of government changes (with GST implications)
Non-profit organisations	<ul style="list-style-type: none"> ● Misclassifying supplies as GST-free ● Misclassifying grants as GST-free

Source: 2008-09 Compliance Program (ATO)

- Canada reported that it uses a risk management approach that focuses on improving its ability to identify high-risk registrants through enhancements to the registration, risk assessment and enforcement processes, legislative and policy changes, broadening the engagement of stakeholders, and increasing research. Its tailored strategies to identify risk through methodologies include:
 - 1) Automated risk-based profiling;
 - 2) Expert and knowledge-based systems to apply criteria that identify potential non-compliance situations and estimate possible revenue at risk;
 - 3) Data mining through the use of automated processes of exploration and analysis of large quantities of data in order to reveal patterns and trends; and
 - 4) A cross-program compliance profile to integrate the CRA's view of any taxpayer's compliance history enabling it to respond to behavioural characteristics through more tailored compliance strategies.
 - Australia, Canada, Ireland and the UK all reported their reliance on automated case-based risk identification systems (see paragraphs xx for more detail).
27. As part of the survey process, all revenue bodies were asked for their assessment of the risk to revenue presented for a range of specific risk areas that are detailed in Table 4.

Table 4 Compliance risk areas identified as “high (H) or medium (M)” risk

Risk area	Australia	Austria	Canada	Ireland	UK
Failure to register	H/M	H	H		H/M
Failure to file returns on time	H	M	M	H/M	H/M
Failure to correctly report:					
— avoidance schemes	H	H	H	H/M	H/M
— evasion schemes	H	H	H	H/M	H/M
— practices to inflate refunds	H	M	H	H/M	H/M
— specific industry issues	H	M	M	H/M	H/M
— cross-border transactions	H /2	M	H	H/M	H/M
— reporting non-compliance	H/M	M	H	H/M	H/M
Failure to pay tax on time	H/M	H	H	H/M	H/M

/1. The ATO noted that while collection of GST on imported goods is the responsibility of Australian Customs it has a number of cross-border transaction risks which deal indirectly with aspects of this question. The mitigation strategies for these risks may result in legislative changes to close loopholes and/or clarify taxpayer understanding which will have a flow on effect to this point. ATO risks are also broader than just importation and deal with connectivity with Australia.

28. Generally speaking, their responses reflect a common degree of “high to medium” concern for the various categories of risk that must be managed to achieve acceptable levels of taxpayers’ compliance. In other words, despite the measures that have been implemented and observations of satisfactory or improved performance—see further comments at paragraph 29—**each surveyed revenue body continues to assess its VAT as a high priority area for ongoing administration.**

Risk treatments

29. The 2004 guidance note emphasised the importance of a graduated/ selective response strategy to compliance behaviour, acknowledging that taxpayers are not homogenous in the postures they take in relation to meeting their compliance obligations. It also stressed the importance of treating the underlying drivers of compliance—rather than the symptoms— and noted that the most effective strategies are likely to be multi-faceted and systemic. This matter is also the subject of further work recently finalised by the Forum’s Sub-group that is contained in a publication released in March 2009—‘Managing and Improving Compliance:

Recent Developments in Compliance Risk Treatments'. The key findings of this work, which focused on the development and use of innovative risk treatments and includes over 90 individual examples of specific risk treatments, are set out briefly in Box 2.

Box 2. Key findings of recent work on innovative risk treatments

The key findings from an analysis of over 90 examples of innovative risk treatments identified by around 20 revenue bodies were as follows:

- ✓ The range of new risk treatments employed by revenue bodies has expanded considerably over the period since the initial research for the 2004 guidance note.
- ✓ Taken as whole, the examples reflect that many revenue bodies are demonstrating increased sophistication in shaping and managing compliance programs in a more strategic way through developing multi-faceted treatment strategies that often have influence over several risk domains. It is also evident that in developing these risk treatment strategies, a more balanced suite of interventions is being applied across each of the 'educate, assist, deter and enforce' dimensions of the Compliance Model.
- ✓ Many of the new forms of treatment strategies commonly incorporate a proactive education & communication component that aims to prevent or deter non-compliance.
- ✓ Many treatment strategies also reflect a focus on effecting changes in behaviour across broader (although targeted) population groups through greater use of co-operative relationships with 3rd parties, including tax practitioners, industry representatives and wider inter-agency collaboration.
- ✓ There is also increased use of external information and data matching to identify aggregated risks and more specifically define target populations in order to develop greater behavioural understanding and consider broader treatment options.
- ✓ Another general observation is that is quite common for revenue bodies to be persistent in seeking compliance—single interventions being replaced with a number of different and sequential interventions until an actual change in compliance is detected.
- ✗ The approach to measurement and evaluation appears much less advanced, in part attributable to failing to gather too little critical information during treatment implementation.

30. The survey's responses reflected a number of developments in line with the directions suggested (and identified in other recent Forum work):

- The UK HMRC reported that its move to campaign/ projects introduces a program of national activities to address significant problem areas and/or achieve specific outcomes, such as including closing the tax gap and behavioural changes. It also provides a vehicle to allow HMRC to adopt a multi-disciplinary approach to tackling non-compliance ranging from education through to investigation and prosecution. HMRC campaigns will have a limited lifespan and be focused in three areas: 1) combating or preventing unwanted behaviours; 2) supporting and implementing policy changes; and 3) dealing with issues which have the potential to lead to non-compliance. The ongoing work against multi-cell fraud considering analysis of high risk sectors, audit of transaction chains, inspection of goods at storage facilities and legislative measures such as joint and several liability is one example of such activities.
- The UK also reported that during 2007-08 it developed and rolled out a new integrated approach to tackling fraud and evasion, including:
 - A central Evasion Referral Team to provide an escalation point for cases of suspected evasion or fraud;
 - Cross-tax Evasion teams, which bring together staff with direct and indirect tax expertise to work cases jointly with the aim of identifying and tackling evasion across all taxes and duties;
 - A new approach to the application of VAT civil penalties, which has been introduced to discourage evasion and ensure that non-compliant activity is heavily penalised once identified;
 - Testing a range of tools and actions designed to identify the proceeds of crime and maximize the value that can be recovered through the criminal and civil systems;
 - A new professional standards strategy, adapted from existing models in police forces and other government departments, to combat threats and vulnerabilities; and
 - Legislative changes to target goods commonly used in MTIC fraud.

- Ireland reported that some years ago it took the strategic decision to develop integrated IT systems that now incorporate all the major business taxes, including VAT, together with PAYE employees in our Integrated Taxation Services (ITS) system. This enables it to take an integrated cross-tax head approach to managing the tax affairs of customers. Therefore, while it undertakes tax head specific projects and programmes to address tax head issues, it has focussed its main efforts to implementing integrated approaches to compliance.
- Australia's approach to the treatment of risks is pursued within the context of its overall compliance risk management approach which is described in Box 3.

Box 3. The ATO's compliance processes

Making it as easy and inexpensive as possible: On the assumption that the vast majority of people want to comply with their obligations, the ATO's starting point is to make compliance as easy & inexpensive as possible. There are three main aspects to this.

First, the ATO consults and collaborates with individuals and their advisers to co-design the administrative processes that affect them. An empathetic, user-based approach ensures administrative solutions are designed around what works for the community. Second, it aims to provide individuals and their advisers with the information they need to understand their rights and responsibilities. Information products are tailored to the needs of different taxpayer segments and industries. People are encouraged to come to the ATO for personalised advice. Third, it aims to provide convenient and inexpensive ways for people to undertake transactions, such as reporting information, and making and receiving payments. The ATO also works with other agencies to develop whole-of-government solutions that minimise red tape and compliance costs - such as sharing of information to pre-fill forms and returns, standard business reporting and multi-agency online accounts.

Verifying and enforcing compliance: While ATO compliance verification activities vary according to taxpayer segments, they generally involve:

- Building risk profiles - identifying risk characteristics among taxpaying groups (such as transaction patterns) by analysing information collected in returns and from third parties (such as financial institutions, government agencies and auditors of self-managed superannuation funds).
- Data matching and applying risk profiles to taxpaying groups - identifying inconsistencies, unreported transactions and other risks by automatically checking returns against their past behaviour and third-party data;

- Reviewing specific individuals/businesses where it identifies inconsistencies or other risks;
- Auditing individuals and businesses where reviews confirm the risk and taking other action where necessary. Tax returns (including activity statements and other reports) are the foundation for verifying compliance, which is why we put so much emphasis on the need for people to lodge returns in full and on time. The returns also contain information required by others, such as the Australian Bureau of Statistics.

When risks are identified, the ATO's contact with people depends on the nature and complexity of the risk. But it typically starts with letters and phone calls seeking more information or clarification, and extends to field visits and audits where required. Risk profiling is as much about identifying individuals or businesses that represent little or no risk to the tax and superannuation systems, as it is about identifying non-compliance.

Source: 2008-09 Compliance program

As an alternative to traditional risk treatment approaches the ATO has developed a new product known as an 'annual compliance agreement' that mirrors a similar approach being pursued for income tax (and also by the Dutch tax Administration where it is goes by the term 'horizontal supervision' and its associated covenants). The ATO's agreements, implemented over the last 18 or so months, businesses can choose to undergo a low-intensity due diligence review of their tax compliance and governance arrangements, systems and controls for managing tax risk. Businesses need to demonstrate good standards of self-scrutiny, governance, risk management and continuous disclosure. Regular meetings and reviews support the relationship. Subject to satisfying the conditions of the agreement, businesses are largely freed of traditional compliance checks. A fuller description of these agreements and the underlying process is set out in Annex 2. While still in its infancy, this initiative appears to have considerable merit.

- The EC's recently published short term action plan for fighting VAT fraud—see 'Communication from the Commission....On a Co-ordinated strategy....' (COM(2008)807 final) can be viewed as reflecting an integrated set treatment strategies to prevent and deal with fraud on intra-community transactions. The proposed treatments envisaged by the plan are set out in Box 4.

Box 4. Proposed short term action plan to fight VAT fraud

1. Common minimum standards for the registration & deregistration of taxable persons;
2. Confirmation of traders' names and addresses electronically for VAT status purposes;
3. Simplifying, harmonising and modernising the current rules on invoicing;
4. Common understanding of VAT chargeability on intra-community transactions;
5. Reducing timeframes for exchange of information on intra-community transactions;
6. Harmonised rules for the exemption of VAT on importation;
7. A range of specific activities to enhance administrative co-operation between states;
8. Increased automated access to information;
9. Strengthening of the EUROFISC network;
10. Measures aimed at enhancing capacity to collect taxes (e.g. joint & several liability); &
11. Uniform instruments for the cross border collection of taxes.

Taken as a whole, this latest plan represents an integrated set of possible measures that can be expected to assist in the fight against fraud. However, the ability of individual member states to effectively execute such a plan will depend very much on the maturity of their strategic approach to overall compliance risk management.

Monitoring and evaluation

31. Compared to the situation observed in 2004/05, it is apparent that increased efforts are being made to improve the monitoring of trends in taxpayers' compliance using a variety of measures/ indicators across the main compliance risk types. This is evident from the data in Table 5 which displays the individual measures reported by surveyed bodies and other information in survey responses.

Table 5 Main measures & indicators used to monitor health of VAT system

Risk category and measure/ indicators	Countries using the measure/ indicator				
	Australia	Austria	Canada	Ireland	UK
Failure to register: Actual / potential registrants	✓		✓		
Failure to file returns on time: % of VAT returns filed on time	✓	✓(2010)	✓	✓	✓
Failure to correctly report: Trend in VAT gap (macro approach)	✓ (2009)				✓
Trend of VAT gap (random audits)				✓	✓
Trend of growth in VAT receipts to retail sales/ consumption etc	✓		✓		
Trend in VAT/ GDP%	✓				
Trend in yielding audits		✓		✓	
Failure to pay tax on time: % of VAT paid on time	✓		✓	✓	
Trend in total debt	✓	✓		✓	
Total end-debt/annual receipts (%)				✓	

32. A number of the more significant observations from the survey are as follows:

- **Use of tax gap measures (based on macro-economic analysis):** The Australian revenue body has decided to explore the value of the VAT gap estimation methodology, along the lines of the methodology developed and used by UK HMRC and elaborated in previous Forum documents. (A more recent description of this methodology and its findings is set out in Annex 1.) In addition, Austrian authorities advised they had undertaken a similar analysis to validate external research findings.

More broadly, as noted at paragraph 19 et seq. the EC's Directorate of Taxation and Customs has commissioned its own EU-wide study of the VAT gap using various top-down macro methods. The Swedish Tax Agency in a fairly recent report ⁶ indicated that an estimate of the aggregate VAT tax gap, applying the macro-economic approach, had been made as part of an overall tax gap estimation exercise for its tax system.

⁶ See 'Tax Gap Map', Swedish Tax Agency.

- **Compliance testing using random audit approaches:** Canada and Ireland reported the use of formal random audits to test compliance for VAT and other taxes, while the UK has recently introduced a similar VAT-focused activity. The Danish revenue body is also known to be finalising the results of its own initial random testing program (including coverage of VAT) largely carried out in 2008.

- **New measures not previously identified:** Ireland reported its intention to use additional new measures and to carry out a number of studies to gauge the compliance impact of its programs;
 - Trend of yielding and non-yielding audits from random audit program.

 - Measured behaviour of tranches of taxpayers: The Revenue is undertaking a study to establish if using the scores of its risk model (REAP) can be used to accurately track movements in compliance behaviour for selected tranches of the case base e.g. audits closed in 2008 can have their scores tracked both pre-intervention and for a number of years on a post-intervention basis—this could be subdivided into cases that had no adjustments and those that had adjustments greater than a specified figure.

 - Re-audit program: This measure is now under consideration. The view is that by re-auditing a proportion of cases that were audited some 2/3 years ago the Revenue will be able to get a measure of the success or otherwise of the original intervention. By tracking the risk score of possible re-audit cases during the interim period the Revenue will be able to monitor them electronically and to select suitable cases for re-audit

The UK HMRC also reported a number of other additional “new” measures that it is developing/ using to supplement its knowledge of the impacts of compliance interventions:

- **Future revenue benefit:** Future Revenue Benefit (FRB) is the estimated monetary amount that will accrue to the department or the business as a result of HMRC’s intervention. It is

applicable to any and all regimes and is calculated to cover a twelve-month period from the date of the intervention that gives rise to the benefit. It is trader specific (i.e. it relates to the preventive effect of a direct intervention). It should be borne in mind that FRB, even when following strict application of the criteria, is subjective—it relies on a trader having and declaring that same liability in the future as estimated, which will not always be the case.

- **Sticking tax (intervention additional liability):** Sticking tax is assessed additional liability and reduced prepayment claims that will not be recovered by businesses through the VAT system. This covers most adjustments to: 1) net payment returns; 2) net repayment returns (paid and prepayment); 3) central assessments; and 4) voluntary disclosures. It also covers the entirety of any voluntary disclosure which can be attributed to imminent assurance activity and which will not be recovered by businesses through the VAT system. The majority of our results are expressed in terms of direct impact i.e. additional yield or loss prevented because demonstrating the preventive and deterrent impact of our activities is highly complex and uncertain in most cases. Central Compliance and Knowledge, Analysis and Intelligence (KAI), together with the relevant supporting Directorates and the Treasury, continue to work on agreeing robust methodologies to help us achieve this.
- **Evaluation of specific risk treatments:** Australia reported the development of a formal methodology to assist “risk owners” evaluate the impacts of specific compliance interventions. The methodology, a copy of which is publicly available on the ATO’s website, is currently being applied to test the effectiveness of interventions in a range of areas, including the cash economy. An extract from an ATO report describing its approach and findings, presented against the background of the four phase methodology, is provided at Annex 3.
- Australia, Austria and Ireland all indicated that the system has performed generally as expected, reflecting in their view, a consistent pattern of compliance. In the case of Ireland, this was supported by a range of trend measures provided in their survey response and published in their annual report (see Table 6).

Table 6 Ireland—VAT Strategic outcome measures (by fiscal years)

Measure	Year				
	2004	2005	2006	2007	2008
Returns submitted timely:					
- Large businesses	89	92	93	91	89
- Medium-sized businesses	83	88	88	87	86
Average % revenue received in due month	85	84	88	88	90
VAT debt as % of gross revenue	2.8	2.1	1.5	1.1	1.3

- Canada reported that the system had operated as expected, reflecting some improvement in patterns of compliance. It noted that its strategic compliance outcome measures (registration, filing, reporting, and remittance)—see Table 7 below with trend measures that are published in its annual report— along with overall positive performance against its expected results supported its assessment that it has positively promoted compliance.

Table 7 Canada—VAT strategic outcome measures (by fiscal years)

Indicator	Target %	Year				
		2004	2005	2006	2007	2008
Businesses are registered	90	86.6	88.8	89.5	93.0	n.avail
Businesses file returns on time	90	92	92.6	91.8	91.4	n.avail
Growth in net revenue with retail sales & personal expenditures	Tracks favourably	Yes	Yes	Yes	Yes	Yes
Businesses that collect GST	N/A	2.6 mn, \$44bn	2.7 mn, \$47bn	2.8 mn, \$52bn	3 mn, \$50bn /1	n.avail

Source: 2008 CRA Annual report

/1. Standard rate of VAT reduced from 7 to 6%.

- The UK observed that its VAT system, in terms of overall revenue collected, has generally performed as expected over the last 2 years reflecting, in its view, some improvement in overall compliance patterns. This observation is supported by the findings of HMRC's VAT gap research activities that suggest a positive trend of improved taxpayer compliance over the last 3 years (see Table 2 of Annex 1).

VAT legislation framework

33. Under this topic, revenue bodies were asked to identify any important legislative reforms recently introduced and/or any unusual or unique features of their VAT system that had been adopted to primarily to improve /more effectively control taxpayers' compliance. They identified a large number of developments that may be of interest:

- Ireland reported that a significant change was introduced in September 2008 in relation to the operation of VAT in the construction industry. This change is referred to as the VAT Reverse Charge. The change applies specifically to principal contractors and sub-contractors in the construction industry. As a result of the change, principal contractors are now legally obliged to charge themselves VAT on supplies from subcontractors (i.e. instead of the previous position (which applies in relation to most other transactions) where the sub-contractor is liable to charge VAT on his/her invoices). The purpose of the amendment was to place the liability for accounting for VAT in the construction industry on a relatively small number of principal contractors as distinct from a relatively large group of sub-contractors.

Ireland also reported a number of other recently-introduced measures: 1) various penalties (for failure to register and keep proper records etc.) have been increased; 2) the VAT registration threshold has been increased; and 3) a number of burden reduction measures have also made, including increased threshold for use of cash accounting basis and reduced filing and payment frequency for small businesses.

- UK noted that as a key part of a wider strategy designed to combat Missing Trader Intra-Community (MTIC) fraud, on 1 June 2007 the UK implemented changes to the normal VAT accounting rules for supplies of certain specified goods, namely mobile telephones and computer chips. Under this change of accounting provision, known as the reverse charge procedure, the purchaser of the goods, rather than the seller, is liable to account for the VAT on the sale. The supplier does not charge VAT, but has to specify on the invoice that the reverse charge applies. Provided that the purchaser has correctly accounted for the VAT under the reverse charge procedure, he will retain the right to input tax recovery, subject to the normal rules. Broadly, the reverse charge only applies to sales within the UK where the specified goods are purchased by a VAT registered business

for business purposes. Sales to non-business customers are unaffected by the change, and normal VAT rules continue to apply.

Further information on the reverse charge and the associated reverse charge sales list procedure are contained in Revenue & Customs Brief 24/07: VAT – Proposed reverse charge accounting for businesses trading in mobile telephones and computer chips: announcement of targeted implementation and details of how the rules will operate in practice; and exposure of draft legislation for comment.

The UK also reported a revamping and updating of its penalty regime relating to inaccuracies in documents, effective 1 April 2008, and applying to the main taxes administered. A more recent act (Finance Act 2008) provides a new penalty regime for belated registration and contains new provisions relating to inspection and information powers, record-keeping requirements and debt collection powers.

- Canada reported that a legislative measure was implemented in 2007 to restrict the payment of refunds to clients until they have filed outstanding returns required under VAT and other programs (income tax, payroll, and excise). This measure was expected to motivate clients to be more compliant with filing all required returns. The 'compliance refund hold' provision requires that the payment of all refunds and rebates be withheld until all outstanding returns under all tax programs have been filed. Also introduced was a late-filing penalty between 1-4% that is assessed depending on the lateness of the return and the removal of collection restrictions to permit the automated application of refunds/rebates to tax debts as soon as they become available rather than waiting the former 90 day period. The calculation of interest was also changed to permit an increase in interest charged: the sum of the 90 day average federal Treasury bill rate plus 4 percentage points. A 2% rate differential between interest change and paid was also introduced.
- Australia reported recent changes to its legislative framework, including: 1) simplified accounting methods for some retailers and small enterprises with a turnover up to \$2million to reduce their costs of compliance; 2) an increase in the GST registration threshold to \$75,000 ; and 3) amendments to associate, margin scheme and grouping provisions. It also noted that a broader review of the legal framework for the administration of the GST was underway, under the auspices of the Board of Taxation.

- Austria reported the introduction of a reverse charge mechanism for specific business to business transactions, monthly reporting obligations for intra-community transactions and a specific invoice requirement for transactions with private persons.

34. A summary of the penalty framework generally applying for VAT offences in the surveyed revenue bodies is set out in Annex 5. As noted above, in a few cases steps have been taken to strengthen the penalty framework.

VAT administration operations

Overall organisation of key VAT administration functions

35. Revenue bodies were asked to identify any special organisational arrangements that were in place or being proposed to facilitate VAT administration for selected functions. Information reflecting their setups is set out in Table 8. Perhaps the most important feature to highlight here is the tendency to use integrated compliance teams covering both income tax and VAT.

Table 8. Organisation features of certain VAT functions

Country	Registration	Refunds processing	Audit/ assurance
Australia	Regional registration teams working across taxes	Regionalised workforce dealing with all activity statement processing /1	Dedicated workforce for GST audits. Some work (e.g. cash economy) cuts across taxes
Austria	Integrated VAT & income tax teams at regional/ district level	Integrated VAT & income tax teams at regional/ district level	Integrated VAT & income tax teams at regional/ district level
Canada	Regional registration teams working across taxes	Dedicated prepayment teams at regional level	Integrated VAT & income tax teams at regional/ district level
Ireland	Dedicated regional teams working across taxes	Dedicated prepayment teams at regional level	Integrated VAT & income tax teams at regional/ district level
UK	Two dedicated VAT registration teams	VAT Central Unit	Two separate arms: 1) Large Business Service; and 2) dedicated VAT teams for other taxpayers /2

/1. An activity statement is an integrated 'across taxes' return filed periodically by business in respect of all of the taxes they are responsible for.

/2. HMRC reported that it is moving towards joined up/ cross tax discipline teams with the intention of doing some integrated verification work.

Registration

36. The Forum's 2004 report on VAT compliance emphasised the importance of revenue bodies having sound VAT taxpayer registration procedures, noting that registration is the first point in time a revenue body has an opportunity to make an initial risk assessment of the registrant. Furthermore, it noted that fraudulent registrations very often are an integral element of contrived schemes to defraud the VAT system (e.g. carousel and refund frauds).
37. Revenue bodies' survey responses revealed examples of different and innovative approaches for ensuring the integrity of the registration process that may be of interest in countries where the registration process is subject to high levels of abuse. The key points are as follows:
- All revenue bodies generally employ a range of "proof of identity" checks as part of their normal registration procedure. Canada, Ireland and UK implement these with actions to identify whether the applicant has previous history with them and, assess their if so, to assess their previous compliance (Refer to highlighted text for example). A detailed summary of comments extracted from survey responses is set out in Annex 4.

"The tools (systems, data components) that are used by High-Risk Analysis Teams are constantly being refined. CRA is also in the process of implementing a cross-program compliance profile that will assist in the integrity of VAT registration and in the identification of compliance risks by providing a history of compliance actions and risk assessments of clients and their associated entities."
 - The UK described a formal structured three stage registration process where applications are screened and, subject to meeting objective risk criteria, may be referred to 1) special risk referral teams; and 2) specialist intelligence teams. It reported that around 5% of applications get referred to 1) and 1% to 2). It also noted that in situations where there is insufficient evidence to refuse an application but there are still concerns about a trader, it can impose conditions on the registration such as requiring a financial guarantee or shortening the first VAT filing/ payment period to enable it to make an early assessment of the taxpayer's compliance.

- A number of revenue bodies also reported that they administer a systematic program for contacting all/some new registrants shortly after registration. Austria reported that it aims to visit all new registrants shortly after business commencement. The UK reported that it aims to contact all registrants, either by letter or phone, to offer advice and support. In 2007/08 some 250,000 businesses were contacted by letters which enclosed brochures and help sheets. In 2008/09, this contact has been refined, whereby help sheets focussed specifically on certain trader groups have been sent, with invitations to businesses to attend presentations and workshops. Ireland reported that a “new business” contact letter is sent to new registrants where they have not filed an expected return. There is a further “new business” contact letter sent following repeated non-compliance. Thereafter, the matter is referred to a caseworker to establish if the business is trading and, if so, to inform the taxpayer of their obligations.
- Australia, Canada and Ireland all reported the use of systematic programs to detect potential VAT registrants using 1) income tax-related information on their internal databases; 2) information from third parties (e.g. corporation regulatory bodies); and 3) sectoral projects. In the case of Canada, a relatively recent initiative is the establishment of an enhanced registration process involving the use of specialist teams that is described in Box 5 (and was also referenced in the Forum’s work on innovative risk treatments published in April 2009).

Box 5. Canada: GST Enhanced Registration Review (GERR)

Background: Fighting GST/HST fraud is one of the Agency’s top priorities. The GERR program recognises the need to assess the probability that a legitimate business entity exists, and to stop the issuance of overstated or fraudulent GST/HST refunds.

Verifying the existence and contact particulars of new registrants at the time of registration is an effective tool in the fight against GST/HST refund fraud. The accuracy of account information is paramount for client contact and compliance actions. The GERR program was developed as a proactive approach to aid in reducing cases of fraudulent registrations by verifying the existence and contact particulars of all new GST/HST registrants, and then matching them against client profiles deemed to pose a risk to Crown Revenue through fraudulent refund claims. High-risk registrations are forwarded to Compliance Programs Branch for a more in depth review.

Description of initiative and objectives: The GERR program is integrated into the Business Number (registration) system. All new GST/HST registrants are transferred by the Business Number system to one of two GERR review teams. The GERR teams in Winnipeg, Manitoba and ST. John's Newfoundland and Labrador are responsible for this review. The objective is to streamline the risk screening of newly registered GST/HST registrants thereby reducing the screening process for Compliance Programs branch. This allows the reallocation of resources formerly used to perform this activity to other compliance actions.

Registration validation strategy: The validation strategy has 4 elements:

- Element 1: Verifying the integrity of Business Number tombstone information provided by the GST/HST registrants at time of registration such as the business name, addresses (physical and mailing), business activity, and contact information. Verifying spelling of names and addresses.
- Element 2: Capturing missing information from new GST/HST registrants through client contact & other Agency tools, respecting the Privacy Act & client confidentiality in order to improve database integrity and to educate clients about the information they are required to provide when registering a GST/HST account.
- Element 3: Identifying GST/HST registrants that meet the risk selection criteria and refer the accounts to Compliance Programs Branch for further review.
- Element 4: Aid in identifying new trends in potential risk criteria.

For the 2006/2007 fiscal year the GERR program reviewed 236,484 recently registered GST/HST accounts for data integrity and referred 35,010 to Compliance Programs Branch for an in-depth review for potential fraud.

Impacts of strategy: The CRA has identified the following positive impacts:

- Capturing missing information from new GST/HST registrants through client contact and other Agency tools has improved the business number system data integrity for compliance purposes.
- Having accurate information in the business number system gives clients confidence when obtaining Business Numbers or program accounts.
- Identifying client accounts that meet the risk selection criteria and referring the accounts to Compliance Programs Branch has enabled them to reallocate resources away from screening towards more intense compliance workloads.

- Providing the early identification and referral of issues such as duplicate business numbers and individual non-filers to the attention of the appropriate sections.
- Earlier detection of fraud issues by Compliance Programs Branch.

Source: 'Managing and Improving Compliance Recent Developments in Compliance Risk Treatments', Forum on Tax Administration (April 2009)

38. While not included in the survey, the Singapore's revenue body (IRAS) is known to have introduced what appears to be a highly valuable strategy that is described in detail in the Forum's work on innovative risk treatments published in April 2009. The key elements of this strategy are as follows:

- **Program for newly registered GST traders:** This program has four elements: 1) GST Assistance Scheme - accounting software grants; 2) collaboration with accounting software providers; 3) compulsory GST education for voluntary registrants (annual turnover < S\$1m); and 4) risk assessment of all new trade.

Under the GST Assistance scheme, each voluntary registrant can get a grant of up to S\$5,000 to pay for accounting software and related costs (e.g. software training). IRAS regards relying on accounting software for GST tracking and reporting as far more reliable than manual methods and it has an on-going arrangement where three well-established software vendors⁷ present at its GST classes to showcase their accounting software. This is seen as a win-win arrangement as it provides the vendors with opportunities to access the new registrant market and helps IRAS heighten traders' awareness on the benefits of using such accounting software in the course of their businesses.

At the point of registration, all new applicants for GST registration are required to complete a questionnaire attached to the application form that helps IRAS assess their inherent risks. A high or low inherent risk rating is assigned to each trader, thereby providing the basis for formulating appropriate compliance responses.

- **Program for existing GST traders:** This program has two basic elements: 1) different reviews and audit treatment based on risk profiles; and 2) compulsory GST education for taxpayers

⁷ APAC, MYOB & Quickbooks.

with errors in GST returns. Compulsory education is targeted at all GST registered traders who have made mistakes in their GST returns and have been compounded for the mistakes. IRAS highlights the mistakes to the management of the business and requires them to attend a compulsory GST class within the next 6 months. Such classes are aimed at re-training these traders and equipping them with sufficient GST knowledge to ensure that GST returns are correctly filed and mistakes are not repeated.

39. Finally, it is perhaps worth highlighting that four of the five surveyed countries—Canada being the exception—have adjusted upwards the value of their respective VAT registration threshold over the last five years. While this has, no doubt, been done as part of an administrative burden reduction policy response it also has the additional benefit of reducing the workload of revenue bodies and reducing the numbers of low-value registrants that must otherwise be registered and monitored. The relatively low value of Canada's GST registration threshold, compared to other surveyed countries, largely explains its abnormally high number of registrants, having regard to size of economy factors—see relevant data in Table 1.

Refund controls (incl. risk profiling)

40. The Forum's 2004 report noted that in any VAT invoice-based credit system there will always be genuine refund claims made by business. This is particularly so where the business makes supplies at a reduced or zero rate of tax, whilst incurring deductible input tax on stock and assets. Exporters are perhaps the best examples of businesses that can legitimately claim refunds as their input tax will invariably exceed output tax. Against this background, it noted that abuse of this mechanism has always been present in VAT but it is only in recent years that many countries across the OECD have been subjected to sustained attacks through false claims for refund. This has led a number of countries to put in place stricter screening of refund claims, although this often has to be balanced with a requirement to effect refunds within a number of days from receipt of a VAT return. Payments delayed beyond these time limits generally attract interest on the amount of the refund claimed. An additional issue in this area for some countries is the sheer number of refund claims to be examined, making it a quite complicated task at times to isolate potentially abusive from legitimate claims.

41. The survey sought to understand the nature of the processes in place for detecting and dealing with those refund claims perceived to be ‘at risk’. However, it is helpful to first understand the circumstances (e.g. volume and overall incidence of claims, number of claims examined) under which each of the participating revenue bodies operates that affect the way in which these arrangements may be designed and how they are conducted.
42. Information provided concerning VAT refund claims is set out in Table 9. Generally speaking, there was insufficient data from across all countries to make any meaningful comparisons, a concern in its own right given the criticality of the VAT refund process.

Table 9 VAT refund data (by fiscal years)

(All monetary amounts in local currency)

Country	Refund claims received (millions)		Refund claims examined (millions)		Value of claims examined (\$bn)		Refund claims adjusted	
	2007	2008	2007	2008	2007	2008	2007	2008
Australia	2.16	2.21	0.079	0.083	13.5 /1	11.4 /1	7,452	8,371
Canada	2.68	n.avail.	1.053	n.avail	n.avail. /1		n.avail.	
Ireland	0.284	0.275	0.054 /2	0.052 /2	3.7	3.3		

/1. Australia- Value of adjustments was \$498 million in 2007; Canada- value of adjustments was \$2.0 billion.

/2. Ireland- the proportion of claims verified was 19%, while the relative value of claims examined was 80%.

43. Against this background, the key observations from the survey data are as follows:
- Australia, Canada, Ireland and UK all administer a computer-based risk profiling system, incorporating a broad range of risk criteria—see Table 10—to identify potentially ‘at risk’ refund claims that are examined on an exception basis. Austria reported a limitation in its risk profiling capability in relation to businesses with a turnover under €100,000. There was a lack of data within survey responses to identify the relative success of these risk rating processes to determine their effectiveness in identifying productive cases.

Table 10 Nature of risk scoring criteria used in risk profiling systems

Nature of criteria	Australia	Austria	Canada	Ireland	UK
Size of refund	✓	✓	✓	✓	✓
Previous compliance history	✓	✓	✓	✓	✓
Business size	✓	✓	✓	✓	x
Refund history/ pattern	✓	x	✓	✓	✓
Length of time registered	✓	✓	✓	x	✓
Nature of business	✓	✓	✓	✓	✓
Existence of other tax debts	✓	✓	✓	✓	x
Status indicator-no/low risk	✓	✓	✓	✓	✓
Other useful criteria	✓/1		✓/1		

/1. The ATO also reported the presence of 'fraud' characteristics as a scoring criterion while the CRA noted that.... 'depending on the industry, regional discrepancies are also used to assess potentially 'at risk' cases'.

- These risk profiling systems vary in their scope and sophistication but the information in Box 6 describing the UK approach may be helpful to readers.

Box 6: UK HMRC: Risk Profiling Development & Management Approach

HMRC only has an automated system for the risk based profiling of all VAT repayment returns upon receipt. It takes the view that the risk from an inaccurate VAT return forms only part of the risk for that taxpayer and believes that the best way to profile the risk of the taxpayer is to consider all of the information it has about the taxpayer, rather than just the VAT return data. As such, it profiles the risk of the taxpayer by looking at the overall risk based on information provided at registration, information from previous audits/interventions, other information held on central systems as well as information from VAT returns to profile the taxpayers.

The process is known as Central Risk Analysis and is effectively a form of risk assessing taxpayers similar to the way that financial institutions assess the credit worthiness of applicants for loans, mortgages, etc. The process is carried out by specialist Analysts in KAI. On an annual basis, they will build a model by looking at the results from HMRC's compliance activity and use specialist software to identify which factors or variables (from all of the data listed in the paragraph above) feature most frequently in the instances where HMRC is: a) most likely to get some yield; and b) most likely to get significant yield. Once these factors are identified, they are given a score and applied to the entire VAT population. Based on the score applied, each taxpayer is allocated to an appropriate Risk Group (i.e. high, medium, or low). This information is made available to Compliance staff and informs the prioritisation of their activity. The taxpayers are regularly re-scored based on latest VAT return information. During the annual re-build, analysts spend considerable time researching the value of adding new data items, e.g. by considering data from other taxes or new derivations of existing data.

- Concerning its approach, Australia reported the operation of special governance arrangements for its automated risk based system known as the Risk Rating Engine (RRE)
 “The RRE is managed by a team of GST Refund Integrity Risk & Strategy business analysts under the leadership of the RRE Business Rules Owner and Refund Integrity Risk Owner. A Credit Refund Integrity Steering Committee consisting of high level ATO executives has formal responsibility providing governance and leadership for the management of credit and refund risk and the associated integrity controls for all refunds across the Tax Office. Systems build/updates to the RRE are undertaken by a GST Projects & Systems area.”
- Generally speaking, surveyed revenue bodies reported that their risk profiling systems use computer-based credibility/validity checks to assess refund claims against a set of variable parameters. Claims which fail the tests are referred for further examination, either on a pre- or post-payment basis. The UK reported the operation of a central VAT Credibility Operations Unit to examine prepayment queries. Where these cannot be resolved, they are referred to a local office for examination. On the other hand, Ireland reported that it used a more decentralised setup (as does Australia) where all claims that fail the checking tests (i.e. a maximum individual repayment amount, an annual net repayment amount or a special status indicator such as ‘cancelled registration or liquidation/receivership’) are referred electronically to a case worker in a local revenue district office

for verification. Austria reported that all refund claims over €7,500 are examined manually.

- Where claims are to be checked on a pre-payment basis, the time limits in place in all surveyed bodies impose a degree of urgency to the process. Australia, Austria, Ireland and the UK identified a range of information sources that are accessed to help verify the validity of the claim, including: 1) checks of internal systems for notes or justification of the claim following previous inquiries or in light of taxpayers' compliance audit history; 2) examining the claim in light of the taxpayers' business parameters; 3) requesting by phone copies of information from taxpayers; and 4) inspections of records on taxpayers' premises—given time constraints these are in-frequent for pre-payment situations.

Audits/verification

44. The 2004 report commented on the relevance of the audit function to achieving improvements in taxpayers' compliance. Among other things, it noted indications of wide disparity in the extent of resources devoted across member countries to audit activities. Related to this, it emphasised that for any revenue body wishing to expand its resource base an open approach to measuring aggregate losses, combined with a comprehensive strategy for addressing all major forms of losses and giving rise to meaningful targets, might be a more successful mechanism for convincing Governments of its resource proposals.
45. The survey sought a limited amount of quantitative and qualitative information on audit/verification operations to shed light on any actual or envisaged developments that may be of interest to members. The key points are as follows:
 - As evident from the information in Table 8, most revenue bodies have implemented, or are planning for, the use of **integrated audit/verification teams** that work across taxes (taking a 'whole of taxpayer' perspective), potentially improving the visibility and effectiveness of their overall verification activities. Based on the survey responses, a drawback to this approach seems to be an inability, which appears avoidable, to provide disaggregated information on VAT audit outputs.
 - None of the survey revenue bodies uses or commits to some form of coverage/ visibility objective for the VAT and, for the most part, are largely risk driven. However, both Canada and Ireland

reported that their verification activities include a formalised random element to test compliance levels.

Canada noted that its Core Audit program (CAP) is designed to test overall compliance with VAT laws using statistical sampling methodologies. Detailed information concerning non-compliance is captured and analyzed for use in estimating compliance rates within the populations sampled and in gaining valuable insight into non-compliance. This information also enables comparison to compliance rates among segments of the population and track compliance trends over time. The information derived from this program permits validation and refinement of risk assessment models and to measure the success of audit strategies. Audit selection for VAT registrants focuses on businesses with annual sales <\$20M, with further population stratification using other variables such as the North American Industry Classification Structure. All CAP Audits are commenced as full scope. The audit approach taken will depend on the internal control system and the quality of the books and records. Further indirect or investigative approaches may also be taken.

In Ireland's case, the random program element consists of a national sample of around 400 taxpayers, encompasses all the major taxes and is executed by the same regional teams carrying out normal audits.

The UK reported that it was considering a plan to implement a random program to produce compliance-related information to supplement its top-down VAT gap measure. If the program goes ahead, the sample would be of the order of 1,000-2,000 taxpayers. However, it will not be large enough to produce annual results for most sectors.

- Data on completed audits (and other verification checks) are set out in Tables 11 and 12. Unfortunately, the data for Austria and Ireland include income tax-related checks and, therefore, are not comparable with the other countries' information. There are some other observations concerning the other countries:
 - Canada's lower rate of GST (i.e. 7 (to 2006), 6 (2007) and 5 (2008) clearly impacts on the aggregate value of audit adjustments made in practice in comparison with both Australia and UK.
 - The audit staff resource data for Australia, Canada and Ireland indicate that relative to their aggregate size, significant revenue body resources are being devoted to VAT compliance programs.

- Australia, Ireland and the UK reported a substantially greater number of interventions (suggesting a larger array of different compliance interventions) than Canada which needs to be explored more deeply (NB: The results of this inquiry will be reflected in the final report.)
- The verification-related data available for Australia and UK reflect administrative efforts to achieve a high degree of visibility/ presence among the registered VAT population, with between 15-20% of taxpayers, on average, being touched by the various forms of interventions carried out in both 2007 and 2008; consistent with this, the value of adjustments made to reported liabilities appears relatively significant at between 4 to 5 percent of annual net revenue collections.

**Table 11 Audit/verification related information
(latest two fiscal years)**
(All monetary amounts in local currency)

Country	Audits and other checks (no.)		Adjustments (no.)		Value of adjustments (millions)		Staff resources (FTEs)	
	2007	2008	2007	2008	2007	2008	2007	2008
Australia	230,355 /1	392,847 /1	n.avail.		1,436	1,704	2,423	2,139
Austria/2	75,337 (16,486)	75,347- (15,175)	n.avail.		2,107 (292)	2,069 (252)	n.avail	
Canada/3	63,306	66,626	40,456	37,471	763	614	2,167	2,149
Ireland/4	14,308 & 237, 626 assurance checks	13,414 & 345,452 assurance checks	60% approx.	n.avail.	688	570	2,106 /5 (staff work across taxes)	
UK	373,748	397,785	73,967	67,656	3,578	3,541	n.avail	

/1. Data includes assurance checks.

/2. Most of the data for this tabulation were sourced from the official publication Annual Report 2007. Audit data relate to all taxes, while bracketed numbers represent special VAT audits.

/3. Number of audits includes prepayment audits of credit returns which account for approximately 2/3 of total; the numbers and values relate strictly to VAT, no income tax results are included.

/4. Data relates to all taxes as no tax-head specific information is available.

/5. Data obtained from Forum's Comparative Information Series (2008).

**Table 12 Audit/verification data—Australia & United Kingdom
(by fiscal years)**
(all monetary amounts in local currency)

Indicators	Australia		United Kingdom	
	2007	2008	2007	2008
Registrants (millions)	2.589	2.599	1.868	1.929
Net VAT revenue (billions)	38.1	42.4	73.2	77.2
Assurance/ verification checks (no.)	230,355	392,847	373,748	397,785
Value of adjustments (billions)	1,436	1,704	3,578	3,541
Checking coverage (%)	8.9	15.1	20	20.6
Value adjustments/ net VAT revenue (%)	3.8	4.0	4.9	4.6

Unpaid VAT debts

46. The survey also sought limited information on the level of unpaid VAT, another area of non-compliance. Three of the surveyed countries were able to provide information, as set out in Table 13.

Table 13 Unpaid VAT (by fiscal years)
(All monetary amounts in local currency)

Countries	2007		2008	
	Unpaid VAT at year end (millions)	% of annual net VAT revenue	Unpaid VAT at year end (millions)	% of annual net VAT revenue
Australia	2,543	6.4	2,661	6.1
Canada	5,320	-	5,876	-
Ireland	242	1.8	196	1.4

Other administrative developments and initiatives

47. As part of the survey, revenue bodies were asked to identify important administrative reforms implemented over the last 2-3 years or which were being considered/ developed for implementation to enhance the management of taxpayers' compliance. Survey responses revealed a rich array of measures implemented and proposed that may be of interest to members. These are set out in Table 14.

Table 14: Recent and expected future developments

Country	Measures implemented	Measures under development
Australia	Annual publication of ATO Compliance Program that articulates key compliance risks by market segment System of Taxpayer Alerts to publicise emerging schemes etc under review GST annual compliance agreements New GST operating model in July 2006	A review of the overall legal framework for GST administration is underway
Austria	Revision of VAT returns to provide more information for risk assessment	Unannounced audits
Canada	Newly-dedicated resources to high risk analysis teams	Initiative to increase regional engagement in compliance strategy development
Ireland	Development of risk analysis system (REAP), with focus of "whole of client" risk assessment and treatment	Phased introduction of mandatory e-filing & e-payments will release resources for compliance
UK	Introduction of campaign/ project intervention strategies (see text) New integrated approach to tackling fraud and evasion (see text) Implementation of recommendations from review of how HMRC works with its largest taxpayers (see text)	Ongoing refinement of overall risk management approaches Consultation on options for new late filing and payment penalties and interest on late payments Treasury tax simplification reviews for VAT include: 1) partial exemption and capital goods scheme; 2) VAT return frequency; 3) VAT retail scheme; and 4) EU-wide complexities.

48. As noted in Table 8, Australia reported the development and introduction of a new GST operating (i.e. organisational) model from 2006. A review to assess the operations of the GST business line, five years after implementation, was undertaken in early 2006. The review contained a range of challenges and recommendations. One of the recommendations was the introduction of a new operating model.
49. This model was adopted on 1 July 2006 and was intended to:
- 1) improve the business line's corporate alignment;
 - 2) provide a national approach to strategy development and risk prioritisation to ensure alignment of resources to areas of highest risk;
 - 3) implement a delivery mechanism that allowed for clear and direct accountability for productivity improvements. The operating model implemented consists of:
 - Risk and Strategy Stream (includes Interpretative Advice and Assistance);
 - Active Compliance Stream (includes LAC & SME/Micro);
 - Cash Economy Stream;

- People, Planning and Performance Stream; and
- Government Relations Stream.

50. One of the key drivers behind the new GST operating model was to ensure alignment of resources to areas of highest risk. This led to the implementation of risk and strategy segments responsible for the management of compliance risk and escalation processes across GST. While this organisational approach differs from the more 'integrated/ across taxes' approach seen in other surveyed bodies the ATO reported that 'integration/ co-ordination' is achieved through the adoption of co-operative approaches to compliance work. The case study described in Annex 3 concerning the treatment of risks posed by cash economy participants is one such example of this co-operative approach to addressing significant compliance risks.

IV. Key Observations, Findings and Recommendations Arising from the Survey of Selected Countries

51. Although confined to a relatively few member countries, the survey has revealed a useful array of developments that build on the Forum's earlier work on VAT abuses and compliance risk management in general.

Key observations and findings

52. The key observations and conclusions are as follows:

- Compared to the situation observed in 2004, there are clear indications of a maturing in the strategic approach to compliance risk management (e.g. increased attention to the development and use of top-down measures covering the major risk types, significantly increased use of better IT tools to detect compliance risks and assess their potential magnitude, more systemic risk treatment approaches).
- Survey responses indicated an improved or consistent pattern of VAT compliance for the countries concerned:
 - In the case of the UK, compliance trend and other data support a conclusion of substantially improved compliance over patterns of serious non-compliance observed in the early 2000's, of the order of around a 20 percent reduction in the estimated tax gap, and lend support to the value of its 'strategic approach' described in the Forum's previous reports;

- In the case of Canada, indications of improved compliance were evident from its range of strategic outcome measures; and
- For other surveyed countries, responses indicated that their VAT systems had generally performed in line with revenue projections and/or other indicators, suggesting a broadly consistent pattern of compliance.
- Notwithstanding the observations of improved or consistent compliance and the measures implemented all revenue bodies continue to rank their VAT as a “high risk” area for their administration.
- The use of random audits for risk profiling and overall compliance monitoring purposes figures in the compliance management approach of three of the five surveyed revenue bodies.
- Revenue bodies are increasingly moving to detect and treat risks on a ‘whole of client’ basis, as opposed to a ‘tax by tax’ approach. Among other things, this is evident in the way IT systems are being designed and the way in which work processes (e.g. audit/ verification) are being conducted.
- Given a number of ‘hard to treat’ compliance risk issues, there has been a fair resort to legislative responses over recent years; numerous efforts to simplify the laws thereby making it easier to comply and easing the burden on taxpayers were also noticeable.
- Revenue bodies have evolved more systematic and specialised risk-based processes for validating the integrity of VAT registrations; three of the five surveyed bodies reported they have a systematic process using internal and/ or external data sources to identify businesses that should but are not registered for the VAT.
- Considerable attention is being given to strengthening case-based risk profiling systems but these require close monitoring and fairly regular updating to take account of changing patterns of compliance behaviours.
- Deficiencies in the performance management information systems of a number of revenue bodies were apparent—there was a dearth of information concerning VAT refund claims and their processing, information on ‘VAT specific’ verification checks

and their results and the value unpaid VAT debt could not be reported in two countries.

- This survey deliberately did not address the issue of VAT fraud arising with intra-community transactions within the EU, which is being addressed by the EC's own short term action plan (as described briefly in Box 4). However, it seems reasonable to conclude that a prerequisite to realisation of that plan by member countries, especially in a time of tough economic and financial conditions, is an effective system of compliance risk management drawing on the approaches and experiences of surveyed and countries, as reflected in this note.

Recommendations

- Revenue bodies, especially in those countries where there are indications of serious non-compliance, are encouraged to examine closely the findings of this study in order to identify opportunities to strengthen their administration of VAT compliance (and other taxes).
- Revenue bodies are encouraged to put in place, if not already the practice, a comprehensive set of performance/output and outcome measures to enable them to monitor key risk areas (e.g. VAT refund claims processing and VAT verification activities) and to gauge the impacts of their targeted risk treatments.

V. ANNEX

Annex 1

HMRC's VAT Tax Gap Methodology

Estimating VAT Losses¹

This estimate of losses from the VAT system excludes losses through illicit activity in spirits and tobacco goods, as these are covered by the HMRC's published excise duty gaps.)

Methodology

1. The methodology for calculating the VAT gap was first published in November 2002⁸.

⁸ *'Measuring Indirect Tax Losses' HM Customs and Excise, November 2002.*

Principle

2. The total level of VAT losses can be estimated using a top-down approach by comparing the net theoretical tax liabilities with actual VAT receipts. The difference between these amounts is known as the VAT gap.

$$\text{VAT gap} = \text{Net Theoretical Tax Liabilities} - \text{Actual VAT Receipts}$$

3. The approach employs a gap analysis (as at 2.1 above), which involves:
 - assessing the total amount of expenditure in the economy that is theoretically liable for VAT;
 - estimating the tax liability on that expenditure based on commodity breakdowns of the expenditure data;
 - estimating the value of tax on the VAT-able expenditure, to derive the gross VTTL;
 - subtracting any legitimate refunds (deductions), occurring through schemes and reliefs, to arrive at the net VTTL;
 - subtracting actual VAT receipts from the net VTTL; and
 - assuming that the residual element, the gap, is the total VAT loss due to any cause.

General Calculation Methodology

4. VTTL is the theoretical amount of VAT that would be collected in the absence of any losses. It is calculated by multiplying appropriate categories of expenditure liable to VAT in the economy by their VAT rate and allowing for other relevant rules determining tax liability.
5. The expenditure series used in the calculation are mainly constituents of National Accounts macroeconomic aggregates. All National Accounts data used to construct VTTL estimates are consistent with the latest Office for National Statistics (ONS) Blue Book.
6. A number of streams of expenditure contribute to the tax base, with most VAT deriving from consumers' expenditure. The main expenditure categories that comprehensively cover VAT liabilities are:

- household spending and non-profit institutions serving households' final consumption expenditure;
- central government current and capital expenditure;
- exempt sector intermediate consumption and other input tax blocks; and
- housing expenditures - certain household and corporate capital expenditure which incurs non-refundable VAT.

Input Tax Adjustments

7. Net VAT liability is the difference between VAT due on taxable supplies made by registrable traders ('output tax'), and that recoverable by traders on supplies made to them ('input tax').
8. VAT liability for the relevant categories can be estimated directly from National Accounts data, with one exception - the exempt sector. Businesses making outputs that are exempt from VAT are generally not permitted to reclaim the VAT on inputs associated with their exempt outputs. In order to make an adjustment for this irrecoverable input tax, a separate HMRC survey is used to ascertain the proportion of purchases on which VAT cannot be reclaimed.
9. A further adjustment is made for expenditure by businesses legitimately not registered for VAT and, as such, the VAT is not recoverable as input tax. This adjustment uses a combination of ONS data and HMRC information on the distribution of business turnover below the VAT threshold to estimate relevant expenditure.
10. Finally, third party data sources are used in conjunction with National Accounts data to inform estimates of business expenditure on cars and entertainment, on which VAT is due.
11. Because the calculation of non-recoverable input tax is complex, the level of uncertainty around input tax adjustments is larger than for the other elements.

Deductions

12. The sum of the VAT liability arising from each of the expenditure categories listed in paragraph 6 gives an estimate of the gross VTTL in each year. However there are a number of legitimate reasons why part of this theoretical VAT is not actually collected.

These can be grouped into two broad categories:

- VAT refunds; and
 - Expenditure at traders legitimately not registered for VAT.
13. VAT refunds are made primarily to government departments, NHS Trusts and regional health authorities for specified contracted out services acquired for non-business purposes. A number of other categories of expenditure cannot be separately identified in the overall VTTL calculation, for which VAT can be refunded. The value of these refunds is taken directly from audited HMRC accounts data.
 14. Traders who trade below the VAT threshold can legitimately exclude VAT on their sales. Expenditure on the output of these businesses will have been picked up in the theoretical liability. To adjust for this an estimate of relevant expenditure is made using a combination of ONS data and HMRC information on the distribution of business turnover below the VAT threshold.

Methodology Changes

15. The detailed calculations used to construct the estimated VTTL are continuously reviewed to identify improvements to the methodology.
16. The proportion of household expenditure on ex-business cars in second-hand car sales is now taken directly from data used to estimate the amount of input tax blocked on expenditure on cars by businesses, which is derived from ONS National Accounts data. This replaces an adjustment previously taken from the Own Resources Account, prepared by HMRC for the European Commission. This change ensures consistency in the data being used throughout the VTTL calculations.
17. The VTTL is now adjusted to reflect refunds of VAT made to the Isle of Man, under their agreement with the UK authorities to simplify tax collection procedures for businesses.

Summary of VTTL

18. Estimates of the contribution to the VTTL of each relevant expenditure component are given in Table 1. Note that the

household element excludes expenditure on purchases of illicit alcohol and tobacco. The revenue losses associated with such purchases are considered in the excise illicit market share estimates and to measure them here would constitute double counting.

Table 1: Expenditure components of VTTL (£bn)

Category	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Household	56.6	59.4	62.4	64.5	66.9	69.9
Exempt	12.7	12.7	12.8	13.8	14.5	15.4
Government	7.8	8.5	9.2	10.1	10.9	11.4
Housing	3.6	3.8	4.0	4.1	4.3	4.7
Gross VTTL	80.7	84.3	88.4	92.5	96.6	101.4
Deductions	5.5	6.0	6.5	7.1	7.6	8.8
Net VTTL	75.2	78.3	81.9	85.4	89.0	92.6

¹ Household component also includes estimates of expenditure by non-profit institutions serving households; estimates exclude expenditure on smuggled alcohol and tobacco.

Measure of Tax Collected

19. Figures for actual receipts of VAT are taken from HMRC's published Consolidated Fund figures. The receipts are adjusted, to reflect timing effects within each financial year, before being used in the model.

Results

20. Table 2 shows the VTTL, net VAT receipts and estimated revenue losses for the years 2002-03 to 2006-07. Due to substantial revisions to National Accounts data, which underlies the VTTL, these figures are different in level to those published at PBR 2006.

Table 2: VTTL, VAT receipts and revenue losses

Measure	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08 /2
Net VTTL (£bn)	75.2	78.3	81.9	85.4	89.0	92.6
Net VAT receipts (£bn) /1	63.6	69.1	72.7	72.9	77.3	81.0
Revenue loss (£bn)	11.5	9.2	9.2	12.6	11.7	11.6
VAT gap %	15.4	11.7	11.2	14.7	13.2	12.5

/1. Net VAT receipts are expressed net of payments and re-payments.

/2. A proportion of the VTTL estimate for the final year is based on a forecast.

21. The results show a fall in the percentage VAT gap between 2002-03 and 2004-05, but then a rise in 2005-06 with a subsequent fall in 2006-07. Overall the level of the VAT gap is lower in 2006-07 than 2002-03.
22. The movement in the VAT gap from one year to the next is determined by the growth in VTTL and the growth in receipts. Growth in VTTL is determined mainly by growth in the total value of transactions liable to VAT and, to a lesser extent, any changes that are made to the tax regime. Figure 1 shows that in 2006-07 receipts grew at a higher rate compared with net VTTL growth and so the VAT gap estimate shows a decrease.

Figure 1: Percentage growth rates of net VTTL and net VAT receipts



Error margins

23. The VTTL model and the top-down VAT Gap derived from it are broad measures, subject to a degree of uncertainty. They are based on an analysis of survey and other data, and include a number of assumptions and adjustments which add both random and systematic variation to the estimates. For the final two years' estimates, there is also an element of forecasting in some of the spending data, which introduces further random variation.
24. It is not possible to produce a precise confidence interval for the VAT revenue loss estimates. The VTTL estimate is constructed largely from ONS National Accounts data which are derived, in the main, from sample surveys and are thus subject to both sampling and non-sampling errors. The ONS does not publish error margins for the relevant input series and so it is not possible to construct

a precise estimate of the impact of these errors on the VTTL. However, a broad analysis of potential errors has shown that the margin of error could be up to ± 4 percentage points.

25. It is important to note that this error margin relates to the point estimates of the VAT gap. Part of the error is likely to result from systematic errors in the source data, which do not contribute to error bounds for year-on-year changes in the VAT gap. Therefore it is likely that the error margins on the year-on-year changes observed in the VAT gap will be smaller than ± 4 percentage points.

Annex 2

Australia. GST Annual Compliance Arrangements (ACA)

GST ACA Program overview

The primary purpose of a GST Annual Compliance Arrangement (GST ACA) is to improve the compliance relationship between the Australian Taxation Office (Tax Office) and a large corporate through a collaborative forward looking approach.

Traditional audit or verification methods examine historical tax information on a typically substantive basis. The GST ACA operates to move the compliance relationship to a more current and real time approach applying a broader concept of compliance assurance rather than only examining specific areas for compliance. The focus is on improving the relationship between the Tax Office and a large business to facilitate transparency and open dialogue between the parties. The parties agree to operate in an environment of open and full disclosure in relation to matters that are considered to materially impact tax compliance. The parties then seek to mitigate risks or resolve issues in real time.

The GST ACA relationship provides benefits that include:

- increased certainty through a real time compliance relationship delivering timely clarification, understanding and resolution of risks and issues;
- a more timely and participative approach to seeking taxation advice and rulings to clarify and resolve issues; including access to senior staff and decision makers;
- a move away from high resource, long term Tax Office compliance activities;

- improved communication pathways established to raise material tax risks and issues through senior contact and escalation points;
- establishing and maintaining Tax Office assurance of compliant tax outcomes providing access to concessionary approaches including agreed behavioural assessment for administrative penalties in the event of tax shortfalls and a reduced rate of General Interest Charge (provided there is no evidence of recklessness or fraud); and
- Opportunity to explore administrative solutions to compliance difficulties including increased thresholds to amend errors and mistake in previous returns in a current tax period.

GST ACA Entry Processes

Generally a GST ACA relationship is established and maintained in accordance with two foundation principles:

- the relationship is predicated on the taxpayer having a good **‘culture of compliance’** focused on effectively optimising voluntary compliance at the corporate level that cascades effectively to tax compliance, and
- That the Tax Office can obtain **‘reasonable assurance’** of the demonstrable existence and application of the good ‘culture of compliance’ through a review of appropriate frameworks, processes, evidence and information.

The ATO defines ‘reasonable assurance’ as an opinion, expressed in relation to the taxpayer’s operating environment, systems, frameworks and approaches that establish the culture of compliance, based on the accumulation of sufficient appropriate evidence that corporate governance, risk management, information systems and compliance frameworks are designed and operate to achieve optimal voluntary compliance at the whole of entity level and specifically in relation to taxation risk management and the development of taxation outcomes and returns.

Evidence of a good corporate culture of compliance is obtained through Tax Office review of taxpayer corporate governance, risk management, information systems and compliance frameworks under a **Governance Assurance Review** that examines evidence of how these are applied, implemented and incorporated into the operational environment. This is at a high level and examines the existence of an appropriate overarching focus on optimising voluntary compliance.

The establishment of a GST ACA includes bringing the Tax Office view of GST compliance to a current position through a **GST Compliance Assurance Review** so that going forward the focus can be on risks and issues as they arise. This sets up the basis of the forward looking joint process to consider and resolve matters in a real time compliance environment.

The Tax Office effectively signs off on the achievement of GST compliance to the extent that full and true disclosure of material risks and issues has been provided including any risks or issues addressed under entry or assurance maintenance processes. This approach continues throughout the operational term of the GST ACA. The GST level review consolidates the Tax Office view of the GST compliance relationship to the point of GST ACA entry

Top 50 Alternative

In May 2008, the Commissioner launched the income tax Annual Compliance Arrangement advising that this would be available to Australia's top 50 corporate entities. The GST ACA approach for the top 50 provides the option to adopt a differentiated GST ACA entry model and provide a similar experience to that applied in the income tax ACA entry process.

Under this approach, before agreeing to sign a GST ACA, the Commissioner requests a letter from the CEO or CFO confirming that the business has complied with the tax governance guidelines as outlined in the Tax Office 2006 Large business and tax compliance booklet.

The GST ACA is signed early in the process with initial compliance and governance assurance reviews conducted under the terms of the GST ACA. The review processes are essential to establishing the assurance based relationship and the environment in which the Commissioner agrees to provide concessionary approaches supporting and encouraging optimised voluntary compliance.

Ongoing Maintenance of a GST ACA

The GST ACA terms include an annual review process whereby we meet with the taxpayer to consider annual assurance maintenance processes, whether the relationship objectives are being met and how well it has been managed as a basis on which to then formally agree to continue with the GST ACA relationship for the next 12 month cycle.

GST ACA Market

We are currently focused on promoting the GST ACA to the large business market. It is available to both the Australian corporate and government sectors.

The ATO is also exploring a GST ACA program for taxpayers in the Small and Medium Enterprises market with a turnover range from \$A100-250 million and anticipate further differentiated compliance arrangement approaches for taxpayers below the \$A100 million threshold.

How many GST Compliance Arrangements are in place?

The GST ACA is based on the Forward Compliance Arrangements (FCA) established by the Tax Office GST business line in 2006.

The Tax Office has partnered with 3 large businesses and 1 large State Government Department to enter FCA's, the ANZ Bank was the first starting with GST and then adding Fringe Benefits Tax, BP Australia followed with GST and Excise, the State Government Department signed up for GST and a large manufacturer was the first with an income tax FCA.

The GST ACA was launched in 2008 and the first arrangement was signed with Integral Energy, effective from 1 November 2008. The ATO is currently working with three top 100 companies with 2 GST ACA's due for signing in the first half of this year and the third in the second half. We have undertaken a large client visit program to introduce the GST ACA to suitable companies. A number of those visited are interested in the product.

GST ACA Overview

An overview of the process is available via the Tax Office internet site at: <http://www.ato.gov.au/content/downloads/lcm00168324gstaca.pdf>

Annex 3

ATO: Cash Economy Project Evaluation with Specific Reference to Impacts on VAT/ GST Revenue and Compliance

This case study outlines the ATO's risk treatment strategy for its cash economy project presented against the background of its formal four phase risk treatment evaluation methodology:

Phase 1: Articulation of the compliance risks involved

1) What is the compliance risk to be addressed?

The ATO adopts a compliance approach that changes behaviour, ensures that voluntary compliance is sustained, and which is recognised by the community as a credible response to non-compliance. For this project, the key risks were identified as:

- Continued community acceptance of participation in the cash economy encourages non-compliant behaviour;
- The community may perceive the ATO as unable to detect and respond to non-compliance in the cash economy;
- Visible non-compliance will erode the integrity of the tax system.

2) Who's involved? What are the behaviours and drivers associated with the risk?

The primary form of non-compliance is failure to declare cash income. Registered participants may also fail to file returns or file on time, fail to accurately report transactions and may not pay on time. Often cash economy participants are poor record-keepers. They may also be non-compliant with other regulatory obligations.

This behaviour often results from a desire to minimise tax obligations coupled with a perception that there is only a small chance that non-compliance will be detected. Behaviour may be driven by low margins and the need to remain competitive. It is often evident in transactions between businesses and consumers, as consumers seek price discounts. In some instances business operators do not fully understand their tax obligations and may perceive the system to be too difficult or costly to comply with. They are often more focused on the operating side of their business.

Consumers may demand discounts for cash payments and make no connection with tax compliance considerations as they have no obligations in this situation. They may perceive little risk for themselves other than having no evidence of payment if the goods or services are not of an expected standard. Many people are also prepared to pay cash for priority access to tradespersons in periods of high demand.

Behaviour is often driven by the perception that everyone benefits from the cash economy and by a failure to recognise the broader impacts in terms of the Government's ability to provide a proper level of services to the Australian community.

The community is often reluctant to report cash economy participants and may accept such participation to a point. However, the community does not accept blatant non-compliance or conspicuously-wealthy lifestyles funded by undeclared cash. Nor does it accept under-reporting of income in order to receive social security benefits or avoid child support payments.

Phase 2: Definition of the outcomes sought and the strategies to achieve them

The outcomes identified as being sought from this initiative were as follows:

- The ATO demonstrates its ability to detect and respond to the cash economy;
- Voluntary compliance by participating taxpayers is sustained;
- Appropriate community education reduces tolerance of participation in the cash economy;
- The community maintains its confidence in the integrity and fairness of the tax system.

An integrated package of strategies was developed, including the following elements:

- **Enforcement:** Identifying those who present a higher level of risk, by making increased use of the ATO's ability to cross-match third party and other data to identify likely non-compliance. A differentiated approach that escalated depending on the taxpayer's attitude to non-compliance was adopted and the strategies deployed ranged from letter campaigns suggesting voluntary disclosure, reviews, desk-based and comprehensive audits, administrative penalties and prosecution referrals.

- **Influence and leverage:** Entailed initiating less costly and leveraged activities that over time should encourage greater voluntary disclosure from participants large in number but relatively low in terms of revenue.
- **Communication:** Use of a variety of channels to educate and inform the community on: 1) the ATO's ability to detect and respond to non-compliance; 2) the assistance it provides; 3) its collaboration with representatives of high risk industries and the tax profession (e.g. using joint press releases); 4) inherent risks posed to consumers by cash jobs; and 5) the cost to the community of non-compliance.
- **Education:** Entailed a range of educational activities including letters, calculators, industry benchmarks, seminars and advisory visits, used either individually or as part of the ATO's Small Business Assistance Program.
- **Engagement:** Engaged of key stakeholders, including tax profession and industry representatives by working collaboratively to improve the ATO's understanding of the cash economy, developing industry benchmarks and related assistance products, and co-designing appropriate responses and building on going working relationships.

Phase 3: Design of indicators (to gauge effectiveness of the risk treatment strategy)

1. What indicators will we use?

A broad range of indicators were identified to gauge the effectiveness of the risk treatment strategy:

- 1) changes to indicators of tax performance at the individual and industry level;
- 2) changes to rates of filing performance for business activity statements;
- 3) payment of outstanding liabilities by participants in the cash economy;
- 4) trend in the number of reports received on the tax evasion hotline;

- 5) responses to various perceptions surveys involving key stakeholders;
- 6) frequency and tone of media comment relating to the cash economy;
- 7) levels of industry “engagement” in the management of the cash economy; and
- 8) levels of compliance by cash economy participants with other obligations (e.g. welfare).

Phase 4: Determining the extent of improved effectiveness achieved

1. Have we been effective in achieving our desired outcomes? How do we know?

Focussed attention to assessing the impacts of the strategy revealed indications of increased voluntary compliance, demonstrated through reporting of cash transactions, return filing and payment obligations by those operating in the cash economy. Specifically:

- **Return filing:** Success is evident from an increase in the number of activity statements overall and filed on time. On time filing of quarterly activity statements increased by 12% after the ATO data matched information from shopping centre operators.
- **Correct reporting:** Success is evident from increases from increases in the trend, relative to other industries, of amounts reported by those in the targeted industries. Observations of the restaurant and café industries and the building industry (sub-trades) showed:
 - Increased GST (VAT) reported for businesses audited in 2006-7. While the year’s average for quarterly GST liabilities for all industries increased by 9.5% and 9.7% in the June and September quarters respectively, taxpayers subject to intervention recorded up to a 60% increase in average net GST (VAT) in the June quarter.
 - Average net GST (VAT) in the June 2007 quarter increased by 25% by taxpayers found to be compliant as a result of the ATO’s interventions, suggesting that its audit activities had

some indirect effect by increased the GST reported, even by taxpayers found to be compliant.

- **Community tolerance:** Community reports concerning alleged cash economy activity to the ATO's tax evasion hotline increased by 74.2% in 2007-08, over the number in 2005-06, reflecting declining community tolerance of cash economy activity.
- **Community confidence and engagement:** Evidence of increasing confidence and engagement from community sectors (e.g. positive coverage of ATO's activities in professional media, improved business perceptions survey results, and increased collaboration with trade associations).

2. Where to from here?

Building on these outcomes and the experience gained, activities for 2008-09 will see development of the help and education activities that provide opportunities for self-correction and voluntary disclosure. However, the importance of maintaining a visible audit presence will remain and the emphasis on improved risk detection will be aided by further expansion of data matching capabilities, with some attention given to identifying situations of conspicuous consumption that are not matched by taxpayers' reported incomes.

Measuring the key elements of our response over the longer term will give us a better indication of whether changes in compliance behaviour have been sustained. Intelligence from the ongoing evaluation will help shape our strategies. For example, we expect to see an increase in the number of reports of tax evasion to our hotline as community gains confidence in how we use this information, our systems will monitor and record the volume and nature of accesses to specific website products, and there will be an expansion of data matching, providing us with better risk detection tools, especially in relation to taxpayers whose lifestyle appears out of step with their reported incomes.

Source: ATO survey response and related inquiries.

Annex 4

Comparative summary of country responses in key areas of administration

VAT registration

Country	Nature of checks conducted to validate integrity of registration application, (including whether they entail: 1) proof of identity–type checks; 2) a requirement for an established bank account located in your country; 3) checking with related income tax records; 4) actual visits to business premises; and 5) any other special activities or requirements on applicants.)
Australia	<p>The Australian tax system allows for an entity in business to apply for an Australian Business Number. The legislation also allows for some entity types to register regardless of whether they are in business e.g. Corporations Law Companies. Registration for Goods Services Tax (GST) is a tax role linked to an Australian Business Number and is either voluntary under a specific threshold or compulsory over that threshold (or if the business is legislatively required to register regardless of threshold). Registering for the GST entitles an entity to claim input tax credits for GST paid to suppliers of goods and services.</p> <p>Proof of identity - Types of checks: Entities eligible to register for either an Australian Business Number or Goods and Services Tax are sole traders, companies, partnerships, trusts, superannuation funds and government. There are a range of eligibility and identity requirements. The entity must satisfy legislative, business/enterprise tests as well as underlying identity validation.</p> <p>Business eligibility checks: To be entitled or eligible for an ABN, the entity must meet one of the following criteria:</p> <p>Criteria 1: The entity can answer 'yes' to the following statements:</p> <ul style="list-style-type: none"> • Its activity is carried out in the: form of a business; nature of trade, or the form of a regular or continuous grant of a lease, licence or interest in property. • Its activity is carried out in Australia or it makes supplies that are connected with Australia. • Its activity is not a private recreational pursuit or hobby. • There is a reasonable expectation of a profit being made (only for partnerships where all or most of the partners are individuals). <p>Criteria 2: An entity is also entitled to register, regardless of satisfying the enterprise test if the entity is:</p> <ul style="list-style-type: none"> • a company incorporated under the Corporations Act in Australia • a charitable institution or trustee of a charitable fund in Australia • a deductible gift recipient in Australia, or • a religious institution in Australia. <p>An entity that does not meet criteria 1 or 2 is not entitled to an ABN.</p>

	<p>GST registration: Whilst there is an option for an entity not to register for GST, an entity must register if it is carrying on an enterprise and either: 1) has an annual turnover of \$75,000 or more (\$150,000 or more for non-profit organisations) or 2) is required to register because of a special rule. An example would be if you provide taxi travel as part of your business, regardless of your annual turnover. Taxi travel means transporting passengers by taxi or limousine for fares.</p> <p>Proof of identity checks: Proof of identity is evidence provided to the ATO of the applicant's existence and identity. For individual or sole traders, we collect proof of the identity of the individual making the application (e.g. birth certificate). This verifies the identity through third party validation.</p> <p>For all other entity types (e.g. companies, partnerships, trusts, superannuation funds and government), we collect information and link the business registration to at least one individual that sits behind the business entity. This will be at least one individual, or other listed persons, responsible for the business entity. A range of other information is collected that verifies the business entities structure (e.g. Australian Private Company), its trading name and various addresses as well as the authorised contact person.</p> <p>Is there a requirement for an established bank account located in your country: There is no legal requirement to provide a financial institution account number for an entity. However, the structure of ATO administrative systems is such that refunds from the ATO will only be paid directly into a recognised financial account located within Australia.</p> <p>Checking with related income tax records: There is no cross referencing of other tax records at the registration stage of the process.</p> <p>Actual visits to business premises: There are no initial visits to business premises at the time of registration. However, the entity may make a request for a workplace visit by the ATO. These visits are designed to assist the new entity to comply with taxation and superannuation obligation. The service is provided free of charge and can be provided at any location in Australia.</p> <p>The meeting generally discusses specific tax information which include:</p> <ul style="list-style-type: none"> • registering for an Australian business number (ABN) • understanding and registering for the goods and services tax (GST) • understanding employer obligations (pay as you go withholding, superannuation guarantee, and fringe benefits tax) • understanding superannuation obligations • understanding activity statement and record keeping requirements and make use of electronic products such as e-record • understanding the range of other taxes and obligations that might apply to your business, and • filing activity statements online via the Business Portal (includes set up & registration).
Austria	Visitation at the place of business after start of business, proof of identity (passports) and use of forms for capturing detailed information.

Canada	CRA validates the integrity of VAT registration applications through several means:
	<ol style="list-style-type: none"> 1) proof of identity - Incorporation documents are required for corporate VAT registration, while social insurance numbers of individual (proprietorship) registrants are required and then validated through our income tax system. For partnerships, agreement documentation as well as the social insurance numbers of the partnership members are requested, however not legally required. 2) There is no requirement to have a bank account in Canada. 3) Other – Income tax records are cross-referenced with VAT data to validate common data fields. Limited visits to business premises are conducted. Further analysis is conducted through Enhanced Registration Review whereby client identification information is validated. Referrals from this review are then analysed further through different programs such as Audit Registration Review and then, if necessary to High-Risk Analysis Teams. 4) Actual visits to business premises are conducted through the course of audit as necessary.
Ireland	<p>We have resources dedicated specifically to Registration. VAT Registration is treated with particular care. Specifically we check:</p> <ul style="list-style-type: none"> ▪ The registration number being used by the applicant ▪ In the case of an individual or partnership the registration numbers and the Common Registration System (CRS) for any records of relationship with other cases. ▪ The PAYE record for any directorship(s) ▪ In the case of companies the registration number of each director ▪ The CRS record of each of these for any “Relationship” records ▪ That the appropriate person signs the registration form. ▪ The address of the business. We consider if it appears appropriate for the type of trade or service being carried on. We establish that the business is in fact being carried on at that address. ▪ The description of the main business activity. If the nature of business is not clear from the form, the applicant or agent will be contacted for a precise description of the business activity. ▪ The tax history of the sole trader, directors, and partners as applicable. ▪ We maximise the use of local & official knowledge to determine that a genuine trade has commenced (or is about to commence). ▪ Where there is a doubt about the bona fides of the application or a suspicion that the application may be bogus or where there is no clear indication that the individual /company has or is about to commence a taxable activity, the case will be selected for a pre-registration visit prior to the granting of the VAT Registration. ▪ In certain circumstances it may be necessary to ask an applicant to provide security, in the form of a bond or guarantee from a bank or other financial institution. ▪ All applications for registration are approved at Manager level.

TOPIC 2 (OECD)

<p>United Kingdom</p>	<p>Regardless of the manner of applying for registration, HMRC carries out a number of risk-based checks at the point of registration. The purpose of these checks is to allow us to identify genuine taxpayers and register them as quickly as possible. We do this by:-</p> <ul style="list-style-type: none"> • verifying the validity of the application; • verifying the validity of the applicant; • identifying whether the applicant has a previous history with HMRC; and • if they have a history, to assess their previous compliance. <p>Re 2) requirement for an established bank account located in your country: applicants are asked to provide details of a UK bank or building society (BS) account. This must be in the name of the business for which the application is made.</p> <p>Re 4) actual visits to business premises: in selected cases –. The purpose of such visits is to check that the premises and activities seen are consistent with, and suitable for the carrying on of, the details provided by the applicant.</p> <p>Re 5) any other special activities or requirements on applicants: see description below.</p> <p>There are potentially three levels of checking of applications, determined by the risk HMRC considers they represent. The initial, semi-automated risk assessment process applies to all applications.</p> <p>The VAT registration process is as depicted below</p> <p>Trader application (paper or online)</p> <p>↓</p> <p>Registration Unit Initial data capture, matching and risk assessment</p> <p>Stage 1</p> <p>↓↑</p> <p>Special Risk Referral Team</p> <p>Stage 2</p> <p>↓↑</p> <p>Specialist Intelligence Team</p> <p>Stage 3</p> <p>During the initial Stage 1 checking, the Registration Units may contact applicants to ask for further information before continuing to process the application. Around 95% of applications require no further risk assessment and the processing is completed. The rest are referred for Stage 2 checking. Only around 1% of all applications are referred to the Specialist Intelligence Team.</p> <p>All applications are finalised through the Registration Unit, so after stage 3, an application may be returned directly to the Registration Units. If there is insufficient evidence to refuse an application but HMRC still has concerns about a trader, it can impose conditions on the registration, such as requiring a financial guarantee or shortening the first VAT period to enable the Department to make an early assessment of compliance.</p>
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Annex 5

Penalty framework for VAT Offences

1. Failure to pay VAT on Time

Country	Sanction normally applied	
	First offenders	Repeat offenders
Australia	General interest charge	General interest charge
Austria	Interest charge	
Canada	Interest charge	Interest charge
Ireland	Statutory interest of 0.0273% per day	Statutory interest of 0.0273% per day, plus increased chance of being audited
UK	First default—issue of surcharge liability notice with warning of a surcharge of 2% of tax outstanding	Subsequent defaults—5%, 10%, and 15% of tax outstanding

2. Failure to correctly report liabilities - careless actions

Country	Sanction normally applied	
	First offenders	Repeat offenders
Australia	Actions deemed 'careless'—25% of shortfall. Actions deemed grossly careless (reckless)—50%.	Generally 20% uplift if entity had prior imposition of same penalty
Austria	??? specify typical amount	On third offence, additional 50%
Canada	Nil (except where gross negligence occurs)	Nil (except where gross negligence occurs)
Ireland	Statutory interest plus 40% of shortfall	Statutory interest plus substantially increased penalties
UK	Mis-declaration penalty (subject to objective tests) of 15%	Repeated mis-declaration penalty (subject to objective tests) of 15%

3. Failure to correctly report liabilities - deliberate actions

Country	Sanction normally applied	
	First offenders	Repeat offenders
Australia	75% of shortfall	Generally 20% uplift if entity had prior imposition of same penalty
Austria	2% additional amount	4% additional amount
Canada	Greater of \$250 or 25% of shortfall	Same as for first offenders
Ireland	Statutory interest plus up to 100% penalty	Statutory interest plus up to 100% penalty
UK	Either mis-declaration or civil evasion penalty of up to 100%	Either mis-declaration or civil evasion penalty of up to 100%

4. Failure to correctly report liabilities - fraudulent schemes

Country	Sanction normally applied	
	First offenders	Repeat offenders
Australia	50% of shortfall amount. 25% if taxpayer had a reasonably arguable position in case of avoidance scheme)	Generally 20% uplift if entity had prior imposition of same penalty
Austria	Penalty up to 2 times tax (imprisonment also possible with prosecution)	Penalty up to 2 times tax (imprisonment also possible with prosecution)
Canada	Penalty ranges from 50-200%	Same as for first offenders
Ireland	Statutory interest plus up to 100% penalty and likelihood of prosecution	Statutory interest plus up to 100% penalty and likelihood of prosecution
UK	Civil evasion penalty of up to 100%	Civil evasion penalty of up to 100%

TAX EVASION MEASUREMENT: THE URUGUAYAN CASE

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Contents: Summary - 1. Introduction. - 2. Method used in Uruguay.- 2.1 The VAT case.- 2.2 The case of the tax on industry and trade income (IRIC) or tax on economic activity income (IRAE).- 2.3 The case of the tax on individuals' income (IRPF) .- 2.4 Method limitations.- 3. Obtained results and dissemination.- 4. Conclusions.- 5. Bibliography.- Annex 1.- Annex 2.

SUMMARY

The purpose of this paper is to present the model used in Uruguay to measure tax evasion.

Firstly, a series of theoretic concepts used herein are defined, such as what we understand by potential collection for the purposes of measuring the subject matter of this work and determining the method used for estimations.

In Uruguay, the General Revenue Office (DGI, in Spanish) has been using a method called "theoretic potential" or "indirect method" to measure the potential collection of certain taxes. Based on such method, such inputs as, mainly, the macroeconomic aggregates of the National Account Systems are used, prepared by the Central Bank of Uruguay (BCU, in Spanish), as well as micro-data provided by the Home Survey prepared by the National Institute of Statistics (INE, in Spanish).

Once the potential collection of a certain tax is obtained, it is then compared against its actual collection, thus arriving at a measurement

of tax evasion, whether as a sum or a percentage, over the potential collection.

Currently this method is used to measure the evasion of the value-added tax (VAT), the tax on industry and trade income (IRIC, in Spanish) and/or the tax on economic activity income (IRAE, in Spanish), as per the period considered for measurement. It has also begun to be used to measure the evasion of the tax on individuals' income (IRPF, in Spanish), although in this case the study is still in its early stages.

Subsequently, the procedures followed in the study of the above mentioned taxes are explained in detail, as well as which are the necessary sources to obtain information.

Lastly, the results obtained in the VAT evasion series are presented for the 2000 - 2008 period.

1. INTRODUCTION

Within the frame of the General Revenue Office's mission of "assuring the collection of the State's resources through the effective application of the regulations on internal taxes that fall within its competence, by promoting the voluntary compliance of taxpayers"¹, the fight against tax fraud and default is among the objectives presented.

To this end it is necessary to know the magnitude of tax default, which is achieved by comparing the potential collection against the actual collection, thus obtaining the tax evasion rate.

By potential collection it is understood the collection that could be actually obtained if all legally bound taxpayers declared the total taxes assessed in their activity. This concept is exclusive of tax deductions or exemptions that certain taxpayers may enjoy, which are considered as components of tax expenditure.

The question remains being how the potential collection of a tax may be measured.

On this regard, the methods mostly used by tax analysts are two: i) direct and ii) indirect.

¹ Decree 192/006 – Mission, objectives, commitments and organizational structure.

The direct method consists in measuring evasion through the examinations performed on a random sample of individuals or corporations, to then extrapolate the results to the total population.

The indirect method or theoretic potential consists in the estimation of the potential collection through the use of external data sources.

Both methods present advantages and disadvantages, which should be known before making a choice in order to achieve the most adequate results.

The direct method requires that the sample being used should be statistically representative, and the results will depend on the quality of the conducted audits. Alternatively, in the indirect method the quality of the results will largely depend on the reliability of the estimations provided by the National Account System and, additionally, in the case of the IRPF, the reliability of Home Surveys.

Once the method is defined and the sum or the evasion rate is obtained, this information is of vital importance for tax administrations, for it allows them to better target the resources allocated for examining certain taxes or activity sectors, and thus achieve efficiency in fulfilling their objectives and missions.

2. THE METHOD USED IN URUGUAY

The General Revenue Office (DGI) has estimated the evasion of the value-added tax (VAT), the tax on industry and trade income (IRIC) and the tax on economic activity income (IRAE), and the tax on individuals' income (IRPF), using the indirect method in all cases. The reason for choosing such method is because the direct method demands a greater amount of resources, whether with relation to the design of representative samples or the examination itself. In general, ordinary examinations entail a biased selection that may deviate from what would be desirable to attain from the representative sample.

2.1 The VAT Case

The estimations of VAT evasion held by the administration are based on the estimation of the theoretical base of the tax as provided from the National Account System.

The potential collection is determined by estimating the non-deductible VAT, which originates in the final consumption of taxed goods and services, in the purchase of taxed goods and services used as intermediate inputs or investment goods for the production of tax-exempted goods and services.

The main components that originate non-deductible VAT payments are:

- The final consumption of taxed goods and services by homes
- The Government's consumption
- The Government's investment
- The taxed intermediate consumption used to produce tax-exempted and export goods and services
- The investment in taxed goods intended to produce tax-exempted and export goods and services

The potential collection of each component is equal to its taxable base times the average rate:

Potential VAT collection per component $_i$ = Component's base $_i$ x average rate $_i$

The aggregate of each component considered results in the total potential VAT collection:

Potential VAT collection = \sum potential VAT collection per component $_i$

With the resulting tax evasion rate:

Evasion = Potential VAT collection – Gross effective VAT collection

The information requirements necessary to estimate the collection of the above mentioned components are detailed².

To quantify the *VAT generated from home consumption*, the following variables were considered:

² For more details on the measurement per component, see Annex 1.

Vselbaira	Data	Information sources
Final home consumption expenditure	External	Banco Central del Uruguay (BCU)
Composition of taxed and tax-exempted goods and services expenditure	External	National Institute of Statistics (INE)
Expenditure of goods and services purchased from small companies and taxpayers in the self-employed workers scheme	Internal research	General Income Office (DGI)
Uruguayans' consumption expenditure abroad	External	BCU
Foreigners' consumption expenditure in Uruguay	External	BCU
Average VAT rate	Internal research	DGI, INE, Ministry of Tourism and Sports (MINTUR)

Based on the final private consumption expenditure of National Accounts, the potential taxable base was estimated for each year.

This rate required some adjustments as a result of considering tourists' expenditure in the country and a discount of Uruguayan homes' expenditure abroad; and also small-sized companies and self-employed workers' scheme taxpayers who do not generate the VAT from their sales but from their purchases.

Once the components of the home consumption base were defined, the effective average rate of the VAT applicable to each of them in each year of the period was determined, to later estimate the potential collection of this tax.

VAT generated from Government's consumption

The estimation of the VAT generated from the purchase of goods and services for Government consumption was conducted based on the following variables:

Variables	Data	Information sources
Intermediate consumption by Government	External	BCU
Operating expenses of the Central Administration	External	General Government Accountability Office (CGN)
Average VAT rate	Own research	CGN, DGI

The component considered in the Government's consumption expenditure³ was the intermediate consumption, because it is representative of the VAT-generated expenditure.

³ Includes: the Central Government, Departmental and Social Security Governments (only for the administration services of the pension system). The institutional agent Government is exclusive of public companies, which are considered private agents.

To the extent that the information in National Accounts gives no annual detail of the structure of this intermediate consumption, the VAT average rate applicable each year to the Government's consumption was determined from the composition of the operating expenditure of the Central Administration⁴ (with the rate corresponding to each expenditure item).

VAT generated from Government's investment

In the case of the Government's investment, the estimation of potential generated VAT was conducted using the following variables:

Variables	Data	Information sources
Gross formation of Government's fixed capital	External	BCU, public companies
Investment expenditure of the Central Administration	External	CGN
Government's imports of capital goods	External	National Customs office (DNA)
Average VAT rate	Own research	CGN, DGI

To determine the VAT potential base associated with the Government's investment, the value of the gross formation of fixed capital (FBKF, in Spanish) of the Public Sector of National Accounts was used. Since this information includes public companies, the investment performed by the latter⁵ was discounted, calculated from the Charts of Property available for Use included in their Balance Sheets.

The VAT average rate applicable to this investment was calculated based on the composition of the investment expenditure of the Central Administration, obtained from the Accountability and Budget Execution Balance report, which presents the investment amounts broken down by program-project and by expenditure item.

VAT generated from the intermediate consumption used to produce tax-exempted and export goods and services

Pursuant to the provisions established in the effective legislation, the VAT included in the purchase of goods and services made by companies constitutes deductible VAT if the goods and services are used for resale or manufacture of taxed products. Where produced

⁴ The Central Administration includes the following institutional units: the Executive Branch, the Legislative Branch, the Judicial Branch, the Government Accounting Office, the Court of Elections, the Administrative Litigation Court, the National Administration of Public Education, Universidad de la República and the Child and Adolescent Institute of Uruguay.

⁵ The public companies considered were: ANCAP, ANTEL, ANP, OSE and UTE.

goods and services are intended for export, the company may opt between discounting the VAT of purchases associated with the payment of other taxes (including the VAT payable for market sales, if the company also produces goods for the local market⁶) and requesting credit certificates⁷. Alternatively, the VAT included in the purchases of goods and services intended to manufacture tax-exempted products cannot be discounted.

To the extent that the collection considered in this paper is gross, the VAT associated with purchases used to produce tax-exempted goods and services as well as the VAT related to export operations were treated as potentially non-deductible VAT.

The estimation of the potential VAT associated with the intermediate consumption used in the production of tax-exempted goods and services or those intended for the external market was performed using the following variables:

Variables	Data	Information sources
Intermediate consumption per economic activity type	Own research	BCU, DGI, DNA
Exports by economic activity type	External	DNA
Percentage of tax-exempted sales by economic activity type	Own research	DGI
Average VAT rate	Own research	BCU, DGI

The determination of the potential base of this non-deductible VAT component required to establish firstly what proportion of the intermediate consumption of the different sectors was used each year in the production of goods and services intended for the local market, and what proportion was allocated to produce export goods. These percentages were applied to the data on intermediate consumption by activity class as obtained from the National Accounts⁸, thus determining the amount used in the production of goods and services

⁶ In this case, the company may discount the VAT of purchases from the VAT of sales corresponding to the operations performed in the local market and use the excess, if any, to pay other taxes or future year taxes (in the case such credit is not used up within the relevant period).

⁷ The credit certificates may be used by the company to pay taxes included in the bills of their goods and service providers, provided that the same are a direct integral part of the cost of the exported goods (in this case, the company pays to its provider the net amount of the bill and delivers the requested credit certificates to the DGI).

⁸ Like the other National Account variables, the amounts of intermediate consumption estimated by the BCU include the VAT, so it was necessary to calculate for each year the corresponding non-VAT amounts using the respective sector average rates of this tax.

targeted at the local market and the amount used in manufacturing export products.

Once the intermediate consumption associated with the production targeted at the local market was defined, the percentage used each year in the manufacture of tax-exempted products was established.

VAT generated from the investment targeted at producing tax-exempted and export goods and services

The last component that is considered as a potential base of non-deductible VAT was the taxed private investment⁹ intended to produce tax-exempted and export goods and services. Its estimation drew on the following variables:

Variables	Data	Information sources
Fixed capital gross formation in the private sector	External	BCU, INE, Ministry of Livestock, Agriculture and Fishery (MGAP)
Fixed capital gross formation of public companies	External	Public companies
Fixed capital gross formation by activity class	Own research	BCU, DGI, INE, MGAP
Imports of capital goods by the private sector	External	DNA
VAT average rate	Own research	BCU, DGI

Since the FBKF data from the National Accounts present a greater aggregation than required, the investment amount contributed by each sector had to be determined by resorting to additional information sources, regrouping activities under new categories¹⁰.

Sector	Source	Available period
Agriculture and livestock	OPYPA - MGAP	2000-2006 ¹
Manufacturing industries	INE	2001, 2003-2005
Electricity, gas and water	INE	2001, 2003-2005
Trade, restaurants and hotels	INE	2001, 2003-2005
Transportation, storage and communications	INE	2001, 2003-2005
Others	Own research	-

⁹ Public companies' investments are included in this category.

¹⁰ The need to regroup the sectors originated in the lack of available information for all activity classes.

As it happens with public investment, part of the private investment benefits from tax exemptions¹¹.

After obtaining the taxed investment of each activity sector, the portion used in producing goods intended for the local market was determined, as well as the portion used in manufacturing export products.

Subsequently, from the investment amount allocated by each sector to the production of goods and services for the local market, the portion of such investment used each year in the manufacture of tax-exempted products was determined.

Once the potential collection per component is obtained, it is compared against the effective collection, considering that the local VAT liquidation is carried out in the month following the month in which the originating act takes place; therefore, the effective collection should be considered as accrued.

2.2 The case of the tax on industry and trade income (IRIC) or tax on economic activity income (IRAE)

Using the indirect method for the study of the income tax evasion also implies obtaining the potential collection thereof. To this end, the tax income must be approximated to the relevant macroeconomic aggregate, which in this case is the Gross Operating Surplus (EEB, in Spanish), that is, the balance corresponding to the income generating account resulting from the National Account System (the Gross Added Value minus Remunerations minus taxes net of subsidies).

The taxable amount derives from the legal regulation, the maximum being between the taxable income, if positive, and zero, in the event of loss.

MI = Maximum {RF, 0}

As approximation to the taxable amount, the operating surplus (EEB) is used; this results from the difference or balance in the income

11 The Act 16.906, effective since 1998, contains rules relating to the declaration of interest of some investments performed in the national territory by both national and foreign operators who are engaged in industrial or agriculture and livestock activities. These investments comprise: the acquisition of personal property directly allocated to the production cycle, the purchase of equipment for electronic data processing, fixed improvements intended for industrial and agriculture-livestock activities, and some intangible goods, among others.

generating account of the National Account System. The same is the Gross Added Value (VAB, in Spanish), which is defined as the Gross Production Value (VBP, in Spanish) minus the Intermediate Consumption (CI, in Spanish), after remunerations (RA, in Spanish) are deducted, minus taxes on production net of subsidies (T-S).

$$EEB = VBP - CI - RA - (T-S)$$

The taxable amount is determined using the EEB, along with the relevant adjustments¹², which results in:

$$MI = EE - RE (-/+) AF - GNA + DI$$

The tax-exempted income (RE, in Spanish) considered is, among others:

- Free-trade zone users
- wood producers
- taxpayers covered in Letter E
- self-employed workers' scheme taxpayers
- taxpayers of other taxes not included in IRIC/IRAE

The Fiscal Adjustments (AF, in Spanish) correspond to the fiscal adjustments that the tax regulation requires to be made in order to determine the taxable income. Likewise, non-admitted expenses (GNA, in Spanish) are actual expenses incurred (which are part of the EEB) but the deduction of which is not allowed to determine the taxable income.

Under the regulation, increased deductions (DI, in Spanish) are defined as certain expenses that may be computed by more than one time their actual amount, and are:

- expenses for training staff in areas considered a priority
- expenses for payment of fees to technicians for their assistance in areas considered a priority
- expenses incurred by companies to obtain the certification under internationally admitted quality standards
- expenses incurred to obtain accreditation of laboratory trials
- expenses incurred in the purchase of labeled seeds by agriculture producers

12 For a greater detail of equations, see Annex 2.

- expenses for incorporating animal genetic material
- expenses for software services rendered by those who are subject to this tax

Once the taxable amount is obtained, it is multiplied by the tax rate, resulting in the potential collection. To calculate the evasion amount, the potential collection is compared against the effective collection, the latter being that declared by taxpayers.

Effective IRIC/IRAE= declared IRIC/IRAE

The tax evasion rate,

$$Tasa\ de\ evasi3n_t = \frac{(IRICP_t - IRICE_t)}{IRICP_t} = \frac{Evasi3n\ IRIC_t}{IRICP_t}$$

$$Tasa\ de\ evasi3n_t = \frac{(IRAEP_t - IRAEE_t)}{IRAEP_t} = \frac{Evasi3n\ IRAE_t}{IRAEP_t}$$

where IRICP and IRAEP pertain to the *potential* collection of IRIC and IRAE, respectively, while IRICE and IRAEE pertain to the *effective* collection of IRIC and IRAE, respectively.

The information sources required to perform the estimation were both internal of the administration itself and external.

- Internal
 - Taxpayers' returns, CEDE and NO CEDE
 - Tax returns of agents responsible for withholdings
 - Payment of taxes by taxpayers
- External
 - EEB obtained from national accounts of the National Account System 1993 (BCU)
 - Economic Activity Census, 1998 (INE)
 - Economic Activity Survey, 2002, 2003, 2004, 2005, 2007 (INE)

2.3 The Case of the Tax on Individuals' Income (IRPF)

The Uruguayan IRPF has been recently created, and its implementation began with the coming into force of the New Tax System in July 2007.

As noted in the introductory summary of this document, the process of estimating the IRPF evasion is in its early stages. Firstly, the analysis of the category II of the tax is presented, which comprises work income and, within this category, the study focuses on the income deriving from salaried work relationships.

The consulted sources comprise the DGI's databases (which receive data from collaborative entities and the taxpayers' returns), the Ongoing Home Survey (ECH 2008) published by the INE and the data from the National Accounts published by the BCU.

The purpose of arriving at a potential collection of the tax based on ongoing surveys has the advantage of following up the evasion calculation for the subsequent years, because these surveys are performed continuously and will allow making an adequate calculation of the current design of computable income for the tax, as well as having the possibility of changing parameters resulting in modifications in the design or the mechanics of the tax in the future.

A two-stage calculation proceeding is followed: a first stage for calculating evasion resulting from the informal economy, understatements or tax fraud; and a second stage for calculating evasion from default or omission.

The first stage consists of two alternative mechanisms, the first one concerning the nominalization of personal income comprised in the ECH, the adjustment thereof by way of a coefficient deriving from the existing income gap between the Survey and the National Accounts (as a way to detect any understatements in the Survey), in order to arrive at a calculation of a potential tax from the income declared in the Survey, adjusted as per the National Accounts.

The second mechanism consists in the distribution of the Survey income (without a previous adjustment for National Accounts) in deciles or bands, to then proceed to make an analogous calculation based on the income declared before the DGI, as a way to identify the tax evasion phenomenon by comparing both income distributions.¹³

Once both income structures (that corresponding to the ongoing survey base and that pertaining to DGI's statement base) are obtained, an

¹³ *The identification of the "evasion" phenomenon through the detection of a disarrangement in the income declared to the DGI from the uppermost to the lowermost bands.*

effective average rate is calculated corresponding to each proposed band or decil. In this way, an effective average IRPF per band or decil is obtained, and by comparing both amounts, the average evasion can be calculated, which allows the later calculation of an evasion rate.¹⁴

Both mechanisms allow obtaining an estimation of the evasion resulting from the informal economy, understatements or tax fraud. The simultaneous utilization thereof allows making a contrast of the obtained results through one and the other, which results in an evaluation of their robustness.

The second stage is concerned with the estimation of evasion as a result of default or omission, through the comparison between the accrued tax (a calculation made from each person's income as it appears in the DGI's administrative records) and its comparison with the IRPF effectively paid in the relevant period.

By consolidating both facets of evasion (the one obtained through the first and the second stages), what is intended is to arrive at a global amount of IRPF evasion and its corresponding rate.

2.4 Limitations to the Theoretical Potential Method

The main limitation relates to the information sources. In the case of the data provided by the National Accounts, the primary characteristics that constitute limitations are:

- estimations are usually available one year later or more, which implies a great delay. In particular, the EEB is available by activity sector for the period 1997-2005, and the relevant publication for 2006 and 2007 is expected by April 2011.
- the most recently published National Accounts' figures are preliminary, and it should be stated that tax evasion measurement studies are sensitive to changes in these variables.
- if there is any error in the estimation, it is carried over to the tax evasion measurement.

¹⁴ *Evasion rate as a quotient between the average evasion and the potential average IRPF based on the ECH.*

In the case of the data deriving from the Ongoing Home Survey, some aspects could lead to estimation errors. Among the most relevant ones is the fact that the net income is surveyed, but not the gross income. The concept of net income is somewhat malleable in practice (net of social security contributions to the health insurance, but it may also be net of other items, such corporate shares or loans discounted from the salary, etc.), which increases the probability of errors in the estimation of the gross or nominal income, which is the reference for calculating the IRPF.

It should be considered that despite the above stated limitations, the method is useful in that it allows determining the magnitude of the evasion and, most importantly, its evolution.

3. OBTAINED RESULTS AND DISSEMINATION

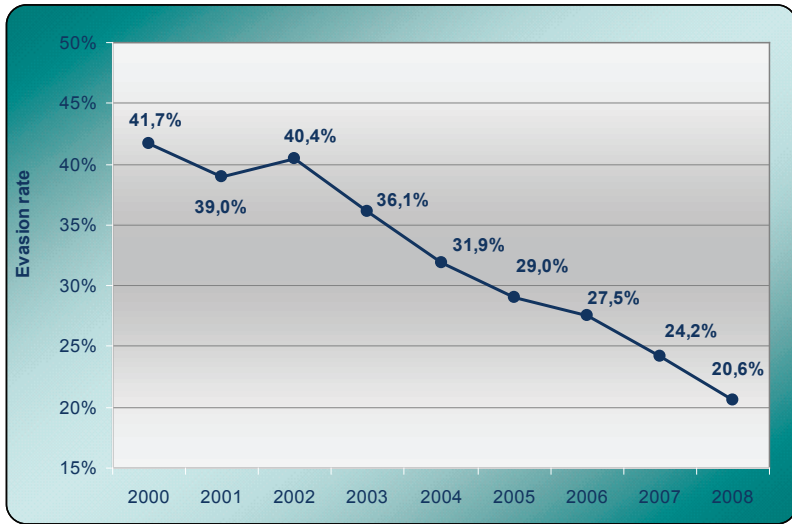
In the case of the **VAT**, there is a tax evasion rate series covering the period 2000 – 2008.

Year	VAT Collection*		Evasion*	Evasion in % PIB	Evasion rate
	Potential	Effective			
2000	33.154	19.335	13.818	5,0%	41,7%
2001	33.133	20.222	12.911	4,6%	39,0%
2002	35.285	21.023	14.262	4,9%	40,4%
2003	43.166	27.577	15.589	4,6%	36,1%
2004	52.354	35.658	16.696	4,3%	31,9%
2005	56.332	39.968	16.364	3,9%	29,0%
2006**	64.807	46.993	17.815	3,7%	27,5%
2007**	73.590	55.777	17.813	3,1%	24,2%
2008**	86.199	68.418	17.781	2,6%	20,6%

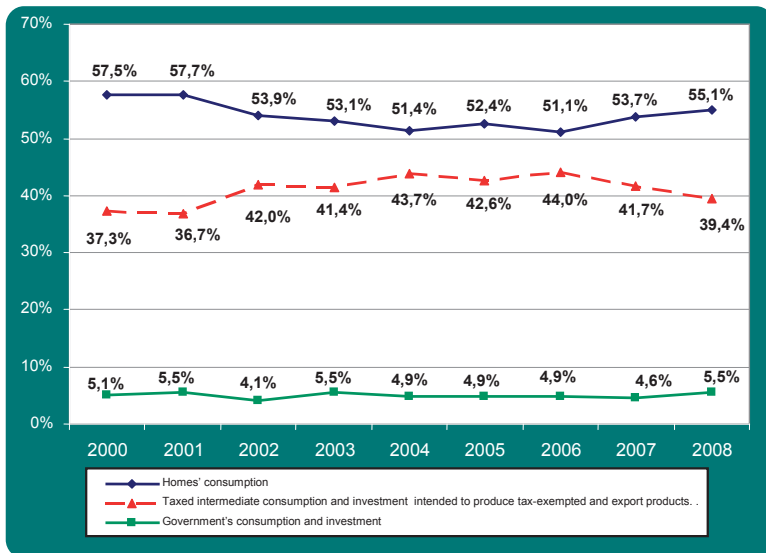
* Figures in millions of current pesos.

** Preliminary.

The indicator's evolution has been downwards since 2003, a trend that has been accentuated in the last two years of the series, recording a reduction of -25.0%. Considering the period as a whole, the evasion rate went down by -50.5%.



Upon analyzing the distribution of the potential VAT among the agents subject to the tax, we observe that during the period, on average, 53.7% of the potential collection corresponded to homes, 41.3% corresponded to companies producing tax-exempted and export goods and services, and the remaining 5.0% to the Government.



The contribution made by the two components having greatest relative weight on the variation of the potential VAT shows that there is no

predominance of any one of them: home consumption records the greatest contribution to such variation in four years of the period, whereas the contribution of intermediate consumption and investment taxed on companies intended for the production of tax-exempted and export goods constitutes the most significant in the rest of the years.

The variations observed in the evasion rate would be mainly attributable to the evolution of the economic activity, the Tax Administration's management and the changes in the tax regulation related to the tax.

The considerable increase in the evasion rate recorded in 2002 (3.7%) is mainly the result of the fall in the activity level, which may have been partly counteracted by the improvement in the DGI's management¹⁵. From 2003, the beginning and the subsequent firming up of the economic recovery, along with a continuous improvement in the TA's management allowed reducing the evasion indicator, which maintained the downward trend during the rest of the period.

In 2007 and 2008, the changes introduced by the New Tax System regarding the VAT regulation (modification of tax rates, as well as its bases, with the inclusion of new goods and services that used to be exempted and the elimination of COFIS), implied a tax sacrifice that accounted respectively for 2.4% and 2.3% of the effective VAT collection. In those same years, the collection attributable to a reduction in the evasion rate accounted respectively for 4.3% and 4.5% of the effective collection, and overcompensated for the fiscal sacrifice associated with the changes in the tax regulation.

This comparison does not purport to indicate that the reduction in the VAT rates (and its consequential tax sacrifice) was the reason for such compensation in tax collection by way of a fall in evasion. Evasion is associated with multiple factors and, under this particular circumstance, the economic activity and the efficiency in the DGI's management may presumably have exercised a greater impact. However, the comparison is useful to size up the economic importance of the reductions observed in evasion, and, additionally, it points out at a virtuous cycle that is frequently highlighted in evasion theories: when the degree of taxpayer compliance is greater, tax collection can be sustained with lower tax rates.

15 The improvement in DGI's management is measured through an efficiency index created for such purpose. The variation of this index was positive between 2002 and 2001, which would indicate that the Tax Administration contributed positively to the increase in collection, despite the recessionary scenario.

In the case of **IRIC/IRAE**, an estimate was made for 2005, considering thirty-four sectors of the economic activity, which were taken from the opening presented by the Central Bank for the EEB. It should be noted that even though the publication of the National Account System is for 43 sectors, only those covered by the tax were considered.

These are:

- Mining and quarrying
- Manufacturing industries (23 industries)
- Power, gas, steam supply and water catchment and distribution
- Construction of buildings and other works
- Wholesale and retail trade
- Hotels and restaurants
- Transportation
- Mail and communications
- Financial brokerage
- Real estate activities
- Machinery and equipment rental, research and development activities

By applying the methodology explained in 2.2, the potential collection of the tax is obtained, which is compared against the effective collection. An estimation of tax evasion is contemplated from 2000 to 2008. But the data corresponding to the EEB by sector for the years 2006 through 2008 has not been published yet.

This is the reason that no results are presented until obtaining a series that may allow showing the trend recorded in the evasion rate over the years, and which may be apt to compare the consistency of the results on a sector level.

As for the **IRPF**, the results obtained so far are both preliminary and partial, and require subsequent processes of contrast and validation before considering their public dissemination. However, even under these circumstances, it is possible to clearly verify through these results that the tax evasion in salaried income is highly concentrated in the formal employment. Therefore, evasion in this section of the IRPF could be attributable to understatements in the formal employment payrolls and, to a much less extent, to informal employment¹⁶. The potential collection of the tax resulting from the informal employment

¹⁶ *Exclusive of single owner informal jobs. It should be restated that this first study focuses on salaried income, that is, those originating in a contract job.*

(which is, by definition, evaded 100%) would have a minor share in the total of potential collection.

A highly significant salary gap is observed in the Uruguayan labor market between formal and informal employment, in favor of the former. The progressive structure of the IRPF, which implies increasing effective rates along the income gradation, translates this salary gap to even more distant taxation levels. Consequently, the result commented in the previous paragraph is consistent both with the reality of the Uruguayan labor market and the tax's design.

Lastly, regarding the **dissemination criteria**, the choice has been to disclose publicly the results once they have been duly validated from a technical viewpoint and a series thereof has been construed for a considerable period, which may allow observing the evasion evolution and its consistency with the evolution of its explanatory factors.

Within this frame, the results of VAT evasion have been presented on an annual basis since 2006, by means of press conferences performed with representatives of the Ministry of Economy and Finance and the General Revenue Office. In the case of the IRIC/IRAE and the IRPF, given the above mentioned technical reasons, the results obtained so far are not sufficient to consider their public disclosure.

4. CONCLUSIONS

Given the importance of tax resources in the State's fiscal policy, one of the objectives of the General Revenue Office is the fight against fraud and the consequential tax evasion.

In order to know the magnitude of the evaded amount, the same has been estimated for the Value-added Tax, and that of the Economic Activity Income Tax and the Individuals' Income Tax is now also being estimated.

For all the measurements, the method used has been the indirect one, which draws on external data sources. The main input is composed of the macroeconomic aggregates obtained from the National Account Systems. Specifically, in the case of the VAT, the private consumption, the Government's consumption, the Intermediate consumption, the Gross Formation of Fixed Capital are considered; in the case of the IRAE, the Gross Operating Surplus, and in the case of the IRPF, remunerations. By introducing some adjustments to this aggregations,

the potential collection of the tax is obtained, which is compared against the effective collection, thus arriving at the evasion rate. In the case of the IRPF, the micro-data from the Ongoing Home Surveys are used as supplementary source.

The results of the VAT evasion rate for the period 2000 – 2008 show a downward trend, except for 2002, reaching a bottom of 20.6% in 2008. These results have been presented at a press conference by the authorities of the Ministry of Economy and Finance and the General Revenue Office.

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Annex 1: Potential collection of VAT by component

The main components that originate non-deductible VAT payments are:

- the final consumption by homes of taxed goods and services
- the Government's consumption
- the Government's investment

- the taxed intermediate consumption used to produce tax-exempt and export goods and services
- the investment in taxed goods intended to produce tax-exempted and export goods and services

Final consumption by homes of taxed goods and services:

$$IVACH = (GCFH - GCUE) \times t_{1a} + GCEU \times t_{1b} + IVAPEM$$

where:

<i>IVACH</i>	potential collection of VAT originating in home consumption ¹⁷
<i>GCFH</i>	expenditure of final consumption by homes
<i>GCUE</i>	expenditure of Uruguayans' consumption abroad
<i>GCEU</i>	expenditure of foreigners' consumption in Uruguay
<i>IVAPEM</i>	potential collection of VAT originating in purchases made by small companies and self-employed workers' scheme taxpayers
t_{1a}	average VAT rate of GCFH
t_{1b}	average VAT rate of GCEU

Government's consumption:

The amount of potential VAT collection by Government's consumption item was calculated as follows:

$$IVACG = GCIG \times t_2$$

where:

<i>IVACG</i>	potential VAT collection resulting from Government's consumption ¹⁸
<i>GCIG</i>	expenditure of Government's intermediate consumption
t_2	average VAT rate of GCIG

17 Since the values estimated by the BCU include the VAT, the relevant non-VAT amounts were determined using the respective average rates of this tax. The calculation was as follows: Consumption without VAT = [VAT consumption inc / (1+t media)], where t media is the VAT applicable in each case.

18 Like in the case of home consumption, the values of the Government's intermediate consumption estimated by the BCU include the VAT, so the corresponding non-VAT amounts were calculated for each year using the respective average rates of this tax.

Government's investment:

The potential VAT generated by the Government's investments was estimated as follows:

$$IVAIG = IG \times t_3$$

where:

$IVAIG$	potential VAT collection deriving from the Government's investment ¹⁹
IG	FBKF of Government net of tax-exempted imports
t_3	average VAT rate of the IG

Taxed intermediate consumption used to produce tax-exempted and export goods and services:

The calculation of the VAT potential base tied to the intermediate consumption used by each sector in the production of tax-exempted goods and services is summarized as follows:

$$CIE_i = [CI_i(1 - \alpha_i)]\beta_i$$

where:

CIE_i	intermediate consumption of activity class i intended for tax-exempted production
CI_i	intermediate consumption of activity class i
α_i	percentage of sales of activity class i intended for export
β_i	percentage of tax-exempted sales of activity class i

Alternatively, the VAT potential base associated in each sector with the intermediate consumption used to manufacture export products was calculated as follows:

$$CIEX_i = CI_i \times \alpha_i$$

where:

$CIEX_i$ intermediate consumption of activity class i intended for manufacture of export products

¹⁹ Also in this case, the amounts of FBKF of the Public Sector estimated by the BCU include the VAT, so the corresponding non-VAT amounts for each year required calculation, using the respective average rates of this tax.

The average VAT rates applicable to the potential bases of each sector were determined using the structure of the intermediate consumption of each activity class, as the same appears in the Offer and Utilization Chart prepared by the BCU for 1997 (COU97).

So, drawing on the potential bases and the average rates applicable to the different activity sectors, the collectible amount of VAT was calculated for each intermediate consumption item tied to the production of tax-exempted goods and services, as follows:

$$IVACIE_i = CIE_i \times t_{4i}$$

where:

$IVACIE_i$ potential VAT collection resulting from the intermediate consumption of sector i tied to the production of tax-exempted goods and services

t_{4i} average VAT rate of intermediate consumption of sector i

In the case of the intermediate consumption tied to the production of export goods and services, the calculation was as follows:

$$IVACIEX_i = CIEX_i \times t_{4i}$$

where:

$IVACIEX_i$ potential VAT collection resulting from the intermediate consumption of sector i tied to the production of export goods and services

t_{4i} average VAT rate of the intermediate consumption of sector i

Therefore, the total potential non-deductible VAT to be collected each year from the intermediate consumption of the sectors producing such tax-exempted (IVACIE) or export goods (IVACIEX) was obtained as follows:

$$IVACIE = \sum_i IVACIE_i$$

$$IVACIEX = \sum_i IVACIEX_i$$

Finally, the total non-deductible VAT tied to intermediate consumption (IVACI) results from:

$$IVACI = IVACIE + IVACIEX$$

Investment in taxed goods intended to produce tax-exempted and export goods and services

The calculation of the VAT potential base tied to the investment used by each sector in the production of tax-exempted goods and services is summarized as follows:

$$IPE_i = [FBKF_i(1 - \alpha'_i)]\beta^*_i$$

where:

IPE_i FBKF net of tax-exempted imports, allocated per activity class i for tax-exempted production

$FBKF_i$ FBKF of activity class i net of tax-exempted imports

α'_i percentage of sales of activity class i intended for export

β^*_i percentage of tax-exempted sales of activity class i

Alternatively, the VAT potential base associated in each sector with the investment targeted at the manufacture of export goods and services was calculated as follows:

$$IPEX_i = FBKF_i \times \alpha'_i$$

where:

$IPEX_i$ FBKF net of tax-exempted imports, targeted by the activity class i at the production of export goods and services

The VAT rate applied to this investment was the base rate, to the extent that the goods involved are assessed at this rate.

Using the potential bases of the different activity sectors, the VAT amount collectible for each investment tied to the production of tax-exempted goods and services was computed as follows:

$$IVA IPE_i = IPE_i \times t_5$$

where:

$IVAIP E_i$ VAT potential collection arising from the investment of sector i tied to the production of tax-exempted goods and services
 t_5 VAT base rate

In the case of the investment intended for the production of export goods and services, the calculation was as follows:

$$IVAIP EX_i = IPEX_i \times t_5$$

where:

$IVAIP EX_i$ potential VAT collection arising from the investment of sector i associated with the production of export goods and services

Therefore, the total potential non-deductible VAT to be collected each year from the investment targeted at producing tax-exempted (IVAIP E) and export (IVAIP EX) goods and services was obtained as follows:

$$IVAIP E = \sum_i IVAIP E_i$$

$$IVAIP EX = \sum_i IVAIP EX_i$$

Hence, the total non-deductible VAT tied to the private investment (IVAIP) was determined as:

$$IVAIP = IVAIP E + IVAIP EX$$

Annex 2: Obtaining the taxable amount of IRIC/IRAE through the EEB

According to the effective legal regulations, the taxable amount of the tax should be determined to pay the income tax, which results from the maximum between the taxable rate, if positive, and zero, in the case of loss.

$$MI = \text{Maximum} \{ RF, 0 \}$$

Below is the taxable income broken down by its main components, which are the Accounting Net Result (RNC, in Spanish), plus the result of the tax adjustments themselves (AF, which may be positive or negative), less the non-admitted expenses (GNA), plus increased deductions.

$$\mathbf{RF = RNC (+/-) AF - GNA + DI (1)}$$

The RNC originates in the operating income (IO, in Spanish) from sales and other income, minus direct costs (CD, in Spanish), which are the costs associated with the production of goods and services, minus administration and sales expenses (GAV, in Spanish), plus the result of other revenues and expenses (OIE, in Spanish, which may be positive or negative), plus the financial results of the year (RFI, in Spanish, which may also be positive or negative), which relate to earned interest and bank expenses, among others.

$$\mathbf{RNC = IO - CD - GAV (+/-) OIE (+/-) RFI}$$

The main tax adjustments are: the adjustment for tax inflation (AJI, in Spanish), to reflect losses or gains of the company during the economic year and which are attributable to the holding of assets/liabilities during inflationary periods, the loss generated in previous years (PEA, in Spanish) and investment-based exemptions (EI, in Spanish), whose term and property payroll have been extended under the New Tax System.

$$\mathbf{AF = AJI + PEA + EI + Others}$$

The **GNA** is the result of applying the “padlock rule”, which states that 100% may be deducted if the person who sells the service or good also pays the IRAE tax; otherwise, in a certain proportion depending on whether such person is an IRPF taxpayer or as per letter E (small-sized company).

The **DI** refers to the expenses incurred in staff training and quality improvement and expenses for scientific innovations.

As approximation to the taxable amount, the operating surplus (EEB) is used, which is the result of the difference or balance in the income-generating account of the National Account System.

$$\mathbf{EEB = VAB - RA - (T-S) (2)}$$

And it corresponds to the Gross Added Value (VAB, in Spanish), which is the gross production value once the intermediate consumption is deducted, minus remunerations (RA), and after subtracting the taxes applied on production minus subsidies (T-S).

By making (1) and (2) comparable, the result of the taxable amount is as follows:

$$\mathbf{MI = EE - RE (-/+) AF - GNA + DI}$$

The RE being the tax-exempted income, which is included in the operating surplus but is not covered by the tax, so is therefore deducted.

INSTRUMENTS AND TECHNIQUES FOR THE MEASUREMENT OF EVASION

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Contents: Summary.- 1. Theoretical framework.- 1.1 Conceptualization.- 1.2 Why measure evasion?.- 2. Methodological framework.- 2.1 Methods to measure evasion in international literature.- 2.2 Research carried out on evasion in the internal revenue service.- 3. Dissemination and actions undertaken to fight evasion.- 3.1 Actions to fight evasion, contraband and informality.- 3.2 Strategies.-4. Bibliography

SUMMARY

Evasion is one of the core problems of the Tax Administration to increase collection and improve taxation effects. Its estimate is becoming more frequent and necessary for the design of tax policy and control strategies. This paper presents some of the main definitions and methodologies for measuring evasion, in accordance with international literature. Likewise, investigations in the Inland Revenue Service regarding evasion issues and the main actions leading to their results in the management of the administration are detailed.

1. THEORETICAL FRAMEWORK

1.1 Conceptualization

Tax evasion is any fraudulent action to prevent the total or partial payment of a tax (Fiscal Studies Institute). All elimination or reduction of a tax amount produced within a country, by those who are legally obliged to pay (Villegas et. al., 2005).

This practice is conscious behavior done in a covert and deliberate manner. However, it may be the case that evasion is unintentional and

open (for example: travelling salespersons), derived from a precarious socio-economic system which excludes from the formal system a segment of the population. From this point of view, informality is part of evasion.¹

The Royal Commission on Taxation of the United Kingdom, defined in 1955, evasion as any activity from which a person does not pay the tax required by existing legislation (Cosulich 1993). As Seville (2005) states, the tax gap or evasion rate is the distance between the collection which would be received by the State, if all taxpayers comply strictly with the standard (potential collection) and the collection that effectively entered into the Treasury.

The causes of evasion are not unique, for Lamagrande cited by Aquinas (2008): “the examination of the phenomenon of tax evasion, allows us to infer its degree of complexity and dynamic character.” Its reduction depends on the removal of the factors involved in such dynamic, and a series of measures appropriate to a given, economic and social context should be carried out in order to achieve this. “Without detriment to circumstances beyond the economic tax field can improve or affect the level of tax compliance.”

1.2 Why measure evasion?

The criminalization of this act is justified as evasion infringes upon the State’s tax basis and undermines the social economy of the market (Ugalde and García, 2007). The importance of the tax burden and its influence on production costs, marketing and service delivery, makes the evading taxpayer enjoy advantages when compared to the rest of the taxpayers. In addition to eroding the government’s revenue (Tacchi, 1993), a tax system with high levels of evasion attempts against the real impact of the system, by altering the principles of equity and social cohesion which pursues the Welfare State (Cosulich, 1993 and Cardona *et al.*, 2007)

Evasion is a stumbling block for development, balanced growth, and in general for tax system justice. Its measurement is justified for two

¹ As Portes and Haller (2004) state: “Consensus seems to be increasing among the researchers of the developed world that the scope of application of the term informal sector covers “the actions of economic agents that do not adhere to the institutional standards established or those to which their protection is denied.” (Feige 1990, page 990). Or, includes “all the income-generating activities not covered by the State in social environments where similar activities are regulated.” For example, unpaid domestic work is an informal activity but it does not affect taxes. Thus, remuneration received by workers of the informal sector may not involve tax evasion if pensions are within the exempted tranche” (A definition of informality).

reasons: (i) allows you to design an economic system to ensure a minimum level of well-being for its citizens, compliance with the principle of sufficiency and avoiding macro fiscal imbalances for the State, and (ii) is an essential input for the management of the tax administrations.

1.0.1 Economic Importance of Measuring Evasion

The final purpose of a tax system is to provide resources to finance public expenditure (Jorrat, 1996). In this solidarity process between the State and society, the system is legitimized provided that it guarantees: (i) a minimum level of well-being through horizontal and vertical equity and (ii) the tax regime should support balanced and sustained economic growth². The importance given by a Government to one or another will depend on the ideology it pursues, but there is no doubt that these two objectives must be present in greater or lesser extent in a tax system

Erosion of tax revenues from evasion brings difficulties to the State to run an efficient social policy. It is estimated that every year about 160 billion dollars are lost due to tax evasion throughout the planet, by invoices counterfeiting and transfer pricing alteration between related parties. On the other hand, if we consider that the budget allocated by developed countries to help poor countries is 103 billion dollars, if evasion is controlled, it could cover more than 1.5 times this budget (Murphy et. al, 2007).

Tax evasion, limits the development of the economies, especially those that do not have a strong tax system. According to Martens (2007), this practice will be responsible for the death of 5.6 million children for the 2000-2015 period, this means 1,000 children per day.

In 2000, the Millennium Development Goals were formed as an effort to eradicate poverty and promote development. However, until 2015 - the end date for the goals – the developing world will have lost 2.5 trillion dollars from evasive practices. In this respect, the World Bank estimates that 0.9 trillion dollars would be needed to meet these objectives in the project implementation period. Evasion would cover 2.7 times that figure (Martens 2007).

In addition to the effects on poverty, the asymmetries in the distribution of income present a positive correlation with the weakness of tax

² *Balanced, because growth may generate greater asymmetries in the distribution of wealth, therefore a mechanism to prevent this must be put in place; and sustainable, because the purpose is to minimize the fluctuations of economic cycles in time.*

systems. Lax tax systems have preferred regressive indirect taxes for their ease of collection. In poor countries only 16% of tax revenue comes from income tax, while 32% is generated by excise taxes. In rich countries these ratios are 28% and 25% respectively (Martens 2007). The dismantling of direct taxation in developing countries has been accompanied by rising inequality, where in the last 20 years the Gini coefficient has increased in 53 of 73 developing countries (Martens 2007).

Evasion affects welfare because it breaks both the horizontal and vertical equity³. In the case of vertical equity, the effective tax rate⁴ of two individuals with different income may be the same because one of them uses mechanisms to reduce its payment. In the manner way two individuals who have equal income may be subject to a different tax rate if one evades its taxes, violating the horizontal equity of the tax system.

Evasion damages growth. Companies that evade their tax obligations have advantages over those that do comply, as mentioned by Stiglitz these distortions produce market failures since the true costs of production or income are not collected, this limits the growth of the affected economies. Even the imbalance that exists between productive sectors (monopolies) in developing countries causes evasion amounts to be centered in large corporations. This creates incentives to capture political power spaces achieving the establishment of foreign policy, tax or industrial incentives, legalizing evasion and causing the tax burden to fall on traditional economic groups (Prats y Macias-Aymar , 2008).

Gold mining companies in some African countries have total VAT exemption for imports and local procurement of goods and services. Finally, according to UNDP in Southeast Asia agriculture accounts for more than 30% of GDP and contributes to less than 6% of government revenues.

The evasion practices of large corporations with institutionally weak Governments generate growth based on the exploitation of natural resources which is concentrated on export sectors of low value added products. An example is the Democratic Republic of Congo, who in 2006 received the negligible value of US\$86,000 for mining rights.

³ *Vertical equity refers to the equal treatment of equals, while horizontal equity is the unequal treatment of unequal.*

⁴ *The effective tax rate is defined as the ratio between the taxes assessed on the individual's income. This indicator shows the society's relative degree of tax compliance.*

Tanzania is another example of this problem, because it has the largest gold reserves of the continent after South Africa, and only receives 3% of the value of total exports of this mineral.

Ultimately, problems generated by evasion on the economic growth and social welfare have economic-political impacts. High levels of evasion weaken society's confidence in the State, and produces lack of legitimacy in its actions. This lack of legitimacy along with high social inequality hinders the emergence of a credible and sustainable fiscal compact (Prats and Macias-Aymar, 2008).

1.0.2 The Importance of Measuring Evasion for the Tax Administration.

According to Jorrat (2003) it is important for the Tax Administration (TA) to have information on the amount of tax evasion in an economy for several reasons. First, it allows the tax administration to orient control plans. Tax control planning should be based on information on quantifiable economic activities and riskier geographic zones and the most used evasive methods. To do this it is essential to quantify this phenomenon not only at the aggregate level, but at sector and territorial levels as well.

Second, it allows you to monitor the results of examination plans and make changes when necessary (Jorrat, 2003). Not having a priori evasion information limits control plans and may cause errors when defining examinations. In the same manner, without evasion figures prior to the tax control prevent assessing how effective these controls were. This delegitimizes the action of the State and causes the TA to enter into a vicious circle where evasion schemes are based on subjective aspects that increase the probability of failure.

Third, tax evasion is an indicator of the efficiency of the Administration (Jorrat, 2003 and Trujillo, 1998). [All] tax systems face difficulties when differentiating between the collection product trend growth of the economy and the proceeds generated by the management of the tax benefit. This issue is resolved, in part, by having periodic measurements of evasion levels which can distinguish the level of efficiency of institutional management, of the inertia of the economy.

Fourth, the Government should consider evasion when deciding the TA's collection goals and when analyzing any amendments to the tax legislation (Jorrat, 2003 and Trujillo, 1998). If in the course of time,

evasion figures in a country does not decline or tax pressure rates do not increase, the tax authority should consider two possible causes: (i) or control plans are not producing the results expected and would have to change the strategy, or (ii) the existing legislation is being an obstacle to improve compliance, therefore a legislative change should be considered. These conclusions can only be reached when a regular quantification of evasion rates are maintained.

Fifth, evasion rates, along with Tax Expenditure quantifications must be inputs for the Parliament and the Executive power at the time of establishing the general State budget. It must also be an important input for bills seeking to assign benefits and tax incentives to the different economic sectors or geographical areas. State policy consistent with national objectives could not assign economic or tax incentives to economic activities that maintain high levels of evasion.

Sixth, to know the evasion breakdown helps to identify the economic sectors that would require a higher degree of simplification of the tax system or in its absence an increased investment in the tax culture to insert it into the formal system. This can be the case of simplified regimes, where proper quantification of evasion by population segments help design a simplified regime that will formalize persons requiring a system of this kind, and not on the other hand be regimes to help evaders. Quantifying evasion can help simplifying the system and reduce informality.

Finally, as noted by Trujillo (1998) to measure evasion especially dimensions the problem. To not know what is the magnitude of the problem prevents finding optimal solutions. Knowledge of the extent of evasion can allocate additional resources to improve institutionalism and/or the management of the Tax Administration.

2. METHODOLOGICAL FRAMEWORK

2.1 Methods to Measure Evasion in International Literature

Estimates of evasion gaps are of particular importance in the management of the Tax Administration, because it enables the design of control strategies according to the characteristics of taxpayers and the aspects that provided for in the legal provisions.

Tax literature has stated different methodologies for measuring evasion. Some of them are focused on measuring total evasion (formal and

informal sector), others the part corresponding to the GDP of the National Accounts System and omitted in tax returns and others to increase the informal economy or underground economy⁵. The main difficulty of the research in this field is that, by definition, evasion is not observable behavior outside of law. This implies, in the empirical framework, that a measurement as from existing databases in the tax administration cannot be obtained directly⁶.

The methods most used in the TA are indirect methods, which give a rough picture of evasion, do not attain to supply the necessary aspects for the design of control programs. In practice, three indirect ways to estimate evasion can be distinguished (Fenochietto 1999):

- Tax Administration Reports. Consists of measuring the effect of tax default on the generation of income for the tax administration.
- Macroeconomic aggregates. Is the use of the statistics of the National Accounts System, the labor market, the underground economy and tax default to approximate tax evasion
- Microeconomic techniques. The use of surveys on a sample of taxpayers.

Hereinafter, the most used methods according to each category are described herein.

2.1.1 Macroeconomic Aggregates

The Monetary Method

The monetary method estimates the size of the underground economy under the assumption that the relationship between the demand for money and national production does not remain constant. Technological innovations generate a decline in the preference for cash. If noted otherwise, the excess cash must be related to the presence of an underground economy under the assumption that money is being used more intensively than the formal economy. This method has limitations, since the demand for money is not a directly observable economic aggregate and the underground economy performs part of its activities in the formal economy.

⁵ *Informal or illegal, underground economy can be defined as the network of transaction that occurs without complying with the tax regulations transgressing the law and evading taxes. This type of trade is reflected on the hidden sales made by the business, retail and wholesale. As such, this fraud involves in some cases the evasion of all taxes established.*

⁶ *However, the relative evasion method is an indirect process that makes exclusive use of the tax administration databases to estimate the evasion in respect of the best compliance practices in the universe of taxpayers.*

The Physical Input Method

The physical input method assumes a stable relationship between a physical input widely used in the economy and national production. Based on this relationship, the size of economic activity is estimated, which is then compared to the production recorded in the National Accounts System. The difference between both figures is considered a non-reported economic activity and is associated with the evaded amount of tax revenue.

The Difference Method.

The difference method compares the income recorded in the National Accounts System with the income reported on tax returns. The difference of two numbers is the evaded income gap. In order for this method to make sense, national income statistics must come from sources other than the Tax Administration.

The Legal Tax Potential Method.

The premise of the legal tax potential method is that the National Accounts System figures are correct and are a good basis for the calculation of income tax and VAT. The evaded tax is defined as the difference between the legal potential tax and the tax in effect collected; this is, the difference between tax revenue that would have been obtained if all legal tax obligations had been paid, and taxes actually collected

The theoretical taxable base for the legal tax potential is estimated according to the tax:

- Value-added tax: final taxed consumption of households of the National Accounts System, plus the taxed intermediate consumption of business sector that produces exempt goods.
- Income tax: the excess gross exploitation, adjusted by monetary correction, less the surplus of exempt and excluded activities, the surplus of companies subject to presumptive income, prior periods losses that may lower the current taxable income, among other deductions, discounts and exemptions.

This method depends on the reliability of the statistics used, the informal value-added registry in the National Accounts System and the possible underestimation of the macroeconomic aggregates

The Constant Tax Coefficient Method

In this method, the fiscal pressure of a year in which tax evasion was minimal is chosen and is used to estimate the potential tax for the year in study. The difference between the estimated tax and the actual tax is the evaded tax

2.1.2 Microeconomic Techniques

The Labor Market Method.

The labor-market method compares the labor participation rates, according to official statistics, with the same rates obtained from surveys done to companies and workers. As from the differences found and based on average workmanship productivity, non-reported labor income, and thus, tax revenues ceased to be received for this concept.

The Survey Method

The survey method consists of obtaining information on taxpayers' income through a survey, which is a source different from income tax statements. Income determined by the survey is compared with the income recorded in income statements, and tax default is estimated based on this. The weakness of this method is that it is subject to sampling bias and the problem of the reliability of data.

The Fixed Point Sample Method

In the fixed point method an inspector visits a company, and stays during the working day to observe the development of the activity. From there, the theoretical sales levels are measured, considering that when the taxpayer is subject to the control of its transactions the true sales level is reflected. However, the presence of the officer Inspector at the place being inspected may interfere with the taxpayer's and the buyers' behaviors. In this case, the figure measured under control is not comparable with the one recorded in other periods.

The Special Verification of Accounts Method

The special verification of accounts method performs "line by line" audits, on a stratified sample of taxpayers, to determine the amount of taxes that are not paid for not abiding by the laws. The advantage of

this method is that it is less expensive and complex than other survey methods and allows reliable estimates of different tax evasion by different segmentation variables (economic activity, geographic location, etc.). On the other hand, the limitation is in considering samples taken from the universe of filers, leaving out the informal economy.

The Relative Evasion Method

The relative evasion method operates on a new concept of evasion, regarding it not as the decline in collection but as a decline of equity in compliance with the tax. In this sense, the method focuses on estimating horizontal inequality in tax evasion, i.e. quantify in what measure tax obligations are not complied among those that do comply. The procedure is to determine the level that each taxpayer should pay according to their activity and some variables as invested and sales level. The estimated tax for each taxpayer is compared to the level of average taxation in that all comply, to then estimate the relative evasion coefficient on the standard deviation of the compliance percentages.

2.1.3 Tax Administration Report

The Selective Sample Method.

Selective sampling method compares the information presented in the returns by a selected group of taxpayers, through examination actions performed by the Tax Administration. The limitation of this method is in the fact that it must be complemented by other statistical tools such as surveys; because its estimate is not random it is highly skewed.

The Special Amnesties Method.

The special amnesties method quantifies tax evasion by using information from income tax returns under the protection of temporary amnesties. This method works on the assumption that taxpayers are induced to declare their actual income in exchange for the suspension of fines or other sanctions they may be subject to. The limitation of this method is that you can skew evasion downwards in the case of frequent amnesties, because in spite of favorable conditions, some taxpayers may continue preferring not to submit to the same to not report their real income and therefore have to pay a higher tax.

Graph 1. Summary of Tax Evasion Calculation Methods.

Criteria	Method	Target Variable	Information Sources	Limitations
Macro-economic Aggregates	Monetary Method	Size - Informal Sector CIT Evasion	National Accounts System (SCN) Production / Money Demand	The demand for money is not directly observable. Furthermore, the underground economy carries out part of its activities in the formal economy.
	Physical Input Method	Size - Informal Sector CIT Evasion	SCN Production / Fully Used Physical Input	
	The difference Method	Total CIT Evasion	SCN Income / Income reported to the TA	National Income Statistics must come from different sources outside the TA
	The Legal Potential Tax Method	Formal Sector CIT-VAT Evasion	VAB- Production - SCN Consumption / TA Returns	Reliability and under calculation of the statistics used. The informal value added is not registered in the SCN
	The Constant Tax Coefficient Method	Total CIT-VAT Evasion	VAB SCN / TA Collection	The year taken to predict must have minimum evasion
Micro-economic Techniques	The Labor Market Method	Size - Informal Sector CIT Evasion	Official job-underemployment rates / surveys to workers and firms.	
	The Survey Method	Total VAT Evasion	Income survey / TA Returns	Sample is skewed and data reliability problems
	The Fixed Point Sample Method	Formal Sector CIT-VAT Evasion	Sample Examination Data / TA Returns	The presence of the inspector may interfere with the taxpayer's and the buyers' behavior, rendering incomparable data.
	The Special Verification of Accounts Method	Formal Sector CIT-VAT Evasion	Sample Examination Data / TA Returns	Samples only come from the universe of filers, leaving out the informal economy.
	The Relative Evasion Method	CIT-VAT Formal Sector Relative Evasion	TA Returns	This method only measures the degree of horizontal inequality in tax compliance
Tax Administration Reports	The Selective Sample Method	CIT-VAT Formal Sector Relative Evasion	Selective examination data / TA Returns	Results must be complemented by other tools such as surveys; because its estimate is not random it is highly skewed
	The Special Amnesties Method	CIT-VAT Formal Sector Relative Evasion	Temporary Amnesties TA Returns	The evasion gap is skewed downwards in the case of frequent amnesties, because of the taxpayers' resistance to not report their real income.

Sources: Various sources.

Prepared by: Tax Studies Department

2.2 Research carried out on evasion in the Internal Revenue Service

In Ecuador, investigations performed on the subject of evasion are fundamental tools for designing strategies to control and tax policy. These investigations are framed in macro and micro econometric techniques for estimating tax gap by sector and geographical location. In addition, there are studies that model the behavior of taxpayers as evasion agents in an environment of general balance.

In this regard, the work has been substantial. Hereinafter the studies developed to date.

2.2.1 VAT and Corporate Income Tax Collection Gap Estimate by Industry

At the end of the year 2007, the Internal Revenue Service developed an estimate of evasion by economic activity of the corporate income tax and the value added tax for the year 2004, taking into account the industries' classification of the Central Bank of Ecuador⁷. The methodology used is based on the process to assess the theoretical potential tax, as from consumption and the Exploitation Gross Surplus – EBE, in Spanish - (adjusted for informality) recorded in the Supply and Utilization Tables of the National Accounts System. This result is compared with the effective collection recorded in the statistics of the corporate income tax and the value added tax of Internal Revenue Service (Andean et., 2008) to estimate the evasion gap of each tax.

Hereinafter are the main methodological guidelines:

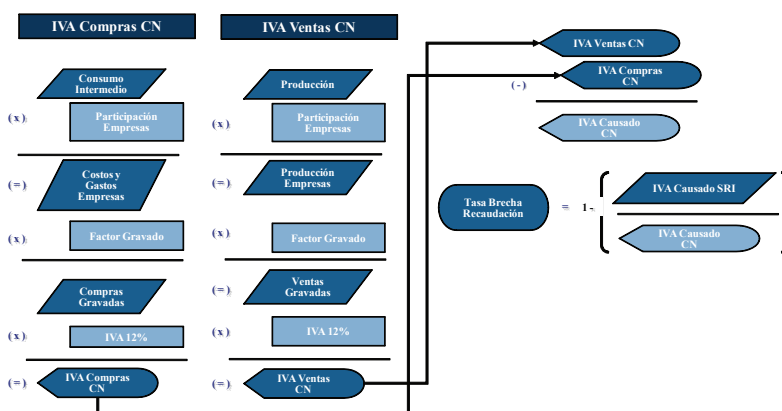
Value Added Tax (Graph 2)

- Standardize Supply and Utilization Tables.
- Identify taxable sales adjusted by informality (households and government consumption, investment in and stock variations) and apply the taxed factor to determine the Sales VAT

⁷ *Validation of economic activities and their standardization according to the Central Bank of Ecuador industry codes was done only for special taxpayers, since they concentrate 75% of the collection. CIIU3 economic activities that were the subject of thorough review were: crude oil extraction, natural gas and related services, the development of byproducts from oil refining, housing rentals, public administration and defense; compulsory social security affiliation schemes. It must be emphasized that the omission of this review can lead to erroneous collection gap rates.*

- Identify taxable purchases adjusted by informality (intermediate consumption) and apply the encumbered factor to determine the purchase VAT
- Calculate potential VAT (Sales VAT – Purchases VAT) through taxed factors in sales and purchases.

Graph 2. Flowchart to estimate VAT Evasion Gap.



Source: Taxation Magazine No. 1

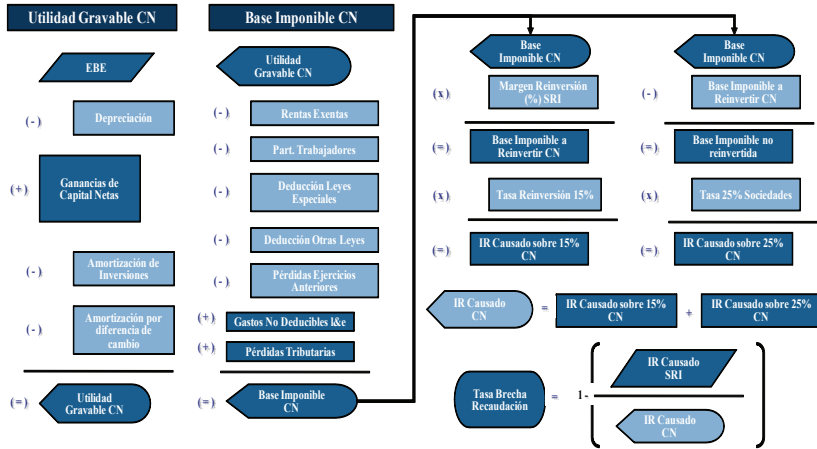
Prepared by: Tax Studies Department

Income Tax Assessed (Graph 3)

- Standardize Supply and Utilization Tables.
- Adjust the industries EBE of the national accounts system, excluding financial intermediation, financial expenses, and depreciation and amortization services; and including financial income, to obtain the profit or loss balance of the fiscal year.
- Subtract the balance of tax reconciliation (exempt income, workers' participation, deductions and depreciation, less non-deductible expenses and losses in past years) recorded by taxpayers to obtain the tax base.
- Estimate the theoretical potential tax by applying the 15% and 25% rate, depending on whether if a profit reinvestment or not⁸.

⁸ The reinvestment percentage passed from 15% to 10% during the December 2007 reform.

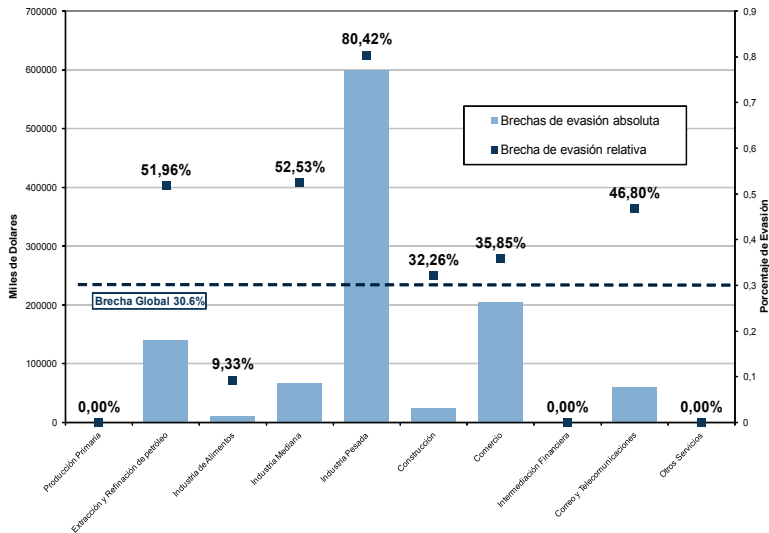
Graph 3. Flowchart to estimate CIT Evasion Gap.



Source: Taxation Magazine No. 1
Prepared by: Tax Studies Department

Regarding the results, the VAT global collection gap was estimated at 30,6%, where (80%) is heavy industries, (53%) mid-size industries, (52%) oil and food and (47%) mail and telecommunications, the activities that are the highest evaders in Ecuador’s economy (Graph 4).

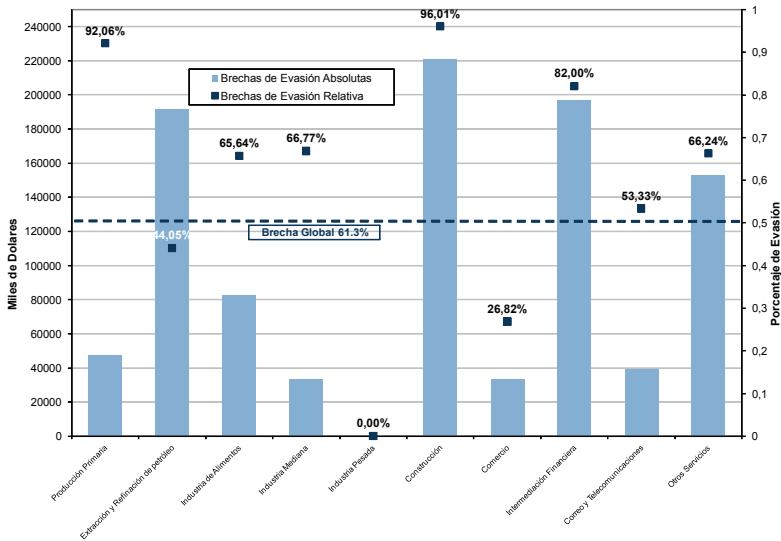
Graph 4. Corporate VAT Evasion Gap. Year 2004.



Source: Taxation Magazine No. 1

On the other hand, the overall income tax gap was estimated at 61.3%. Industries that had a gap above this level were primary production companies (92%), food (65%), mid-size industry (66%), construction (96%), financial intermediation (82%), and other services (66%) (Graph 5).

Graph 5. Corporation CIT Tax Gap. Year 2004.



Source: *Taxation Magazine No. 1*

2.2.2 General Applied Tax Balance Model

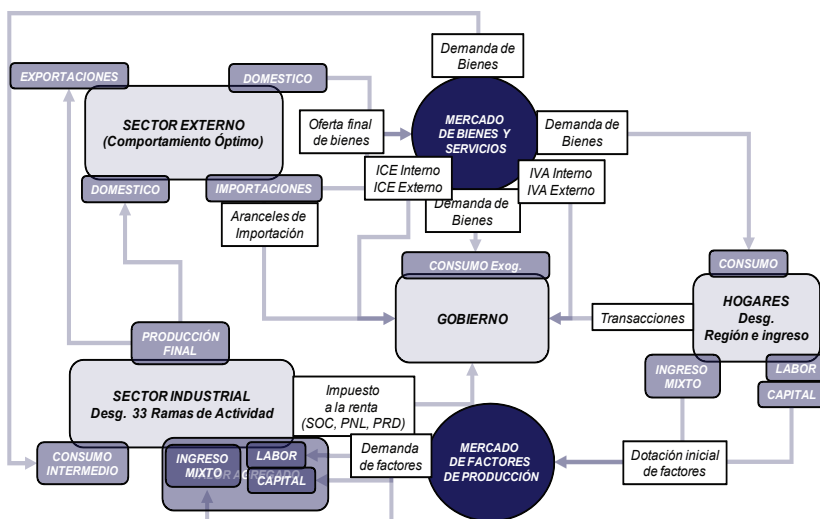
Today's complex environment includes existing interrelationships between social and economic variables, which call for improvements in macroeconomic modeling, in order to capture the economic reality of a country in a more positive way and specify results in the evaluation of economic policy. One of the topics of greatest interest here has been tax evasion because its correct set-up in the economic system helps to specify the tax incidence analysis and identify the main factors in tax revenues.

The General Applied Tax Balancing Model (MEGAT, in Spanish) was born as a counterfactual analysis tool of policies in the Ecuadorian economic system, with incorporates the tax evasion behavior into the VAT added value tax and the Assessed Income Tax payment. Therefore, some specific approaches are adopted as the model of Adgnmano and Salmano (1973) in the payment of direct taxes and the perspective of Marrelli (1979) in the payment of indirect taxes.

MEGAT as other general equilibrium models is formulated from competitive markets in a small and open economic system with increasing or decreasing technologies in the production and external marketing of goods and services, responding in principle to the concept of Walrasian Equilibrium for all agents and markets that form the same.

This economic system initially comprises 31 production sectors that supply and demand between 31 goods and services present on the domestic market, in addition to the exports and imports thereof done as from 3 different regions in the world (USA, Andean Community and the rest of the world). Furthermore, there are 2 institutional actors in the economy; one consolidated by 6 types of households (classified in urban skilled and unskilled, and rural non-agricultural, small and large producers) which offer 3 types of factors of production (remunerations mixed income and gross surplus exploitation) to the productive sector for revenue and perform their consumption activities and another formed by the Government whose main activities are tax collection (internal and external ICE, internal and external VAT, income tax, tariffs) and its later distribution into the economic system (Graph 6).

Graph 6. National Economic System, MEGAT Basic Dimensions



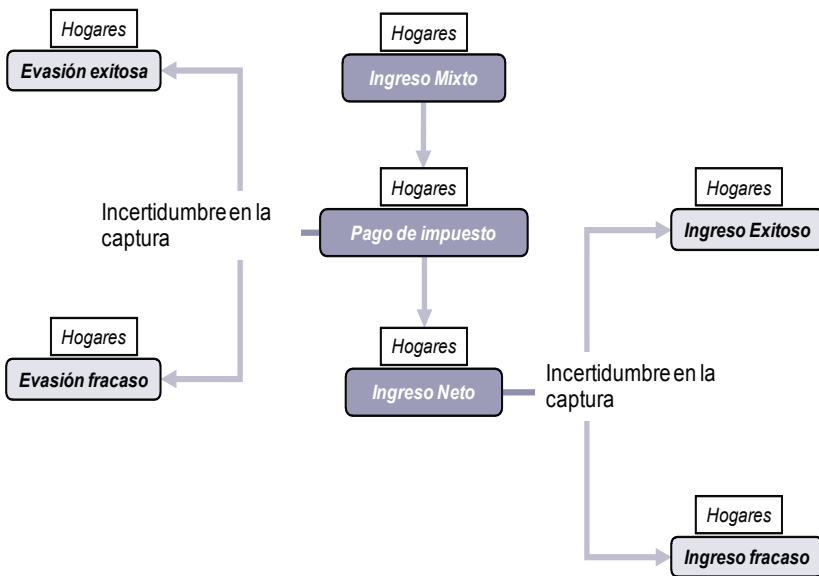
Source: Applied General Tax Balance Model
Prepared by: Tax Studies Department

Tax Evasion in the Payment of CIT corresponding to individuals

In principle, the presence of an evasion agent in the production sector that detaches the behavior in the payment of the CIT by individuals, similar to how it is done in the Adgnmano and Salmano model; introducing perception close to the control done by the tax administration within the detection probability handled by the agent. Additionally, it is assumed that this agent in spite of also declaring VAT, does not evades it due to withholding and control mechanisms scattered in the economic system.

As a result, this taxpayer decides to evade or not depending on the expected usefulness of its income, assuming that there is an endogenous and changing possibility (as perceived through its behavior) of being detected and fined later by the Tax Administration. If the taxpayer decides to evade but is not detected, it shall receive additional income for concealing part of the taxable amount which should have been paid a given tax rate; otherwise, if the taxpayer is detected evading income, it will have to pay a fine on the taxable base that it concealed, which generally is greater than the current tax rate, with the purpose of discouraging evasion (Graph 7).

Graph 7. Individuals CIT Evasion Flowchart.



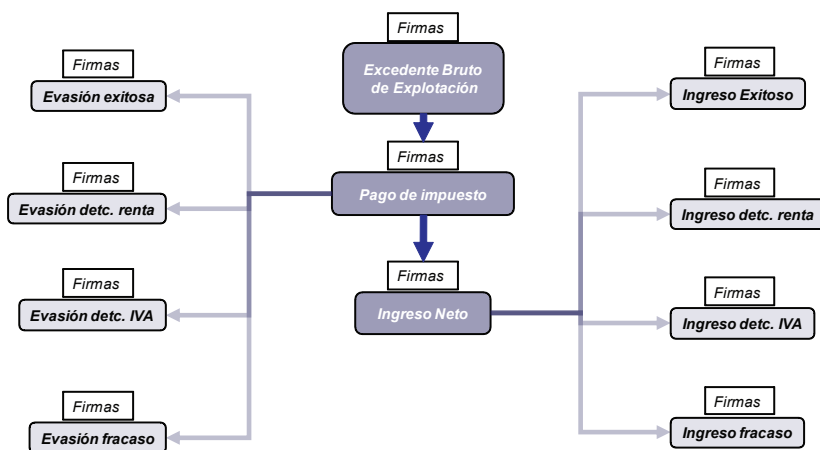
Source: Applied General Tax Balance Model
 Prepared by: Tax Studies Department

Tax evasion in the payment of Corporate VAT and CIT

In the previous structure, another module is integrated to disassociate behavior in the payment and evasion of the CIT on the profits generated by the production sector. Furthermore, it is assumed that these taxpayers are the only ones in the economic system that have the option of evading or not the payment of the VAT.

Corporations have the option of concealing part of the taxable base in the payment of the CIT, VAT, or both, to increase their income considering the possibility of being discovered, audited and sanctioned. Other hand, the likelihood of capture known and perceived by the taxpayer represents the control done by the Tax Administration, given the type of evasion that it carried out (Graph 8).

Graph 8. Corporate VAT-CIT Evasion Flowchart



Source: *Applied General Tax Balance Model*
Prepared by: *Tax Studies Department*

MEGAT enables the evaluation of the impact of a tax policy in the economic system and the change in evasion gaps.

2.2.3 SRI User Satisfaction Survey. Perception of Evasion.

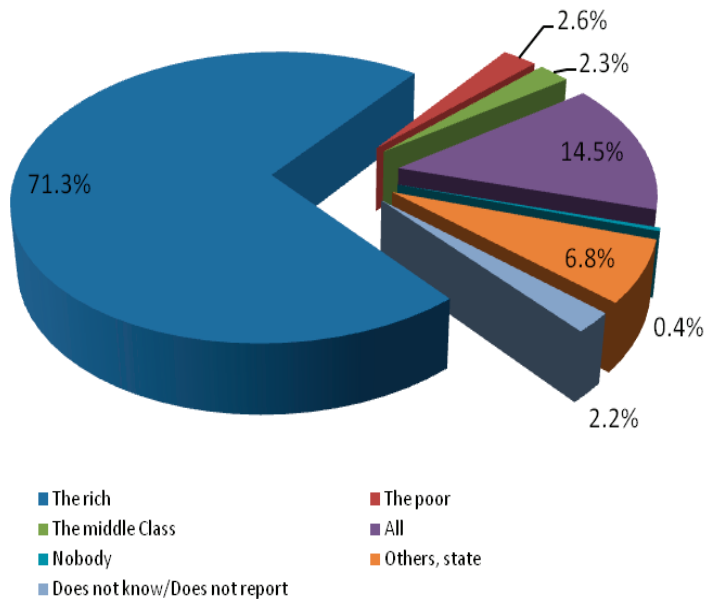
The Internal Revenue Service user satisfaction survey was a process developed in December of 2008. The objective of this survey was to determine the level of satisfaction and the degree of improvement that the institution has had in the different services offered to taxpayers and users, through questions such as: type of service used, rating of the services provided by employees, consultants, returns, and access to

services through the Internet, etc. It also stated certain questions to measure the taxpayers' perceptions on evasion control and sanction topics, (2009 INEC).

This survey was done through direct interviews to people attended during December at the different agencies of SRI nation-wide, after concluding the process that brought them to this agency (Intercept Method). The database contains the opinions of 2,865 taxpayers, distributed proportionally according to the size of the 8 regional offices.

According to the taxpayers' opinion on evasion by economic strata (Graph 2), 71.3% of the total number of taxpayers, believe higher-income people are the main source of evasion. Furthermore, a 14.5% believes that all people in general evade taxes and 6.8% believes specific taxpayers, such as merchants and large companies are the greatest evaders. These statistics allow insight into the theoretical results of some evasion models, such as directly proportional relationship between income and the individuals' susceptibility to evade taxes.

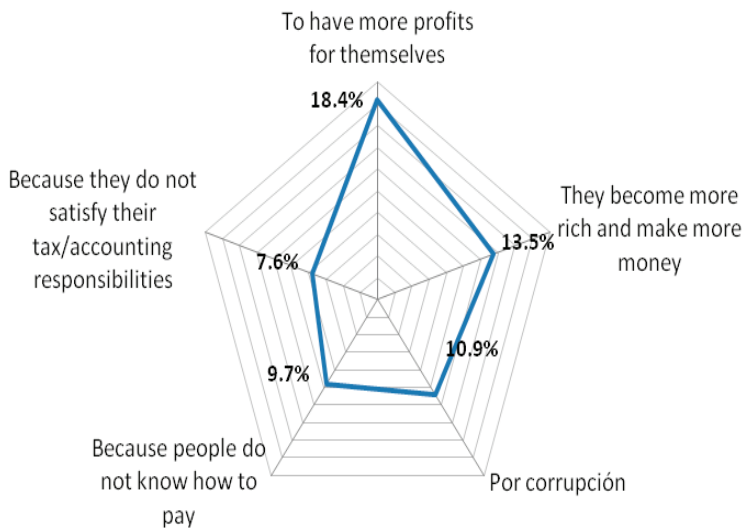
Graph 9. Who do you think are the ones that evade most taxes? Perception Survey. Year 2008



Source: 2008 Perception Survey
 Prepared by: Tax Studies Department

Regarding the taxpayers' perception on the reasons that motivate evasion behavior (Graph 3), 18.4% and 11.5% of the population surveyed believes that the desire for greater profit and wealth, are respectively the main reasons that encourage tax evasion. Likewise, 10.9% believes evasion is caused by acts of corruption.

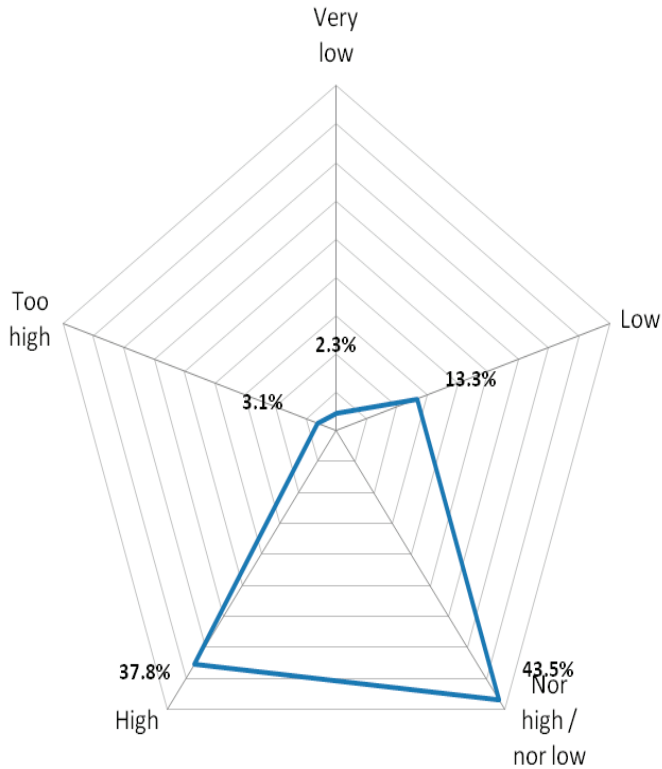
**Graph 10. Why do you think people evade taxes?
Perception Survey. Year 2008**



*Source: 2008 Perception Survey
Prepared by: Tax Studies Department*

Finally, the subjective probability of detecting non-compliance with tax obligations probability is also collected and analyzed. 43.5% of taxpayers state that this probability is either very high or very low; while 37% think that this possibility of being captured is moderately high. Furthermore, less than 15% of the population believes that this probability is low or very low.

Graph 11. The Probability that the SRI Detects Taxpayers in Default with their Obligations Perception Survey. Year 2008



Source: 2008 Perception Survey
 Prepared by: Tax Studies Department

2.2.4 Fiscal Gaps according to Economic Activity and Region.

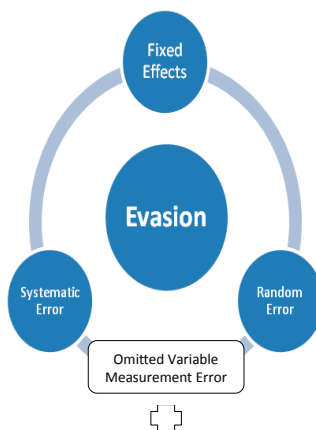
In 2009, the Internal Revenue Service showed its interest in the development of new methods to estimate evasion gaps, by applying different conceptual frameworks from traditional ones such as relative evasion. With this initiative the tax gap study on economic and regional activity arises, where in an econometric manner the collection gap in the statement and payment of Bodies Corporate (Corporations) Income Taxes is estimated, by the place of the generation and activity of the economic fact during the 2003-2007 terms, by using the financial statements approximately 40,000 taxpayers.

To do this, two panel models are proposed, based on a variant of the estimation technique for the total productivity of factors, which

incorporates the approach of omitted variable and measurement error by stochastic frontier in the tax return. Both models aim to estimate the evasion gap and analyze its sensitivity, since the great uncertainty surrounding the measurement of the non-observable component makes this process necessary (Aguar and Castro, 2009)

Both models consider the phenomenon of evasion as an unobservable component that does not change over time, due to the existence of norms and institutional structures that enable its permanence in time. This phenomenon is possibly infiltrated among legal mechanisms used to minimize the tax payment on a sector basis, however the determinants of these elusive practices occur in a totally different context. False random occurrence for errors or potential errors in the tax reports are added to this. Together, both factors constitute the measurement error in the econometric estimation.

Graph 12. Methodological Proposal



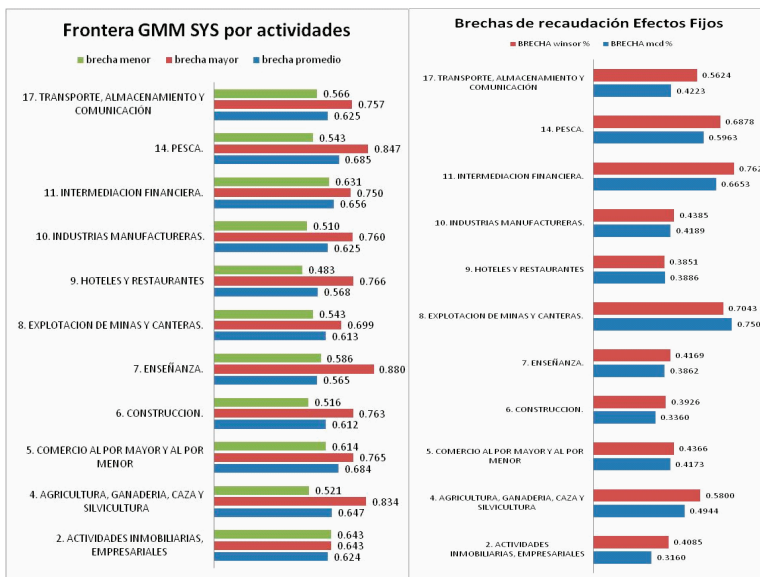
*Source: Fiscal Gaps according to Economic Activity and Region.
Prepared by: Tax Studies Department*

The first methodology uses a Fixed Effects Vector Decomposition (FEVD), which quantifies the bad tax and business practices gap through the time-invariant according to economic activity. In order to extract the tax gap, on this component a regression is done on the variables similar to the business efficiency, such as total and intangible assets, total labor costs, the company's age, percentage market share and total asset concentration. The residues obtained from this regression are used later to adjust the tax assessed on companies at a potential amount, which is later used to establish a potential maximum tax of the "best

tax practice⁹ pursuant to various statistical criteria¹⁰ (maximum level, Winsor 95%, minimum covariant distance). Facing this standard, the evasion gap is estimated by type of activity, comparing in relative terms the average real tax assessed.

The results of this model indicate that Mining and Quarries Exploitation, financial intermediation, fisheries and transport, storage and communication activities are the most important sectors with gaps ranging from 75% to 42% in deflated terms for 2003-2007 period. This value represents the average distance (in percentage terms) between the corporations of this activity and the companies that have the better tax compliance, given that a constant level of sales is maintained, expenses, labor, assets, leverage and other explanatory variables (Graph 12).

Graph 12. Fiscal Gaps



Source: Fiscal Gaps according to Economic Activity and Region.
Prepared by: Tax Studies Department

9 It is important to mention that this best tax practice considers that all the other aspects affecting the tax assessed are constant, that is: total assets, labor expenses, sales, intangible capital, among others. That is, it attains to make companies comparable. Therefore, a better practice does not mean to pay more taxes in absolute terms, but how much the payment of the company regarding its expected value defers, maintaining systematically constant its characteristics during the five years considered. In this regard, the maximum potential tax or the benchmark is real tax level that has been attained by at least one company in the study – although generally there are more -. More specifically, it is the tax that would be attained given the average characteristics of the sector and the best tax practice.

10 Statistical criteria used constitute the maximum level, the Windsor Measurement 95% and the Minimum Covariance Distance - MCD.

The second model consists of a Generalized Moments Model System (GMM-SYS), which incorporates more complex elements of statistical theory (instruments in delays and differences) to the specification of the previous model to correct measurement errors, concurrency¹¹ in the estimation of tax determinants.

This tax expected from this model is divided for the one obtained by Minimum Ordinary Squares (MCO, in Spanish), taking the resulting coefficients as a proxy for poor tax practices.

The logic of this process is that if there is a systematic measurement error in the signatures log balances, the predicted value of the corrected model will provide a good approximation of the actual value, and therefore any difference on this (as compared to the estimate by MCO) will determine the unobserved fiscal gap.

On these coefficients, the procedure is the same as in the previous model to obtain the tax gap by type of activity, establishing the potential maximum tax of the “best tax practice” in each sector.

This alternative form of estimation does not change the results significantly at sector level, thus demonstrating the strength of the same, at least for the sectors with higher tax gap. In general, the results again displayed a fairly stable average gap for the four sectors with greater gap estimated in the FEVD model.

However, it is important to highlight that construction activities, are situated at a higher level of evasion 50% than that previously estimated of 33% (Graph 12).

3. DISSEMINATION AND ACTIONS UNDERTAKEN TO FIGHT EVASION

3.1. Actions to fight evasion, contraband and informality

Once reviewed the quantitative tools to measure the evasion, it is important to analyze the use given to the quantification of evasion in the formulation of tax policy and improving the management of internal revenue service – SRI, in Spanish-, aimed at combating tax fraud.

11 Concurrency is an endogenous problem that occurs when one or more of the explanation variables is determined jointly with the dependent variable, through an equilibrium mechanism.

The estimate of the evasion gap was done jointly between the Tax Studies Department and SRI's National Directorate of Tax Management. The estimation methodology was laid-out and discussed in different technical institutions, such as the Central Bank of Ecuador and private trade unions, such as chambers of commerce, industry and construction.

In September 2007, the Ecuadorian Tax Administration unveiled the gap evasion for Ecuador, the figure reached US\$ 2.4 billion; 61.3% in income tax collection and 31% in VAT, and these figures were published in various media outlets.

"The director of the SRI reported annual tax evasion reaches approximately US\$ 2.4 billion." Tax evasion in different sectors is: primary production 96%, financial intermediation 82%, industry 66%, food 65.6%, mail and telecommunications 53%, extraction and oil refining 44% and trade 26.82%." (Diario del norte, page 12, 2007)

Thus, the Tax Administration disseminated evasion data through the SRI institution Magazine "Taxation" in April 2007. "Taxation" magazine addresses various and vitally important issues for the country which enable public decision-making based on theoretically based arguments and on economic, social and actual facts.



Jointly with the release of "Taxation" magazine, the SRI disseminates General Applied Tax Balance Model (MEGAT), as a tool for the evaluation of economic policy that allows distinguishing taxpayers' tax evasion of in the economic system.



In July 2008 the Inter-American Center of Tax Administrations (CIAT), together with the SRI organized the “International Taxation, Evasion and Decentralization Seminar” in Ecuador, which discussed the methodologies for the calculation of evasion and possible mechanisms for combating tax fraud.

3.2 Strategies

3.2.1 Tax Reform

One of the main objectives which motivated the tax reform “Tax Equity Act” was the reduction of tax evasion, increase the taxpayer base and strengthen tax control.

3.2.2 Creation of a Large Taxpayer Department

To lower tax evasion, the Tax Administration created the Large Taxpayers Control unit. For October 2008, the tax administration exceeded their tax goals among other things, for greater tax evasion control, especially Large Taxpayers.

3.2.3 Focused Tax Assessments

In October 2007 the Tax Administration announced that the construction sector had a 96% gap of evasion. From this estimate, SRI determined glosses for about \$ 111.1 million to this sector.

Furthermore, during the 2007 - 2009 periods the Special and Large Taxpayers of the transportation, telecommunications, oil, agro-industry and industry sectors were audited and this generated a total debt of US\$ 315 million.

3.2.4. Reduction of Informality through Simplified Tax Systems

In August 2008, the Internal Revenue Service presented the Ecuadorian Simplified Taxation Regime (RISE, in Spanish), which replaces the payment of the Value Added Tax (VAT) and the Income Tax (IT), through monthly quotas provided for by law.

In this manner the Tax Administration seeks to facilitate payment by small and medium size businesses to fight evasion and economic informality.

3.2.5 Promote Tax Culture

The low tax culture is one of the factors causing tax evasion. Therefore, SRI defined strategies to change tax culture in the country and develop the concept of “tax citizenship”. This concept is understood as the commitment of individuals with society, to exercise the correct and ethical use of their rights and fiscal obligations based on the trust of fair and transparent public spending as well as the reciprocity of the participating public agencies

In this context, the Internal Revenue Service declared the 28 April “Tax Culture Day.”

3.2.6 Implement the Statement of Assets and Liabilities for Bodies Corporate

One of the mechanisms for combating the evasion and controlling individuals was the implementation of the statement of assets and liabilities to estimate the different incomes of the taxpayers. This information is confidential in the Tax Administration.

3.2.7 Promote Billing

In order to prevent tax traps and false invoices, the Tax Administration made changes to the invoices emission authorization process.

Thus, the “1-800 Factura” (1-800 invoice) program was created to

address citizens complaints for the non-delivery of sales vouchers, mainly in the health, housing and real estate lease sectors

3.2.8 Generate Risk

With the purpose of generating risk in the productive sectors and reduce default caused by lack of information or a wrong advice, workshops were organized where the concerns and interests of economic sectors were addressed.

The following were among the topics presented: the omission of income, the economic fact, expenses without livelihoods, the treatment of remunerations, the depreciation of fixed assets, bad accounts provisions, amortization of deferred assets, refunds and “gross up”, under capitalization, commercial leasing, low inventory, fixed assets, casualties tax reconciliation, transfer pricing and estimated assessment.

Furthermore, the procedures to be followed by taxpayers in accordance with tax legislation and the tax control process of the Internal Revenue Service were explained.

In addition, the procedures to be followed in accordance with tax legislation and the process of the Inland Revenue Service tax control taxpayers were explained.

These workshops were done with the participation of different trade unions, such as: Industrial Chambers, Chambers of Commerce, Accountants Associations and the Office of the Comptroller General

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INSTRUMENTS AND TECHNIQUES FOR THE MEASUREMENT AND ANALYZE OF TAX EXPENDITURE

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Contents: Summary.- 1. Background.- 2. Tax Spending Estimate.- 2.1. Legal Framework.- 2.2. Concept of Tax Spending in Brazil.- 2.3. Sources of Information.- 2.3.1. Internal Sources of Information. – 2.3.2. External Sources of Information.- 2.4. Methodology for the Estimate.- 3. Results.- 3.1. Consolidation by Type of Tax.- 3.2. Distribution by Geographic Region.- 3.3. Classification by Budget Sector.- 3.4. Main Tax Expenditures. - 3.5. Tax Expenditures related to Social Security Contributions. Evolution of Tax Spending. - 4. Conclusion. - Bibliography.

SUMMARY

The key objective of this work is to explain the experience of Brazil in the gauging of indirect Tax Spending. It addresses aspects dealing with the legal framework, adopted concepts and methodologies, sources of information, the situation of tax spending analysis, and a brief overview of the results obtained.

It certainly is worth mentioning that the scope of this work is limited to the taxes that are part of the province of the Union. This is so because Brazil, as a Federal Republic made up by the Union, the States/ Federal District, and Municipalities, has autonomous tax structures and administrations.

1. BACKGROUND

The Brazilian System has been permeated by tax exonerations in order to meet the most varied objectives, including the incentive to the development of economic sectors and the promotion of the even

distribution of revenues among the country's geographic regions in order to curb the significant inequality existing among them.

Up until the beginning of the 1980s, when despite the Tax System's coexistence with these exonerations, there indeed was no official word on the systematization of the role of tax benefits, let alone on the quantification of its costs; in other words, there was no official word on what amounts were not being collected as a result of these benefits. The first efforts made in Brazil to identify and quantify the costs derived from the concession of tax incentives were made at the beginning of the 1980s; however, they were basically restricted to academic activities¹ and focused on the income tax of individuals and corporations.

In 1988, Brazil passed significant political and administrative reforms within the framework of a National Constituent Assembly, which had been set up to draft a new Constitution for the country. Specifically regarding Fiscal Policies, on that occasion, changes to the Tax System were introduced and general rules for the preparation of the Federal Budget were established, having as a pivotal point an increase in transparency in the evaluation of public accounts, as a consequence of the discussions on the issue, which had already been studied by society at large.

Among the rules for the improvement of the Budget, it is worth mentioning the establishment, in the Constitution, of the compulsoriness of drafting the regional Report, which would be discussed along with the budget bill and the estimate for the amount that would not be collected as a result of the concession of tax benefits.

That same year, 1988, a commission within the Ministry of Finance was established. It was made up by officials from the Secretariat of Economic Affairs (SAE) and the Secretariat of Federal Revenues (SRF), and its objective was to comply with the constitutional mandate. This is how the first Statement on Tax Benefits (DBT) was drafted, and it was incorporated into the General Budget of the Union (OGU) in 1989. The legal duty of drafting the following annual reports fell into the Secretariat of Federal Revenues.

1 Vilela, (Luiz Arruda – i) “Gastos Tributários e Justiça Fiscal: O Caso do IRPF no Brasil” [*Tax Expenditures and Fiscal Justice: The case of the IRPF in Brazil*] – 1981 – PUC – RJ, ii) “Uma proposta de gastos tributários no Brasil” [*A Proposal for Tax Expenditures in Brazil*] – 1986 – *Revista de Finanças Públicas* [*Public Finances Magazine*], no. 366, and “iii) A identificação dos Gastos tributários no Brasil” [*The Identification of Tax Expenditures in Brazil*] – 1989 - INPES/IPEA.

In the preparation of this first report, difficulties typical of the beginning of any process took place either because of having to face what was unknown until then or because of technical or legal reasons, such as the lack of clarity regarding the concept of tax spending that would be adapted to the characteristics of the Brazilian Tax System, the non-existence of historic series, the variety of incentives, and the precariousness of adequate information and statistical sources.

At the time, however, what was more important was the decision to implement the constitutional mandate and begin the process. The fact of having a list of all benefits distributed by type of tax and a corresponding amount, however precarious, became a major gain, taking into account that the improvement of technical and legal matters would definitely take place along the process.

This is what in effect has taken place from the beginning until now. The basic sources of information, especially the Tax Returns of individuals or corporations, with the alteration or creation of fields for the collection of data directly for the application of the methodology of the estimate, were improved to an extreme. It is also worth mentioning that there was a closer rapprochement with the external bodies that are responsible for the administration of resources stemming from tax benefits and, thus, are repositories of information useful for the process.

An especially relevant event was the study conducted in 2003 to revise and improve the concept of tax spending in order to promote further standardization in relation to the understanding adopted at the world level. This enabled the realignment of incentives (inclusion and exclusion) and the direct alignment with budgetary roles (Social Security, Health, Education, and so on), and it even promoted changing the term “tax benefit” to “tax expenditure,” making the annual report be called “Report on Tax Expenditures (DGT).”

2. TAX SPENDING ESTIMATE

2.1. Internal Sources of Information

In Brazil, the drafting of the report using the tax spending estimate is a legal obligation of constitutional nature. This concept was introduced in the Federal Constitution enacted in 1988 in order to offer congressmen, during the analysis of the Budget, a broader vision of the actual government spending (direct and indirect) with a certain budgetary role. Thus, §6 of Article 165 states:

“Art. 165 (...)

(...)

§6 The draft budget bill shall be accompanied by a regional report on the effect on revenues and expenditures due to exemptions; amnesties; write-offs; subsidies; and benefits of financial, tax, and credit nature.”

Later, the so-called Law on Fiscal Responsibility (Complementary Law 101, of May 4, 2000), which deals with balanced public accounts, broadened the compulsoriness of the quantification of tax expenditures, expanding to the other entities of the federation (States and Municipalities) and making the rules even more transparent for the concession and quantification of the budgetary-financial impact. In addition, it outlined compensation measures, as established in Articles 5 and 14, described below:

“Article 5 The annual draft budget bill, drafted along with the pluri-annual plan and with budgetary guidelines and regulations of this Complementary Law in a compatible way:

(...)

II – shall be accompanied by the document referred to in §6 of Article 165 of the Constitution, as well as by the measures to compensate revenue waivers and the increase in compulsory expenditures that are continuous;”

“Article 14. The concession or expansion of the tax incentive or benefit which results in a revenue waiver must be accompanied by the estimate of the budgetary-financial impact in the fiscal year when its validity must begin and the following two years, and it must comply with what is outlined in the LDO and meet at least one of the following conditions:

I – the proponent must prove that the waiver was taken into account in the revenue estimate of the budget bill, in the form of Article 12, and that it will not adversely affect the fiscal goals outlined in the same annex of the LDO;

II – it must be accompanied by compensation measures, in the period mentioned in the main article, by means of an increase in revenues stemming from an increase in rates, the broadening of the base for the estimate, and the increase in or creation of the tax or contribution.”

2.2. Concept of Tax Spending in Brazil

Notwithstanding some coincidences at the world level regarding the concept of tax spending, there still are many differences that make it practically impossible to make direct comparisons. There is no single concept that could be universally accepted and adopted by all the countries that make tax spending estimates.

Certain tax exonerations can be understood by some as a rule for the correction of deviations from or of the promotion of equity and, therefore, do not include the amount estimated as tax expenditure, whereas for others, these same exonerations can be interpreted differently due to the characteristics of their own tax systems.

In Brazil, the concept used in the period of 1988 to 2003 referred to the term “tax benefit” as a synonym of “tax expenditure,” and following this vision, the Secretariat of Federal Revenues used to draft, in the same period, the Report on Tax Benefits (DBT) on federal taxes.

However, that concept of tax benefit, adopted for the drafting of the report, failed, for instance, to follow the budgetary vision or, in other words, the possibility of replacing an indirect expenditure for a direct one. Consequently, some related tax benefits did not meet the concept of tax expenditures, and others that were considered tax expenditures were not considered among the constant tax benefits outlined in the report.

As an example, the deduction of the base of the estimate for the Income Tax of Individuals regarding dependants, especially children, is cited. For some years, this exoneration was classified as a Tax Expenditure. However, following the revision of the concept, this classification was no longer valid due to the fact that it was considered more of an element of promotion of tax equity and the progressiveness of the Income Tax of Individuals. In Brazil, there is no associated government program either, such as a stimulus for births.

This is why in order to improve the concept that had been used until then and promote further standardization under the understanding adopted in other countries, the term “tax expenditure” started being used in effect to replace the term “tax benefit” as it is more adequate for the revision of the concept, which beginning in 2004, has been used following these criteria:

- a. They are indirect government expenditures incurred by means of the tax system, trying to address economic and social objectives;
- b. They are explained in the regulation that refers to the tax, becoming an exception to the tax system referred to, reducing the potential collection, and increasing the taxpayer's economic availability;
- c. They are compensatory in nature when the Government fails to adequately tend to the people regarding the services that are part of its responsibility;
- d. They are considered an incentive when the Government wishes to develop a certain economic sector or region.

As a complement to the aforementioned criteria, the following steps began to be taken to identify what is indeed considered tax expenditure in the set of exonerations of the tax system:

- 1) Determine all the tax exonerations taking as base the tax system as a reference;
- 2) Assess, using the established criteria, what are the exonerations that constitute direct expenditures and that can be replaced by direct expenditures linked to government programs.

The identification of the exonerations that constitute tax expenditures has the same tax law as a foundation. This is how the exonerations that stem from general tax rules applied to taxpayers, without distinction, and from rules that get the Tax System closer to constitutional tax principles are considered to be integral part of them, and therefore do not constitute tax expenditures.

2.3. Sources of Information

In Brazil, the quantification of tax expenditures is supported by internal and external sources of information.

2.3.1. Internal sources of information

The main internal sources of information are the Tax Returns filed by individuals and corporations at the Tax Administration. In this regard, it is worth mentioning that all corporations (companies) are obligated to submit their tax returns, listing even those items that are exempt or immune. This is how it was possible, since the beginning, to improve the way data was entered into the system, data that is essential to estimate and analyze tax expenditures through the alteration or creation of fields appropriate for the returns.

As an example, next we present some types of benefits whose information is included in specific fields in the tax returns of companies in general:

- a) Exemptions and reductions of the income tax due from companies that open in the northern and northeastern regions of the country with projects in economic sectors that are a priority for the development of these regions;
- b) Deductions from the base of the income tax estimate, subsidy expenditures incurred by corporations in the Workers' Food Program previously approved by the Labor Ministry;
- c) Deductions from the income tax due from part of donations and sponsorships in favor of programs that support cultural and audiovisual activities;
- d) Deductions from the income tax due from donations made to the Protection Fund for Children and Adolescents;
- e) Deductions from the base of the income tax estimate for expenditures incurred in industrial or agricultural technological research and development activities;
- f) Deductions from the base of the income tax estimate for donations made to teaching and research institutions;
- g) deductions from the income tax estimate for expenditures incurred by companies, such as medical, dentist, pharmaceutical, and social security services for employees and leaders;
- h) Sales taxed with a zero rate by the Pis and the Cofins, such as, for instance, the sales of books, paper, agricultural raw materials, and so on.

In addition to this, immune or exempt companies, as well as the companies that are part of the SIMPLES (simplified form to estimate a set of taxes), are obligated to file a specific tax return.

Just like corporations, individuals are also obligated to provide information, in their own fields of the tax returns to which they are subject, on deductions or reductions of taxes due, and the estimate base as a result of an incentive, such as education and health expenditures.

In addition to this, the Tax Return forms are revised annually to verify the need for adjustments and alterations, including those aimed at compiling information to subsidize the task of estimating tax expenditures.

2.3.2 External Sources of Information

The external sources of information also constitute a fundamental support for the tax expenditure quantification process. This information basically has its origin in the bodies that manage resources stemming from tax incentives, including the Manaus Free Zone, by means of the Manaus Free Trade Zone Superintendence (SUFRAMA); the Ministry of Science and Technology (MCT); and the Ministry of Development, Industry, and Foreign Trade (MIDIC).

As long as the Tax Administration requests it, these bodies forward all the information they have on the various forms of incentives whose funds they manage.

In this regard, it is especially worth mentioning, for instance, the Manaus Free Trade Zone, which registers, by type of merchandise, all the consolidated asset and liability entries by the various sectors of the economy. This enables the creation of a data bank with information essential for the quantification process of the tax expenditures dealing with this specific area.

The role played by the external sources notwithstanding, there still is not an integrated network for data transmission.

2.4. Methodology for the Estimate

The estimate for tax spending in Brazil is done by type of taxes and separately for each benefit item. This is why there is no single methodology that can be applied, taking into account that the various types of benefits have their own characteristics. Therefore, as a general rule, the preparation for the application of the method follows these guidelines:

- a. A list by type of taxes is drafted along with each type of benefit, which according to the concept used, will generate a tax expenditure;
- b. The most adequate source of information is selected for this specific item;
- c. The necessary information for the specific case is extracted; and
- d. The estimate is made.

In short, the following premises are adopted in the preparation of the estimate for the tax expenditure:

- The effects of the change are not considered in the behavior of taxpayers because of the concession of the benefit, assuming that the activities would be carried out, at the same level, if they were subjected to normal taxation;
- The possible indirect effects on the collection of other taxes caused by the concession of the benefit are not estimated.

Thus, by virtue of these premises, suppressing the tax benefits, an increase in collection would not take place at the same level as the values estimated for the Tax Expenditures. To do so, adjustments would be necessary, incorporating effects from suppositions about the change in the behavior of taxpayers given the new situation without benefits. Will the activities continue to be carried out at the same level? Would taxpayers spend less? Would compliance with the new tax obligation be in full?

It is worth stressing that the sources of information with actual data, which are used as base for the preparation of projections, have a time lag of approximately two years. Therefore, the projections for 2008 were made using real 2006 data as base.

Examples of data extracted from Tax Returns:

1) **Deduction from the Taxable Income of Individuals**

Data:

- Fiscal Incentive: Deduction of health expenditures from the taxable income
- Return: IRPF – 2006.
- Real value of the deductions: R\$ 24.334 billion.
- Average rate estimated from the IRPF-2006: 11%
- Tax Spending 2006

Estimate:

2006 Tax Spending = Real value of the deduction x the average rate of the IRPF

2006 Tax Spending = 24.334 x 0.11 = R\$ 2.677 billion.

Projection for the 2008 Tax Spending = 2006 Tax Spending x Index of correction of the 2008 IRPF collection divided by the 2006 collection.

Projection for the 2008 Tax Spending = $2.677 \times 1.52 = \text{R\$ } 3.086$ billion.

2) **Regional Development – Deduction from the Individual Tax Due.**

Data:

- Fiscal Incentive: exemption of taxes due to the establishment of a company in the Northeastern Region.
- Tax Returns: IRPJ – 2006.
- Real value of the tax deduction: R\$ 589 million.
- Tax Spending - 2006:

Estimate:

2006 Tax Spending = Real value of the deduction of the taxes due.

2006 Tax Spending = R\$ 589 million.

Projection of the 2008 Tax Spending = 2006 Tax Spending x Index of correction of the 2008 IRPF (Personal Income Tax) collection divided by the 2006 collection.

Projection of the 2008 Tax Spending = $589 \times 1.31 = \text{R\$ } 771$ million.

3. RESULTS

The information on the estimate for tax spending from a specific year is consolidated in a report called “Statement on Tax Spending (DGT),” which integrates the set of information on the Federal Budget that the central Executive Branch forwards to the Legislative Branch up until the last business day of August of the year preceding the budget’s reference year. It is up to the Legislative Branch to analyze and turn into a law the budget document. It is worth mentioning that the data on tax spending are for informational purposes and, therefore, are not subject to the same treatment given by the Federal Budget to direct expenditures.

The “Statement on Tax Spending (DGT)” lists, in detail and by type of tax, all the types of tax benefits that according to the concept used trigger indirect expenditures by means of the tax system. In addition to this, there is a succinct description of the basic legislation and of the term of validity of each type of benefit. After the draft Budget Bill is

submitted to the Congress, the Secretariat of Federal Revenues posts the Report on Tax Spending on its Internet page.

Below are some tables related to the 2009 estimate that illustrate the report:

3.1) Consolidation by Type of Tax: it presents the values estimated for the 2009 Tax Spending, and they are presented in a consolidated form by type of tax.

Chart I
2009 Tax Spending Forecast
Consolidation by Type of Tax

Tax	R\$ million	
	2009 Forecast	%
Income Tax	36.171	35
COFINAS	29.419	29
I. Industrialized Products	17.030	17
CSLL	6.087	6
PIS-PASEP	5.651	6
I. Imports / Linked IPI	6.427	6
Others	1.172	1
Total	101.956	100

Source: RFB

3.2) – Distribution by Geographic Region: it presents the estimate for the 2009 tax spending, classified by geographic region.

Chart II
2009 Tax Spending Forecast
Geographic Region

Region	R\$ million	
	Tax Spending	Part. %
North	22.170	21,7
Northeast	10.524	10,3
Central-West	5.257	5,2
Southeast	51.764	50,8
South	12.242	12,0
Total	101.956	100

Source: RFB

3.3) – Classification by Budget Sector: it presents the consolidation of tax spending by budget sector.

Chart III
2009 Tax Spending Forecast
Consolidation by Budget Sector

	R\$ million	
Budget Sector	2009 Forecast	%
Commerce and service	32.258	33
Industries	20.817	20
Health	12.560	12
Labor	9.577	9
Agriculture	8.415	8
Education	4.056	4
Social security	4.015	4
Others	10.258	10
Total	101.956	100

Source: RFB

3.4) – Main Tax Expenditures: it presents the main tax expenditures.

Chart IV
2009 Tax Spending Forecast
Main Tax Expenditures

	R\$ million	
Tax expenditures	2009 Forecast	%
Micro and small companies	25.705	26
Manaus Free Zone	17.432	17
Non-profit organizations	9.941	10
Agriculture and agricultural industry	6.581	6
Exempt and non-taxable revenues - PF	6.425	6
Regional development	5.581	5
Medicines	5.058	5
Others	25.234	25
Total	101.956	100

Source: RFB

3.5) – Tax Expenditures related to Social Security Contributions: it presents the tax expenditures dealing with social security contributions. It is worth mentioning that this amount does not include the values listed in other charts. The legal justification to estimate the tax expenditures dealing with social security contributions was established beginning in 2007 as a result of the merger between the Secretariat of Federal Revenues and the Secretariat of Social Security Revenues.

Chart V
2009 Tax Spending Forecast
Social Security

Mode	R\$ million	
	2009 Forecast	%
Simple at the national level	9.617	54
Philanthropic institutions	5.832	33
Rural production exports	2.432	14
Information and Communication Technology	24	0,1
Total	17.905	100

Source: RFB

3.6) – Evolution of Tax Spending: it presents the evolution of tax spending in the years 2003 and 2009 and its percentage participation in terms of collection and the GDP.

Chart VI
Collection x Tax Expenditure
2003 to 2009

Period	Collection	Tax Expenditure	R\$ million	
			Part. %	
			In Rev. Sec.	In GDP
2003	259.576	25.704	9,90	1,51
2004	296.856	34.322	11,56	1,77
2005	347.580	41.011	11,80	1,91
2006	372.912	57.586	15,44	2,48
2007	431.962	69.774	16,15	2,69
2008*	477.855	76.056	15,92	2,63
2009*	540.028	101.956	18,88	3,30

**Estimates*

4. CONCLUSION

In Brazil, contrary to the significant evolution of the quantification of Tax Spending, the analysis of its effects on economic sectors or geographic regions where it was introduced remains incipient. There are isolated and very embryonic initiatives by the academic sector and some other bodies, but there is no systematic execution of research and assessments capable of confirming the effectiveness of the benefit in terms of the achievement of its objectives, especially regarding an increase in the level of employment and tax revenues and an encouragement to invest.

In this regard, the RFB has promoted seminars with the participation of representatives from all the bodies that are involved in the process to gauge, manage and control Tax Spending. The objective of such seminars is to integrate the various key players involved in the process and discuss the estimate methodology while moving forward with the analysis process.

There currently are ongoing initiatives, especially in the area responsible for the execution of the Federal Budget – the National Treasury Secretariat – in order to integrate the direct (Federal Budget) and indirect (Tax Spending) expenditures as a means to making budget management more transparent.

A similar measure has been adopted by the Audit Court of the Union (TCU), which established the compulsoriness of presenting the information dealing with tax spending on the part of the management bodies.

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CHALLENGES FOR MEASURING TAX EXPENDITURE

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Contents: 1. Introduction.- 2. Tax expenditures budget: conceptual aspects.- 2.1 What are tax expenditures?.- 2.2 Disadvantage of the tax expenditures.- 2.3 Tax expenditures budget.- 3. Tax expenditure assessment challenges.- 3.1 Institutional and legal structure.- 3.2 Application of a coherent and transparent methodology.- 3.3 Information management.- 3.4 Control and examination by the Tax Administration.- 4. Conclusions, Challenges to be Solved and Next Steps.- 5. Bibliographic references

1. INTRODUCTION

Tax expenditures, understood as that revenue the public tax administration ceases to collect by virtue of the application of concessions or special tax regimes, is one of the several tools governments have available to execute their public policies. Its purpose is to favor or stimulate specific economic sectors, activities, regions or agents. This variable is also known as “tax waiver”, referring to the fact that, in this manner, the public tax administration partially or wholly waives applying the general tax regime, in view of a higher economic or social policy objective.

The tax expenditure concept appeared in the early sixties, practically simultaneously in Germany and in the United States, countries that were the first ones to prepare tax expenditure budgets, as a way to provide transparency to public actions executed by these means, as is normally done with direct expenditure. Afterwards, during the eighties, this practice was extended to almost all Organisation for Economic Co-Operation and Development (OECD) countries and to a few developing countries.

¹ Based on the work by the same authors entitled “Tax Expenditure Budget: implementation concepts and challenges”, IDB Working Paper # IDB-WP-131. Luiz Villela is senior economist of the Fiscal and Municipal Management Division of the Institutional Capacity and Finance Sector of the Office of the Vice President for Sectors and Knowledge of the IDB. Andrea Lemgruber is senior economist of the Tax Administration Division of the Fiscal Affairs Department of the IMF. Michael Jorratt is an IDB Consultant

The international community's demand for greater transparency in tax policy matters, along with a growing trend to use tax concessions, particularly in developing countries that seek to attract investment, spread the interest on the tax expenditures topic to the rest of the world. In 1998, The International Monetary Fund launched its Code of Good Practices on Fiscal Transparency, which, along with OECD recommendations on tax expenditures, contributed to disseminate the problem and call attention to the importance of its estimation in several countries.

However, in spite of such efforts, it must be admitted that tax expenditure continues to be a matter that has not been studied in depth, especially in developing countries, and that we cannot yet count with systematic analytical methodologies that allow us to evaluate the dimension of tax expenditures and make comparisons and analysis between countries. Especially in Latin America—region that has used tax expenditures as a tool to attract investments—, this is an essential topic to know the practice of granting incentives and its effects. It is also an essential tool for prior evaluation of tax reforms, when seeking to increase collection, simplify procedures or improve equity.

The purpose of this paper is to present some of the main guidelines related to the elaboration of tax expenditure budgets.² The same particularly underscores practical aspects related to the estimation of tax expenditures, which are illustrated by means of the experiences of OECD member countries and of the Latin American countries with respect to which there is data and information available.

2. TAX EXPENDITURES BUDGET: CONCEPTUAL ASPECTS

2.1. What are tax expenditures?

The primary objective of a tax system is to collect the necessary revenues to finance government expenditure. Each citizen must contribute a proportion either of their revenue, consumption or wealth, which will be destined to financing public goods, social expenditure or other activities that have positive economic effects for society.

However, the manner of collection is not irrelevant. The tax structure must have certain qualities, such as efficiency, equity and simplicity.

² *The discussions carried out at the International Seminar on Tax Expenditures, carried out on November 2008 in Washington, D.C. have been useful for this study. The Seminar, which counted with the attendance of 71 participants from 19 countries and 6 international organizations, fostered the exchange of experiences on the topic in Latin American and Caribbean countries.*

Efficiency is linked to the fact that taxes must be collected interfering as little as possible with persons' decisions. Equity is understood in a double meaning: horizontal and vertical. Taxes tend to be horizontally equitable, that is to say, they must equally affect persons with like ability to pay taxes. In turn, they must be vertically equitable, in the sense that persons with a greater ability to pay taxes have to proportionally pay more taxes. Lastly, it is preferable to have a simple tax structure rather than a complex one, because simplicity lowers other costs associated to taxes, such as those related to administration and compliance, which at the same time reduces space for evasion and avoidance.

Frequently, governments also use taxation systems to promote certain economic policy targets, such as promoting savings, stimulate employment or protect national industry. In such circumstances, the tax system plays a role similar to government expenditure, but through the State waiving all collections, or part of them, that it was entitled to from specific taxpayers or activities. This waiver is what is known as tax expenditure.

It must be pointed out that tax expenditure may affect differently the tax structure's efficiency, equity and simplicity qualities. However, in the measure that a specific group of taxpayers or activities is favored, this will necessarily translate into a loss of horizontal equity. From this point of view, it may be said that tax expenditure budgets also constitute, in a certain way, reports that show the degree of horizontal inequity of taxes.

The OECD (2004) defines tax expenditures as a transference of public resources carried out by means of the reduction of tax liabilities with respect to a reference tax (benchmark), more than through direct expenditure. One of the main difficulties at the time of defining and identifying tax expenditures within a specific legislation lies, precisely, in agreeing on a reference tax or standard against which tax legislation provisions may be compared. This matter will be dealt with in depth below. For the time being, it suffices to point out that tax expenditure quantifications may be radically different depending on the definition adopted, which includes, among other things, the impossibility of performing reliable comparisons of the tax expenditure magnitudes between different countries.

In some countries other characteristics are added to the foregoing definition, which constitute additional requirements demanded from tax treatments for a tax expenditure to be considered as such. In any

event, there is no consensus with respect to whether those should be taken into account or not. In the OECD report (1996), the following are mentioned as examples of the requirements demanded by some countries: (i) tax concessions must benefit a specific industry, activity or class of taxpayers; (ii) they must have a specific purpose (other than the efficient operation of the system), that can be readily identifiable with an objective that may be carried out alternately with other instruments; (iii) the tax in matter has to be sufficiently broad in order to have an adequate reference tax against which to measure the value of the concession; (iv) it has to be administratively feasible to change the tax system to eliminate tax expenditure, and (v) there must be no other provisions in the tax system that broadly compensate the benefits of tax expenditure.

From the tax technique point of view, tax expenditures may take different forms, as the following:

- Exemptions: Earnings or transactions that are excluded from the tax bases. They are found in the legal standards under different denominations, such as “exemptions”, “exonerations”, “non-levied events”, etc.
- Deductions: Amounts that may be discounted from the tax bases.
- Credits: Amounts that may be discounted from the taxes.
- Reduced rates: Tax rates lower than those generally applied.
- Deferrals: Postponements or delays in the payment of a tax.

According to the 1996 OECD report on tax expenditures, the identification of these constitutes a classification exercise, which consists in dividing tax provisions into those that are part of a reference tax or standard and other that are deviations with respect to that standard. When a tax provision deviates from the reference or standard, it is said that there is a tax expenditure. The same report points out that, in general, the reference tax includes: the rates structure, accounting conventions, the deduction of coercive payments, the provisions that facilitate administration and the provisions related with the international tax liabilities.

2.2. Disadvantage of the Tax Expenditures

Tax expenditures constitute an additional instrument among the different public policy tools available to governments, such as direct budgetary action or regulatory action over specific activities. In this sense, they should be permanently subjected to assessment, both in

what respects to the justification of a specific state intervention and its relative efficiency in comparison with the other available instruments.

The main disadvantages of tax incentives with relation to direct budget expenditures when trying to implement a public policy are:

- (i) **Focalization:** From the beneficiaries' point of view, tax franchises have a simpler access than direct subsidy, because they operate in a relatively automatic manner, while a subsidies program requires a beneficiaries' application and selection system. On the contrary, from the State's point of view, being automatic, tax franchises are less focalized, because they benefit the target group as well as any other that meets or simulates meeting legal regulations.
- (ii) **Horizontal inequity:** Tax expenditures usually generate inequity horizontally, because not everybody has the same consumption preferences or needs. Thus, for example, when exemptions are established with respect to VAT, either to improve progressiveness or to promote the consumption of merit goods, there is a greater proportional reduction of the tax burden of families that express a preference for assets that are exempted, in detriment of other families with equal level of earnings but that privilege the consumption of non-favored assets.
- (iii) **Incentives for evasion and avoidance:** The application of tax expenditures makes the tax structure more complex, which increases evasion and avoidance. Slemrod (1989) summarizes the reasons for that into the following four ones: first, the uncertainty caused by said expenditures regarding the correct interpretation of the legal standards; second, the decrease in the tax administration's capacity to assess, because the audit demands more time as the regulations become more complex; third, the greatest difficulty imposed on taxpayers to meet their tax liabilities, which leads them to default on part of them, either due to lack of knowledge or to compensate the costs imposed on them by the system; and lastly, the greater opportunities to manipulate the tax system, given that the greatest spaces for evasion and avoidance that open up as the complexity of tax regulations increases.
- (iv) **Increase in tax compliance costs:** In general, the greater the number of tax incentives, the greater the costs in time and money taxpayers must face to meet their tax liabilities, and these costs not always fall on the incentive beneficiaries. For example, exemptions with respect to VAT benefit end consumers, but the higher compliance costs derived from the special records needed for accounting for VAT credits and exempt sales fall on the sellers.

Regarding income tax, franchise control, in many cases, requires counting with information that must be provided by third parties.

2.3. Tax Expenditures Budget

In general, direct budgetary expenditure is permanently subject to public scrutiny. The elaboration of an annual budget that must be subject to parliamentary approval allows this. On the contrary, tax expenditures remain hidden in earnings forecasts and are subject to parliamentary only in the event of their initial approval

From the strictly budgetary point of view, the difference between direct expenditure and tax expenditure is that the first one is developed in two stages: the receipt of revenues and the payment of the subsidy or the transference; in turn, in the second one, payment is compensated with the revenue, therefore omitting those two stages. In this sense, the traditional manner of presenting earnings, net of tax expenditures, violates the budgetary principle of non-compensation of earnings and expenditures.

From the public policies point of view, tax expenditures are an alternative state intervention tool, that is after results similar to those that could be obtained by means of direct government expenditure. Therefore, they should be subject to the same transparency controls and criteria as the latter. As is pointed out in OECD (2004), a less rigorous control of the tax expenditures in relation with direct expenditures creates incentives to establish subsidies and transferences in the form of the former, aside from objective considerations that could justify such choice. This endangers the distributive, macroeconomic and administrative functions of the budget and may endanger the tax system's primary earnings collection function.

Tax expenditure budgets are financial reports that account for the aforementioned problems. In effect, they grant transparency to the use of tax concessions and facilitate the adequate control of these and the more efficient allocation of the resources.

There is no standard format for tax expenditure budgets, therefore their structure and contents differ a lot from one country to another. However, the following are some elements that are frequently included in them: (i) definitions, concepts and coverage; (ii) reference taxes description; (iii) tax expenditures description; (iv) assessments of historical tax expenditures (one or more years); (v) tax expenditures projections (one or more years), and (vi) assessment methodologies.

What can be found in such budgets are some international good practices guidelines that stress the importance of assessment and of filing tax expenditure budget reports.

3. TAX EXPENDITURE ASSESSMENT CHALLENGES

The effective implementation of the tax expenditures budget is a complex task that involves different aspects, among which we highlight here³: (i) an adequate institutional and legal structure; (ii) the application of a coherent and transparent assessment methodology; (iii) information management; and (iv) the control and examination function by the tax administration.

3.1. Institutional and Legal Structure

Assessment, monitoring and control of tax expenditures constitute complex administrative activities because they are multifunctional (they encompass different areas of interest or expertise) and intergovernmental (they involve different ministries and, in the case of federative countries, different governmental levels). With relation to the functions they encompass, in general, agencies that work in tax policy, tax administration, budget and program evaluation intervene in the process. In what respects to intergovernmental aspects, they have participation in the legislative branch as well as in the executive branch, national, state and/or municipal governments, and regulatory agencies.

An example of the amplitude of this network of agencies is the participation of free zone administrators, of economic sectors monitoring agencies or of national development agencies (for example, tourism, foreign investment), which count with detailed information on the operations of many companies that receive tax benefits. Consequently, it becomes necessary to establish a clear division of tasks and powers, and promote a close coordination between the agencies involved in the task.

To that end, it becomes essential to count with a clear legal framework in what respects to tax expenditures. In general, this framework is established in the fiscal responsibility laws, in the budget laws and/or in the tax laws or codes. There are several points this legal framework must cover; for example, the very determination of the obligation to

³ Among other important aspects that will not be covered in this study we can mention a) the integration with the countries' budget process; and b) the systematic assessment of costs and benefits if tax expenditures are granted.

estimate the tax expenditures budget, as well as the responsible agency, the calculation frequency and the presentation of the assessments. It is common practice and advisable that the tax expenditures budget be estimated annually and presented together (or integrated) with the budget proposal. Another important determination is that every benefits concession be granted only by legal action (and not through decrees or other infra-legal measures, for example). It is also common to determine that draft laws requesting the granting of new benefits be accompanied by assessments of losses and suggestions for the compensation of resources. The more complete and well determined the legal framework is, the greater the security of all administrative acts and procedures in the assessment and control of tax expenditures.

3.1.1. Agency Responsible for the Tax Expenditures Budget

An important aspect and that deserves special attention is the assignment of work for the coordination and final assessment of the tax expenditures to a single office. Even when there is a series of agencies involved in the process, it must be determined which one will, at the end of the day, be the one responsible for the coordination of the work, in order to avoid methodological inconsistencies and unnecessary expenditures due to overlapping of administrative tasks. The OECD recommendation is that this responsibility must be under the Ministry of Treasury.

In fact, there are many reasons that make it preferable to delegate this responsibility on the Ministry of Treasury. According to Minarik (2008), the first one of them is that the centralization of the assessments allows taking advantage of economies of scale. For example, the development of a simulation model allows to simultaneously estimate several tax expenditures. On the contrary, the decentralization of the assessments would force the implementation of multiple models, at least one for each program agency, adding their development and maintenance costs. In second place, the centralization of assessments brings about methodological consistency benefits.

We may also add to the above reasons that the main sources of information for assessments are the tax databases. In this sense, The Ministry of Treasury personnel has a relative advantage in terms of knowledge and access to that data. Without detriment to the foregoing, program agencies will have to collaborate in obtaining the necessary data to carry out the assessments when it is not possible to obtain them from tax sources.

Hence, once the responsibility of the tax expenditures assessments has been assigned to the Ministry of Treasury, it must be defined what specific area or agency of said ministry will be in charge of preparing the information and carrying out the assessments. There are two natural candidates for this task: the tax administration and the office in charge of earnings projections, and both display positive and negative aspects. On the one hand, the main advantage of the tax administration is its direct access to the tax statement databases, which constitute the source of basic information to perform the assessments. The administration also has greater knowledge of the tax system and benchmarks in what the tax expenditure is legally granted. On the other hand, the budget offices are the most appropriate to integrate tax expenditures in the budget cycle, but will have difficulties to access data broken down by company (even in matters related to the fiscal secret in many countries).

The advisable thing would be to assign the data search and access task, analysis and assessment to the tax administration, which would send the calculations for the budget office to include them in their budget proposal. And to that end, cooperation and the exchange of information between agencies is essential.

3.1.2. The Challenge in Federative Countries

In federative countries or those where there is a strong decentralization, sub-national levels are in many cases, significantly responsible for tax pressure and also for tax expenditures. In these countries, tax expenditures budget assessments should include information of the states (provinces or departments) and municipalities. The central (federal) government is the natural candidate to take over the coordination for this work, ensuring harmonization of the methodology, exchange of information and the aggregation of national returns

This is an issue where not even the federative countries with developed economies have made much progress. In some countries, sub-national levels are involved in a sort of tax competition, which creates difficulties even to see the full list of benefits granted. A fiscal responsibility law with national scope can, at least, provide a legal framework to try to systematize data aggregation and give greater transparency to the tax expenditures budget.

To this end, in countries such as Brazil and Colombia, fiscal responsibility laws⁴ impose the compulsoriness of estimating the fiscal cost of the tax

4 Art. 14 of Complementary Law 101, of May 4, 2000, in Brazil, and arts. 5 and 7 of Law 819,

exemptions granted in the past, as well as of making explicit the fiscal impact of any Bill, order or agreement that orders any expenditure or provides tax benefits. However, since these countries have not set a standard assessment methodology, sub-national governments that meet the obligation of estimating tax expenditures use different and possibly inadequate criteria. Furthermore, in the case of Colombia, formally a unitary organization country, many lawyers believe that a national standard could not impose the use of a specific methodology without adversely affecting the autonomy guaranteed to sub-national governments.

It is possible that a feasible alternative in this sense would be the cooperation between the central Government and the sub-national governments, as well as work to generate awareness among citizens and the legislative bodies and sub-national control regarding the need for accountability.

3.2. Application of a Coherent and Transparent Methodology

Progress in the systematic elaboration of tax expenditure budgets requires a reliable assessment of the latter. The following must be sought in order to succeed in this challenge: (i) adequate identification of the tax expenditures, and (ii) development of specific assessment methodologies.

3.2.1. Identification of the tax expenditures

A list of all expenditures associated to the different encumbrances of the tax system must be made for the correct identification of tax expenditures. To that end, it is necessary to previously define the standard or reference tax that will be used with relation to each tax, to then identify the deviations with respect to that standard or reference. This reference tax is a sort of “ideal”, that is to say, a tax without any type of exceptions that is applied over an ample base, such as revenue or consumption. It is also necessary that taxes for which the tax expenditure will be measured be defined. However, in this stage it is convenient to be as thorough as possible, to avoid the a priori exclusion of apparently minor taxes that could have important concessions.

In what respects to the election of the reference tax, it will become necessary to choose between a broad and comprehensive focus, the so-called *conceptual focus*, or a more restrictive one, such as the *of July 9, 2003, in Colombia.*

legal focus (the following section includes detailed information on each focus). It must also be decided what information will be incorporated in tax expenditures budget. On one hand, it may be chosen to include only those line items that have previously been defined as tax expenditures. On the other hand, all legal provisions that imply a lesser tax collection will be included, identifying, of course, those that, in the criteria of the authority, correspond to such expenditures. From the fiscal transparency point of view, the broad focus with an abundant amount of information⁵ appears as the best alternative.

Three general focuses

Craig and Allan (2001) point out that there are three general focuses used by the countries to define reference taxes and identify tax expenditures.

In this paper they will be given the following names: (i) **conceptual focus**; (ii) **legal focus**, and (iii) **analog subsidy focus**.

The **conceptual focus** attempts to link the reference tax with a “standard tax structure”, which does not necessarily bear relation with the legal definitions of the tax. For example, many countries use the Haig-Simons tax concept to define the reference in income tax.⁶ That is to say, the reference tax is defined as that whose tax base is the Haig-Simons revenue, into which some adjustments are introduced to reflect situations where it is not administratively feasible to apply the pure concept. Thus, taxation on capital gains on realized based is often considered part of the tax reference, even though in the pure Haig-Simons concept such income should pay taxes on the accrued

⁵ *In this respect, Canada, for example, has chosen to present reports with the greatest possible amount of information, reporting any deviation with respect to a conceptual reference tax system, which only incorporates the basic structural elements. Therefore, the Canadian tax expenditures report also includes many tax provisions that are generally not considered tax expenditures. These assessments, which are added to the report separately and are known as “memorandum items”, are classified into three groups: (i) measures that are considered part of the reference system (for example, credits to avoid double taxation on dividends); (ii) measures that generate discussions on whether they should be considered tax expenditures (for example, the deduction of the cost of business meals, which can be taken as a necessary expenditure to generate revenue or a tax expenditure), and (iii) measures for which the available information does not allow the separation of the tax expenditure component from that portion that is part of the reference tax system (for example, the deduction of the cost of meals of a certain class of workers). Although this focus has the virtue of contributing the most information possible, it also implies risks. Seguin and Gurr (2004) point out that with such abundant information there is the risk of inducing the report user to consider that all items are tax expenditures or potential sources of increased earnings.*

⁶ *According to this concept, a person’s revenue is defined as the variation his/her equity experiments between two points in time, plus the consumption made during this period.*

base. Consequently, every time that the actual tax is not applied on this conceptual income, or applied to a smaller amount, a tax expenditure appears. In the case of VAT, the standard tax structure might be a pure VAT, which taxes all end consumption, without exceptions

The **legal focus** takes tax legislation in force as the basis for defining the reference tax and, therefore, to identify the tax expenditures. In order to illustrate the difference with respect to the conceptual focus, it can be assumed that a given country's VAT law defines as a taxed fact the sales of movable property and services, and expressly exempts health services. Under the legal focus, there would be a tax expenditure associated to the health services, which are explicitly exempt in legislation, but there would not be one associated to real estate, since these are not part of the legal definition of the tax base. However, with the conceptual focus there would be two tax expenditures: one associated with health services and another to the use of owned real estate, as both represent consumption.

Finally, **analog subsidy focus** identifies only those tax concessions that are clearly analogous to a direct subsidy as tax expenditures. In practice, this approach leads to an identification of tax expenditures that is very similar to the legal focus.

In short, the conceptual focus is more comprehensive definition than the one of the other two approaches, which will result in a more extensive list of tax expenditures and a greater cost for these.

The main problem of the legal focus, with relation to the conceptual focus, lies in that many tax concessions may remain hidden due to the tax technique applied by legislators. In effect, from the economic point of view, it is the same thing if when properly determined it is not subject to the VAT because it lies outside the definition of taxed fact or because the law expressly exempts it. In both cases there is a benefitted product, an activity or a group of taxpayers. However, under the legal focus, only the second case will be made transparent as a tax expenditure. This is the reason why one of the OECD guidelines for best practices in tax expenditures points out that the reference tax has to be global and unique, and that it must not necessarily represent the tax base regulations (see OECD, 2004).

According to the study by Craig and Allan (2001), among the OECD countries, six apply the conceptual focus (Australia, Belgium, Canada, Finland, Ireland and Spain), five choose the legal focus (Austria,

France, Holland, Korea and Portugal) and two choose the analog subsidy focus (Germany and the United Kingdom). In turn, the United States uses two reference taxes: one according to the conceptual focus and another that follows the legal focus (see table 2). In Latin America, Chile follows the conceptual focus, while Argentina, Brazil, Colombia, Ecuador, Guatemala and Peru choose the legal focus (see table 3).

Other distinctive characteristics of the reference taxes

The three above-mentioned focuses are related to the tax base, which is one of the characteristics that define reference taxes. However, these encumbrances have other features, which need to be defined.

In the case of the income tax a decision must be made, among other things, regarding the structure of the tax reference rates, taxation unit, taxation period and accepted deductions. Common practices of the countries include the following:

- **Rates structure:** It is considered that the progressive rates structure contained in the law is part of the reference tax. This means that the usual exempt tranch in the rates scales does not give rise to a tax expenditure, as well as the marginal rates less than the maximum.
- **Tax unit:** in general, tax units accepted in the law (for example, individual, marital or family statement) are taken as part of the reference tax. That is to say, the lesser (or greater) taxation derived from the marital statement, instead of the individual one, does not give rise to a tax expenditure.
- **Tax period:** It is considered that the tax periods defined in the law are part of the reference.
- **Deductions:** Deductions of the expenditures needed to generate revenue are usually taken as part of the reference tax—which is consistent with the Haig-Simons definition of revenue—, as well as the deductions of compulsory payments.
- **Others:** Accounting conventions to determine revenue, the provisions that attempt to facilitate tax administration, those that attempt to avoid double taxation, those related to international taxation, and the deduction of losses from previous periods are generally included as part of the reference.

In the case of VAT and other indirect encumbrances, the reference tax must specify, among other characteristics, the tax rate, the treatment of the carryovers and refunds accepted.

- **Rates:** The customary practice is to consider the generally applied legal rate as part of the reference. Consequently, reduced rates will give rise to tax expenditures and surtaxes will produce negative tax expenditures (although not all countries record them).
- **Carryovers:** In general, it is assumed that the legal treatment of carryovers is part of the reference. In the case there is a sector or group of taxpayers privileged with a carryovers refund, undoubtedly, said treatment must constitute a tax expenditure.
- **Refunds:** It is customary that VAT refunds to exporters be considered as part of the reference tax. This is consistent with a VAT at destination with consumption base.

The “Specific Group” Requirement

Some countries (Australia, Belgium, Korea and Argentina) establish that a tax concession is only considered a tax expenditure if it favors a specific industry, activity or class of taxpayers. From this point of view, a tax provision that deviates from the reference tax, but is applied to most taxpayers, would not be a tax expenditure, but a structural characteristic of the tax. In principle, this requisite seems reasonable, because in the measure that a provision benefits all taxpayers equally, it may be thought that it keeps relation with the design proposed for the tax, in terms of efficiency and equity qualities. For example, the tranch exempt from personal income tax is a provision that favors most taxpayers, which follows equity criteria in the tax design and that is usually considered part of the reference tax.

However, we must warn that few tax concessions have this characteristic, therefore some precautions must be taken in their identification. In first place, some tax provisions are of general application but within a subset of taxpayers, therefore they should be considered tax expenditures. For example, an accelerated depreciation system, which is available for all companies, could be considered in some countries as part of the reference tax. Notwithstanding, said criteria does not take into account that such benefit is specific for the subset of taxpayers that develop business activities and who determine their income on the complete accounting basis, but is not available for the rest of the taxpayers, such as workers or companies subject to other income determination regimes. In second place, some concessions are available for most taxpayers but not necessarily benefit all equally. For example, a VAT exemption in favor of a good from the basic food basket may be qualified as general, in the sense that all households consume said good. However, the exemption favors in greater measure households

for which this good represents a greater share of their consumption, therefore it should also be considered as a tax expenditure.

It is likely that it was the foregoing considerations the ones that led several countries to define tax expenditures as those treatments that deviate from the reference tax, without making reference to the specific nature of the same.

3.2.2. Methodologies to estimate the cost of tax expenditures

3.2.2.1. The three assessment methods

In the specialized bibliography, three “methods” are identified for estimating the cost of tax expenditures, methods that in reality correspond to three different concepts, which may be measured: **waived income**, **earned income** and **equivalent direct expenditure**.

Before explaining the difference between them it is convenient to bear in mind that the application of a tax expenditure induces changes in the behavior of taxpayers. For example, if earnings generated by specific savings instruments are exempted from taxes, there will be a greater demand for such instruments and, therefore, revenues of that type will be higher to those that would have been produced without the application of the preferential treatment. Likewise, if an income tax deduction is annulled, it is likely that, to compensate for the loss of the benefit, taxpayers use in a greater measure other deductions allowed in the law. The recognition of these and other changes in behavior in tax expenditures assessments makes evident the differences between the three methods pointed out.

The **waived income method** measures the loss of earnings that takes place after introducing a tax expenditure. It supposes that there is no change of behavior whatsoever in taxpayers, that is to say, that their behavior is the same one they exhibited during the application of the tax expenditure. This method is also known as *ex post measurement*.

In turn, the **earned income method** tries to estimate the additional collection that is possible to obtain with the annulment of a tax expenditure. Unlike the previous method, in this one —also called *ex ante measurement*— changes in taxpayers’ behavior are taken into account. In practice, the application of this method is quite limited, because it poses the difficulty that assessments must be available for the supply and demand elasticity of the goods or revenues favored

with a preferential tax treatment. This method must also consider the changes in behavior with respect to evasion. A part of the potential revenue derived from the annulment of a tax expenditure will end up being evaded, as it happens with a portion of the collection of all taxes.

Lastly, the **equivalent direct expenditure method** estimates the subsidy or the transference that would leave taxpayers with a net tax revenue similar to the one they obtain with the existence of the tax expenditure.

To understand the difference between this method and the previous ones it is convenient to distinguish between two types of tax expenditures: the “tax subsidies” and the “tax transfers” (see OECD, 2004). The first ones are those that are linked to the purchase of specific goods, like for example VAT exemptions. The second ones are those that are not linked with the purchase of goods, such as, for example, reduced rates.

The equivalent direct expenditure takes into consideration the fact that transferences normally are part of taxable earnings. Therefore, if we want to estimate tax expenditure on the same base as a direct transference, we must add the amount of the tax that would affect said transference. However, in the case of those tax expenditures that qualify as tax subsidies, the above adjustment is not necessary, because direct subsidies generally do not increase the taxpayers’ taxable income.

The choice of the best method depends on the desired outcome. If we wish to obtain a precise assessment of the greater collection that may be obtained with the elimination of a specific tax expenditure, the most adequate method is the earned income one. In turn, if we want to establish a parallel between the direct expenditures budget and the tax expenditures budget, the best thing to do is to use the equivalent direct expenditure method.

In that respect, OECD (2004) points out that the “best practice” consists in estimating tax expenditures by the waived income method, but correcting the results by an equivalent tax margin, in those cases where the equivalent transference is subject to taxes. According to what is explained in the above paragraphs, this practice is equal to the application of the equivalent direct expenditure method. The basis for the OECD’s recommendation is that the utilization of a different method would give rise to the false idea that the tax expenditure is an alternative that is relatively cheaper than the direct expenditure.

However, tax expenditure reports are also commonly used to look for alternative tax reforms. In these cases, assessments by means of the equivalent direct expenditure method may feed wrong expectations regarding increases in collection that could possibly be expected with the annulment of some tax expenditures. Likewise, it may be convenient to elaborate complementary assessments that show figures closer to the increase in collections that may be obtained with the annulment de los tax expenditures. To achieve that it is possible, for example, to adjust the waived income figures applying the constant total expenditure assumption, used in Chile and Argentina. Likewise, it is reasonable to also consider that a portion of the waived income will be evaded. If there are tax compliance assessments for the main taxes, the waived income may be weighed by the compliance rate of the respective tax.

It must be pointed out that practically all countries that prepare tax expenditures reports use the waived income system, which is the simplest estimating methodology and the one suggested for beginning. The United States applies the waived income method as well as the equivalent direct expenditure method. In Latin America, both Chile and Argentina use a supposed change in behavior: the constant total expenditure assumption. According to this one, the annulment of a franchise translates into a lower income available for taxpayers and, therefore, in a lower consumption and VAT payment.

Now then, once the waived income assessments are available it is not difficult to elaborate assessments for the equivalent direct expenditure. To that end, tax expenditures must be classified into two categories: those that could eventually be replaced by a transference subject to taxes and those that could be replaced by a subsidy or a transference not subject to taxes. Then, the waived income assessments of the first group must be increased in the value of the tax equivalent transfersences would have to pay, following the procedure described in the previous chapter. In the case of personal income taxes, an additional calculation will be required to determine the average weighed marginal rate with which transfersences would be taxed, which can be estimated without great difficulties if statistics on the beneficiaries of each tax expenditure disaggregated by revenue tranches are available.

Table 1**Definition and measurement of tax expenditures (OECD)**

Country	Definition and measurement		
	Definition of tax expenditure	Focus	Concept being measured
Germany	There is no explicit definition. References to benefits received by the companies or economic sectors.	Analogous subsidy.	Cash based waived income.
Australia	Tax law provisions that tax certain classes of taxpayers or types of specific activities in a manner different from the reference structure chosen.	Conceptual.	Accrual based waived income.
Austria	Earnings waived by the federal government by means of exceptions to the general tax standard, which benefit natural persons or bodies corporate for private activities performed in the interest of the public at large.	Legal.	Accrual based waived income.
Belgium	Earnings waived through tax incentives in the shape of exceptions from ordinary taxation, which are granted to certain taxpayers or economic, cultural or social activities, and that could be replaced by direct subsidies.	Conceptual.	Waived income, cash based.
Canada	Deviations with respect to the reference tax.	Conceptual.	Waived income, cash based.
Korea	Reduction of national tax earnings resulting from the application of special provisions, such as exceptions to the normal tax system, to reduce the tax burden of a specific group of taxpayers.	Legal.	N.I.
Spain	There is no formal definition.	Conceptual.	Waived income, cash based.
United States	It is a preferential exception to the reference standards of the tax structure.	Conceptual and legal.	Waived income, subsidy equivalent and present value, cash based.
Finland	Deviation from the normal basic taxation structure to support specific purposes.	Conceptual.	Cash based waived income.
France	Legal provisions whose implementation induces lower tax earnings for the State in comparison with the application of the reference or standard, which is the basic tax calculation principle.	Legal.	Cash based waived income.

Country	Definition and measurement		
	Definition of tax expenditure	Focus	Concept being measured
Holland	Deviations with respect to the reference tax system.	Legal.	Accrual based waived income.
Ireland	There is no formal definition.	Conceptual.	Waived income.
Italy	Favorable tax treatment, which, although structural, is an exception to the principles of tax generality, uniformity and progressiveness.	N.I.	Accrual based waived income.
Portugal	There is no formal definition.	Legal.	Waived income.
United Kingdom	Tax reliefs that are alternatives for government expenditure and that have similar effects.	Analogous subsidy.	Accrual based waived income.

Source: OECD (1996), Craig and Allan (2001), Swift et al. (2004) and reports from the countries. S.I.: No information.

Table 2
Definition and measurement of tax expenditures
(Latin America)

Country	Definition and measurement			
	Definition of tax expenditure	Focus	Concept being measured	Unit responsible for assessments
Argentina	Amount of earnings the public tax administration ceases to collect, in a definite manner, by granting a tax treatment that strays from the one of a general nature established in the tax law, with the purpose of benefitting specific activities, zones or taxpayers.	Legal.	Waived income, corrected for the constant total expenditure assumption.	National Tax Research and Analysis Office, Treasury Secretariat, Ministry of Economy and Production.
Brazil	Indirect government expenditures made by means of the tax system, that seek to assist economic and social objectives.	Legal.	Waived income.	Receita Federal.
Chile	Collection that the public tax administration ceases to collect for the application of franchises or special tax regimes and whose goal is to favor or promote specific economic sectors, activities, regions or agents.	Conceptual.	Waived income, corrected for the constant total expenditure assumption.	Internal Taxes Service.

TOPIC 2.2 (IDB)

Country	Definition and measurement			
	Definition of tax expenditure	Focus	Concept being measured	Unit responsible for assessments
Colombia	Tax benefits granted to promote economic activities or less developed regions.	Legal.	Waived income.	DIAN.
Ecuador	N.I.	Legal.	Waived income.	SRI (since 2007).
Guatemala	Those situations in which the generating factor that should have given rise to the tax has been formalized and, however, there is no obligation to pay the taxes, unlike the rest of the taxpayers. The generally applied concessions are considered part of the standard.	Legal.	Waived income.	SAT.
Mexico	That amount that is not collected due to the existence of special fiscal treatments, administrative facilities, authorized deductions, exempt earnings, preferential rates, fiscal stimulus and specific resolutions.	S.I.	Waived income.	Treasury and Public Credit Secretariat.
Nicaragua	Transferences the State makes to specific groups or sectors, but instead of performing them by means of the budgetary expenditure it performs them by means of a reduction in the taxpayer's tax liability.	N.I.	N.I.	Ministry of Treasury and Public Credit.
Peru	Any tax measure that results in a loss of tax earnings for the State and the corresponding reduction of the tax burden for the taxpayer, which has not occurred under the application of a general tax law.	Legal.	Waived income.	SUNAT.

Source: Craig and Allan (2001), Swift et al. (2004) and reports from the countries.
N.I.: No information.

3.2.2.2. Forms of calculation

In what respects to the specific methodologies to calculate the waived income, these will depend on the type of tax expenditure that must be estimated and on the information available in each case. The experience of the countries shows that, in general, it is necessary to

resort to an ample variety of forms of calculation (see table 4). However, in view of the common characteristics that are observed among those, it is possible to highlight the following four methodological types:

- **Direct collection from earnings statistics**

Even though it is uncommon, it is possible that certain tax expenditures, specifically some credits against the taxes, be declared in some specific item of the tax statement forms and be recorded in an account of the database of the earnings office. In these cases, the waived income will correspond exactly to the balance of said account.

- **Assessments with aggregated statistics**

These methodologies consist in the carrying out of simple arithmetic operations on aggregated statistics, obtained mainly from tax statements but also from other sources, such as national accounts. This focus is appropriate, particularly when the cost of the tax expenditure is a simple portion of the total transactions. This is the case, for example, of exemptions and deductions of the companies' the income tax, where the waived income is estimated as the aggregated amount of the deduction or of the exempt revenue multiplied by the tax rate. It is also convenient to use this method to estimate the income waived by the application of reduced rates, simply applying the rule of three on the effective collection of the respective rate.

This method is also used in some countries to estimate the cost of deductions and exemptions of the personal income taxes, in which case one must multiply the aggregated amount of the deduction or exempt revenue by a weighed average marginal rate. This rate must be previously calculated with data from some base year and updated every certain amount of of years. The ideal thing would be that there be a weighed average marginal rate for each deduction or exemption, given that the profile of the beneficiaries is not necessarily the same for each tax concession. With this focus we can achieve a good approximation of the waived income, although its results are less precise than those that would be obtained by means of an aggregated simulation or micro-simulation.

- **Aggregated simulation models**

In this focus, just like in the previous one, work is performed with aggregated statistics from mainly tax sources but also from national accounts, budget surveys and others. Yet, unlike the previous methodology, in this case a greater opening or stratification of the

aggregated statistics is required, as well as the development of mathematical algorithms of a greater relative complexity.

Models of this type are applied to the calculation of deductions and exemptions of personal income taxes. For example, in Australia (Brown, 2004) this type of model is elaborated, same that is called “distributional modeling”, from data on income distribution and tax concessions for taxable income tranches, using the administrative databases as sources of information.

Models based on input-output matrices to estimate the cost of VAT exemptions also fit under this category. In spite of the frequent lack of information on exempt activities in the administrative databases, the VAT methodology poses an additional difficulty, which makes it unadvisable to exclusively use data from taxpayers’ tax statements to perform these assessments. In fact, the loss of collections associated to an exemption is determined not only by the added value of the exempt taxpayer, but also by the buyer’s tax profile: there will only be collections when the buyer is an end consumer or an exempt intermediate consumer. Therefore, the best way to estimate these tax expenditures is to do so through models based on input-output tables, which allow calculation to be made with greater precision the potential non-deductible VAT that is not collected due to the application of an exemption. These models consider intersectorial sales and purchases and sales associated to the different goods and services. The tax expenditure is estimated as the difference between the non-deductible VAT under the assumption of annulment of the exemption and the non-deductible VAT under the legislation in force.

- **Microsimulation models**

Microsimulation models analyze data detailed at the individual level, that arise, in general, from tax statements, although sometimes alternative or complementary data sources are used, such as budget surveys or company financial statements. In some countries the taxpayers universe is incorporated in the models, while in others they choose to work with a statistically representative simple. In the former gains are achieved in precision, but response times are lengthier and technological tools with greater capacity are required.

La microsimulation essentially consists of recalculating the taxes each taxpayer should pay simulating changes in tax regulations. The waived income is obtained as the difference in collection between a situation

with change in standards and another one without any changes whatsoever. Often, these models are elaborated with data from a base year, which are updated every certain amount of years. That is why at the time of performing the assessments, the model has to be adjusted so that it reflects the tax regulations in force. Likewise, the initial results must be updated to reflect the growth of the tax bases.

These models are especially useful to evaluate tax expenditures that benefit groups of taxpayers with unobservable characteristics in the aggregated statistics, as well as exemptions and deductions in taxes with progressive rates, and to quantify the joint or simultaneity effects of the tax expenditures. Microsimulation is also useful to determine the necessary parameters for the assessments with aggregated statistics or with aggregated simulation models, such as, for example, the weighed average marginal rates.

3.2.2.3. Choice of an Accounting Base

Assessments from the different countries may also differ with respect to the accounting base chosen, which may be cash based or accrual based. The first focus considers the impact of tax expenditures on the cash flow of the public tax administration in a specific period. The second one takes into account the impact on tax liabilities accrued in favor of the public tax administration in a specific period. In the choice of one or the other, agreement with the direct expenditure budget must be sought. If this has been elaborated with a cash focus, the tax expenditures budget must be prepared with a cash basis, and vice-versa.

3.2.2.4. The Specific Case of Tax Deferrals

Deferrals correspond to a specific case of tax expenditures, characterized by the postponement of the payment of the corresponding obligations. An example of deferral is the accelerated tax depreciation schemes, which allow to move to expenses the cost of fixed assets quicker than it would be reasonable in accordance with the loss of their economic value or with the financial accounting standards. These schemes give rise to a lower income tax payment during the first years of useful life of physical investments, in relation with a normal depreciation scheme. Yet, said situation reverts in the following years, when the assets are already fully depreciated and, therefore, the payment of income tax is higher to the one that would be produced with the application of the normal regime.

In most countries a cash criteria is applied to measure the tax expenditure of the deferrals. That is to say, the collection that would have been made in the analyzed period if there had been no deferral whatsoever is estimated, and the effective collection for the period is subtracted from this figure. Evidently, the return in a specific period may be positive, when the postponements of the period are greater than the recoveries, or negative, when the recoveries are greater than the postponements.

An alternative manner to quantify deferrals is to do so according to the present value method. In this case, collection differences that will take place in the future due to the deferrals originated in the analyzed period are estimated, and then the present value of that cash flow profile is calculated. In such circumstances, the figure will be obviously positive. This methodology is only used in the United States for the deferrals.

3.2.2.5. Problems for Calculating the Total Tax Expenditure

Another methodological aspect that must be taken into consideration is the one of the interactions between the different tax expenditures, which can be summarized by saying that the tax expenditure of A plus B is not necessarily equal to the tax expenditure of A plus the tax expenditure of B.

This becomes particularly relevant in the personal income taxes with progressive rates. In effect, if A and B are tax base deductions for a specific taxpayer, it may happen that the individual annulment of A keeps the taxpayer in the same revenue tranch, just like the individual annulment of B. However, the simultaneous annulment of A and B could place it in a higher revenue and marginal rate tranch. Under this assumption, the joint tax expenditure would be greater than the sum of the individual tax expenditures.

In the case of VAT exemptions there are also interactions, although in the opposite sense. The annulment of exemption A reduces exempt intermediate purchases and, therefore, the transfer of the non-deductible VAT for the production of B, and vice-versa. Therefore, the joint tax expenditure will be less than the sum of the individual tax expenditures.

In view of the above, most of the OECD countries—like Austria, Belgium, Canada, Finland, France, Ireland, Italy, United Kingdom and the United States— directly omit the total lines in their returns tables.

3.2.2.6. Coverage, Frequency and Classification

In what respects to the coverage of tax expenditure budgets, this is, the taxes that are included in the assessment, in practically every country income tax is taken into account, both for persons and companies. Among OECD countries, only Austria, Ireland and Holland perform measurements for this tax. A good part of them also incorporate VAT, although sometimes restricted only to exemptions. Canada, Portugal and Spain measure tax expenditure in the VAT and in income tax, exclusively. The rest of the countries also incorporates other taxes, both direct and indirect (see Annex I).

Among Latin American countries that measure tax expenditure, all incorporate at least the income tax and the VAT. Chile and Colombia only measure these two taxes. Argentina, Brazil, Guatemala, Mexico and Peru also include other taxes, such as, for example, duties to imports and specific consumptions.

With respect to the frequency of the assessments, it is annual in the vast majority of the cases analyzed. The exceptions are Germany, where the frequency is biannual, and Italy, that performs sporadic measurements.

The ways to classify or group tax expenditures in the budgets are diverse and change from one Country to another. As may be appreciated in Annex I, tax expenditures are classified according to the tax, the tax technique used to grant the benefit (exemptions, deductions, credits, deferrals and reduced rates), the budget function, the objective sought, the benefitted economic sector and the geographic zone.

3.3. Information Management

A basic requisite to perform reliable assessments of the tax expenditures is to count with sufficient good quality and timely information. However, in many countries the importance of that matter is not perceived and the collection and analysis of the same is not organized in integrated systems; in addition, most of them continue to appeal to manual and biased collection.

There are three well-defined stages in the information management process: data collection, treatment and analysis.

3.3.1. Data Collection

Basically, there are two types of tax data sources: internal sources (statements and special forms for tax benefits) and external sources (information from third parties and from other agencies involved, such as the administrators of duty free zones). In the case of external information, in general, it is necessary that information exchange agreements be signed.

Information from internal sources

In general, the main source of information to perform the tax expenditure assessments is the data contributed by the taxpayers themselves, through their tax statements and the complementary information required by the tax administration.

If the agency responsible for the assessments is the tax administration itself, there will then be a more expedite access to that whole volume of information, which will enable the development of, for example, the microsimulation models. On the other hand, when the responsibility for the assessment falls on a different agency, access to this data may be limited. In effect, the legislation usually imposes reserve with respect to the data of the taxpayers that tax agency manages. In such case, alternative manners to access the la information will have to be found, such as, for example, through nameless databases or else by means of aggregated statistics.

It may also happen that the agency responsible for the assessments delegates the management of the microsimulation models on the tax administration. In this work scheme, the responsible agency defines the model design requirements and the simulations that must be made, while the tax administration executes the design, carries out the simulations and delivers the results.

Customization of the tax statement forms

In many countries, the assessment of tax expenditures becomes difficult due to the shortage of appropriate data at the corresponding information sources. In effect, tax statement forms not always collect all the information that would be desirable for these purposes. It is common, for example, that fully exempted taxpayers be freed from the obligation of filing statements, which leads to seeking alternate sources or make strong assumptions to obtain assessments, or simply omit them.

In view of the above, a strategy to increase the availability of information lies, precisely, in customizing the tax statement forms, or create new sworn statements, in such a way to as to collect a greater volume of background related to the concessions. In that sense, the very exercise of elaborating the tax expenditures assessments allows to identify the lack of information.

It must be underscored that the collection of information related to tax concessions is useful not only for the tax expenditures assessments, but it also allows for a better control of these activities by the respective administration, which results in a double benefit. Obviously, requesting a greater volume of information implies costs both for the taxpayers and for the administration, but, on the other hand, the massive use of Internet as a means to relate to these has allowed the lowering of such costs for both parties.

Information from external sources

A matter of the greatest importance for tax assessments is the autonomy in the access and processing of the information. Those who have worked in their elaboration know that the lack of autonomy is one of the greatest problems to achieve timely and quality assessments, because it means to depend both of the “good will” of the owner of the information and the skill to adequately process the data. Therefore, it is advisable that the unit responsible for the assessments counts with the highest degree of autonomy possible in the access and processing of the information.

In general, even in countries where agencies foreign to the Ministry of Treasury or specifically to the tax administration (for example, other ministries, duty free zone administrators, regulatory agencies) already regularly provide the information, often the same comes printed on paper, or else it has been collected in a non-systematic manner or by means of a non-specified methodology. This constitutes a very serious problem for the implementation of the tax expenditure budgets, although it is a customary practice in many countries.

One way to make progress and achieve expedite and timely access to the information from other agencies is to do so by means of the formalization of data delivery. To that end, a useful instrument is the signing of information exchange agreements, which specify, among other things, the specific and detailed information requirements, the means that will be used for its transfer, the periodicity and delivery

dates, those responsible for the administration of the agreement in each institution. It must be underscored that this type of agreement is useful even in the case that the tax administration is the entity responsible for the assessments, because, as it has already been pointed out, there is a series of sources of non-tax information that are necessary to perform specific tax expenditures assessments, such as, for example, national accounts statistics, input-output matrices, budget surveys and the financial statements of the companies.

3.3.2. Treatment of the Information

One of the challenges posed by the treatment of the information is the coordination between the I.T. unit that has the data and the unit responsible for the assessments. Frequently, access to those is not adequate and demands a lot of definition work between both areas. Fortunately, technological alternatives are available, which are more and more accessible, which allow autonomous access of the user areas to manage the information, such as data warehouses. These tools integrate in a standard format the diverse operational databases, allowing access to and the processing of microdata, either for the elaboration of microsimulation models or aggregated simulation models, or for the generation of aggregated statistics.

A computerized system information capture and treatment is the best solution for an effective implementation of the tax expenditures budget. For example, we may think about the possibility of developing an government intranet web portal where all agencies involved (defined in the exchange agreements) directly feed the tax expenditures information system, with direct access to a centralized database. In this manner more timely access to the data would be secured, without depending on the availability of resources from the agency that owns the information. This system could even be the administrator of all the concession stages of a tax benefit, for example, in cases where prior authorization from some ministry or agency is needed (in some cases the benefits are granted by list of companies or economic sectors).

Lastly, data precision and detection of inconsistencies must also be taken into account, in such a way that the information that must be analyzed be of the best possible quality. The use of the information in tax assessments always requires a previous stage for preparing the data obtained from the operational bases. For example, information consistency must be checked, out of range data must be eliminated and evident errors must be corrected. In the measure that controls in

collection procedures are improved, we may count with better quality information and the time needed to obtain the assessments will be reduced.

In the context of tax statements, the reception of these via Internet has had a positive effect with relation to the quality of the data, which evidently favors the tax administration's audit tasks, but also has an indirect positive effect for the use of the information for other purposes, such as tax expenditures assessments. In this case, the better quality is the result of consistency controls made in the applications for the sending of statements, which avoid frequent errors in manual procedures, such as, for example, the differences between the totalizing values and the sums of the partial values, or the omission of mandatory information. In some occasions, this type of control is applied only on the section of the forms that contain the determination of the taxes to be paid, but is unfortunately omitted in others that contribute complementary information and that quite often are useful to estimate tax expenditures.

3.3.3. Data Analysis

After data collection and treatment we may move on to the analysis phase of these, where fiscal transparency measures are supported as well as the decision-making regarding changes in the tax policy. With the purpose of offering the greatest guarantees regarding those functions, in general, the tax expenditures budget is presented per type of tax, budget function, geographic region and economic sector. In some countries tax expenditures are also already analyzed by revenue profiles, in such away so as to determine their impact on equity.

3.4. Control and Examination by the Tax Administration

The tax administrations have the function of controlling the correct use of the concessions in their scope of action, because tax expenditures introduce greater complexity in tax legislation, creating new possibilities for abuse and new types of fraud in the incentives system. Thus, the tax administration must verify that taxpayers make use of the tax expenditures pursuant to the law, avoiding the exploitation of the evasion spaces that are normally generated when establishing exceptions to the pertinent regulations. Classic examples of controls related to tax expenditures are the examinations linked to duty free zones operations, exemptions and reduced VAT rates, income tax

deductions, presumed credits and erroneous subjective classification (for example, third sector, non-governmental organizations, universities).

To that end, the administration must make use of the habitual examination tools, such as mass cross-referencing of information and the selective audits. The choice of one tool or another will depend on the specific characteristics of each tax expenditure. For example, some personal income tax deductions or exemptions—such as pension funds contributions, mortgage interests or savings in specific financial instruments— may be easily controlled through mass cross-referencing, by means of computerized systems, between the amounts declared by the taxpayers and those reported by the receiving institutions. This type of information cross-referencing eliminates the possibility of evading resorting to the fictitious engrossing of deductions or exempt revenues, except in the case of collusion with the receiving institution.

Other types of tax expenditures —generally those that benefit companies or VAT exemptions— must be controlled by means of selective audits. The knowledge of the design specificities of each one of those is key for defining the revision programs that aim at controlling specific evasion spaces. For example, VAT exemptions open up possibilities for evasion by means of manipulating the ratio of exempt and taxed sales, which determine the VAT percentage of the inputs that is recoverable as credit. Therefore, an audit to a taxpayer with exempt sales must include, among other things, the revision of these proportionality calculations.

Cabe señalar que la mayor eficiencia de la tax administration en el control de los tax expenditures reduce los costs relativos de éstos, mejorando su desempeño en relación con tools alternativas de public policy, como son los gastos directos. Por otro lado, también es importante que la administration sea capaz de transparentar los mayores costs operativos que derivan de la aplicación de las concessions tributarias, and que las autoridades, a su vez, tengan en consideración esos mayores costs a la hora de definir el budget de la entidad. De otra manera, una examination deficiente de un nuevo tax expenditure redundará en un menor control, and por ende una mayor evasion, de las demás tax provisions.

Likewise, it must be highlighted that it is essential that work be performed with an aim to a greater integration between the tax

expenditures assessment and control activities. Assessments may and must be the first step for a more efficient examination of their correct use. In other words, tax expenditures assessments do not need to be constrained to the study areas of the tax administration, but there should be a systematic feedback with the examination areas. The tax administration has to work with tax expenditures risk profiles (for example, type of benefitted taxpayer, area or sector, duty free zone) and assign personnel specialized in the control of said expenditures.

4. CONCLUSIONS, CHALLENGES TO BE SOLVED AND NEXT STEPS

When this work is over, reference should be made to three general references and some important challenges for the future agenda. The first one of those stresses that there has been great progress in the treatment of these topics in Latin America, especially in what respects to assessments of the magnitude of the tax expenditure. There are variations in the methodologies, but in general the assessments are based on the *ex-post* methodology, of loss of collection. The second observation stresses that the treatment of tax expenditure is essentially focused in the transparency of expenditures in general, but there is still no generalized perception that tax expenditures are equivalent to direct budget expenditures. The third observation underscores that there is still no work to evaluate the benefits that should result as an offsetting item of the tax expenditures. Work is just beginning to measure the costs of tax concessions, but very little is being done to measure results.

It is clear that there is still a long road ahead in the future, with many challenges. Some of these challenges are the result of internal circumstances of the countries, such as, for example, moving from the calculation of tax expenditures at the federal level to the sub-national levels. There is also consensus in what respects to counting with more and better information to perform the assessments.

Other challenges are related to the effort to harmonize or make homogeneous the methodologies and procedures adopted among the different countries, both in the VAT—the most important tax in the countries of the region—and in the companies' income tax, especially those related to the promotion of investments. Said methodological harmonization is very important in order to make it possible to make comparisons. Total uniformity is not possible, because tax expenditures reflect the idiosyncrasy of each one of the countries.

It is also primordial that progress be made in the analysis of the economic policy underlying tax expenditures, in order to look for ways to limit their proliferation, which weaken taxation systems and makes the corresponding administration complicated. Lastly, a greater effort to integrate tax expenditures with the budget is essential. It is also essential that there be limits on the tax expenditures like the ones on direct expenditures.

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ANNEX I

Coverage and structure of the tax expenditure reports in Latin America.

Country	Coverage		Reports				
	Taxes measured	Government levels	Inclusion	Purpose and utilization	Legal requirement	Frequency	Classification
Argentina	VAT, profits, contributions to Social Security, fuel, foreign trade	Federal Government	Includes all tax expenditures according to the definition.	Fiscal transparency.	No.	Annual.	By tax, by modality and by sectorial or regional promotion regime.
Brazil	Taxes on imports, on income, on industrialized products, on financial operations and on rural property, and contributions to Social Security	Federal Government	Includes all tax expenditures according to the definition.	N.I.	Yes.	Annual.	By budget function, by region, by modality and by tax.
Chile	Income tax and VAT.	Central Government	Includes all tax expenditures according to the definition.	Fiscal transparency.	Yes	Annual.	By tax, by modality and by benefitted sector or objective.
Colombia	Income tax and VAT.	Central Government	Includes all tax expenditures according to the definition.	N.I.	N.I.	Annual.	By tax.

Country	Coverage		Reports				
	Taxes measured	Government levels	Inclusion	Purpose and utilization	Legal requirement	Frequency	Classification
Guatemala	Income tax, VAT, financial products, duties, oil, tobacco, beverages, circulation of vehicles and cement.	Central Government	Includes all tax expenditures according to the definition.	Fiscal transparency.	No	Annual.	By tax and by economic sector.
Mexico	Company and physical persons income tax, value added tax (VAT); special taxes: production and services (IEPS), new automobiles (ISAN) and on possession and use of vehicles (ISTUV), fiscal stimulus.	N.I.	N.I.	N.I.	Yes	Annual.	By tax and by modality.
Peru	VAT, income tax, tax selective consumption, <i>ad valorem</i>	Central Government.	Includes all tax expenditures according to the definition.	N.I.	N.I.	Annual.	By tax, by modality and by sector.

Source: Official reports from the countries.

N.I.: No information

USE OF THE RESULTS OF TAX GAP MEASUREMENT FOR STRUCTURING THE RISK MAP AND DESIGNING CONTROL PLANS

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*Contents: Summary.- 1. Introduction.- 2. The underground value added.-
3. Estimation of evasion of taxable amounts.- 3.1 Value added tax.-
3.2 Regional tax on productive activities (IRAP).4. Conclusions.-5.
bibliography*

SUMMARY

The mission of the Italian Tax Administration is to maximize taxpayers' compliance with tax obligations. In planning the strategy inherent in fulfilling its mission, it is necessary to adopt appropriate methodologies to estimate potential collection, i.e. the maximum collection enabled by current tax legislation¹.

Tax evasion is the most critical factor accounting for the gap between potential collection and effective collection. This paper analyzes the calculation sources and methods adopted by the Administration, setting forth the uses of this indicator as a parameter to schedule activities. The Administration has followed the top-down approach, chiefly based on comparing the tax data to national account aggregates.

Tax evasion, the typical underlying variable that is complex to assess, calls for the use of several independent calculations to undertake a reliability analysis based on the observation of the results attained. Rather than an end, this paper is the beginning of future developments, as presented in the conclusion.

¹ Sevilla Segura (2006).

1. INTRODUCTION

The Italian Tax Administration's (hereinafter, the Administration) activity is ruled by an agreement with the Ministry of Economy and Finance. Such agreement establishes the objectives to be met and the resources required to do so. The objectives are referred to the activities we shall pursue (number of controls and services rendered) as well as the collectible amounts following tax controls.

Knowing the objectives is relevant in fulfilling the Administration's mission, namely to maximize taxpayers' compliance with tax obligations.

In order to plan the strategy, face the potential risks and foresee the criticalities tied to the fulfillment of the mission, we must rely on appropriate methodologies to estimate potential collection, defined as the maximum collection enabled by current tax legislation². In other words, "potential collection is that which would be collected if no taxpayer would voluntarily breach the law and involuntary errors would amount to zero³".

The most critical factor explaining the gap between potential collection and effective collection is evasion, which stands as the main aggregate by which the Tax Administration's performance should be assessed⁴.

The objective of this paper is to present the sources and the calculation methods adopted by the Administration to estimate tax evasion as the missing portion of the tax potential, setting forth the uses of such indicator as a parameter to schedule the Administration's activities, making the most efficient use of the finite resources available.

Numerous publications are available on the possible methods to calculate evasion⁵. The Administration undertakes the top-down approach, chiefly based on comparing the tax data to national account aggregates.

The following measurements are especially considered: the underground value added, estimated by the Italian National Statistics' Institute (ISTAT, as per the Italian acronym) and two evasion estimations based on the VAT and the Regional Tax on Productive Activities (IRAP, as per the Italian acronym).

² *Sevilla Segura (2006)*.

³ *Das-Gupta, Mookherjee (2000)*.

⁴ *Viol (2006)*.

⁵ *For a summary, refer to OECD (2004a, 2008)*.

The calculation of the underground sets the general benchmark framework, VAT evasion follows an approach based on the exchange of goods and services (demand-side) and the IRAP is a proxy of the gap existing in the business profit-earning process (supply-side).

For the Administration to apply it clearly, we must first define the benchmark framework of the three indicators with respect to the taxable amount and the applicable potential collection:

1. The comparisons based on the aggregates of National Account expenditures and the resources account (GDP, Final Consumption, etc.) comprise the transactions recorded on the businesses' profit and loss account and exclude the net worth status; therefore, the calculation of tax evasion from the collection amount is incomplete, since it fails to comprise evasion arising from changes in net worth;
2. The national account system provides a reliable indication of the potential profit and not the subsequent tax; thus, we recommend comparing with the tax data on the taxable amount rather than on the tax potential;
3. From item 2, we may infer that all evasion types arising from an incorrect tax statement with a tax base that was filed correctly are excluded from the estimations (such as the application of a VAT rate different from the actual one).

Despite such limitations, the comparison with the national accounts' system data offers a wealth of information, since profit earning is the time of wealth creation of the country from which all the forms of taxation originate, directly or indirectly. On the other hand, tax evasion based on total or partial concealment of the tax base accounts for the most relevant form of tax evasion, since it is the most difficult one to identify.

For evasion indicators to have operating relevance, they are broken down to comprise type of tax (VAT, IRAP), economic sector, geographical area and taxpayer type.

The paper is structured as follows: the second item is aimed at informing on the methodology and the sources to calculate the underground value added employed by the ISTAT, the subsequent item discusses VAT and IRAP tax evasion and, finally, it presents a number of conclusions and references to future papers.

2. THE UNDERGROUND VALUE ADDED

Since 1993, the United Nations System of National Accounts (UNSNA) establishes that the national accounts estimations shall also include the informal economy. The informal economy includes different groups of activities; this paper shall focus on the underground economy, defined as: “legal productive activities that are not registered mainly due to a deficiency of the statistical data collection system or to economic reasons; that is, the will to avoid the tax and social contribution obligations in order to reduce production costs⁶”. Therefore, the national statistics’ institutes rely on methodologies that enable them to estimate and include the underground economy in national account aggregates⁷.

Within the underground economy, the ISTAT isolated the item that statistics fail to record owing to the economic underground⁸, which represents the legal productive activity which nevertheless escapes direct observation because of its connection to tax evasion⁹. The ISTAT applies the Labor input method (LIM) approach because the elements of the GDP are obtained by expanding into the universe the per capita data obtained from the studies undertaken in businesses through the employed labor input (measured in terms of Full Time Equivalent Unit, FTE).

To summarize, the estimation-development process is based on the following phases:

- a. Calculation of the total FTE considering the registered component (regular) and the non-registered one (irregular), the total regular and irregular FTE constitutes the national accounts’ benchmark universe;
- b. Based on the studies performed in businesses, we may calculate the per capita values for output, intermediate costs and value added, with the possibility of correcting them as required, whether based on an invoice understatement or a cost overstatement;
- c. By multiplying the result obtained in b) by the FTE set forth in a), we obtain a preliminary supply estimation (GDP);
- d. The estimation of c) is part of an Input-Output system that compares with demand-side estimations (consumption, investment, etc.), since individuals are less reluctant to file the data on expenses than on income earned, the demand data exceed the supply and, based on such discrepancy, the new GDP correction is applied.

⁶ For a more in-depth analysis, refer to OECD (2002).

⁷ For a summary on the international methods employed, refer to UNECE (2008).

⁸ Baldassarini, Pisani (2000).

⁹ Always considering the caveats presented in the introduction.

Therefore, from a theoretical standpoint, the ISTAT estimations capture the concealment of the total added value produced (based on the estimation of irregular FTE) such as partial concealment arising from an invoice understatement or an exaggerated cost overstatement (items b and d).

The ISTAT regularly published the measurements of the economic underground¹⁰. Based on the latest data available, we may infer that in 2006, 16.9% of the GDP was produced by the underground sector (Figure 1). Likewise, 38% of the underground economy results from the employment of irregular labor and the remaining 62% is concealed with other methods. On the other hand, we may obtain a measure of the phenomenon by macro-sectors of activity (Figure 2), from which we infer that 80% of the underground comes from services, 17% from industry and the remaining 3% from agriculture. The small percentage figure of agriculture is based on the fact that this sector has very little impact on the GDP, and thus, although marked by high evasion rates, represents a marginal share of the underground economy.

Figure 1. Breakdown of the GDP based on the economic underground and its components

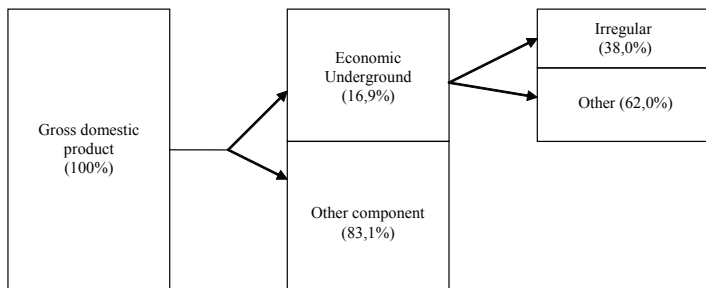
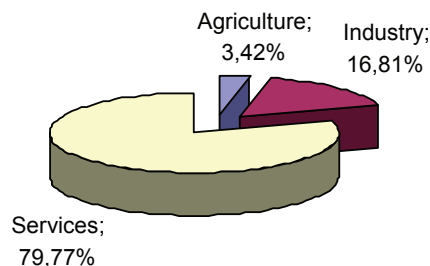


Figure 2. Breakdown of the economic underground by sector of economic activity



Source: ISTAT

¹⁰ For more updated estimations, refer to ISTAT (2008).

Therefore, the ISTAT estimations of the economic underground only provide the general benchmark framework of the potential taxable amount, but also suggest potential general guidelines on which to focus control activities (informal labor, etc.) and focus attention towards the macro-sectors posing highest risk.

Based on such features, the Administration employs the regional GDP calculated by the ISTAT as the indicator to assign the monetary recovery objectives that each regional office¹¹ undertakes to attain in the budgetary allocation phase for the activities.

3. ESTIMATION OF EVASION OF TAXABLE AMOUNTS

The ISTAT information of the economic underground, although a relevant benchmark factor, fails to fully meet the Administration's need. Firstly, because the value added, to the extent it is an elementary unit of national wealth, represents an indirect indicator that excludes the regulatory specificities vis-à-vis the assessment of the tax bases.

On the other hand, we may actually observe that the evasion rate of the income produced may not be truly significant if it is tied to the tax bases stemming therefrom. Such differences may be due to: norms that regulate the assessment of the different tax bases, the degree of complexity of the obligations tied to the specific tax¹², the degree of difficulty in concealing certain types of taxes compared to others¹³.

On such grounds, the Administration conducts its own tax evasion estimations, diversified by type of tax.

3.1 Value Added Tax

Tax compliance may be better analyzed when considered from the VAT approach. In fact, although it fully affects the end consumer, its transfer mechanism in the different stages of the productive and commercial chain makes it a "central" tax in the overall tax behavior. Many of the figures of tax evasion (concealment of the overall productive chain, understatement of income, overstatement of costs and/or accounting of inherent costs) are generated by a reduction of the VAT base.

The methodology adopted by the Administration accounts for the adjustment to the Italian reality of a method that is widely spread

¹¹ *The agency is articulated across the territory in 21 regional offices.*

¹² *Androni et al (p. 852), Christie, Hozner (2006).*

¹³ *Viol (2006).*

internationally, based on national account data¹⁴. The Italian approach is centered on the assessment of the potential VAT base, obtained by changing national accounts' flows to match them with the tax regulations.

Pursuant to the notions set forth in Reckon (2007), two tax evasion definitions are adopted: "not remitted" and "not collected" VAT base.

The first one (not remitted - without complicity) considers that there is no complicity between the selling party and the buying party and, therefore, tax evasion is materialized because the selling party fails to remit the VAT applicable.

The second one (not collected - with complicity) measures the tax base and the tax that the selling party did not invoice to the buying party by virtue of a mutual agreement; tax evasion is thus materialized by the selling party's failure to invoice.

The example in Chart 1 clarifies the difference between both behaviors. Chart 2 assumes three types of transactions between a selling party and the end consumer, who share the same VAT base of € 1,000. On the other hand, it entails a single tax rate amounting to 20% and the absence of costs deductible from the invoiced tax.

Transaction 1 is not affected by evasion, therefore, the selling party invoices VAT for a €200 amount, which is subsequently paid to the tax authority. On the national accounts, the amount registered in the consumption of families is € 1,200.

Transaction 2 assumes an agreement between the selling party and the buying party, according to which the former accepts an informal payment amounting to € 1,000, without the corresponding invoiced or remitted tax. On the national accounts, the amount registered on the consumption of families is € 1,000.

Transaction 3 does not feature an agreement between the selling party and the buying party; therefore, the former invoices the latter € 1,000 for the tax base + € 200 for VAT, but fails to deposit the money with the tax authority. On the national accounts, the amount registered on the consumption of families is € 1,200.

¹⁴ Nam et al. (2001), *HM Custom and Excise (2004)*, *HM revenue and Custom (2006)*, Reckon (2008, 2009), in the case of Italy, refer to Marigliani, Pisani (2006).

Table 1. Example of 3 types of transactions considered in VAT estimation (VAT rate=20%)

ID.	VAT base	VAT invoiced	VAT actually remitted	National accounts' figures	Economic behavior
1	1,000	200	200	1,200	No evasion
2	1,000	0	0	1,000	Evasion with complicity
3	1,000	200	0	1,200	Evasion without complicity
Total	3,000	400	200	3,400	

Chart 2 describes the way in which the transactions reported on Chart 1 are reflected on the evasion estimations. The base premise is the end consumption on the national accounts, amounting to € 3,400, which includes an actual VAT remittance amounting to € 200. This premise is related to the tax statements featuring a € 1,000 VAT base and a VAT remittance amount of € 200. Evasion, which is unknown in the aggregate, is € 2,000 for the base and € 400 for VAT.

If we assume that evasion occurs with complicity, we must subtract the actual VAT remittance (€200) from the National Account premise (€ 3,400), thus obtaining a potential base of € 3,200, € 1,000 of which have been filed and € 2,200 evaded. In this case, we overestimate the tax base evasion (€ 2,000).

Table 2. Impact of the different kinds of fraud on estimated tax evasion

N.A. figures: Final consumption = 3,400 of which: VAT actually remitted = 200

VAT return: VAT base 1,000; VAT=200.

Effective evasion (not observable): VAT base = 2,000; VAT = 400.

Aggregates	With complicity (Not collected)	Without complicity (Not remitted)
N.A.	3,400	3,400
VAT actual remitted	200	
Potential VAT base	3,200	3,400/1.2=2,833
Estimation of VAT Base Evasion	2,200 Overestimate	1,833 Underestimate

The Administration uses the following information groups in its calculation:

1. Final consumption by households (261 items);
2. Intermediate consumption by government (17);
3. Intermediate consumption by non-profit institution serving households;
4. Intermediate consumption by industry (58);
5. Intermediate consumption by product (5);
6. Gross fixed capital formation by government (11);
7. Gross fixed capital formation in dwellings (new and improvements);
8. Gross fixed capital formation by other market sector (58);
9. Valuables.

The tax under consideration enables to draft sufficiently extensive historical series; in the case of Italy, reliable information is available as from 1980. Likewise, the calculation methodology enables to perform estimations in brief terms. Therefore, the potential VAT base is used to perform long-term analysis as well as considerations on the most recent evolution of regulatory compliance.

As regards the structural analysis, an econometric estimation was conducted, which tends to isolate the context variables that influence evasion, in order to capture the Administration's specific role¹⁵. Empirical evidence confirms that there is an important positive relation between the system's tax rates and tax evasion. The positive correlation between evasion and the economic cycle is also less intuitive, in the sense that evasion tends to drop in the recessive stages of the cycle and to grow in the expansion stages. This relation may be explained by the behavior of marginal companies operating partially or fully in the informal market; since they are also weaker they tend to be the first to be expelled from the market in times of crisis. Upon isolating the structural factors, we identify that taxpayers perceive a negative relation with the Administration's control power.

3.2. Regional Tax on Productive activities (IRAP)

The studies performed on VAT fail to render detailed information by economic activity and geographical area. Therefore, we have used the IRAP, a relatively recent tax created in 1997. This tax assumes the regular regional undertaking of activities organized autonomously for the production or exchange of goods or rendering of services.

¹⁵ For a summary of the general evasion data, refer to Androni et al. (1998) and Christie E., Hozner M. (2006). Specifically for VAT, refer to Keen, Smith (2007), Nam et al. (2001).

The features of this tax are:

- ✓ A large taxpayer universe spanning the operators comprised in the assessment of the GDP almost in full;
- ✓ A tax base that is very similar to the value added to the cost of the national accounts' factor;
- ✓ Regional articulation performed on the basis of the production carried out in the location.

The three above-mentioned features facilitate comparison with the national accounts' data and enable detailed analyses both from the sectoral and territorial perspectives¹⁶.

The analysis of the supply enables, on the one hand, to divide the taxpayer universe on the basis of business size.

Finally, on the basis of the IRAP, we may distinguish between the evasion component generated by informal labor and the one stemming from other types of fraud.

The Administration employs such estimations mainly for territorial analyses, to identify the areas with highest tax criticality as well as the sectors with the highest exposure to tax evasion risk, considering the area where they belong. In particular, we rely on information that subdivides the national territory into 102 provinces, within which six economic activity sectors are detailed¹⁷.

4. CONCLUSIONS

This paper described the sources and methods of the key indicators applied by the Administration to estimate the tax gap and set forth a number of notions on how such information is used to plan and schedule the Administration's activity.

The methods use the top-down approach and are based on the comparison with macro-economic aggregates, which is extremely useful to provide a general benchmark framework of the system's structure and evolution.

Considering that evasion is a typically underlying variable and one which is particularly complex to estimate, it is necessary to use several

¹⁶ For further information on the methodology, refer to Pisani, Polito (2006).

¹⁷ The detail of the economic sectors is limited to a greater territorial breakdown. At the national level, estimations are conducted for 50 branches, while for the 20 regions the sectors are limited to 20.

independent estimations in order to undertake a reliability analysis based on the observation of the results obtained.

More than an end, it is the starting point for future actions. In order to attach greater operating value to the indications obtained from the top-down approach, we must integrate them with bottom-up techniques, based on the use of the results of tax controls¹⁸, in order to better qualify the information by type of taxpayer (for example, differentiating individuals from corporations) and extend the types of taxes that may be affected by tax evasion (for example, income tax).

Once the database is fine-tuned, we must analyze the grounds for evasion, in order to neutralize the effect of the scenario variables and isolate the role of the Tax Administration in reducing the tax gap, and therefore, increasing voluntary compliance. The latter variable is the most important objective in fulfilling the Administration's mission.

¹⁸ Please refer to OECD (2004b).

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TOPIC 3

STRATEGIES FOR IMPROVING VOLUNTARY COMPLIANCE AND THE COLLECTION OF TAXES

Lecture

Topic 3

STRATEGIES FOR IMPROVING VOLUNTARY COMPLIANCE AND THE COLLECTION OF TAXES

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Contents: Introduction.- 1. Tax compliance.- 1.1 Strategies to facilitate tax compliance.- 1.2 Strategies to control tax compliance.- 1.3 Strategies to induce compliance.-2. The Future.- 2.1 Approach from the treasury-taxpayer relationship perspective.- 2.2 Approach from an operating action perspective.- 3. Conclusion

INTRODUCTION

The global crisis that began in the United States plunged most central countries into a deep recession, and had a resulting impact on the economies of our countries. In this context, in Argentina the National Government was determined to overcome the crisis with strong anti-cyclic measures in order to fuel consumption and investment, instead of applying classic expenditure adjustment measures.

In our capacity of managers of the tax policy, we set out to strengthen the companies' working capital with special measures tied to diverse sectors of the economy.

As advisors in the design of tax policies, we established general measures targeted at fostering investment by offering payment facility plans with lower than the market debt financing rates.

Additionally, specific objectives of the TA relating to the performance of obligations were pursued in each case. We will provide an example of some anti-cyclic measures issued and designed inside the TA:

- Tax Agreement: it was an important, exceptional and extraordinary effort of the National State intended to allow taxpayers to finance debt, disclose capital and non-reported personnel.

Based on a strong vote of confidence in the country's economy, the Tax Agreement brought forward 32,800 million pesos and the support of over 205,000 taxpayers.

- The disclosure of capital and the regularization of workers are synonymous with being confident in the economic future, since both translate directly into "investments". The State treasury finances the present with a view to the future, betting on the sustainability of the economic activity and the employment, generating in addition the expansion of the taxable base for the coming years.
- Tax obligation deferrals due to an economic emergency, addressing the impact of the crisis on export products, added to a prolonged drought in some regions of the national territory. The National Government ordered a state of agriculture and livestock emergency and postponed due dates.
- Under its capacity of advisor in the design of the tax policy and in response to the strategic call to counteract the crisis with anti-cyclic economic measures, a fiscal credit system was extended, which promotes the incorporation of national components into the production of capital goods.
- By late 2009, special payment plans were established for taxpayers to regularize tax debts incurred subsequently to those included in the Tax Agreement, with interest rates that were significantly lower than market rates. This pursued the alleviation of the fiscal burden of economic actors upon observing the first signs of improvement in the country's indicators.

One of the four core objectives of the TA's 2007-2010 Strategic Plan is to control the compliance with tax obligations, by reinforcing the idea that it should happen voluntarily. To such end, effective controls are pursued which may discourage the adoption of irregular behaviors and may correct deviations, and provide quality services that facilitate such compliance. The key words are "control" and "services".

Voluntary compliance is leveraged within a certain fiscal climate. Maintaining a fiscal climate apt for voluntary compliance entails dynamic and ongoing work. And this is because the taxpayers' perception is not only the result of the Tax Administration's actions but also of diverse factors of the political and economic environment of each country; an

environment that – besides globalization – is pervious to the world's political and economic trends.

The 43° Resolution of CIAT's General Assembly, "A modern vision of the Tax Administration", warned on the need to be extremely expeditious in adapting the Tax Administration to today's changing environments. It recommended, among other things, the design and implementation of mechanisms and tools to foster and facilitate the compliance of obligations through the recognition of the positive behavior of taxpayers- "Positive benefit".

The giddiness that has characterized the globalization process in the last two decades will jeopardize the organizations that, given their size and organizational culture backgrounds, are unable to respond to the challenge of an ever changing and multifaceted environment.

The technology and communications development paved the way for centralization plans that brought forward extraordinary benefits, such as the unification of data and procedures, the improvements in control and management processes, their extension, and the expansion of taxation universes; but they may also bring about the risk of a TA with slow reflexes.

This demands the agility and deployment of a multifaceted range of facilitation, control and tax compliance inducement actions.

1. TAX COMPLIANCE

The first point for discussion in this paper is concerned with the issue of tax compliance and specifically with the strategies implemented by the TA in order to facilitate, control and lead to voluntary compliance.

It is important that we firstly give a short description of the concepts used in the discussion. According to Dino Jarach¹, the tax obligation in general, from a juridical perspective, is a juridical relationship "ex lege" whereby a person (primary person, taxpayer or tax-liable person) is obliged by the State to pay a certain amount of money upon verification of the taxable event established by the law.

The tax procedures law provides that the assessment and collection of taxes will take place based on the tax returns that must be filed by the person responsible for paying the tax, in the form and the terms

¹ Jarach, Dino, *El hecho imponible*, Abeledo-Perrot, 3rd edition, Buenos Aires, p. 73.

established by the AFIP. This implies that, in principle, the taxpayer or the tax-liable person is responsible for the correct interpretation of the tax legislation, its application to the taxable event, the association of the taxpayer with the obligation, the quantification of the taxable base, the definition of the tax rate and the quantification of the tax². Ultimately, the first way or mechanism to assess the tax obligation is the “self-assessment”, or the assessment by taxpayer.

Then, we could say that tax compliance consists in submitting the tax return timely, including therein comprehensive and accurate information in order to assess the tax obligation and pay the balance thereof, if applicable.

Achieving a tax compliance that purports the verification of all taxable events could not be the goal of any TA. And this is because there is a series of intrinsic and extrinsic factors to taxpayers which lead to non-performance, namely:

A natural resistance to fulfilling rules or, in other terms, the tendency of society towards illegality and a state of lawlessness³.

Faulty tax returns in terms of how they are prepared, possibly due to problems in the interpretation of tax rules, a lack of knowledge of such rules, or involuntary mistakes in preparing the tax forms. In this group we may include those complaining about the complexity of the tax regulation, the high number of obligations to be fulfilled or simply the difficulties in accessing the TA.

Failure to submit and/or pay due balances (delinquency).

Now that we have differentiated the non-compliance groups, in order to define and implement strategies, we must first identify the target groups of such strategies. The tax compliance improvement strategies will then be targeted at the following purposes:

- Facilitation
- Control
- Inducement

We will discuss each of them separately.

² Koss, Ricardo H., *Chapter VI: Tax assessment, 75° Anniversary of Act N° 11.683, Tribute of the School of Economics - UBA, Edicon, Buenos Aires, p. 228.*

³ Nino, Carlos, *Un país al margen de la ley, Ariel, Buenos Aires, p. 28.*

1.1 Strategies to facilitate tax compliance

◦ Taxpayer registration

The first step taken by the AFIP to implement tax compliance facilitation strategies is closely related to the “collection cycle”, understanding by it the total actions to be performed for the full compliance with the tax obligation.

This collection cycle begins with the “registration” of a citizen with the TA, after which it becomes a “taxpayer or tax-liable person” (the term citizen should be construed widely here, for we may include the registration of corporates that become taxpayers).

To perform this first activity, the AFIP focused on a total reengineering of the Single Taxpayer’s Register.

During 2009’s first quarter, the rule governing the creation of the Register System was dictated, which administers the information relative to the attributes and characteristics of the persons, whether natural or artificial, filed therewith.

The strategic objective that led to the system implementation was the integration of the diverse registers in the AFIP into a “Register System” used in real time by all control, customs, tax and social security systems, thus eliminating any duplication of data, and based on the idea of a single agency, single window, single data and the utilization of web technology.

- Single agency: the concept of single agency derives from the merger between the General Income Directorate and the National Customs Administration in 1997, into what today is the AFIP. As a matter of fact, the concept of single agency had had little practical application (in this sense), for every taxpayer who wanted to enroll in the registry would have to undergo two diligences: one in the DGI to obtain the CUIT number and another at any of the divisions of the DGA (General Directorate of Customs) to obtain the foreign trade operator permit. With the implementation of the register system, the registration of taxpayers and tax-liable persons has been fully integrated, for the whole registration process is now performed through one single presentation before the DGI’s division corresponding to the fiscal domicile, thus integrating the steps that used to be performed at the DGA.

- Single window: this concept is applicable not only internally but also to other registration bodies. The National Registry of Corporations is the best example of it. The General Inspectorate of Justice (IGJ, in Spanish), as the body that administers the National Registry of Corporations, is the first body to use electronic forms to incorporate data into such Registry. The use of IT means and interactive action – in the corporation registration procedure – by the IGJ and other local registration authorities with the AFIP – within the scope of their jurisdiction-, is a significant landmark in electronic governance (a topic we will discuss later here), and will allow the verification of fiscal data of the partners and authorities of new corporations whose incorporation or modification of data is required for registration. This diligence is carried out exclusively – for the implemented corporation type - in the IGJ, and this body is responsible for providing taxpayer with the fiscal data (CUIT number) that are previously forwarded electronically to the IGJ by the TA.

In other words, the concept of single window involves other public bodies which, given their specific responsibilities, participate in the general circuit of the registration of individuals or corporates.

- Single data: the deployment of the organization's IT systems was based on the single data strategic guideline. Evidently, single data conveys a general integrated architecture of all the different services offered by an organization, on the understanding that the oneness nature of the data in the case of the Register system relates to:
 - A single repository that eliminates the permanent replication of diverse areas, of databases with special registers of taxpayers.
 - A single, integral and reliable source of information not only for taxpayers but also for the managerial vision.
 - One document supporting each event.
- Use of web technology: from the registration and after the tax code is obtained, the level of presence security (a topic we will discuss in detail later), the registration, modifications and discharges of register data are carried out through the Internet, with no need to go to any of the AFIP's divisions (whether the DGI's or the DGA's).

The register system is composed of three modules:

- Tax register: the list of natural and artificial persons bound to register in the AFIP and other bodies, even where they are not in a position to acquire rights and obligations and fulfill tax (customs, fiscal and social security) duties.
- Tax registry: it is a general register institution that keeps the data required to identify natural and artificial persons, including other persons likely to acquire rights and obligations regarding tax matters associated with customs, fiscal and/or social security funds. It also includes the data relative to the tax legal personality of registered persons (identification, addresses for tax purposes, obligations and rights).
- Special registries: are register institutions of a particular nature which keep track of the data of persons who by reason of their business are bound to enroll in them in order to exercise tax rights, carry out transactional registrations or enjoy certain benefits, in accordance with the provisions of customs, fiscal and/or social security regulations.

The register system was conceived within the frame of the “opening to the Internet” strategic initiative, which has led the information updated by the taxpayers and tax-liable persons to be performed through the web.

To describe the circuit shortly, a registration number is enrolled by means of a presence diligence for identity validation purposes. Thereafter, the operations are carried out by signing in to the AFIP’s webpage, reporting the economic activity to be developed, the taxes for which the registration is requested and reporting the business domiciles.

In a second instance, the taxpayer may change the reported fiscal domicile, which will be validated with a visit by the post office courier, who will deliver a domicile confirmation code. The entry of such code in the register system will generate the confirmation status of the reported fiscal domicile.

For the purposes of requesting the cancellation of the registration – either wholly or partially – upon the termination of the causes that led to the enrollment obligation, the taxpayers and tax-liable persons must submit the request for cancellation by electronic transfer of data through the body’s webpage.

- **System sign-up – Fiscal Code**

The second step in the design of facilitation strategies consists in allocating a fiscal code to each taxpayer. At the time taxpayer approaches the AFIP's division, whether in their own name or on behalf of a corporate to obtain the fiscal code, and, if applicable, in association with such corporate, certain persons are required to provide biometric data and undergo scanning of their documentation.

The fiscal code is a federal registration/authentication/authorization system. This means that we have to analyze the four characteristics deriving from such definition.

1. - **Federal:** the fiscal code is used by other public administration bodies on a national, provincial and municipal level.

2. - **Registration method:** is the set of procedures executed by a division (of the State or company) to award the identification code to a user requesting it. The entity (AFIP) acts as a "Registration Authority".

These procedures define:

- The manner in which the User applies for the identification code.
- The manner in which the AFIP determines the real identity of the individual requesting the identification code for themselves or on behalf of another person (individual or corporate). This procedure validates the identity of the principal and the role of the User=>Principal relationship.
- The manner in which the AFIP delivers to the User the authentication elements of the identification code, for example, the password, a digital certificate or a smart card.

The registration procedures may be carried out directly by the AFIP or through delegation (as is the case of certain fund transfer networks that delegate the execution of these procedures to the banks).

3. - **Authentication method:** is the set of procedures and techniques carried out by the AFIP to determine that the person that is trying to access the system using a certain identification code is actually the person who was awarded such identification code through the registration methods, along with the relevant authentication elements.

4. - **Authorization method:** is the set of procedures and techniques executed by the AFIP to determine what services the User may perform with their identification code (closely related to compliance control strategies).

There is a fifth element that is worth mentioning, and is the security levels. These levels are obtained from the combination of the registration and authentication procedures that provide jointly to the AFIP the different levels of security that allow determining that the person that is attempting to carry out a certain service is really the person they say it is.

The model is also based on the concept that interactive services are always operated by individuals (there is no other possibility) and that these individuals may be operating these services on their own or on behalf of another individual or corporate.

Having described the fiscal code scheme, other matters related to the New Information and Communication Technologies (ICTs) gain relevance, since from the time the taxpayer obtains the fiscal code, most diligences in the register system and the filing and payment of tax returns are conducted through the web.

The firm orientation towards the Internet implies an additional effort to bridge the existing digital and cultural gaps. In this sense, the AFIP strives to provide web access to those sectors in the population that are deprived of it and establishes aid methods to facilitate the use thereof by citizens who are not acquainted with it.

The need to bring the on-line desk closer to the citizens has required putting at the disposal of the citizens deprived of web access, alternative channels under similar assistance conditions. In this sense, the focus has been placed on opening new service centers and exploring social collaboration mechanisms to provide assistance and facilitate Internet access.

In addition, new communication forms and channels have been developed, which have resulted in the availability of more accessible and transparent information and processes, using the potentialities of the available technology in communications- mobile telephony and text messaging.

- **Electronic Governance**

The sudden appearance of ICTs over the last decades has generated a significant impact on the daily life of society. Aware of this new reality, the National State outlined the adequate frame to drive the intensive use of these new technologies in order to enhance public management on an ongoing basis, offer improved services to the citizens, assure the transparency of the government's acts, facilitate diligences and reduce costs, generate new space for participation, reduce the digital gap by including less favored persons, companies and communities, and facilitate the integration of the national production in the global market.

The result of this purpose was reflected in the approval of the Executive Order No 378/2005, which started up the National E-Governance Plan after laying the foundations of its scope and objectives. Instruments such as the Internet, call centers, web services, e-diligences and e-documents were used in its implementation. Ultimately, all the implemented strategies have responded to the National E-Governance Plan.

- **Preparation of tax returns**

The ICTs have been applied in the preparation of tax returns since 1994, when the first items of application software were developed, which ran on DOS.

This strategic line formulated 15 years ago has remained unaltered over the years, and has accompanied the progress of the ICTs, allowing the development of data exchange systems with taxpayers.

On this regard, we may cite as examples of application the income tax return that contract employees must submit⁴, which is generated without the need to have local software facilities. Besides, the application design drew on the spirit of simplification, which explains the fact that it does not follow the traditional preparation of tax returns but rather is completed through successive steps and has a system of questions that enable or disable further fields⁵ (it should be remembered that in the desk application all the screens are displayed for data loading, and are only restricted by certain initial taxpayer descriptions). Upon

⁴ *Where they earned total gross profits for the fiscal year equal or in excess of ONE HUNDRED AND FORTY-FIVE THOUSAND PESOS (\$ 144,000.-).*

⁵ *See final comments of the 43th CIAT's General Assembly: leveraging mass control activities (tax return and payment).*

completing data loading, the same application allows filing the tax return, after which it issues the relevant receipts.

Another recent example is the enrollment or reclassification affidavit that those who wish to enroll in the Simplified Small Taxpayer System must submit. The preparation and filing are performed in a similar way as that described above, allocating the relevant category and issuing the credential for payment purposes. This concept of simplification has allowed implementing a successful reclassification in less than 30 days⁶, with results that illustrate the magnitude of the reached universe.

Total Accesses: 352.022	
Adherence	65,993
Reclassifications	286,029

Finally, the system called “Mis Facilidades” (my facilities), whereby taxpayers and tax-liable persons apply for payment facilities, also reflects the simplification and facilitation strategy followed by the body, which allowed over 100,000 taxpayers to regularize debts for 7,632 pesos in only three months. As in the preceding examples, this system operates in line with the taxpayer, keeping loaded data until the time taxpayer decides to submit their filing.

Today, all tax return filings are carried out through the web (2,300,000 in February of 2010). Large taxpayers are obliged to pay out their obligations through the Electronic Payment Ticket, as well as export rights. Eighty-three percent (83%) of monthly tax revenues is received through electronic payment mechanisms.

- **Tax Account System (SCT, in Spanish)**

The implementation of the Tax Account System (hereinafter, SCT) as a supplement to the full-cycle control actions that have characterized the body’s actions in the last years entails a quality leap towards the minimization of delinquency and non-performance, thus reinforcing primary control actions by way of systems that collect data, transactions and tax-liable persons’ attributes in their relationship with the body.

⁶ Approval of Act N° 26.565, which modifies the Simplified System (Self-employed workers’ scheme).

We could define the SCT as a computerized transactional information system that allows automating the body's collection processes.

The system's design contains the two first strategic objectives of 2007-2010 Plan:

- I. - Control compliance with tax, customs and social security obligations; and
- II. - Provide quality services that contribute with specific solutions for citizens.

While it is not the intention here to give a detailed description of this system, some essential characteristics, associated with "sub-examination", are worth underlining.

In this sense the transparency of the information is a fundamental pillar to improve tax compliance. Transparency has been defined as one of the guiding principles of the National E-Government Plan, upon establishing that facilitating the access of inhabitants and citizens to the government's acts and the public information through on-line publications, is indispensable. The concept of transparency is applicable to the SCT not only with regard to the accountability of debits and credits, but also because it also includes follow-up of the government's management of balances arising from such accountability.

The actual magnitude of the change could be tightly summarized as follows: until the implementation of this system, taxpayers had no access to the accountability performed by the TA; only those making on-line filings (which at the time the SCT was implemented did not constitute the entire universe of taxpayers) were able to visualize the filing ticket, but not the intrinsic data of filed returns, nor the final accountability of debit and credit balances.

Through the SCT, taxpayers can visualize filings, the accountability entered by the AFIP in its systems, the credit and debit balances resulting from the accountability, in the same way as the internal areas visualize them; in other words, the same system is used by TA's officers and taxpayers alike (concept of single data).

Even though the change is key to the treasury-taxpayer relationship, it is even more significant in light of the fact that taxpayers are allowed to visualize the body's whole management. The demands for payment

or the requests for filing can be visualized, as well as notices (which although received by taxpayer from the post office courier, can also be visualized in the system) and the commencement of any debt recovery proceedings.

In addition, the taxpayer or tax-liable person may pay out debt balances, use credits or modify them (from a tax procedure perspective).

Where we refer to the payment of debt balances, we mean the possibility of generating Electronic Payment Tickets from the debt balance of an account in the system. This allows assuring the proper allocation of payment to debt balances.

Secondly, the taxpayer can use the credit balances to pay out other tax obligations (offsetting).

Offsetting of obligations occurs where two persons, in their own right, qualify as creditor and debtor reciprocally, whatever the causes of either debt may be. This terminates the two debts, with force and effect of payment, up to the extent of the lower debt, from the time that both debts began to coexist (section 818 of the Civil Code, hereinafter "CC").

The Fiscal Procedures Act admits that offsetting as a means of terminating tax obligations may be practiced by administrative initiative by the fiscal body or else at the request of taxpayer. The Argentine doctrine points out at the existence of two types of offsetting: automatic and non-automatic.

In the case of the automatic offsetting, and in light of the accountability showed by the system, we observe that upon the entry of a tax return whose tax is higher than the sum total of tax advances (advances, withholdings, payments on account), which were previously allocated to the tax/fiscal period by the taxpayers and calculated by the system itself against the assessed tax, we verify the existence of credit balances of free readability of the same tax in previous fiscal periods, which are used from the oldest period of time until depletion or until full payment of the debt of the relevant period, whichever occurs earlier.

Alternatively, under non-automatic offsetting, the system does not execute any action because it is the taxpayer who has to drive the utilization of credit balances against their debts. Upon action by the taxpayer, whether through a transaction enabled by the system itself

of the presentation of the ad-hoc form (F 798), there is a double accountability whereby the original amount of the tax/fiscal period is debited and the target amount of the tax/fiscal period is credited.

Lastly, when we refer to the modification of balances we do it from a tax procedural perspective, because it allows, for example, the reduction in payable advances through the filing of a tax return for such purposes. This operation – the option to reduce advances – occurs when the persons responsible for remitting advances, in accordance with the regulating provisions, consider that the amount to be remitted for such item will exceed the final amount of the obligation of the fiscal period to which such amount should be allocated – net of deductibles from the advance calculation base-, and may opt to make the cited payments on account for an amount equivalent to that resulting from an estimation made by them.

Needless to say, if upon termination of the fiscal year in which such advances should be allocated, the assessed tax is higher than estimated, the compensation interest should be remitted for the portion of the advances not remitted, as a result of having exercised the reduction option.

In this way, through the implementation of a fast and simple tool, taxpayers can adapt their balances without having to go to an administrative office.

1.2 Strategies to control tax compliance

- **Control system - SCT**

When it comes to control mechanisms, the first idea that comes to mind is “control systems”. Because the main characteristics of the control system implemented by the AFIP have already been discussed when we described facilitation strategies, we will now analyze them from a control perspective.

Before describing the change in the control paradigm conveyed by the SCT, we should briefly recount the history of the AFIP’s control system (prior to the DGI).

Before the implementation of Sistema Dos Mil [System Two Thousand] (in 1991), the performance of large taxpayers was supervised by resorting to segmentation. A group of taxpayers would comprise the “portfolio” of an account officer.

In 1991 the control strategy focused on a narrowed universe of taxpayers that accounted for the highest percentage of tax collection. The management of such universe was decentralized.

Later on, it was decided that the universe of taxpayers under control should be expanded. The system Dos mil Regional [Regional Two Thousand] was implemented, which had a similar design as that of the former.

After some years of experience and based on the “full cycle” management strategy, in 2006 it was decided that the databases of both systems should be centralized and become managed in a centralized fashion.

Several aspects of this centralization were discussed:

1. - It was a stage prior to the Tax Account System
- 2- It homogenized control actions: the preparation of an operating schedule assured the systemic uniformity and universality of control actions on non-performance.
- 3.- It allowed increasing labor quality: definition of a new role for the operating areas, which would be transformed into Account Analysts, participate in the ongoing improvement of processes, resulting in increased labor quality by adding value to daily tasks.
4. - It brought forward a systemic approach: any technological project should be approached systemically, by considering not only the direct impact on a specific area, but also the interactions and implications in all areas of the organization. This assures that the improvements in the specific area, far from becoming a problem to other areas, will favor them concomitantly and the entire organization will be able to improve its performance. The advancement of information technology had triggered the proliferation of fragmented systems which, while allowing management in the short term, were not apt to be integrated to the new platforms, with the resulting effect of information diversity and disparity.

Eventually we attained the implementation of the SCT and the change in the control paradigm, which does not have to do with the type of management (the centralized management has already been adopted) but rather with a different way of thinking control in the TA.

A significant change in paradigm occurred, which had been developed by the body in the last years. Until then, control actions focused on balances assessed by taxpayers, whose amounts were reflected in the tax returns; while an “ex post” control was performed in respect of concepts that operate as payment on account. With the implementation of the SCT, controls are performed on the assessed tax reported by the taxpayer, discounting payments on account under the records filed with the Treasury’s databases⁷. Put it differently, an “ex ante” control is exercised which allows that the registration and control of balances to be remitted may be performed by the system itself. This change implies a greater control capacity for the Body and a cost reduction for taxpayers.

- **Tax Code – Relations Manager**

As in the previous topic, the Tax Code is part of the facilitation strategies while at the same time is connected with control activities. It resides mainly in the Relations Management scheme.

The Relations Manager is defined as the individual who, using their Tax Code, performs actions:

- a) on their own behalf,
- b) on behalf of an artificial person as its legal representative, or
- c) on behalf of another individual.

Alternatively, there are other persons who are designated by the Relations Manager to use and/or interact with the IT services or carry out certain acts or diligences.

In other words, an interrelation is generated among the individuals who operate the systems, which allows assigning and delegating responsibilities in the use of IT transactions.

- **Operating schedule**

As for management actions upon non-performance, the AFIP – as stated before – has adopted a centralized management strategy notwithstanding the possibility of the operating areas to perform specific diligences.

The centralized actions are targeted at certain segments of taxpayers, which determine the frequency in which the responsible group operates.

⁷ *Some items operate as payment on account, which the AFIP has no previous record of (e.g., similar taxes paid abroad). In this case, the data are taken from tax returns and computed against the assessed tax. The control –in these cases- is “ex post”.*

So, large taxpayers (nearly 180,000) are requested for payment twice a month, whereas the rest is requested on a monthly, bimonthly, biannually or annual basis, following a specific operating schedule.

Alternatively, debt recovery proceedings, unlike the requests for payment, are not based on the classification of taxpayers but on the amounts due.

Below is a table showing the relevant data of 2009:

Assessments due to lack of payment	
Obligations	4,288,748
Total amount assessed	\$ 13,724 million
Debt Vouchers	
Obligations	1,086,333
Total amount executed	\$ 3,322 million

- **Control of specific economic markets**

The controls are performed over taxpayers, and these have their own particularities as to their economic activity, regional distribution, exploitation modalities, culture, etc.

The TA carries out ongoing control initiatives on specific markets consistently with the divisions determined by the economic activity on the universe of taxpayers. From the point of view of both facilitation and controls, an economic approach is required, in addition to the tax approach, to determine the policies relative to both objectives.

In effect, all activities pay taxes on their sales; however, the modalities of the agriculture business are not the same as those of mining, the production of capital goods or the food retail trade. In some activities, taxes are evaded by masking production; in others, by sub-billing sales or selling without invoice; or fictitious credits of inexistent third-party agents or suppliers are created. In each case what is pursued is, in addition to discouraging evasion, fostering voluntary compliance, expanding the tax base – without increasing the tax rates or taxable bases – and fighting informality, thus avoiding extra costs to taxpayer and enabling taxpayer the implementation of measures.

So diverse economic markets have been the targets of specific control measures throughout 2009, namely:

- Grains: in 2009, there were modifications to the former control on grain motor transportation, which enabled the Grain Traceability code, an indicator that is obtained from an Internet service and usable in a safe environment with the Tax Code, by entering identification data of the load trucks, the transportation company, the broker, the recipient, the origin and destination places, species and harvest and other data indicative of the load and route sheet. At the destination, it is the recipient taxpayer's responsibility to obtain a settlement code from the CTG. Thus, an electronic control element was incorporated, which is verifiable along the way by possible checking points, compared to the old paper documentation that was prone to falsification, adulteration and mainly the multiple use of one same authorization, as common evasion modalities.
- Foreign Trade (scanner): the TA has 12 trucks fitted with scanners, modern software, which allow – by calculating areas and lines – an internal layout of transportation vehicles, in order to verify loads and cargos. Permanent regional operations are performed. In addition, there are a great number of scanners placed in the most important ports. Non-intrusive, x-ray inspections are supplemented by the presence of dog teams specially trained to detect smuggling goods. In 2009, over 15,000 kilograms of narcotics were detected.
- Foreign trade: the use of the electronic invoice was incorporated, which allowed the introduction of data that did not appear on paper, such as the final destination and the intermediate route of goods, in order to identify possible cases of triangulation likely to alter the value of the merchandise. Obviously, taxpayers will also be able to enter electronic debit and credit memos in the case of any possible cancellations or reimbursements.
- Surety bonds: the electronic invoice was also implemented for foreign trade-related operations. Over one hundred thousand foreign trade operations occur every year in our country, and all of them must be invoiced through this means in order to crosscheck the policy number, the possible endorsements and the exporters' billing. This is a cross-check measure.

- Internal retail trade: there are over 320,000 tax controllers operating in our country. These devices are coupled with the merchants' cashiers and store the sales receipt of every transaction in paper log tapes that should be stored for 5 years. Upgrading of these devices will allow the incorporation of electronic information storage devices, which will transmit to the TA and will enable knowing the set of operations of taxpayers. A census of existing controllers will be carried out and fiscal incentives will be provided to soften the costs of the technological renovation. This is a facilitation measure that discourages evasion in addition to allowing cross-check controls.

1.3 Strategies to induce compliance

- **Fiscal climate**

The first meaning given by the Royal Spanish Academy to the word "climate" is a set of atmospheric conditions characteristic of a region. In the specific case of the "fiscal" field, the climate would be a set of fiscal indicators.

The Organization for Economic Cooperation and Development (OECD) proposes considering some overall indicators that measure the relationships between the tax revenue and the national income, or more specifically, the relationship between the capital tax and the income earned from such capital. It also suggests the use of combined indicators resulting from the measurement of income taxes, sales taxes and indirect labor costs. This is a suitable approach for making investment-related decisions; however, it is not immediately applicable to the fiscal climate.

In our organizations' view, a suitable fiscal climate is that which encourages the voluntary compliance with all the obligations arising from the legislation imposed on the country's economic actors. All the measures recommended by the diverse assemblies of CIAT, such as transparency, ethics, expenditure accountability, facilitation, tax evasion controls and preventive policies and the expansion of the tax base, are intended for a suitable fiscal climate.

In this sense the TAs are active with regards to creating a fiscal climate that they believe is suitable for their missions and functions.

- **Tax Agreement**

The Tax Agreement was the most important anti-cyclic measure – from the taxation perspective – in 2009.

As far as the tax amnesty is concerned, the final result shows a reported debt – from 169,000 taxpayers – of 14,700 million pesos. It is worth pointing out here that 80% thereof consisted of non-prefinanced debt deriving mainly from the acceptance of the body's adjustments. Also important is that 40% thereof pertained to income taxes, a share that largely exceeds the percentage of such tax in the normal distribution of tax revenues.

Companies were accumulating debt – either reported spontaneously or adjusted for the AFIP – from the tax that is directly assessed on their activity, and the tax amnesty allowed them financing thereof. The manufacturing industry is the economic sector that abides by the tax amnesty the most, and if we consider that this sector is largely composed of small and medium-sized companies, the original aim to sustain companies and employment in this world economic crisis cycle has materialized successfully.

Alternatively, the “exteriorization” system allowed the reporting of funds and property for a total of 18,113 million pesos. The economy sector that abided by this system the most were business and real estate services, which concentrated 94% of the total amount exteriorized in investments, property and deposits in the local market. The final sum of the regularization system is equivalent to 11.1 millions worth of construction m², 4,500 schools or 70,100 trucks. The comparisons illustrate the magnitude of the exteriorization. In addition, the tax base is expanded for the next fiscal years.

- **Facilities Plan – Anti-cyclic measure**

The payment facilities system was intended to normalize the situation of taxpayers who had a debt with the State Treasury, as a way to turn the page from 2008-2009's economic crisis.

The implementation of the plan implied an important decision made by the national government. It was an anti-cyclic measure intended to build a launching pad for 2010's economic takeoff, aimed at sustaining the economy, the production and the employment level.

The final result shows that over 100,000 taxpayers regularized debt for \$ 7,632 million pesos.

- **Tax information exchange agreements**

Following the outbreak of the crisis, G20 countries proposed increasing transparency and information exchange with a view to fighting evasion and money laundering. .

As executers of one of the national government's guidelines on this matter, this TA began to sign tax and banking information exchange agreements in 2009 with the Principality of Monaco, the Bahamas, Andorra, Costa Rica and San Marino, which are added to those signed in the previous year. These agreements were recommended not only by the G-20 but also by the OECD, which in its Global Forum on Transparency and Information Exchange constituted a review group, in which the AFIP was a driving force and an active participant.

These agreements will allow collecting information relative to the ownership of corporations, trusts, foundations and other corporates, as well as income taxes or foreign trade operations.

However, obtaining information from other countries is not the only aim; expanding the internal network of information exchange is also required, including public and private bodies. For example, this TA signed an agreement with the life insurance national authority under which collection of the mandatory life insurance of all workers will be performed through our electronic platform, which allows identifying the policy of each of the 7.9 million employees registered with over 600,000 employers, who will be able to load data only once through a web service created therefor in a Fiscal Climate safe environment, or through the electronic generation of their tax return with the application that the TA makes available to employers for the purposes of reporting payroll, indirect labor costs and social security contributions.

- **Program “IVA y VUELTA”**

An automobile raffle program was launched for citizens remitting coupons to the body and who report sale invoices of merchants located within the national territory. The number of coupons exceeded 1.7 million, which accounted for over 8 million reported invoices and the participation of more than 150,000 citizens. Thirty-eight (38) raffles were carried out throughout 2009.

The universe of reported merchants was used to select specific cases for examination. This measure was intended to foster tax education, the citizens' engagement in tax control activities and voluntary compliance.

2. The Future

Throughout this paper we have mentioned and discussed the main strategies deployed in 2009 to improve voluntary compliance and tax collection.

This framework outlined at the beginning of 2009 has been sustained over time. Therefore, it is worth describing (below) the main initiatives contemplated for 2010, which will undoubtedly have an impact on voluntary compliance and tax collection.

2.1 Approach from the treasury-taxpayer relationship perspective

- **Comprehensive Electronic Withholding System (SIRE, in Spanish)**

The procedures act provides that the collection of taxes will be performed at the same source when the Federal Administration of Public Revenues establishes what persons and in what cases will act as withholding and/or collection agents.

The generalized collection at source has two major consequences: a) it is an efficient means to avoid tax evasion; and b) for the taxpayer, withholdings have practical effects similar to those of the mandatory reserves for the compliance with fiscal obligations when due.

The Federal Administration of Public Revenues has set forth withholding schemes for different taxes.

The Withholding Agent (hereinafter, WA) takes on the role of a collection agent and replaces the fiscal body. To this end, they are required to fulfill a series of formal and material requirements intended for the proper operation of the "withholding at source" system.

This has brought about diverse inconveniences originating in the AFIP-Agent Withholding agent-Withholding taxable person relationship, among which stand out the following:

- The WAs do not file the tax return evidencing the withholdings, so the Administration is not knowledgeable of the withheld amount.
- The WAs report incorrect withholdings: as a consequence, the TA is unaware of the amount of credit attributable to the person subject to the withholding
- The WAs generate inexistent credit memos in order to reduce the tax burden: through this artifice the remittance of withholdings effectively made is eluded.

In order to reduce to a minimum the dissociations between the information on WAs and on Withholding taxable persons, a fully computerized system connected on-line with the AFIP is proposed.

Basically, the withholding agents will report on-line through the system to the AFIP the withholdings made, and may also generate the corresponding tax return, assessing the amount to be deposited in the Treasury.

The withholdings not stored in the AFIP's base may be recorded as "subject to verification" by the withholding taxable person. In other words, the sum total of the withholdings and collections recorded by the Treasury, in addition to those added by taxpayer, will be computable against the assessed tax, pursuant to the provisions of the procedures act.

This system reduces the WAs' administrative burden significantly. Also, it will result in greater benefits for the withholding taxable persons, because they will not have to report the withholdings made from them and will be certain that the operation is known by the Body.

- **Register System – Registration of biometric data**

From the first quarter of 2010, all the individuals applying for the CUIT must present their identity cards for scanning purposes in order to be registered, and will be required to submit their biometric data (signature, picture and fingerprint). In addition, they will be given a tax code with a security level equal to the Division's presence authentication mechanism.

As it is the case today, the division will continue registering the identification data and the legal and fiscal domiciles of applicants. Upon completion of the diligence, the division will have the necessary information to proceed with the verification of the domicile reported

by the taxpayer, after applying the selection criteria. At this point, and based on the analysis of the taxpayer, there is a possibility that certain cases be validated through the current scheme, that is, by sending the domicile confirmation code through the post office courier, which must be entered in the register system by the taxpayer.

Certainly, the implementation of this strategy will allow:

- Protecting the citizen and their data against tax identity theft
- Counteracting the perpetration of offences through the use of false documentation.

2.2 Approach from an operating action perspective

- **Strengthening of operating areas**

Here, we should make a brief reflection upon a fundamental and more often than not overlooked element, for the attainment of any organizational purpose: the human resources.

Strategies are designed and carried out by people. Hence, the success both in the design and the performance of the strategies relies on the persons who carry out these two actions.

The recommendations of the 43th Assembly mentioned the enhancement of supporting processes that may allow the strengthening of the tax administration. Among other things, they discussed the development of e-learning platforms for technical training and the creation of indicators to measure performance, with a view to establishing, adjusting, correcting or modifying management plans in accordance with the results obtained along the way.

On this regard, there are also other matters that should be brought to light, as are an adequate overall salary and personal incentive policy, the continued monitoring of the workplace environment and the establishment and dissemination of a code of ethics, all these experiences that the AFIP has been developing on an ongoing basis and with highly successful results.

Going back to the above cited recommendations, an e-learning platform has been set up, called Campus AFIP, through which the Code of Ethics has been disseminated and overall training and technical specialization courses have been provided.

- **Control Panel – Collection advance mechanisms**

The tax phenomenon, understood as a set of acts performed by a society's economic actors under the scope of a TA, may be approached in different ways. It may well be the case of an organization that receives from the social environment the stimuli that trigger its control and management mechanisms, these being dynamic and fast as per the current challenges, or may perceive itself, as stated before, as one more element of the fiscal climate, a dynamic and modifying actor within such climate.

In one paradigm, the perception of the tax phenomenon by the TA is that the economic actors make decisions in the here and now of the fiscal climate. In another, the tax phenomenon is investigated, monitored, modified and even driven by the TA's actions. This second more conscious, more active view is construed as starting with the modification of the actions of our operating managers, by raising their management quality with exploration and information monitoring tools made available to them and the establishment of overall objectives, thereby fostering self-control. Naturally, every organization designs strategic plans for the achievement of their objectives and goals, related in this case to the collection of taxes, the performance of which must be monitored and whose basic purpose is the establishment of general guidelines.

These plans will determine the organization's course of action and provide a basis to estimate the degree of probable success in the attainment of objectives. Furthermore, a manager's natural activity is to envisage future lines of action intended to assure the organization's overall objectives.

The information will be a critical factor to it; abundant and diverse information deriving from multiple sources and in different formats, that must be gathered, ordered, handled and used in order to obtain an added value.

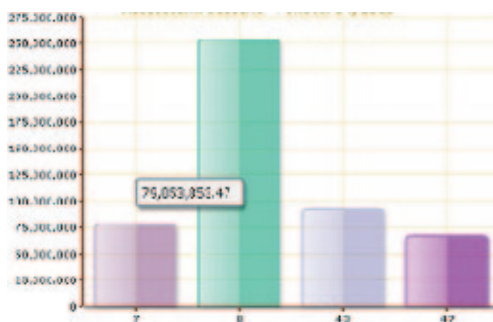
The evolution of business intelligence systems as a result of the advancement of ICTs allows the use of information as a strategic tool, supported by computerized tools, which puts at the disposal of the managerial levels varied information exploitation instruments.

Needless to say, the compliance with the organization's general objectives, reflected in plans, assures the predictability of the

decisions made by the top authorities of the National State. In this sense, monitoring of such plans is critical.

The operating area needs updated and permanent information to contribute with its natural speed to the general process of monitoring and assuring collection programs. To this aim, the following is pursued:

- A platform apt to stand as a fast and intuitive work desk for the manager, on-line, customized, with access control, with the possibility to store work sessions, print reports, add and close windows, add features (indicators and communication and analysis). This platform will be the support of the indicators.
- A set of indicators, a packaged feature offering data and graphs to create the vision of a business' aspect. The indicators are proposed as separate features that could be developed over time, all focused on one specific aspect of the collection business, but with general common characteristics. An indicator is a graphic and data functionality that shows, over the time line or the fiscal line (successive accrued fiscal periods), a portion of the evolution of one aspect of the business; e.g., the fiscal debits reported in the sales tax, or the number of hired staff. These business aspects are derived from receipts (documents evidencing a collection event), such as banking or non-banking payment receipts and tax returns for assessment or information purposes.



Tax	Collection
7	79,053,853.47
8	254,661,838.52
43	92,845,377,08
47	68,185,755,80

- A set of indicators shows the whole vision of a particular aspect of the tax business. Each indicator has in addition a space for annotations that displays an explanatory text. What is pursued is to evaluate conducts and monitor the business' evolution; hence, the need to distribute information over some time line, for the

purposes of providing an anticipatory projection.

The manager should be able to navigate along three data layers: jurisdictional data grouping in the set chronological line, the universe of relevant taxpayers in such time window and data from a specific taxpayer.

- A set of user's manuals, strongly practical and presenting work guidelines that may not only facilitate management of the tool but also allow the manager to imagine all the analytical possibilities provided by each indicator.

- **Knowledge management**

The proposal of a knowledge management platform also falls within the frame of human resources strengthening.

The collection, classification and interconnection of the operating knowledge scattered among the TA's agents is pursued, promoting the agents' participation in order to create a tax knowledge community.

This intends to homogenize the scattering and drive new knowledge by way of cumulative and associative natural processes. In this sense, an IT platform will be implemented this year to provide support to such objectives.

Every organization has an amount of knowledge distributed among its members. This knowledge appears in diverse forms and has different origins; i.e., formal, informal, empiric, factual, theoretical, etc. Knowledge is a valuable asset.

On the other hand, such scattering may cause unbalance, contradictions or gaps in each individual or in a group of individuals. Since their beginnings, libraries have had the foundational spirit of "concentrating" knowledge. But viewed as a live, multifaceted matter, the organizational (specialized) knowledge needs a more dynamic platform. Since it is not about compiling (unobjectionable) legislation but rather organizing business knowledge that is useful, scattered, renewable and practical, the engagement of the community in the business is crucial. The assumption is that everybody should have a share of that knowledge.

Ultimately, what is pursued is to generate an intellectual tangible asset apt to be distributed.

3. CONCLUSION

The Tax Administration, both in its role of advisor in the design of tax policies and manager and executer of such policy, must become a dynamic and modifying actor within the fiscal climate, and shall procure that the tax phenomenon should be investigated, monitored and even led by the TA's actions.

From the point of view of strategy formulation, every TA should rely on the use of Information and Communication Technologies, and generate systems that facilitate voluntary compliance and tax collection, operated by the taxpayer on the Internet, with centralized collection management and agile operating managers apt to assure monitoring and collection programs.

The fulfillment of the TA's overall objectives reflected in plans assures predicting the decisions of the National State's authorities, and allows implementing public policies of common interest through the use of tax resources.

BENEFITS AND COSTS IN THE APPLICATION OF A SEGMENTED TAXPAYER APPROACH IN THE LATIN AMERICAN TAX ADMINISTRATIONS

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(Chile)

*Contents: Summary.- 1. Introduction.- 2. General Background.- 3. Segmentation
Criteria.- 4- Segmentation Scopes.- 5. Benefits of the Segmented Scheme.-
6. Costs of the segmented focus.- 7. Results after one year.- 8. Conclusions*

SUMMARY

The application of the segmented focus at the Internal Revenue Service (SII, in Spanish) of Chile is the answer to the internal diagnostic stating that the high success rate tax attained from revenue paid voluntarily and the deterrence power of potential evaders resulted in the depletion of the control model that was being implemented.

Therefore, a new model of Attention, Support and Examination focusing on taxpayer groups is established in 2007 and a model for this change is also established, which promotes the coordination of efforts and provides Taxpayers service excellence in Attention, Support and Examination processes.

The change to the new model, starts in 2008 and covers the areas of Attention and Support, Examination, Legal and Regulatory Framework, Information Systems, Training, functional structure, as well as the adequacy of the areas of control and assistance at the National Directorate (Central Unit), in order to give appropriate support to this new form of operation, and the intervention of 100% of the regional offices of the SII.

Implementing the above brings about significant costs to the taxpayer and this is related to the transition or mutation from one model to another; i.e., increased noise at front desk offices or disorientation due to the temporary transfers of departments as a result the readjustment of facilities. The tax administration has also undertaken significant costs; i.e., temporarily reduce the number of taxpayers audited, through to Selective Examination, thanks to specialized and targeted training.

The gradual implementation of the new model, meant that the application was concluded mid 2009; however, it already displays significant benefits for the taxpayer and the tax administration; as for example, the number of times that a taxpayer must come in person to finish processing declined from 1.8 times, before applying the model to 1.2 times with the implementation of the new model, which increases by more than 35% control coverage for some segments and increases in over 40% the effectiveness of controls, measured in audit performances.

1. INTRODUCTION

One of the key elements in the success of the Tax Administrations is applying a business model that allows the reduction of their taxpayers' evasion rates, minimizing at the same time the cost of compliance.

In the case of the Chilean Internal Revenue Service (SII), the "Taxpayers Segmentation" draft project status showed that it was successful and with a strong emphasis on control: the high rate of tax revenues paid voluntarily and the great capacity to deter potential evaders are evidence of this.

However, the internal diagnosis aimed at a depletion of the model. The control processes were designed for an "average taxpayer" that did not consider the different characteristics of the businesses, and the need to maintain incentives to taxpayers that correctly pay their taxes is detected, giving an excellence service level.

The Taxpayers Segmentation project developed at the SII, is the answer to the previous diagnosis; where a management model is established focusing on taxpayer groups and not on the processes as it used to be.

2. GENERAL BACKGROUND

Even though 97.7% of tax revenues are collected voluntarily, this achievement is largely based on the fact that the SII has been able to “dissuade” 67% of the Taxpayers that have a relative disposition to comply with the payment of taxes (Figure No.1), which proves the relevance of managing evasion risk perception among Taxpayers.

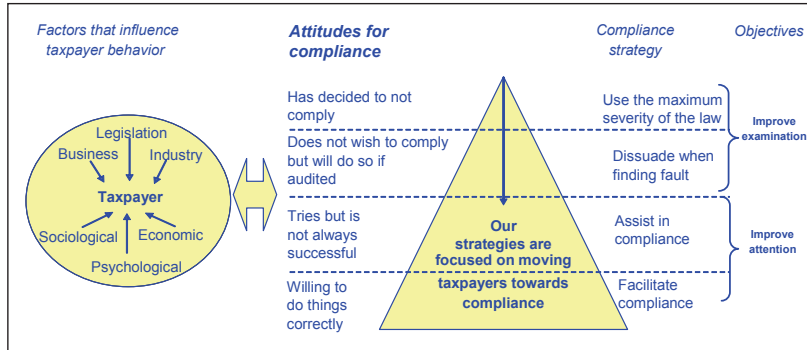


Figure No.1: Taxpayers' Tax Behavior

Segmentation is grouping Taxpayers according to similar Attention, Assistance and Examination characteristics and thus offer a quality service implementing specialized and differentiated treatments for these segments.

A first effort to group Taxpayers, carried out by the Internal Revenue Service, took place in 2001 with the creation of the Large Taxpayers Directorate (DGC) but, for the other Regional Offices, it was as of the segmentation Project, in 2007, where a change model was established aimed at segments in order to provide a greater quality in the attention, assistance and examination processes. Complementarily, this change involves an adaptation at the National Directorate (Central Unit) to provide adequate support to this new operation modality.

In this way, at the end of 2008 the SII changed its actions and moved from processes based on or associated to taxes (Operation Revenue, Operation VAT, Selective Examination, Preventive Examination) to an attention, assistance and examination scheme, where privilege is given to the coordination of efforts for the identified segments.

3. SEGMENTATION CRITERIA

Segmentation criteria were obtained from the collection of the information carried out from the SII Database and whose preliminary result organized Taxpayers in five clusters: Natural Persons, Micro Enterprises, Small Enterprises, Medium Enterprises and Large Enterprises.

i) Criteria for Attention and Assistance

Taxpayer Attention and Assistance, for the five segments, are centrally managed by the Taxpayer Attention and Assistance Department of the National Directorate; and is executed at each Regional Office, by a specialized Department with the same name.

ii) Criteria for Examination

Taxpayer examination is centrally managed by two functional Departments; the Persons, Micro and Small Enterprises Department and the Medium and Large Enterprises Department of the National Directorate. Audits and revisions are executed by the specialized Departments with the same name at the Regional Offices; therefore, a taxpayer must be served only by the group or team it belongs to by segment brand.

iii) Criteria for Determining Segment

The cutoff criteria used for Natural Persons is to not be subject to income tax and not be an individual entrepreneur. For enterprises, cutoff criteria are shown in Figure No. 2.

Segment	Annual Sales Amount (US\$)	Annual Purchases Amount (US\$)	Own Capital Amount (US\$)
Large Taxpayers	Greater than or Equal to 4,000,000	Greater than or Equal to 4,000,000	Greater than or Equal to 20,000,000
Medium Taxpayers	Greater than or Equal to 1,000,000	Greater than or Equal to 1,000,000	Greater than or Equal to 5,000,000
Small Taxpayers	Greater than or Equal to 100,000		Greater than or Equal to 95,000
Micro Taxpayers	Less than 100,000		Less than 95,000

Figure No. 2: Segmentation Cutoff Criteria

The current results, from the application of the foregoing criteria, show the following results:

Persons Segment: These are Taxpayers that are not subject to capital income tax. They represent 58% of total taxpayers and 73% are only dependant workers or retirees.

Micro and Small Enterprises Segment: These are most taxpaying enterprises (97%) and represent 41% of total Taxpayers. The most frequent tax regime is Full Accounting and they have the highest number of Attention and Examination actions. 97% filed Income through the Internet and 96% monthly VAT returns. They represent 9% of sales and 13% of total tax revenues.

Medium Enterprises Segment: The segment represents 0,6% of total Taxpayers. 92% of these filed Income through the Internet and only 17 issue electronic documents. Only 20% of the taxpayers have been Examined by the Service, 3% requests Exporters VAT refund and 2% refund for change of taxpayer.

Large Enterprises Segment: It is 0,4% of total Taxpayers and carry out more complex and diversified businesses. They carry out tax planning, use franchises, carry out reorganizations, there is transference prices risk and count with tax advisors. They interact with others abroad, in what respects to businesses and enterprise property, presence in several jurisdictions and a high volume of information and documents. Only 1,361 of these Taxpayers are responsible for 73% of tax revenues and of sales at the country level.

4. SEGMENTATION SCOPES

At the SII central administration level (National Directorate), the segmentation scope is 100% and involves the totality of the staff of the Examination areas and incorporates other support areas such as those related to the administration of human and technological resources. At the Regional Offices level, the scope is 100% of them and involves 80% of the staff.

Furthermore, the development of differentiated treatment strategies, procedures and products per type of taxpayer is considered, as well as control indicators, attention quality, assistance and examination targets, and composition of specialized work teams, infrastructure adaptation, training and dissemination.

- i) **Attention and Assistance:** Give quality attention and assistance, through efficient use of protocols, tools and communication channels; attention can be in person, virtual or through the telephone.
- ii) **Examination:** Differentiated treatment by taxpayer type; maximizing coverage through Mass and Preventive Examination for the Persons, Micro and Small Enterprises Segment; and applying audit techniques, examination guidelines and audit work sheets; through Selective Examination for Medium and Large enterprises.
- iii) **Legal and Regulatory Scheme:** Efficacy and simplification in the communication and Access to the regulatory scheme, pursuant to the degree of complexity of the tax operations that the taxpayer carries out.
- iv) **IT Systems:** Provide new computer systems that promote taxpayers' self-attention and better access to the information property of the tax administration. Similarly, inside the SII, tools that allow a better analysis of the information during the examination are incorporated, standardizing processes and improving their quality.
- v) **Training:** For the groups that serve or control Persons, Micro and Small Enterprises, geared towards the use of IT systems for mass attention and training in issues of greater tax complexity (for example mergers and tax planning) for Medium and Large Enterprise groups.
- vi) **Functional Structure and Allocation:** In the attention and assistance areas, the restructuring of groups and the generation of specialized teams in taxpayer attention and assistance. In the control area, quick solution examination teams for Persons, Micro and Small Enterprises taxpayers; and the composition of multitask teams for Medium and Large Enterprises.

The abovementioned scopes, have different degrees of complexity for the implementation of the segmented focus. Figure N°3, shows the degree of complexity of the most important scopes described:

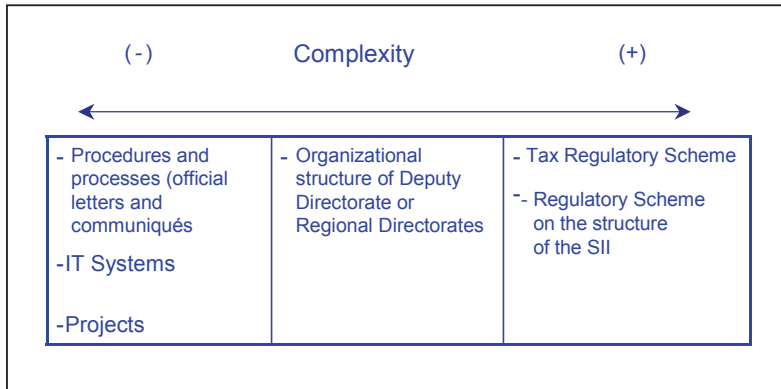


Figure N°3: Scope of Segmentation and Degree of Complexity

According to the above figure (Figure N°3), we are at a lower level of complexity for the IT Systems scope, medium level complexity for the Functional Structure and Allocations and a high level of complexity to make changes at the Tax Regulatory Scheme level.

5. BENEFITS OF THE SEGMENTED SCHEME

Hereinafter, the most important benefits from the application of the segmented focus:

i) Benefits for the Taxpayer.

Attention and Assistance

- **Timely Attention and Assistance:** A 30% drop in waiting time for attention, due to the increase of taxpayer attention and self-attention points at the Regional Offices.
- **Response Quality:** Increase in the quality of responses delivered to Taxpayers; due to the incorporation of specialized officers that may respond to any consultation or request.
- **Tax Information:** Increase in the quantity and quality of the information the SII makes available to the Taxpayer; to know the status of procedures as well as of revisions and Audits.
- **Procedure Simplicity:** Increases transparency towards the Taxpayer; through the incorporation of a standard procedure, where all the procedures are carried out in a single place in the Regional Office.

- **Lower Compliance Cost:** Lowers tax compliance cost for the Taxpayer; due to the incorporation of new technological support tools aimed at self-attention and the incorporation of training on its use by officers from Attention and Assistance.

Examination

- **Attendance to Audits:** The amount of times the taxpayer must attend to the SII at the summons of the tax administration is reduced; because an attention is carried out that is comprehensive and independent from the process.
- **Tax Refund Request:** The challenge and refund process is sped up, because focus may be applied for some processes on those higher-risk index petitions.
- **Procedure Standardization:** Increase in transparency for the taxpayer, because the Audit procedure is standardized and new technological tools are incorporated for each taxpayer segment.
- **Documentation Required:** Elimination of requesting history from the taxpayers that is already in the hands of the SII through other revision processes. This is thanks to the coordination of focalized revisions and management aimed at taxpayers.

ii) Benefits for the Tax Administration

Human Resources

- **Team Creation:** Creation of work team specialized in attention and with the necessary competencies for the Taxpayers examined.
- **Quality of Work Life:** Improves quality of life inside the Service, due to changes and reconditioning of current spaces and furniture used by the officers.
- **Institutional Identity:** The officers' commitment is strengthened with SII's work, when perceiving that the institution is important for the country, given the magnitude of the investment aimed at improving operations.
- **Allocation of Examiners:** An increase in the allocation of Examiners for Attention, assistance and examination is achieved.

Attention and Assistance

- Procedures in Offices: Lowers congestions in procedures at Regional Offices and more time is devoted to attention per taxpayer and best work practices are shared and replicated.
- Points of Attention for Procedures: The amount of points of attention for procedures are increased at all Regional Offices.
- Taxpayer Assistance: An area specialized in Assistance is established at the Regional Offices, Internet contents are redesigned and improvements are made to the Help Desk.
- Integration of Attention with Examination: Increase in the degree of integration of Attention and Assistance with Examination; because if there is a procedure in Attention and Assistance that requires Control, it is immediately passed on to another instance for its resolution.

Examination

- Feeling of Control: The feeling of control increases in the Taxpayer, because specialized teams are set up, Mass Examination products are implemented that allow increasing coverage and increase the degree of coordination between the internal areas of the Service.
- Control according to Taxpayer characteristics: Differentiated controls are implemented that have, as consequence, a greater effectiveness in examination. For Persons, Micro and Small Enterprises examination is aimed at Mass Examination and Examination Presence. For Medium and Large Enterprises controls are aimed at Selective Examination. Knowing the Taxpayer: Business knowledge is increased due to the specialization of officers for adequate controls to each taxpayer segment.
- Examination Quality: A greater quality Examination is implemented and the degree of tax certainty increases; because the teams specialized in Audits incorporate professionals of different specialties who participate from the beginning of the examination.
- Regional Vision: Knowledge about each Office's reality is substantially improved at the central level; given that the examination plans and programs adjust to variables that consider

the specific characteristics of each Region of the country; for example, main businesses per season in the region and/or amount of attention posts at the Regional Office.

- Communications and Generation of Networks Inside the SII: Communications and feedback are strongly increased within the Regional Office, between Regional Offices and between these and the National Directorate (Central level).
- Central Coordination: Coordination increases between the Legal, Standards and Examination areas; which allows increasing tax quality and certainty of Audits and revisions.
- Collaborative Work; Collaborative work is encouraged between officers of the same and different groups; because efforts and processes must be integrated for the Taxpayer's benefit. (Replacement teams, Group meetings to identify situations to be improved, development of Workshops and Internal Training, etc.).
- Planning, Management and Control: Regional planning and management efficiency is increased, because a vision per taxpayer segment allows to adapt the workload of all processes that involve the segment. This allows a more strategic vision of the use of the control and Assistance processes.
- Continuous improvement: The revision, results analysis and general assessment process is incorporated as a permanent practice of all business processes carried out by the tax administration, which allows to make its actions profitable and will maintain long-term quality standards.

6. COSTS OF THE SEGMENTED FOCUS

i) Costs for the Taxpayer

- Execution of Works: Increase in the degree of temporary taxpayer dissatisfaction with the execution of civil Works; because the Taxpayer had to be served elsewhere or in facilities under repair.
- New Service Organization: Greater degree of dissatisfaction, because if the process examiner was known, the same would go to him and was served directly, regardless of what segment had to see the case.

ii) Costs for the Tax Administration

- Infrastructure Adaptation: High cost to enable and readapt physical spaces. In some cases and because the staff continues executing its duties the lease of temporary spaces is required.
- Temporary Adjustment of the Examination: The effective control carried out (amount of taxpayers examined) during the implementation of the project, undergoes significant reductions, which in some cases reach approximately 50%. The use of this release of resources was destined to additional training work for the new tasks, change management workshops and Project dissemination.
- Socialization and Internal Dissemination: Creation of new work teams at the central level that visit and are in permanent contact with all Regional Offices in the country, during the whole project development cycle. This is for the assessment of regional tasks and needs to face the change, adaptation of local administrative procedures, internal coordination schemes, etc.
- Training of Officers: 50% increase in normal openings for training of officers assigned to control as well as to attention and Assistance, due to the specialization of duties and updating of knowledge.
- Change Management: Contracting of HR experts to accompany the change in all its stages.
- Dissemination to Taxpayer: Lecture cycles are added for Business Associations with a high dissemination cost and entering into agreements with Professional Associations.
- Work environment: Destine efforts to maintaining the work environment, due to the characteristics pertaining to a change process.

7. RESULTS AFTER ONE YEAR

One year after implementing the segmentation project, the following progress may be highlighted:

- The average amount of times people have to come to SII offices to complete a procedure goes down from 1,8 to 1,2 times.

- 5% increase in the amount of procedures or self-attentions made by the Taxpayer through the Internet platform.
- In average, there is a 40% drop in the amount of Taxpayers that must pass to a verification process, focusing the attention in this second stage on more substantial problems, where this is no longer an additional step in the procedure.
- An additional 50% in collections for the Persons and Micro and Small Enterprises segment due to communication of differences in the VAT Operation process.
- 16% increase in coverage on established businesses, through examination presence actions in the field, which increases the feeling of control.
- 37% increase in the amount of taxpayers under Mass Examination and 42% increase in effectiveness measured according to performance.

8. CONCLUSIONS

- The Taxpayers Segmentation project, as other change processes, brings along big disturbances internally and externally; that is why it is indispensable that consideration be given at all times to all those involved as a critical success factor.
- Differentiating between Taxpayers allows providing a better Service quality (Attention, assistance and examination); because the same problem has a different impact depending on the taxpayer type, with differentiated solutions and performance indicators (collections, total sum, etc.).
- Focus efforts by Taxpayer type, allows knowing more about the Taxpayer's business and grants greater legal certainty to the Audits that are executed.
- Although the Taxpayer Segmentation project provides important results in the short term; nothing guarantees that these will be repeated in the following cycle; and, therefore, the focus should be a continuously changing process (like the real world is), but one the organization is prepared to face.

TAX REGISTRY ENHANCEMENT: DEBUGGING, UPDATING AND USE

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Contents: 1. The Netherlands Tax and Customs Administration (NTCA).-1.1 General.- 1.2 Organization structure.- 1.3 Points of departure in the work of the NTCA.- 2. File management and large-scale processes.- 2.1 Organization of large-scale processes.- 2.2 Client registers relations management.- 2.3 Key registers.- 3. Supervision.

1. THE NETHERLANDS TAX AND CUSTOMS ADMINISTRATION (NTCA)

1.1 General

The NTCA has the following general policy objective:

Citizens and companies are prepared to meet their statutory obligations with respect to the NTCA (compliance).

The NTCA encourages citizens and companies to be prepared to meet their statutory obligations. From its service attitude the NTCA sees to good communication with citizens and companies to achieve this objective. In addition, the NTCA adequately monitors the compliance with statutory obligations and enforces compliance with these obligations through criminal proceedings, if necessary.

The more than 30,000 employees of the NTCA are responsible for a wide variety of tasks. The best-known task is that of imposing and collecting taxes and premiums. Annually, the NTCA processes the various declarations of 6 million private individuals and 1.1 million entrepreneurs.

The NTCA does not only collect taxes but also distributes payments. For instance, the NTCA pays the provisional tax refunds and benefits that households can receive for the costs of childcare services, rent or care. Other major work processes are:

- fraud detection;
- supervising the import, export and transit of goods;
- supervising the compliance with the tax laws and regulations.

1.2 Organization Structure

The NTCA is part of the Ministry of Finance. The organization structure of the NTCA includes:

- the Director-General and the management team NTCA;
- the Directorate-General for the NTCA (12 teams);
- 13 tax regions;
- the Customs Administration (1 national office and 9 customs regions);
- the Central Administrative Office;
- the Fiscal Inquiry and Investigation Department and Economic Investigation Service (Fiscale inlichtingen- en opsporingsdienst en Economische controledienst, the 'FIOD-ECD');
- the National Office Benefits (Toeslagen);
- the Tax Information Line (BelastingTelefoon);
- the Centre for Professional Development and Communication (Centrum voor kennis en communicatie);
- The Centre for Facility Services (Centrum voor facilitaire dienstverlening);
- the ICT of the NTCA. It consists of:
 - the Centre for Application Development and Maintenance (Centrum voor applicatieontwikkeling en -onderhoud);
 - the Centre for infrastructure and exploitation (Centrum voor infrastructuur en exploitatie).

1.3 Points of Departure in the Work of the NTCA

a. The NTCA does not trouble citizens and companies unnecessarily

Citizens and entrepreneurs often regard the government as one entity. Their perception is: what one government branch knows should be known to the entire government. The government supports this idea and is therefore working on a system of key registers. This adds substance to the point of departure that a citizen has to provide data

to the government only once, after which each public organization can make use of them. The NTCA participates in this development and has been the official supplier of income data within the government since 1 January 2009 with the Key Register Income (*Basisregistratie inkomen*, 'BRI').

The NTCA does not want to trouble businesses unnecessarily either. The measures are in line with the cabinet objectives to reduce the administrative burden on companies significantly. An example is that it has become possible to perform invoicing electronically under the same conditions that apply for hard-copy invoicing. With the Customs Administration such measures are taken as well: by allowing data traffic to be electronic, simplifying the customs system and working with supranational schemes, the Customs Administration can reduce the administrative burden on entrepreneurs. Furthermore, the Customs Administration plays an active role in the e-Customs projects for electronic mail traffic at a European level.

b. The NTCA simplifies complex large-scale processes

With many large-scale processes the NTCA uses ICT applications with which the information required for determining assessments and issuing surcharges is processed fast and efficiently. The processes required for information processing are standardized and digitized in such a way that the activities can largely take place automatically. This means that citizens and companies get certainty about their tax position more quickly. In addition, the chance of errors is greatly reduced by the use of digital documents.

c. The NTCA improves supervision

The NTCA is working on improving and enhancing supervision. The major aim regarding supervision for the next few years is to work more in the actual situation and to focus more on cooperating with those liable to pay taxes and other parties involved in the tax process. The basis of this new approach is trust. Where trust is justified, the NTCA wishes to make things as easy as possible for companies and citizens. Where the trust is violated, the NTCA will increase supervision and will act effectively and decisively.

For all forms of supervision the NTCA aims at optimum adjustment between costs and benefits. With respect to the benefits, the NTCA does not only look at the tax risks or financial interests but also at

the social impact. Enforcement directions are therefore being worked on: deliberately choosing the aim and the means of enforcement to achieve the aim. These may be traditional means, such as book or fraud audits, or relatively new means, such as horizontal and visible supervision.

d. The NTCA improves services

The NTCA still uses the slogan 'We can't make things any nicer, but we *can* make them easier'. Sometimes, when something goes wrong, this slogan is less appropriate, but in general it is appreciated by the public. In their services, the NTCA gives citizens and companies pride of place and looks for possibilities to make things even more convenient for these target groups.

For the large group of people who complete their tax declaration electronically, the NTCA reckons with the possibility that not everybody uses the same software. Therefore the NTCA makes three types of declaration programs available: Windows, Linux and Apple.

In addition, the NTCA provides help via the Tax Information Line desks and for all kinds of provisions for trade unions, unions for the elderly and social intermediaries.

The introduction of the precompleted tax return is on schedule. This is possible because the NTCA already has many data on those liable to pay taxes, rendering asking for these data again in the declaration superfluous. The taxpayer does have to check if the precompleted information is correct, though, and should make correction or additions where necessary. In the next few years, the citizens will only have to complete a small part of their tax return themselves. Further standardization of work processes and information systems, too, is a means to improve the services.

This is done at the Customs Authorities, for instance. In doing so, the NTCA is following an international trend: the World Customs Organization (WCO), the United Nations and the Organization for Economic Cooperation and Development (OECD) have led the way. Businesses also present useful alternatives, such as the use of XBRL (a standard for exchanging financial data via the Internet) and the use of open standards and open sources in automation. The Customs Administration therefore provides the possibility to entrepreneurs of sending declarations for the major tax revenue in XBRL. As a result,

it becomes more attractive for them to invest in the required software. Additionally, the NTCA together with the respective policy departments will aim at further simplifications in the field of legislation and regulations (Interministerial Policy Review).

2. FILE MANAGEMENT AND LARGE-SCALE PROCESSES

2.1 Organization of Large-Scale Processes

Central Administrative Office

Imposing, collecting, detection and control are the core tasks of the tax customs regions of the NTCA. Since 1 January 2006, the payment of income-related Benefits is included as well.

The organization part Central Administrative office of the NTCA (B/CA) is responsible for the execution of the large-scale and central part of these processes of the NTCA. This pertains to administrative tasks – from sending and processing various declarations to sending notes about them – and large-scale (supervision) tasks.

Three quarters of all tax declarations, contributions and payments are handled automatically. B/CA is in charge and ensures that the various processes remain transparent and manageable. B/CA also handles the declarations and messages that cannot be handled automatically. The declarations that require some extra attention are delivered at the offices by B/CA. In addition, B/CA arranges the moments at which the automation centre processes the data received from third parties. In so doing, B/CA covers the entire field ranging from receiving to providing information. Within these large-scale processes, B/CA wishes to provide tailor-made solutions as much as possible. Speed, lead time, continuity and efficiency are the key words here.

The NTCA registers the data of those liable to pay taxes in one central system: Relations Management. The data of private individuals liable to pay taxes and all entrepreneurs are included in Relations Management (*Beheer van relaties*, 'BvR') system. The client register is a separate process besides the means processes. The central management of the client register is also in the hands of the B/CA.

2.2 Client Registers Relations Management

2.2.1 Central register

The NTCA has a sound client register for the execution of their tasks. A complete, up-to-date and reliable database with the natural persons and bodies that are (possibly) liable to pay taxes is essential. The many internal and external developments, such as making declarations electronically, the cooperation with the public organization Employee Insurances Implementing Agency (*Uitvoeringsinstituut werknemersverzekeringen*) and the NTCA, the tasks with respect to income-related schemes, the Basic Business Register (*Basisbedrijvenregister*) of the Chamber of Commerce and the uniform use of the social security number, make an even stronger focus on the quality of client registration by the NTCA necessary. Reliable, general client data are essential for trouble-free primary processes and for the obligations of the NTCA in the context of government-wide key registers, for instance.

The BvR information system is the central client register of private individuals and companies that are (possibly) involved in taxation and the execution of non-tax matters.

Those liable to pay taxes are private individuals (natural persons who do not enjoy profit from business activities) and companies (bodies, fiscal entities turnover tax or natural persons who are no private individuals).

The client register is a separate process besides the means processes. This means that the automation systems in which tax assessments, letters etcetera are created, derive the client register data from the client register. In these systems, no 'own' client registers are kept. An up-to-date and reliable client register is required for sound services, correct client handling, anti-fraud activities and efficient and effective large-scale processes. In addition, the client register is very important for external registration as well. Data from the NTCA are also used by external public organizations.

The BvR also plays a major role with respect to the identification of personal details from other organizations. The social security number, a unique number issued to every natural person automatically assigned at registration in the BvR, is a key word. For organizations, the tax registration number is a comparable key word.

2.2.2 Updatedness of data

As a central client register for the entire NTCA, the BvR became operational on 3 December 1990. The data of those liable to pay taxes are registered in the BvR, in which external files are used that provide the data automatically for purposes of both the first delivery of data (entry of those liable to pay taxes) and the processing of movements. Keeping the client register up to date is a joint task of the B/CA and the tax regions. A large part of the data is delivered automated by external sources to the Central Administrative Office. However, the client register also includes data reported or determined/controlled by the tax regions, for instance when the person/company liable to pay taxes appoints a representative to whose address certain documents are to be sent. The entry of such data is the responsibility of the regions that conduct the direct communication with the person/company liable to pay taxes.

Depending on the nature of the change, there are regulations about the term of entry. For instance, a new entrepreneur reporting with a request for a turnover tax refund is to be included in the BvR within two days. Also if a criminal investigation yields missing individuals/companies liable to pay taxes, their details are to be included within two days. In the next few paragraphs, it is stated in more detail which data are captured in the BvR system for the various types of individuals/companies liable to pay taxes.

2.2.3 Natural persons

For the BvR, the database of natural persons kept by the municipalities, the **Municipal** Personal Records Database (*Gemeentelijke Basisadministratie persoonsgegevens*, 'GBA'), is the major source for the registration of natural persons who are liable to pay taxes. The GBA system is one of the key registers (see next paragraph).

This system provides a major part of the changes in the data of natural persons in an automatic way, such as reports of birth, death and changes in the following details:

- address;
- marital status;
- children;
- emigration/immigration;
- tax representative;
- liability to pay tax.

2.2.4 VIP data

For a number of individuals liable to pay taxes in senior public positions who, from the perspective of publicity, are in a vulnerable position, measures have been taken to prevent Tax Authority officials from having unrestricted access to the personal or tax details of these individuals. This group of VIPs includes members of the Royal family, cabinet members, chairpersons of the Upper and Lower House of the Dutch parliament and their spouses/partners.

If an individual liable to pay taxes is in the VIP category, this does not only apply to the BvR but also to other local and central systems. The special protection implies that there is a limit to the inspection and mutation of the personal and tax data.

2.2.5 Companies

In the Netherlands, everybody running a company needs to be registered in the Trade Register. The Trade Register is kept by the Chamber of Commerce. In the BvR, the NTCA has a digital copy of the Trade Register, which is refreshed daily, to ensure that the system remains up-to-date. Every new entry and changes in entries in the Trade Register are automatically copied in the BvR, and the NTCA links a tax registration number to every company in the Trade Register. Details entered include:

- address;
- registered office;
- trade name;
- relations;
- incorporation date;
- managing directors.

The NTCA itself also has/receives indications that need to be captured in the client register, for instance an application for a wage tax number of an existing company employing staff for the first time, or the observation that staff is employed with respect to an audit of the books. For bankruptcy to be pronounced by the Court, there are working agreements between the Courts and the Central Administrative Office, so that the NTCA is informed of a declaration of bankruptcy timely. The Central Administrative Office processes the report and informs the respective tax region actively as well.

2.3 Key Registers

2.3.1 Introduction

From the previous paragraph it becomes apparent that details on those liable to pay taxes are stored in various registers with various public organizations. Citizens and entrepreneurs often regard the government as one entity. Their perception is: what one government branch knows, should be known to the entire government. The government supports this idea and is therefore working on a system of key registers.

This adds substance to the point of departure that a citizen has to provide data to the government only once, after which each public organization can make use of them.

The government improves its services to citizens and companies by sharing details already known with the government, such as name, address and registered office, within the government. These key registers are under development, so that the government needs to request many details only once. This saves citizens and companies a lot of time and effort in their contacts with the government. It also contributes to more effective fraud combating, law enforcement and cost savings. Privacy is safeguarded when data are shared. Public organizations are only allowed to obtain the data they need for the implementation of their legislation.

2.3.2 Points of Departure

What is a Key Register?

Key registers contain the vital data of the government, such as the data about all citizens, companies and organizations. These are the systems in which so-called authentic, high-quality data are captured. Thanks to this high quality, the government can use these data in its work without the need of any further investigation.

Authentic Data

Authentic data are data derived from a key register which bears the hallmark of 'authenticity' in the law or in lower regulations. This means that the data are at first hand, from the source, as much as possible. Several conditions are attached to authentic data. In the event of doubt about the correctness of authentic data, they can be placed 'under investigation'. In such cases, the obligations may sometimes lapse.

Compulsory Use

In the performance of their activities, governments and other organizations with a public task, such as schools and hospitals, are obliged by law to derive authentic data, such as personal details, from the key registers. They are no longer allowed to ask citizens and companies for these data and to capture these data in their own systems.

Feedback Obligation

In the event of any doubt about the correctness of data, governments are held to report this to the respective key register. In turn, the keeper of this key register is held to investigate the correctness of the data and correct them if necessary. As many organizations use the key registers and reporting incorrect data is compulsory, the quality of the data will remain high.

Tasks and Responsibilities

Tasks and responsibilities have been delegated per key register to various organizations. For each key register, a minister bears political responsibility.

Harmonizing Relevant Legislation

Every key register has specific legislation. This makes the exchange of data more difficult, since definitions are not always unequivocal. Therefore, it is very important that legislation is harmonized by adjustments, where this is possible. Where harmonization is not possible, because a basic administration has its own definitions and systems for instance, mutual agreements are made for the key registers.

Privacy

The protection of privacy is laid down by law. Public organizations and civil servants are exclusively given access to personal details if this is necessary for the performance of their task under public law. A civil servant responsible for issuing a parking permit is allowed to inspect registration number data from the Key Register Vehicles (*Basisregistratie Voertuigen*). However, he may not use these data for any other purpose. The Data **Protection** Authority (*College Bescherming Persoonsgegevens*) monitors compliance with the law.

Right to Inspection and Correction

According to the Personal Data Protection Act (*Wet bescherming persoonsgegevens*), everybody is entitled to inspect his/her personal details and have any incorrect details corrected. In the future, citizens can easily inspect their details at MijnOverheid.nl. They can submit a request to correct any details with the organization that keeps the register.

Other data in key registers

It is possible that non-authentic data are entered in the key register as well. Non-authentic data are data in a key register that have not been legally specified as authentic. In the event of non-authentic data, compulsory use and compulsory feedback are therefore not laid down by law and can be arranged in consultation between the keeper of the register and the recipient.

The system of key registers

13 key registers are currently being developed:

- Municipal Personal Records Database;
- Trade Register;
- Addresses and Buildings;
- Land Register;
- Topography;
- Large-Scale Topography;
- Vehicles;
- Income;
- Wages, Industrial Relations and Social-Security Benefits;
- Valuation of Immovable Property;
- Registration Non-Residents;
- Subsurface.

The eventual idea is that these separate key registers are going to be used as a single, logical and coherent whole. This has several advantages:

- Improvement of services and reduction in the financial burden on citizens and companies;
- Better possibilities for enforcement and fraud combating for the government;
- Improvement of internal efficiency.

Of course, the quality of the data included in the key registers needs to be high, so that public organizations can use each other's data without the need of any further investigation.

Generic Provisions

In order to get access to the system of key registers, all administrative bodies are to be connected with it in the same way. These organizations are to work according to the same processes. By making use of generic provisions and processes (processes that are the same for everybody), governments can be aligned seamlessly to each other.

2.3.2 Key Registers and the NTCA

For every register one organization is responsible. Thus, the Chamber of Commerce is responsible for the Trade Register, and the municipalities manage personal details in the Municipal Personal Records Database (GBA). Since 1 January 2009, the NTCA has been responsible for the Key Register Income. The NTCA provides the income data to administrative bodies that need them for implementing income-related schemes.

In addition, the NTCA uses data that are available through the key registers, such as the Municipal Personal Records Database, the Trade Register, the Land Register and the Valuation of Immovable Property.

Thus, the NTCA is both recipient and supplier.

Supplier: Key Register Income

The NTCA is supplier, because they are the Key Register Keeper (*Basisregistratiehouder*) of the Key Register Income (*Basisregistratie Inkomsten*, 'BRI') and thus supply income data to other administrative bodies. To be able to supply income data, the NTCA has set up a transparent and qualitative process for collecting and providing income data, incorporating possibilities for complaints and appeal. If necessary, income data can be adjusted, and feedback and investigation obligations can be processed.

The BRI contains the authentic income data of about 13 million citizens. The authentic income data are the total income for the respective tax year or the taxable annual salary. The BRI started with the income data for the calendar year 2008. The total income for a tax year is only

'authentic' after the respective year has ended. If there is no income tax assessment or if not income tax assessment is determined, the taxable annual salary applies as authentic income data. The taxable annual salary is based on the declaration of those liable to pay taxes. These salary data are supplemented with other salary data that are known to the NTCA (for instance data retrieved from annual statements of those liable to pay taxes). If there is or will be no assessment and if there are no salary data, no income data will be included for the respective citizen. On request, the NTCA reports to other public organizations that the income data are '0'.

Citizens take cognizance of the authentic income data via government decisions that are based on these data. This may pertain to a provisional or a final income tax assessment but also to a decision on an income-related scheme of another public organization. Citizens do not receive separate letters about income data (of course, they can make a request for this, or they can inspect the data in due course via the personal Internet page MijnOverheid.nl).

Citizens have various possibilities to lodge an appeal against incorrect authentic income data. If the income is stated in a tax assessment, the complaint can be lodged with the NTCA. If another public organization uses the income data and if the citizen does not agree with the amount stated in the income data, the citizen can also lodge a complaint. The citizens may choose if they lodge a complaint with another public organization or with the NTCA. It is only possible to lodge one complaint against one decision. After the decision on a complaint the citizen may appeal with the Court.

Recipient

The NTCA is the recipient of other key registers, such as the Municipal Personal Records Database (GBA), the Trade Register and the Land Register. At various terms, the NTCA makes compulsory use of the authentic data when making a decision, for instance when determining the final income tax assessment. In the event of 'serious doubt' about the correctness of authentic data, the NTCA is held to report this to the respective key register keeper, stating the reason (often their own observation) and possibly the alternative data. For example, when letters from the NTCA sent to the address from the Municipal Personal Records Database are returned as undeliverable, there is reason to doubt about the correctness of the address data in the Municipal Personal Records Database. In such events, the key register keeper

will investigate. If the NTCA cannot afford to wait until the investigation has been completed, the NTCA will be allowed during the investigation to request the data themselves or to use the data from their own database.

Organization

One desk has been set up for providing data and the key registers: like with the client register this is the Central Administration. From there, the data are distributed over the primary processes. In its capacity as central desk the Central Administrative Office also performs the feedback to other key registers and monitors the handling of this feedback. Finally, the Central Administrative Office is the contact for feedback of other administrative bodies and for the notices of objection they receive. The citizens may also submit notices of objection directly.

3. SUPERVISION

Supervision further builds on and makes use of the basis of a smoothly running registration of those liable to pay taxes. The NTCA structurally and systematically chooses an instrument or combination of instruments which fits in well with the intended influence on the behaviour of groups of those liable to pay taxes on the basis of the effect the NTCA wishes to achieve and the available capacity.

One of these instruments is horizontal monitoring. The relationship between government and business has changed dramatically in the past few years. The two parties have reached a situation in which they are on an equal footing, and their relationship has become more focused on cooperation and making agreements. Besides, companies have become increasingly transparent in their business operations, sometimes voluntarily, sometimes by virtue of legislation and regulations. The NTCA responds to these developments by sharing the responsibility for compliance with legislation and regulations with companies and organizations in the industry, where this is possible. This shared responsibility is laid down in covenants or compliance agreements. Companies that enter into a covenant with the NTCA, are no longer subject to intensive controls; mostly, they will be replaced by random controls. Only bona fide companies qualify for this kind of treatment. Due to this new form of supervision, the NTCA can spend more time on investigating companies that do not abide by the rules so well.

For being able to make a good choice between the various instruments, it is necessary to have some knowledge in advance of the behaviour of those liable to pay taxes and of the (im) possibilities of a certain supervision instrument (the 'knowledge'). Before choices are made (and activities are performed), the NTCA analyses the issues. To this end, the NTCA invests in monitoring those who are liable to pay taxes and their relevant environment, and make risk and behaviour analyses.

The knowledge pertains to the following fields:

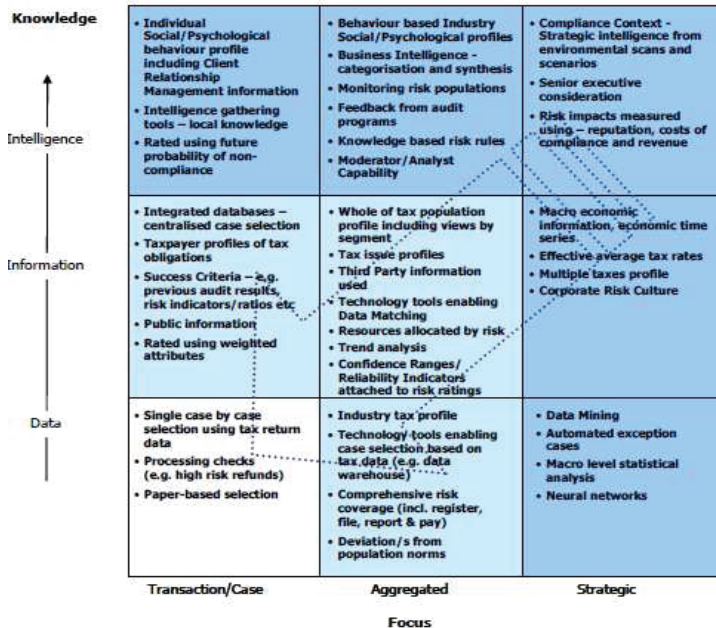
1. The risks and behaviour of those liable to pay taxes;
2. The (effect of the) NTCA's own acts;
3. The environment in which those liable to pay taxes and the NTCA operate.

The basis for intelligence is the information already available to the NTCA derived from declarations, collection and detection. In addition, the NTCA uses new strategies. Due to the use of key registers, physical supervision ('in the street') and digital supervision (on the Internet) for instance, the NTCA gains insight that is developed outside the formal relationships of modern information society.

OECD Model: From Data to Intelligence

For ordering the (possible) designs/products to gain knowledge and make knowledge more substantial, the NTCA uses a model that is also used in an OECD perspective. This model is intended to clarify at which levels, in terms of knowledge and technology, and with which focus activities (may) take place. The model is included below. The point of departure used in the model is that there is a build-up of data from information to intelligence (shown along the vertical axis: knowledge) linked to a development from history to the future. Data are often a reflection of events in the past, information may help find patterns and trends beyond data sources, and intelligence provides added value in developing forecast models (future). The point of departure along the horizontal technology axis is that the development towards strategic/tactical intelligence requires a more model-based approach and a better developed technique. The model used by the OECD is further detailed in the guidance note 'Compliance Risk Management: Managing and Improving Tax Compliance' (Committee on Fiscal Affairs, October 2004).

Figure 2.2 Detailed Risk Identification Model



The model provides some insight into the position of tax authorities in the development of their ‘knowledge’. Of course, this development depends on the supervision strategy used, since the supervision is supported by intelligence.

In the Netherlands, the focus in the time ahead will be on the following fields:

- A coherent and programmed approach of investigation for supervision (focused on behaviour, for instance);
- Measuring the effect of interventions;
- Strategic orientation of the environment (including the Internet, legislation, the media, trends);
- Cooperation with external parties.

And of course, not in the least: being in step with internal developments. Cross-border cooperation is not only important for exchanging tax data on those liable to pay taxes but also in the context of sharing investigation findings and compliance strategies. An organization like CIAT contributes to this major exchange!

TAX REGISTRY ENHANCEMENT: DEBUGGING, UPDATING AND USE TAXPAYERS' REGISTRY

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Contents: Summary.- 1. Introduction.- 2. Actions targeted at a continued updating and improvement of the single taxpayers' registry in the current comprehensive information system of the Tax Administration (SIAT, in Spanish)- 3. Actions intended for the design, development, updating and continued enhancement of the RUT in digital taxation- 4. Effective legal provisions affecting tax registries- 5. Conclusions.

SUMMARY

This paper sets out specifically the updating and debugging actions taken by the Costa Rican Tax Administration in order to have a taxpayers' registry apt to generate more reliable and updated information.

The strategies used since 2003 are explained, which are intended to locate hidden taxpayers, as well as the IT applications developed, the information loaded on-line from other institutions and the changes in the procedures that have resulted in a better registry.

Also, the paper explains the transitional process undergone by the Costa Rican administration towards a new way of managing taxes; the actions taken to migrate from one IT system to another without affecting the continuity of a business and to achieve improved information quality and operating efficiency and effectiveness.

Finally, the legal provisions which rule matters relative to the registration of taxpayers and the impacts of such rules and their interpretation in practice are presented, stating the analysis thereof as a relevant opportunity for improvement.

1. INTRODUCTION

The registry of taxpayers, denominated in Costa Rica “Single Taxpayer’s Registry” (RUC, in Spanish) until 2009, or “Single Tax Registry” (RUT, in Spanish) as from 2010, constitutes one of the primary management instruments and the first control level in the Tax Administration. With good reason many definitions describe it as the backbone of any country’s tax management system. Regardless of the term used to refer to it, this registry or census of taxable persons, the RUC or RUT – ultimately synonyms- must be the primary focus of the tax authorities in order to assure its quality and continued improvement.

The General Income Tax Office has established the updating of its taxpayers’ registry and the quality of the data its strategic objective, aware of the fact that having reliable and accurate information has become an indispensable instrument for the proper performance of the diverse extensive and intensive control actions, as well as for a better performance of the collection function. This objective may be summarized in the following actions:

- Standardize and improve the content and design of RUT forms in order to enhance the quality and quantity of the information required by the Tax Administration.
- Improve the quality of tax registries through correction protocols, drawing on the technical diagnoses performed and the experience accumulated from the different debugging programs carried out within the frame of management model modernization projects of the Costa Rican Tax Administration.
- Implement effective procedures for updating actions, to be incorporated into all control actions, and provide timely assistance to taxpayers.
- Review and enhance data capture and processing proceedings, maximizing the use of electronic means to achieve entry of quality information, and detecting, where possible, original errors or inconsistencies in order to correct them on a timely basis.
- Make the best use of the information in the hands of other public and private institutions and organizations to incorporate potential taxpayers and update records.

As far as the income tax is concerned, in Costa Rica, the registry of taxable persons is composed only by the businesspersons and professionals subject to the corporate tax, as well as by withholders. As of December 31 of 2009, a total of 460,000 taxpayers were registered.

This census integration may be explained in the nature of income taxation in Costa Rica, where “permits” are required for the yields of corporate or professional activities, labor and movable assets. The taxes on the last two types of yields are liquidated through a releasable withholding. The tax related to corporate yields (the corporate tax under the law) must be liquidated by means of an annual self-liquidation return, and the taxable persons must fulfill a series of obligations, such as registering themselves and making quarterly advances.

At the level of the primary identification data, there is the advantage that each citizen has a single identification number for all legal purposes in Costa Rica, which allows a great consistency of consultations and information. The consultation by identification number guarantees that the information displayed is the real information of the consulted person or identification number. For example, every time the identification number of a taxpayer or natural person is entered, the system searches through the Civil Registry’s database – the primary, truthful and accurate source on a national level - and extracts from it the name of the person corresponding to the identification card, thus guaranteeing the integrity of the information.

In addition to the identification data, the fiscal domicile of each taxpayer is included, as well as their business domicile; i.e., the place where taxpayer carries out their business activity which may obviously coincide with the fiscal domicile. The fiscal domicile defines the enrollment of taxpayer in a certain territorial administration, in conformity with the regulation. Both for changes associated with registrations – changes in the relevant census information (changes in domicile, legal representative, etc.) – and changes associated with deregistration, an official census statement must be used. The failure to perform this formal duty is categorized as an infraction and is subject to administrative penalties.

The registry contains information on the diverse tax obligations, including taxpayer’s obligation to submit information statements and the frequency of such statements. The economic activity carried out by the taxpayer is also registered.

Today, the Costa Rican Tax Administration is undergoing a transitional process towards a new integral tax management model that stems from the need to achieve improved management, control and services, supported by the strategies of Digital governance. This new model, reflected in an ambitious large-scale project, entails profound modifications in the organization, regulations and procedures; and the new information system, called Digital Taxation, which has been operating since late 2007, stands as a big opportunity to consolidate a process of correction and updating of the taxpayers' registry, which has characterized the Administration's actions over the last years, while at the same time has fulfilled the strategic objective of migrating towards a single registry of taxpayers of higher quality and in line with the world's highest standards, to conclude no later than by 2011.

This paper comments on the past and ongoing actions intended to achieve such strategic objective, in addition to specifying the characteristics, the interpretation and the practice of the legislation that has been evaluated and which is believed to need greater improvement in order to adapt to the objective.

2. ACTIONS TARGETED AT A CONTINUED UPDATING AND IMPROVEMENT OF THE RUC IN THE CURRENT INTEGRAL INFORMATION SYSTEM OF THE TAX ADMINISTRATION (SIAT)

For several years different actions have been continuously and permanently been implemented, which have affected positively the information quality included in the RUC. Based on a series of diagnoses made between 2001 and 2003, all them consistent with the need to improve the registry, which was at that time outdated and had a great amount of incorrect information, intensive work has been developed, among which actions stand out the following:

- Ongoing debugging plans in sectors of greatest fiscal interest: large taxpayers, excise taxes, consumptions, special systems and taxes (duty-free zone, duty-free customs system (*perfeccionamiento activo*), casinos and gambling, simplified taxation) and certain selected groups of taxpayers.
- Engagement of all the staff at the General Income Tax Office in the update of the RUC. An Order provided the responsibility of all tax officers to obtain all relevant data and update the system when interacting with taxpayers.

- Officers in the Territorial Administrations devoted exclusively to updating the RUC as part of the operating plans in the areas of Tax Collection and Records.
- A series of strategies were implemented for taxpayer location, such as: exchange of information with other State institutions that provide first need services, which have updated and highly reliable information, such as power and telecommunications companies, water supply companies, social security organizations and insurance companies. The exchange of information was also used with the institutions in charge of the national registries of natural persons and bodies corporate.
- Drawing on the joint work with such institutions, an integrated consultation system was developed, called "Telephone consultation", which allows accessing all the information in such institutions on line. In supplement of the consultation system, the services of a private company engaged exclusively in providing data of natural persons and bodies corporate were hired.
- In the services field, a summarized catalogue of material and formal obligations was prepared, to deliver to the new taxpayers at the time of registration. Such catalogue sets out the obligation of taxpayers to modify their registry data upon any changes made, or upon deregistration or cessation of activities.
- The registration diligence requirements were simplified by way of the instructions "Summary of requirements for addressing diligences at the Taxpayers' Registry" and "Voluntary registration, deregistration and modification procedures at the Taxpayers' Registry of the General Income Tax Office", which contemplate overall case requirements and integrate any other registration diligence that was hitherto regulated individually.
- The registration form was originally a single-version multipurpose form that contained the three diligences, i.e.: registration, modification and deregistration. Upon conducting a survey that concluded that users had trouble filling them, the contents of the form were simplified and broken down by diligence, in addition to assigning a different color to each form and issuing the relevant brochures for each diligence.

- A summary of information relating to all diligences concerning the registration, requirements, special registrations, legal bases, etc., was prepared and posted on the web page.
- As regards systems, a full redesign of the Taxpayers' Registry's modules in the current information system of the Tax Administration was performed. The statistics module was adjusted for a new redesign, allowing for the tabulation and lists of taxpayers and statistics in accordance with the registration, modification and deregistration diligences.
- Additional modules were created, such as the supplementary RUC, the error correction module and the module that identifies all taxpayers appearing as not localized. This module is one of the primary inputs for Tax Administrations when performing data updates and debugging.
- The economic activity databases were updated to be entered into the United Nation's International Standard Industrial Classification of All Economic Activities, Version III. This change allows obtaining accurate statistics by economic and industrial sector. Additionally, tax obligations were tied to the performance of a specific economic activity. This has made it possible to allocate the tax obligations actually corresponding to a taxpayer upon registration, assuring correct statistical data for each tax.
- The taxpayer's registration, modification and deregistration system was developed and made available on the Internet through the TRIBUNET "*Pay your taxes over the Internet*" system, as well as the registration of electronic billers.
- The Taxpayer Identification System, "SIC" (in Spanish), was implemented. This is a practical application for inquiring and verifying the name or corporate name and the personal identity card number of natural persons and bodies corporate. It is available on the web page of the Income Tax Office, as well as in compact disk format. It is mainly intended to facilitate the presentation of the identity card and the name of third parties that are to be specified in information statements.
- Each module and tool that is implemented in the RUC has been accompanied by lectures or training workshops provided to the officers at the offices responsible for these proceedings.

- Quality control processes were implemented to oversee the quality of registration forms. This action had a positive effect, for a considerable percentage of errors were detected, which allowed taking the relevant corrective measures.
- The registration modules of the SIIAT are maintained on a permanent basis, on the assumption that they must operate effectively and coexist with the new system for a period of at least two years.

3. ACTIONS INTENDED FOR THE DESIGN, DEVELOPMENT, UPDATING AND CONTINUED ENHANCEMENT OF THE RUT IN DIGITAL TAXATION

From the stage of definition of the requirements and the scope of the new digital taxation management model in 2005, to the planning, budgeting and hiring processes, and concluding with the start-up of the project by late 2007, a balance strategy has been discussed extensively to maintain the effective operation of the current system (SIIAT), as explained in the previous section, and assure that the new system (Digital Taxation) contemplates in its design and implementation all that is necessary to fulfill the objectives of high quality and effectiveness.

The implementation of the developments in the Digital Taxation Project is attributable to a “controlled pilot” strategy under which the new products will be tested in practice with large taxpayers and a few other taxpayers who contribute most to tax revenues and whose information has the greatest transcendence for tax control purposes, or are easier to control.

As far as the tax registry is concerned, since 2008 all large national and local taxpayers have operated in the new system, those who would file their returns on the Internet before the implementation of the new system, taxpayers of specific and excise taxes and taxpayers engaged in certain economic activities under special conditions who are, on account of that, easier to identify and control. These taxpayers can make use of the voluntary services of data modification and deregistration from the RUT, and the Administration has mechanisms to assist all updating process in the system.

The registration module is currently being developed for the rest of taxpayers. This has required the creation of a data migration strategy from the current to the new information system; even so, when

this strategy was exhausted, taxpayers should undergo mass re-registration processes and start the process all over again.

From 2008 and during 2009, segmented loads of taxpayer information were made from the Integral Information System of the Tax Administration (SIIAT) to the new Digital Taxation solution, migrating in the first place the data of large taxpayers, specific taxes and other taxes, as explained above. Following this first stage, conceived under the controlled pilot for preparation and refinement of the tools until its final implementation, is the migration strategy that must be developed in 2010 and 2011, which should conclude with the implementation of the Digital Taxation of most taxpayers who have not yet been migrated from the SIIAT to the new system.

The process begins in 2010 with the announcement to the organization of the strategy intended to achieve a successful migration of the category “Other taxpayers” (mass migration) to the new digital solution.

What is pursued is that the Administration and the involved divisions at the General Income Tax Office should know the procedure to follow during the data migration process. Once this is communicated, the process will be delimited as per each division and the task to be performed within the whole process.

Lastly, priority should be given to specific groups, in accordance with the completeness of their data and the performance of their obligations as a condition for migration.

The following main actions have been identified:

Determination of the balance of taxpayers: The final balance of taxpayers apt for migration must be determined by searching the databases. This will entail official automatic deregistration intended to clean the register of inactive taxpayers.

Execution of the official deregistration: The official deregistration will proceed in order to reduce effectively the register of taxpayers at the SIIAT. This official deregistration will proceed with taxpayers who as of 2008 have recorded no income tax payments for 3 years.

Determination of the new balance: A balance will be in place prior to the income tax return for 2009. Such balance includes some inactive taxpayers in two maximum periods; this will be considered a provisory balance until the tax return for that period is filed, whose

deadline is due on March 15 of the year following such period. In this case, it was due last March 15 so it is from that date that the whole information may be processed, which could take some additional months.

Provisory deregistration: The IT Area will mark out in the SIIAT the taxpayers who are deregistered and will maintain them provisionally under such condition until the tax return filing of 2009 occurs or not, in order to render it final. If taxpayer fails to file 2009's tax return, an official automatic deregistration of such taxpayer is made in the SIIAT. Alternatively, taxpayers who file 2009's tax return will be removed from the provisional deregistration and will be incorporated into the migration population.

Migration population: The RUT Subdirectorato will determine (after the filing of 2009's income tax return) the active population to be migrated to Digital Taxation. Such population would be composed of as follows:

	SIIAT's active taxpayers
Minus	Taxpayers deregistered automatically
Minus	Inactive taxpayers (failed to file 2009's tax return)
Plus	Temporary inactive (filed 2009's tax return)

Inclusion of "Dummies": The Digital Taxation requires that at least some taxpayer's identification data should exist in order for the migration to take place, on account of such data being mandatory. The IT Division, pursuant to the guidelines set forth by the RUT Subdirectorato, will proceed to update or complete the identification data of taxpayers that are incomplete. To this purpose, some filling or "dummy" data have been created which allow the migration. This does not mean that these data will remain as such, for the taxpayer will have the obligation to update them when first signing up in the Digital Taxation. The *Rule FURNRUT17- Validation of migrated master data* was created for this purpose.

Data loading in the Digital Taxation system: Once the data extracted from the SIIAT are refined, they are forwarded to the Digital Taxation Project section, where they will be loaded into the new digital solution. Given the uncertainty of its continuity or activity, this database will be treated as per the rules on compliance with the income tax return, as follows:

If taxpayer files tax returns with data, they are maintained in the Digital Taxation database and are included in the category of active taxpayers.

If taxpayer files tax returns with zero data, they are placed under the category of temporary inactive taxpayers.

If taxpayer fails to file the tax return, they are placed under the category of temporary inactive taxpayers.

Temporary inactive taxpayers: Under the business rules for the operation of the Digital Taxation system a database was created for inclusion – for identification purposes- of taxpayers filing tax returns with zero data (inactivity indicator) or who fail to submit tax returns for a certain time. They will remain in this database for three years until their inactivity is (or not) rendered final; upon the lapse of this period, the official automatic deregistration will proceed.

It should be stated that this process does not include taxpayers who have been reported in information statements; neither does it include taxpayers who have shown signs of non-performance as per the information available in the tax intelligence and risk management processes, or who have unfinished diligences or requirements.

If during this period the taxpayer files a tax return, they will be removed from this database and the cycle will begin again, and they will be reincorporated into the Digital Taxation database.

Active taxpayers: Taxpayers whose filings are constant and who show signs of activity will be maintained in the active taxpayer database.

Notwithstanding the possible case that the migration strategy is exhausted, as briefly described before, the Costa Rican Tax Administration does not rule out the possibility of resorting to a re-registration process in order to assure that the RUT is consistent, supported by correct information and updated on a permanent basis.

4. EFFECTIVE LEGAL PROVISIONS AFFECTING TAX RECORDS

The Tax procedures act or general taxation act of Costa Rica, called Code of Tax Rules and Procedures, contains five sections that govern the fiscal domicile and one that sets forth the non-performance of the taxpayer's or taxable person's obligation to report identification information to the Tax Administration. As these sections are short, we will transcribe them below:

SECTION 26.- Natural persons

For all taxation purposes, the country domicile of natural persons is assumed to be:

- a) The place of their usual residence, which is presumed to be the place where the natural person remains for more than six months during the fiscal year;
- b) The place where the natural person carries out their civil or business activities or has taxable property, in the case the residence is not known or is difficult to locate.
- c) The place where the taxable event occurs, in the absence of the above; and
- d) That chosen by the Tax Administration in the event there is more than one domicile of those contemplated in this section.

SECTION 27.- Bodies corporate

For all taxation purposes, the country domicile of bodies corporate is assumed to be:

- a) The place where their management or central administration is located;
- b) The place of their headquarters in Costa Rica, in the case such management or central administration is not known;
- c) The place where the taxable event occurs, in the absence of the above; and
- d) That chosen by the Tax Administration in the event there is more than one domicile of those contemplated in this section.

The provisions of this section are also applicable to de facto corporations, trusts or estates and analogous entities other than natural persons.

SECTION 28.- Persons domiciled abroad

The following rules apply to persons domiciled abroad:

- a) If they have a permanent domicile in the country, the provisions of sections 26 and 27 shall apply;
- b) In the rest of the cases, the domicile is that of their legal representative; and
- c) In the absence of a legal representative, the domicile shall be the place where the taxable event occurs.

SECTION 29.- Special domicile.

Taxpayers and tax-liable persons may establish a special domicile for taxation purposes with the express authorization of the Tax Administration, which may deny its acceptance by a grounded resolution if this is detrimental to the proper performance of tax termination and collection tasks.

The acceptance by the Administration shall be presumed in the absence of any opposition issued within thirty days.

The special domicile thus constituted is the only valid domicile for all taxation purposes.

The Tax Administration may at any time demand the constitution of a special domicile or a change in the existing domicile when, by means of a grounded resolution, it proves the occurrence of the circumstances contemplated in the last part of the first paragraph of this section.

SECTION 30.- Obligation to report the domicile

The taxpayers and taxable persons are obliged to communicate their tax domicile to the Tax Administration, providing the necessary references for an easy and proper localization thereof.

Such domicile shall be rendered legal for as long as no new changes are reported.

In the event of default in the obligation to report the domicile, the domicile will be determined by applying the presumptions referred to in the preceding sections, notwithstanding the penalties applicable under the provisions of this Code.

SECTION 78.- Failure to file the statement of registration, modification or deregistration

The taxpayers, taxable persons and other individuals who fail to file to the Tax Administration the statement of registration, deregistration or the modification of any relevant information on their legal representative or their fiscal domicile within the terms provided in the relevant regulations or laws concerning the different taxes, shall liquidate and pay a penalty equal to fifty percent (50%) of their base salary for each month or fractional month, but the total penalty may not exceed the amount equivalent to three base salaries.

The previous section relative to the fiscal domicile seems to be suitable and consistent with the organizational scheme of the Costa Rican Tax Administration, which is characterized, like most of them, by a territorial segmentation by taxpayer type and the centralization of guiding functional decisions at a national level.

As convenient as it may be, the enrollment of taxable persons in a certain territorial administration is not without problems.

Our practice has shown us that taxpayers, taking advantage of it, will attempt to “vanish” by fixing a fiscal domicile where they may be least noticed by the Tax Administration. For example: a merchant engaged in operations of a considerable magnitude in the Southern Zone of the country (characterized, at least as far as internal tax management is concerned, by a minor business development and a dominant rural territory), who is for that reason very visible, establishes his fiscal domicile in San José (the country’s capital). Hence, he becomes just one more among the numerous taxpayers enrolled in the Territorial Administration of San José, a section with a lower relevance within such Administration. As a result, the high probabilities of withstanding inspections on account of being enrolled in the Territorial Administration of the Southern Zone are enormously reduced in San José. Needless to say, all the operations, including the business management, are maintained in the Southern Zone.

The same happens with some taxpayers who, when informed that an administrative action has been initiated, change their fiscal domicile despite not having moved the place of their business management or business operations, with the only purpose of misleading the tax authorities and, ultimately, attempt to frustrate the administrative action.

This state of affairs has been leveraged by a well intentioned, though mistaken, administrative criterion. So far, the Administration has believed that the options contained in subsections a) through d) of section 26 (domicile of natural persons) and the same subsections of section 27 (domicile of bodies corporate) of the Code of Tax Rules and Procedures, are freely chosen by the taxable person.

After reviewing the issue, it has been recently concluded that, on the contrary, this entails a preferential relation of options, under which the first option should be registered and if, and only if the first is not possible, the second, and so forth. Obviously, the registration of a

domicile different from the first domicile would assume the taxpayer's motivation and the express acceptance of the Administration.

Why is that so? Because the fiscal domicile is not only the place to deliver any notices to the taxpayer, but also the place where any administrative actions should take place intended to verify and assure the performance of tax obligations. It should be underlined that in the case of natural persons, option a) of section 26 cited above, it is the place of usual residence, and in the case of bodies corporate, option a) of section 27, it is the place where the management or the central administration is located.

Both options are consistent with international stipulations, albeit with some difficulty in the case of natural persons, where it should be understood that it clearly concerns the "vital center" for bodies corporate, because the text is consistent with the idea of "effective management". In the latter case, this is the most adequate place: it is, ultimately, the place of the effective management, where the persons knowledgeable of the businesses are located, those who make decisions, who can answer to administrative requirements. It is at such place where the records and the information required for the performance of any administrative action are carried.

At present the Government of Costa Rica is driving a National Program for the Prevention and Fight against Tax Fraud, within which frame, and as a result of several months of studies conducted by the technical officers of the highest ranks of the institutions of the three Branches of the Republic, having competence on tax matters, a special plan has been created to implement the recommendations made by such technical team. Many of them are targeted at the modification of regulations and laws concerning tax procedures, in order to provide more effectiveness to the Tax Administration and to rule out loopholes that may lead to tax elusion or evasion which favor a lower compliance today. In this sense, the review of the legislation and the above cited criteria represents an important chance for improvement with high probabilities of success.

5. CONCLUSIONS

Arguing about the transcendence of the taxpayer census would be redundant. It is around such census that the success of the tax management revolves.

While it could well be said that the taxpayer census or registry in Costa Rica presents a design consistent with modern conceptions and that great efforts have been made in recent years to improve it, with very clear and concrete achievements, there is still a long way to go.

The transition towards a different way of managing taxes, “Digital Taxation”, has forced the Costa Rican Administration to redesign process and procedures in order to achieve substantial improvements, increase performance, quality, services and speed, as well as control capabilities. The registry of taxpayers has not been alien to this transition and, on the contrary, it sees in it the possibility of consolidating as a tool for providing accurate, updated and highly effective information, as it should be the case.

The implementation of the recommendations within the frame of the National Program for the Prevention and the Fight against Tax Fraud could improve the regulations that govern matters related to the registry of taxpayers, and thus become another valuable and close opportunity to enhance it.

To conclude, the Costa Rican experience shows a process that has evolved since 2003 from a registry more dependent on taxpayer’s willingness to enroll, modify or update their data on their own initiative, to a more active registry that, apart from the voluntary services, takes advantage of any updating possibilities that arise, whether as a result of the interaction with taxpayer or the intensive use of external information sources. This vision of a more active and dynamic registry is constantly strengthened and is incorporated as a priority into the modernization projects of the Tax Administration as a whole, as well as into the opportunities for regulatory reforms that could turn it more effective.

EFFECTIVE MECHANISMS FOR THE COLLECTION OF TAXES AND THE RECOVERY OF DEBT IN TIMES OF CRISIS

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Contents: Summary.- 1. Backgrounds – The international crisis.- 2. Uruguay and the crisis.- 3. Mechanisms adopted by the tax administration.- 3.1 Designation of liable taxpayers.- 3.2 Some assumptions of liability in Uruguay.- 4. Conclusions.

SUMMARY

Certainly, this last economic crisis found Latin American countries better prepared than in previous times.

Notwithstanding, in the looming crisis, all countries adopted the necessary cautions to lessen its effects.

As far as the fiscal policy is concerned, assuring the State's income stability constitutes a fundamental standard, for it allows financing dynamic active policies favoring economic activity and such social policies that are apt to mitigate the consequences in the most vulnerable sectors.

In Uruguay, a set of measures of diverse nature was displayed to that end.

For reasons of space, in this paper we will focus exclusively on one of these measures: the designation of liable taxpayers.

We will discuss the possible contributions of such designation to the stability of public revenues by assuring the effective collection of taxes.

In addition, some considerations will be made of the category of liable taxpayers and what aspects should be pondered and evaluated for their designation.

Lastly, we will list some cases of liable taxpayers appointed in Uruguay who are considered worth mentioning for a number of reasons.

1. BACKGROUNDS – THE INTERNATIONAL CRISIS

During the period between 2003 and 2008, Latin America recorded an unexpected sustained product growth by levels which averaged between 4% and 6% of the GDP, which was an absolutely exceptional situation in the last 40 years.

In this context, the international financial crisis bursts upon the scene and rapidly falls back into a global economic crisis.

The effects of the crisis plunged practically the totality of the continent's countries into recession.

Given the damaging effects that economic crisis infringe upon social bodies (mainly the sectors in the lowest income layers), the role of public policies is vital.

With the idea of a free interplay of market forces adjusting these situations automatically being left behind, the necessary public intervention is now widely recognized.

In particular, the fiscal policy is required to fulfill a relevant role in this scenario.

Avoiding the income fall is a challenge for governments when it comes to sustain the expenditure and allow the continuity of social policies, and finance anti-cyclical policies.

In this context, tax administrations are vital actors to assure the achievement of contemplated objectives.

2. URUGUAY AND THE CRISIS

Practically all countries in Latin America reacted to this global recessive scenario by announcing and implementing active policies targeted at mitigating the effects of the crisis.

The measures adopted by each country varied according to the possibilities and the realities of each of them and to how the crisis affected them particularly.

In Uruguay, the set of implemented measures was very extensive and encompassed diverse areas.

To begin with, some measures consisted simply in the strengthening of policies that were in line with the country's overall development strategic guidelines.

These instruments were aimed at maintaining the competitiveness of the national production and increasing investments.

Furthermore, a series of specific measures was implemented, targeted at addressing the sectors most damaged by the crisis while preserving the employment level.

In addition to the above cited economic policies, a series of mechanisms was established in the Tax Administration with a view to assisting in the overall proposed objectives.

Fortunately, Uruguay was able to overcome the effects of the international crisis with the result that, albeit a slowdown in growth levels, the country never entered a recessionary phase. As a matter of fact, it was one of the few countries which recorded product growth during the period under consideration.

This was attributable not only to the measures adopted when the crisis commenced, but also to the significant role played by other measures adopted in previous years.

In this brief presentation we will discuss one of the mechanisms structured around the Tax Administration with the objective of maintaining the level of tax revenues: the designation of liable taxpayers.

3. MECHANISMS ADOPTED BY THE TAX ADMINISTRATION

The Latin American tax administrations are used to performing amid crisis scenarios.

So there are in Uruguay a number of mechanisms typically applied during times of crisis which had been enforced in previous crisis.

In many cases the application of these mechanisms is provisional, with the option to renew them for as long as the crisis effects persist.

Particularly in the case of the current crisis, the following mechanisms were implemented:

- Designation of liable taxpayers
- Information exchange agreements
- Flexibilization of the banking secrecy
- Additional powers for the Tax Administration
- Payment facility systems

For reasons of time and space, we will focus only on the first of the mechanisms described above (the designation of liable taxpayers), and discuss the designations made in Uruguay.

3.1 – Designation of Liable Taxpayers

3.1.1 – The liable taxpayer in the Uruguayan law

Within the concept of taxable person we find the category of *liable taxpayer*, which has gained increasing importance over time.

On this regard, section 19 of the Uruguayan Tax Code (CTU, in Spanish) provides:

“Section 19.- (Liable taxpayer).- A liable taxpayer is that person who, without assuming the capacity of taxpayer, must, by express provision of law, fulfill taxpayer’s payment obligations and formal duties, and is therefore vested in all cases with the right of repetition”.

This rule is acknowledged to stem directly from Section 27 of the Tax Code Model for Latin America (MCTAL, in Spanish), which defines liable taxpayers as: *“those who, without having the capacity of taxpayers, must, by express provision of law, fulfill taxpayers’ obligations”*.

From the transcription of the definition it is therefore inferred that the liable taxpayer does not assume the capacity of taxpayer, with taxpayer¹

¹ Section 17 of the CTU: *“Section 17.- (Taxpayer).- A taxpayer is that person in respect of whom the event originating the tax obligation is verified.”*

being the person in respect of whom the taxable event originating the tax obligation is verified.

It is therefore concerned with certain persons who, despite not being the ones in respect of whom the taxable event is verified, are anyway bound by law to pay and fulfill certain formal duties.

VALDÉS COSTA² explained that a taxpayer is that person bound by their own debt, whereas a liable taxpayer is that who responds for the debt of another; according to this author, the differentiating factor between both persons is the ownership or lack of ownership of the debt³.

PARLATO refers to “another’s debt”, by stating that it is a “debt originating by reason of a taxable event imputable to another person”⁴.

DINO JARACH⁵ argues: “a taxpayer is the person bound to pay the tax in their own right and, if I am allowed the expression, the person bound by nature, because it is in respect of them that the juridical cause of the tax is verified”⁶.

The substitution factor deserves to be considered separately.

There is no doctrinal consensus regarding whether it is a particular case of taxpayer or liable taxpayer.

For the Uruguayan legislation, as for a great part of the Latin American doctrine, it is a particular case of liability.

² VALDES COSTA, Ramón, VALDES DE BLENGIO, Nelly and SAYAGUES ARECO, Eduardo, “Código Tributario de la República Oriental del Uruguay, Comentado y concordado” [Tax Code of the Western Republic of Uruguay, commented and accorded], FCU, Fifth edition, October 2002, p. 259.

³ Sections 24 (Bound by their own debt – Taxpayers-) and 27 (Bound by the debt of another – Liable taxpayers-) of the MCTAL provide likewise.

⁴ PARLATO, ANDREA: “Tratado de Derecho Tributario” [Treatise on tax law], directed by A. Amatucci, p.201.

⁵ DINO, JARACH: “El hecho Imponible”, Abeledo Perrot, Buenos Aires 1971, p.168.

⁶ As it would be excessive for the purposes of this presentation to expand on the analysis of the category of liable taxpayers, for more details on this analysis you may refer to the excellent work of BLANCO ANDRES, “Los Agentes de retención y de percepción en el Derecho uruguayo”, Revista Tributaria del Instituto Uruguayo de Estudios Tributarios N° 166 (January – February 2002).

We also recommend the work presented by VICTORIA LARRAÑAGA and HÉCTOR LÓPEZ at the Tax Conferences of the DGI, “Sistema de responsabilidad tributaria en el derecho vigente” [The tax liability system in the existing legislation] (2008).

Section 57° of the Act N° 18.083 provides:

“SECTION 57°.- Substitute liable taxpayers.- Substitute liable taxpayers are such persons who must liquidate and pay the whole tax obligation in substitution for the taxpayer.

Once the liable taxpayer is designated, the taxpayer is released from any liability as to the tax collector for the relevant obligation. Such release does not prevent taxpayer from exercising all the rights vested in his condition as such, before both administrative and jurisdictional bodies.

The substitute liable taxpayers shall have the right of repetition in all cases, pursuant to the provisions in Section 19 of the Tax Code.”

Alternatively, there are other opinions that visualize substitution as a particular case of taxpayer.

This last thesis prevailed in the current wording of CIAT’s Tax Code Model, where the substitute is explicitly defined as “*taxpayer*”.

In particular, section 29 of the above cited model provides:

“Section 29. Substitute taxpayer.

1. Substitute taxpayers are taxpayers who, by provision of law and in substitution for the direct taxpayer, are obliged to fulfill the tax obligations.
2. The substitute taxpayer may demand payment of the paid out obligations from the direct taxpayer”.

The solution adopted by the model results in the differentiation of two classes of taxpayers: direct and substitute.

We will hereafter refer to substitutes as another case of liable taxpayers, a solution adopted by the current regulatory frame in Uruguay, which is the case discussed herein.

Going back to the category of liable taxpayer, another aspect that should characterize it is the requirement that its designation be made by law.

Some bodies of regulations provide in addition that liable taxpayers may be appointed by the Administration, provided that the legal power to do

has been established⁷. This was the position adopted by CIAT's Tax Code Model, which provides in section 31° the following:

“The Tax administration, through the issuance of general rules, may designate withholding or collecting agents who may intervene in acts or operations in which they may exercise the withholding or collection of the relevant tax, as well as withdraw or suspend such capacity where, in its judgment, payment of the withheld or collected values is not guaranteed”.

It is significant that the law should contain the hypotheses that shape the liability, and in addition establish the nature thereof.

In this sense, it should be mentioned that it is particularly important that the scope of the liability created by the law should be accurately delimited.

The liability's characteristics are tied to the type of person that is being defined.

According to this, the liability may be classified into joint and several, accessory or substitute⁸.

The joint and several liability implies the possibility that the Tax Administration may claim the totality of the debt either from the elected joint taxpayer or the taxpayer themselves; in the eyes of the tax creditor, there are no differences between joint and several debtors. If the tax creditor holds the liable taxpayer liable, they will file a legal action for payment against the taxpayer for the totality of the amount paid.

The accessory liability establishes the right of discussion, which implies the tax creditor's need to firstly claim debt from taxpayer and, upon exhaustion of the latter's property, claim the unpaid portion of debt from the subsidiary liable taxpayer.

As to the substitute liability, the state treasury is precluded from claiming credit from the taxpayer, thus removing the latter from their

⁷ Section 23 of the CTU states: “The liable persons in their capacity of withholding or collecting agents are those appointed by law or by the Administration, being legally authorized previously, who by reason of their functions...”

⁸ Due to space reasons we cannot expand on the analysis of these categories. For an in-depth analysis, you may refer to BORDOLLI, JOSÉ CARLOS and FAGET, ALBERTO: “Sujeción pasiva y responsables tributarios” [Taxpayers and liable taxpayers], paper presented at the 17th Latin American Conference of Tax Law, Cartagena, Colombia, 1995.

capacity of “debtor”, with the substitute taxpayer remaining as the single taxpayer on behalf of the substituted taxpayer, who acts exclusively as guarantor and may exercise the right of repetition against the taxpayer for the totality of the amount paid.

After making these general considerations regarding liable taxpayers, what remains to be analyzed is the reason for linking the tax obligation to a person other than the taxpayer themselves.

From the answer to this question we may infer the main characteristics that liable taxpayers should have.

Broadly speaking, the designation of liable taxpayers stems from the difficulties encountered in the management, collection or control of taxes under certain circumstances⁹.

In this same sense, the Uruguayan jurisdictional body, the Administrative Litigation Court (TCA, in Spanish), provides that the norm of liability should be applied as a last remedy once all the ordinary control possibilities of the Tax Administration have been exhausted¹⁰.

This line of argument in the national doctrine was developed by BORDOLLI¹¹ and incorporated into the resolutions of the 3rd River Plate Taxation Conference.

According to this, from the economic (non juridical) point of view, the liable taxpayers are considered a sort of “auxiliary agents” or “collaborators” of the Administration.

The obligation of these persons is defined by the norm that designates them, which may consist in both payment and the provision of information.

In no case may the participation of a liable taxpayer release the Tax Administration from its supervising function.

9 GIANNINI, ACHILLE DONATO: “Instituciones de Derecho Tributario” [Tax law institutions], Ed. De Derecho Financiero, Madrid, 1957, p. 133.

In the same line, SAINZ DE BUJANDA, FERNANDO: “La responsabilidad tributaria en régimen de solidaridad” [The tax liability in the solidarity system], “Hacienda y Derecho” [Finance and law], Volume V, Instituto de Estudios Políticos, Madrid, 1973, p. 242.

10 TCA’s ruling N°61/97.

11 BORDOLLI, JOSÉ CARLOS: “Los agentes de retención. Condiciones y límites para su designación” [Withholding agents. Conditions and limitations on their designation], Revista Tributaria of Instituto Uruguayo de Estudios Tributarios N° 85 (July - August 1988), p. 280.

So, the tax liability is based on the security and the assurance of the tax credit¹².

R.CALVO ORTEGA¹³ explains that, pursuant to this *security* purpose, the public nature of the tax liability leads the lawmaker to extend liability to other taxable persons other than taxpayer, insofar as they are related to them by some type of link or relationship.

As a consequence, in situations where due to business modalities, or the taxpayers' characteristics or any other circumstance, the control possibilities by the Tax Administration are reduced, or by any other reasons the tax credit is at risk, the possibility of designating liable taxpayers – among other strategies – could be contemplated.

In this hypothesis, if any person is identified as tied to the taxed operation or the taxpayer, and if such person exhibits further payment guaranties than does the taxpayer themselves, then the designation may prove effective.

In this context, the liable taxpayer is placed “*next to*” or “*in place of*” the taxpayer (depending on the type of defined liability), in order that the obligation be assumed by the liable taxpayer and the State should assure the collection of the tax.

The 4th Recommendation of the 17th Latin American Conference of Tax Law – Cartagena, Colombia, 1995, Topic 1, “Taxpayers and liable taxpayers”, summarized it as follows: “... *the liable taxpayer category stems from the need to consolidate or enhance tax collection...* Both the taxpayer and the liable taxpayer are subject to the tax obligation. The former is that in respect of whom the taxable event is verified, whereas the latter is the person that is bound to fulfill the tax obligation, not upon verification of the taxable event but by provision of law”.

The major protection of the state treasury's interest “...is attained by the introduction of two rules: the primary rule which provides for the taxable event typical of the tax and the imputation of the juridical effect related to the main obligee; and the secondary rule, which presupposes the effect of the first rule and in contemplating, in addition, a specific assumption, extends the obligation as to the liable person.”¹⁴

12 VICTORIA LARRAÑAGA AND HÉCTOR LÓPEZ: “Sistema de responsabilidad (...)” [*Liability system*]; in the work cited. p. 9.

13 R. CALVO ORTEGA: “Curso de Derecho Financiero I” [*Course on Financial Law*]; p. 177.

14 PARLATO, ANDREA: “Tratado de Derecho (...)”; p. 209.

It is important to point out that the mere fact that a certain activity or business should entail control difficulties is not sufficient reason for the designation of liable taxpayers.

While such circumstance may be a first hypothesis, in order to advance towards the designation it is essential that other aspects be verified; it is – as it is usually stated in mathematical terms- a “*necessary but not sufficient*” condition.

It is therefore important to underline that liable taxpayers should not be appointed for any reason.

The decision to appoint a liable taxpayer should be the result of a careful analysis of the circumstances, after concluding that the negative externalities brought about by the designation are largely exceeded by the advantages that motivate it.

In all, there must be a positive balance between the costs saved by the state treasury and the costs transferred to the liable taxpayers, or other type of negative effects that the designation may bring forth.

What additional aspects should be verified?

Firstly, it is obvious that the potential liable taxpayer must be identified, that is, an individual or corporate must exist who is tied to the operation or the taxpayer, and who may be held liable.

Secondly, special attention should be paid to the fact that the designation of a liable taxpayer should not introduce distorting elements into the market, which may lead to an inefficient allocation of factors, or may reward the non-performance of tax obligations.

This calls for a comprehensive analysis of the market of the good or service into which the liability will be introduced prior to the designation, and the identification of how such liability may impact from an economic perspective.

Special attention should be paid to designated liable taxpayers who show bad tax behavior, for if any of the possible liable taxpayers markets the good in question informally, the gap that differentiates such good from other goods in the formal circuit could be widened.

In effect, in this case the difference between a product in the formal market and one in the informal market will not only be the VAT (and possibly any excise tax), but also the addition of the withholding or collection.

Here is an easy example of a practical application of this problem.

Let us assume a good that is marketed in the retail circuit and shows serious problems of VAT evasion.

If in any of the previous stages (for example, during manufacture) all the agents show an acceptable tax behavior, they could be appointed collecting agents for the VAT corresponding to the stage where problems are detected (in this case, the retail circuit).

Now, well, if serious control problems were also found on the manufacture level, then the appointment would not be advisable because we would be increasing the “*award*” for the informal sector upon introducing collection.

Finally, it should be analyzed if the potential liable taxpayer is qualified for such appointment.

In effect, the fact that there exists a person tied to the operation is not enough; the prospect appointment requires that the person should have certain attributes in order that the tax collection activity of the Administration is facilitated, and provides the system with a higher degree of certainty regarding the expected collection of taxes.

3.1.2 – Recommended attributes for the designation of liable taxpayers

Some of the attributes or characteristics that are recommended for the designation of liable taxpayers are:

- **Solvency**

One quality that seems important for the election of a liable taxpayer is that such person should have the necessary solvency to meet the possible obligations that may arise from their designation.

If the reason for the designation is the assurance of the tax collection by the State, it is not necessary to overstate that the designee should be able to meet their emerging debts in full.

However, under certain circumstances the designation may fall upon certain persons who are less solvent than the taxpayers themselves, but who under specific situations may still offer further assurance to the State.

This is the situation, for example, of residents who hold relationships with non-residents who earn income from a Uruguayan source; in this case, the resident is held liable to the obligation of the non-resident taxpayer, in absolute disregard to the solvency analysis of the resident.

In effect, in the above described situation the simple fact that it is a resident person clearly makes it easier to supervise and manage than in the case of a non-resident.

The designation of a liable taxpayer implies in addition the imposition of a series of formal obligations tied mainly to the provision of relevant information to the Tax Administration, the filing of tax returns and the issuance of supporting documentation of possible withholdings.

This is the reason that the designees should have a suitable administrative infrastructure in order to be able to meet efficiently the formal obligations imposed on them.

So, the liable person must be qualified to meet all the obligations imposed on them.

This transfer of administrative tasks to the liable taxpayer may achieve highly significant levels, so the impact this may have on the potential designees should be considered.

A reasonable balance should be stricken between the obligations transferred to the liable taxpayer and the possible benefits obtained from such designation.

It should also be noted that in the case of withholdings and collection, a financial benefit is gained as a result of holding the amount withheld or collected during a certain time (until it is deposited with the state treasury).

- **Reliability**

Another relevant aspect that should be considered is the degree of reliability that could be attributed to the designees.

It usually happens that in marketing or distribution channels where compliance problems are detected, there is some participant in one of the stages of the economic circuit who exhibits a greater degree of reliability than the rest do. In this case, such person may be appointed if they also meet the other required attributes.

Reliability is also relevant because in the case of withholdings or collection, the liable taxpayer can manage considerable amounts, with the result of a significant concentration of the risk.

The definition of these liability systems should be accompanied by the design of a more burdensome penalty system than the ordinary system.

As regards withholding and collecting agents, the penalty for not paying timely withheld or collected amounts is 100% of the unpaid amount, whereas the penalty for any other case is 20%.

Furthermore, letter H) of section 96° of the Tax Code provides a simple assumption of fraud intent when the version of the withheld amount is omitted.

In line with this, section 47° of the Decree-Law 14,948 of November 7 of 1979 establishes:

“Unless proven otherwise, failure by the collecting agents to timely pay the taxes collected by the General Revenue Office shall be presumed as an intention to evade taxes.

The tax fraud shall be penalized with fines from 5 to 15 times as much the tax amount that was evaded or attempted to be evaded”.

Lastly, section 19° of the Decree-Law 15,294 of June 23 of 1982 categorizes the crime of misappropriation in the case the withholding and collecting agents fail to pay the withheld or collected tax within the terms provided for such purposes¹⁵.

- **Control facility**

One factor that could be decisive in making the decision to appoint

¹⁵ “Section 19°.- The agents responsible for withholding and collecting the taxes collected by the General Revenue Office who fail to pay the withheld or collected tax within the term provided by the effective regulations, will be presumed as having committed misappropriation.”

a liable taxpayer is the greater possibility of control that the Tax Administration may achieve with such appointment.

The greater possibility of control may result from the modality of connection between the liable taxpayer and the taxable event, as well as from the different specific circumstances that may condition their participation in the activity in question.

In general terms, when it comes to businesses or activities that exhibit control difficulties in the retail stages, where there is a reduced group of suppliers having a reasonable degree of credibility, these may constitute eligible candidates to be bound by the tax obligations of those who are in the subsequent stages of the economic circuit.

In certain situations, the simple fact that the prospect liable taxpayers may constitute a significantly smaller group than the group of taxpayers is a reason that motivates their designation, provided that all the other requirements are verified.

- **Possibility of compensation**

One element that should be considered in the design of a policy for the identification and designation of liable taxpayers is that the designees should be tied to either the activity or the taxpayer, in order that they may be allowed to receive economic compensation once they have fulfilled their duty to pay the tax obligation, and so that they should not respond exclusively with their own property.

Given that the liable taxpayer is a debtor for the account of another, they should be able to receive compensation for the tax burden. The relationship between the liable taxpayer and the taxpayer will be governed by the private law, whereas the obligation of taxpayer is governed by the tax law.

This possibility of reimbursement, or compensation, may be verified (“*ex ante*”) prior to paying out the obligation, or else the liable taxpayer may recover the funds used in paying the obligation after (“*ex post*”) making such payment.

With this compensation, the economic impact of the tax would fall upon the person that the law has identified as owning a certain taxable capacity, that is, the taxpayer.

- **Simplicity**

In some occasions the designation of a liable taxpayer may simplify the system.

The concern for migrating to simplified tax systems is shared by everyone; however, this objective is increasingly difficult in an environment where due to multiple factors the economic activities are ever more complex.

And this is because it is extremely complicated to move forward to simplified tax systems without jeopardizing equity.

In this continued attempt to strike a balance between simplicity and equity, certain types of withholdings (definitive in some cases) may be considered a suitable tool for such purpose.

We will come back later to this issue when we discuss a specific case of a liable taxpayer, but we may cite as an example the case of banking institutions.

As a matter of fact, in Uruguay the banks were appointed withholding agents for the Tax on Individuals' Income (IRPF, in Spanish) and the Tax on Non-residents' Income (IRNR, in Spanish), corresponding to the interest on bank deposits.

Such designation was intended to give taxpayers the option to render such withholding definitive, thus releasing them from having to declare the relevant income¹⁶.

- **More information**

Information management has become a fundamental goal of the management of contemporary tax administrations.

Having reliable information is an objective to which more and more administrations allocate additional resources.

In this context, the participation of a liable taxpayer may contribute to the provision of relevant information for the administration.

16 This was possible because the IRPF in Uruguay has a "dual" structure, with two clearly differentiated categories, where the income included in one of them (that including financial income) is assessed with a flat rate. In the context of a traditional or synthetical IRPF, this measure would have no simplification effects.

3.2 Some Assumptions of liability in Uruguay

Over the last years, the designation of liable taxpayers in our country has increased significantly.

From the vast case law existing in our Tax System, we will comment on some cases that are believed to have some interest in the light of the good results shown by some designations.

3.2.1 Payers of non-resident taxpayers

This is maybe one of the most common cases of liable taxpayer appointment, a category that is likely to exist in the body of regulations of nearly all countries.

As previously noted, the reason is that the control and follow-up of entities doing business in the country on a non-permanent basis is very complex; hence, the suitability of appointing the resident taxpayer who pays or credits the relevant income.

This assertion may be played down in the light of section 27 of the OECD's Model Tax Convention on Income and Property, relative to the assistance in Tax Collection, but such relativization is only applicable to countries holding an effective Convention which in addition includes this clause, where a designation is absolutely pertinent.

As we said before, within the frame of this designation, there may be cases of liable taxpayers offering insufficient reliability, given that the only link that led to their designation is that they are a non-resident's payer.

This risk is increased if the resident taxpayer is not engaged in activities on a permanent basis.

An example of this, which has deserved a special treatment in our legislation, is given by the organizers of public shows where non-resident taxpayers take part.

In these cases, the resident corporation (the show's organizer) would be legally incorporated only for the purposes of the show, and was absolutely insolvent, with the result that it provided little assurance to the Tax Administration as a liable taxpayer, and it was very difficult to collect from the organizer.

In view of this “*scenario*”, the owner of the site where the show was staged was also held liable to the Tax on Non-residents’ Income (IRNR) and the Value-added Tax (VAT).

In this way, the owner of the site makes sure that payment of the relevant taxes is made even before the show takes place.

This allowed having a designee with backup assets and who, by virtue of their relationship with the business, had the possibility of claiming payment of the tax.

3.2.2 Employers

The case of the designation of employers as liable to the IRPF of their employees is also a case that may be observed in nearly all countries, so we will not expand largely on it.

It is worth mentioning only that in Uruguay the withholding was designed in such a way that if the worker earns only that income, what the employer withholds during the whole year coincides with the generated IRPF, so they are released from having to prepare and file the tax return.

This is possible because the employer must adjust the withholding pertaining to the month of December so that on adding it to the total withholdings accumulated during the year, it coincides with the tax that such worker generated for that income.

In this case, the withholding releases a great number of workers from having to file the tax return, with a resulting impact both on the administration and the taxpayers themselves.

3.2.3 Credit and debit cards

The use of credit and debit cards as a means of payment is being increasingly spread as a consumption practice.

On the other hand, the entities that administer these payment systems are few and have a sufficient infrastructure to take on all the tasks inherent in a fully solvent liable taxpayer.

In the light of these circumstances, it was considered suitable to hold them liable to the taxes originating from the operations financed by them.

Through this mechanism, the State Treasury is certain to collect a highly significant percentage of the generated taxes¹⁷.

In addition, the engagement of these liable taxpayers also stands as a highly valuable source of information to the administration on account of the increasing participation of these financial instruments in consumers' habits.

3.2.4 Notaries in the sale of real property

In Uruguay the sale of real property is required to undergo a series of formalities in order to be perfected.

In effect, the sale agreements must be filed with the public registry and a certified notary must intervene perceptively.

Because the participation of the certified notary is mandatory in this type of business, and since it configures the event that originates the IRPF (where the seller is an individual), it was considered suitable to hold them liable to the tax originating in the purchase and sale of real property.

The certified notary, without whose signature the business cannot be transacted, is entitled to demand the amount of the tax originated from the operation and deposit it later with the state treasury.

The withholding thus made may be considered definitive, so the taxpayer may be released from having to declare such operation¹⁸, with the resulting relief implied both for the taxpayer and the General Revenue Office.

3.2.5 State

In Uruguay the public sector has a significant participation in the economy.

It is a very relevant purchaser of goods and services, so it was considered suitable to hold it liable when performing its purchases.

17 The credit administering entities detract 5% of the total price of the operation. Currently, 1.58% of the total revenues are collected thereby.

18 The "dual" structure of the IRPF allows considering the withholding final and avoiding the inclusion of this income in the tax return, given that it has no impact on the progressive nature of the tax by reason of being income assessed by a proportional rate.

Hence, any state entity purchasing goods or services was appointed VAT-withholding agent, subject to withhold 60% (sixty percent) of the billed tax.

In this particular case, the State is a 100% reliable agent, which poses no risk of evasion.

3.2.6 Large taxpayers

Given the great success of the withholding explained in the previous paragraphs, it was considered suitable to extend the group of taxpayers subject to the tax withholding when purchasing inventories.

In this sense, all taxpayers categorized as “*large taxpayers*” by the Tax Administration were appointed liable taxpayers.

Even though these taxpayers do not have the same high degree of reliability as the State has, they are very well-known and serious companies which can be absolutely relied upon.

On the other hand, they obviously have the administrative infrastructure required to meet reasonably the system’s requirements.

3.2.7 Uruguay’s Soccer Association

As it is publicly known, soccer in Uruguay is a business with a relatively high importance.

The remunerations of soccer players are well above the average of the rest of the country’s workers.

In addition, they are public celebrities, so it was very important that the Tax Administration should verify perfect tax compliance by this activity sector given its public repercussions.

When the Tax on Individuals’ Income (IRPF) was reestablished, a system was structured intended to assure the effective collection of the football players’ IRPF.

Because the money that is collected from television rights firstly enters the Uruguayan Soccer Association (who is knowledgeable of all football players’ contracts) and is then distributed to all clubs, the Association was held liable to the IRPF of the football players.

This appointment has proven very effective.

3.2.8 Cold-storage stores

The meat market presented some control difficulties in the retail circuit.

Alternatively, on the other end of the marketing chain, at the level of the industrial stage, there was a reduced group of cold-storage stores with sufficient structure to bear the obligations arising from a liable taxpayer designation.

In this case, the category of collecting agent was opted, holding the cold-storage stores liable to the VAT corresponding to the subsequent phases of the industrial stage.

3.2.9 Health

For a great many years the health sector in Uruguay had been wholly exempted from taxes.

With the Tax Reform occurred in 2008, the sector came to be taxed like any other sector in the economy.

Hence, self-employed service providers (health providers) came to be taxed with the IRPF and the VAT overnightly.

It was a highly heterogeneous and populated group that had never had any kind of contact with the Tax Administration, so it was understood that designating the entities paying for these services as liable taxpayers could be a suitable instrument apt to contribute to the proper collection of the relevant taxes.

Therefore, healthcare service providers contracting services with healthcare professionals were held liable to the IRPF and the VAT corresponding to the persons billing services to them.

In this opportunity, the withholding was determined considering the fact that the taxpayers practically lacked an administrative infrastructure and any experience of relationship with the tax authority, therefore, effective voluntary compliance would be highly unlikely.

4. CONCLUSIONS

Overall, the category of liable taxpayers stems from the need to assure the State Treasury's interests.

Such need arises from certain difficulties in controlling certain activities.

Nevertheless, the designation of liable taxpayers cannot and should not be the first tested solution upon the emergence of such difficulties; such a decision should be the result of a careful and comprehensive analysis of the circumstances characterizing the relevant operations and markets, and after ruling out other actions that the Tax Administration itself may adopt.

The designation of liable taxpayers should abide by the neutrality principle, in order to avoid any distortions in the operation of the markets likely to "reward" the activity of certain economic agents.

Furthermore, the identification of liable taxpayers should see to it that the same meet a series of attributes.

The solvency and reliability of the prospect liable taxpayer are two characteristics that appear to be very important when considering its designation.

The designation should fall upon persons whose links with the tax obligation may facilitate control largely, whether by reducing the universe of units for examination or transferring the risk of tax defaults to more reliable persons, like the State, for example.

The design of a system of liabilities should see to it that the designee may recover the cost of the tax obligation.

Finally, the designation should be established by law, or else by the Tax Administration provided that the law stipulates the same.

EFFECTIVE MECHANISMS FOR THE COLLECTION OF TAXE AND THE RECOVERY OF DEBTS IN TIMES OF CRISIS

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Contents: Summary.- Presentation.- 1. Mechanisms implemented by the tax administration to collect taxes.- 2. Mechanisms implemented to assure the recovery of tax debts.

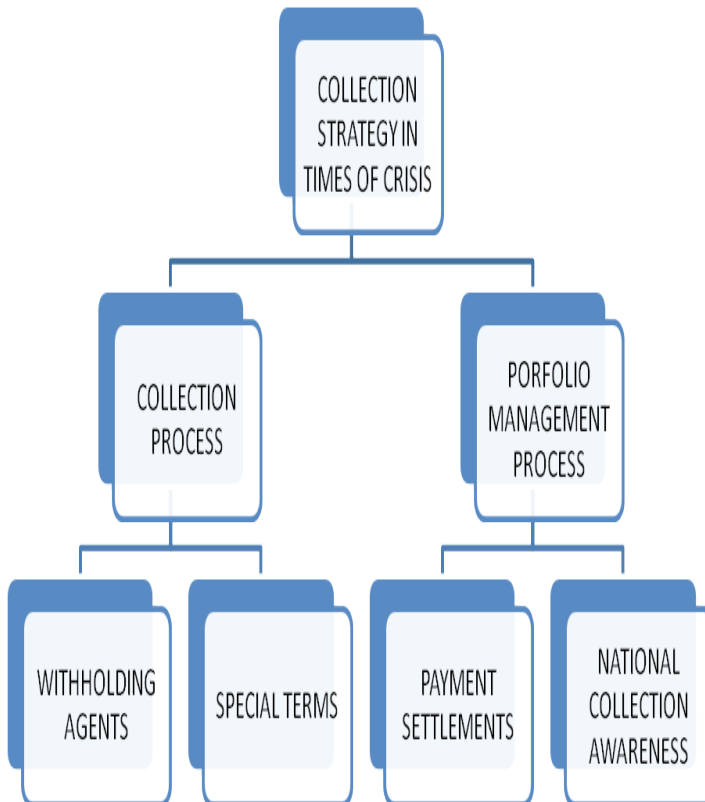
SUMMARY

In the development of its Strategic Management, the National Tax and Customs Directorate has been strengthening control actions in the last two years in order to assure the proper compliance with tax obligations by taxpayers and Customs Users, in response to the State's demands and the risks generated from the global economic crisis.

The tax administration has established collection tools through its tax legislation; the ongoing tax collection mechanisms evidence the core role played by withholding agents in the tax collection process, among which are the taxpayers classified as self-withholders, as well as special terms for filing returns of tax withholdings at source and the VAT.

A mass collection strategy was carried out throughout 2009 preceded by an advertising campaign, which included visits by a large number of officers targeted, in first, at achieving effective collection or payment commitments by means of a persuasive collection management, or exercising coercive jurisdiction where this was not possible (seizure, attachment, property auction and default penalization).

This has resulted in continued positive behavior observed in the collection of internal revenues and the achievement of the goals set, although external revenues have shown some erosion associated with the foreign exchange crisis both in exports and imports.



PRESENTATION

In the development of Strategic Management, the National Tax and Customs Directorate has been strengthening control actions in the last two years in order to assure the compliance with tax obligations by taxpayers and Customs Users, in response to the State's demands and the risks generated from the global economic crisis.

To overcome the crisis the country adopted the following strategies:

- Investment in infrastructure to generate employment and promote competitiveness – anti-cyclical policy
- Strengthen investors' confidence to sustain private investment dynamism
- Investment in social protection to sustain consumption by the most vulnerable population
- Assure access to financing

In furtherance of the annual strategic review, the DIAN has set the following objectives:

Maximizing tax revenue in accordance with the regulations

Enhancing tax collection coverage

Enhancing integral revenue per client

In 2009 the tax administration was able to steer its efforts towards bringing forward actions in different fronts, pursuing compliance with formal obligations and speeding up payment by taxpayers by way of an improved use of information through awareness campaigns on the importance of the VAT for the development of Colombians; and by bringing forward real-time presence campaigns with defaulting and delinquent taxpayers.

As a result, a good behavior has been recorded in the collection of internal taxes, thus achieving the set goal; although there has been some erosion in external revenues associated with the foreign trade crisis both in exports and imports.

	A. Attain excellence in operations		B. Re-redirect the entity towards service		C. Consolidate autonomy and identity		D. Contribute towards the Country's competitiveness	
Finance	Maximize tax revenue pursuant to the regulatory framework							
	Optimize the Cost/Benefit ratio	Optimize tax collection coverage	Optimize comprehensive entry by clients	Maximize the value of the DIAN brand	Maximize access income to national and international cooperation resources	Reduce costs Relating to compliance with obligations	Reduce client costs relating to customs operations	
Client	Promotion actions to counter evasion, avoidance, contraband and exchange violations							
	Build trust, credibility and image improvement							
Processes	Offer customers permanent assistance	Improve reaction times in regards to clients	Increase customer satisfaction levels		Mobilize the communication of the results on the use of state resources		Mobilize TAC Legislation simplification and harmonization	Provide juridical stability and certainty with a united criteria
	Strengthen intelligence and comprehensive control	Ensure the reliability of the processes	Orient, speed-up, make more flexible the entity's process towards knowledge on the client and deliver of value		Modify, align and shield process against subjectivity, corruption and the violation of values		Lead the development of national mass management and services network	Actively contribute in speeding-up the strategy and planning of the regulatory framework
	Speed-up, simplify and make processes more flexible	Facilitate and optimize customs operations	Prioritize service vocation in the official's career path plan		Develop enabling strategic alliances	Strengthen the prevalence of the tax authority		
						Make the administrative regulatory framework more flexible		
Learning and innovation	Generate organizational capacity to use the information		Transform internal culture towards customer service	Prioritize service vocation in the official's career path plan	Generate a culture of transparency, commitment and value generation	Innovate with effective control tools	Improve the capacity of the Corporate Intelligence process	Strengthen the entity's strategic skills
			Investigate and innovate in service models and means					
	Consolidate organizational capacity to accomplish the mission and achieve the vision							
	Strengthen and implement a system to attract, train, develop, assess, retain and continuously and adequately compensate personnel							
Assure the generation, management and dissemination of the required knowledge throughout the organization as well as its value chain								
Have available reliable information and qualified and sustainable technological support								

Table 1

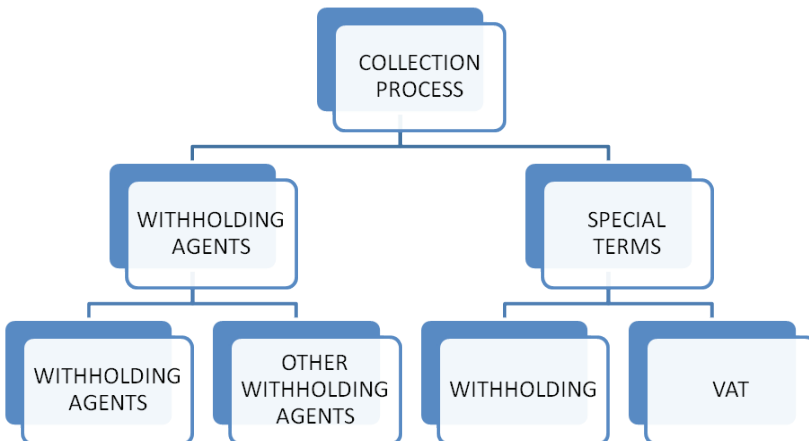
The Colombian tax administration has diverse technical and regulatory mechanisms for portfolio collection and management. These tools are part of two of the mission processes for portfolio collection and management developed by the National Tax and Customs Directorate (DIAN).

The mechanisms the DIAN uses to facilitate the collection of taxes administered by it are permanent and are independent of the provisional economic situation; they are an essential tool to collect taxes and reduce the portfolio resulting from the default in tax obligations.

They allow the administration to respond rapidly to the challenges posed by the worldwide economic crisis. These are:

1. MECHANISMS IMPLEMENTED BY THE TAX ADMINISTRATION TO COLLECT TAXES

The tax administration has set forth collection tools through its tax legislation. The ongoing collection mechanisms evidence the core role played by withholding agents in the tax collection process, among which are the taxpayers classified as self-withholders as well as the special terms provided for filing returns of tax withholding at source and the VAT.



Tax collection process

Withholding agents

Definition

To define the capacity of a withholding or collecting agent it is necessary to state that the withholding at source is intended to gradually attain the collection of taxes possibly within the same taxable fiscal year in which the tax was originated; i.e., that the collection of the tax is advanced in order to guarantee the payment thereof. Hence, withholding agents are a category of taxpayers defined by the international doctrine as: “the persons designated by the law or the Administration to be directly liable, in their capacity of withholding agents and upon obtaining a previous legal authorization, who by virtue of their public functions or their business, job or profession, are engaged in acts or operations in which the relevant tax withholding can be made”.

Who are withholding at source agents?

In light that the task of withholding agents consists in withholding from the amount of money owed to a taxpayer a certain legally established amount for tax and then forwarding it to the state treasury through the tax administration, withholding at source agents of the income tax under the Colombian tax regulations are: public-law entities, equity funds, securities funds, pension or disability funds, consortiums, joint ventures, organized communities and other individuals or corporations, undivided estate or *de facto* business associations, who are engaged in acts or operations in which they must, by express legal provision, withhold or collect the relevant tax.

Withholding agents of the VAT under the provisions in the Colombian Tax Bylaws are:

(...) “1. The following state entities:

The State, the departments, the capital district and special districts, the metropolitan areas, municipal associations and municipalities; the public divisions, the State’s industrial and business companies, partially government-owned corporations in which the State holds a >50% controlling interest, as well as indirect and direct decentralized entities and any other corporation, regardless of their denomination, where there is a majority of state-owned interest, at all levels and,

in general, the State bodies or divisions authorized by the law to subscribe contracts.

2. Those classified as large taxpayers by the National Tax and Customs Directorate, whether liable to the VAT or not, and those who are designated by the DIAN as sales tax withholding agents.

3. Those contracting services taxed within the national territory with persons or entities having residence or domicile in the country, with relation to such services.

4. Taxpayers in the ordinary system, where they acquire personal tangible property or taxed services, from persons who belong in the simplified system.

5. Entities issuing credit and debit cards and their associations, at the time of making the relevant payment in the account of affiliated persons or shops. The tax value will not be part of the base to determine the commissions earned from the use of debit and credit cards. Where payments to the account of the persons or stores affiliated to credit or debit card systems are made through purchase or payment companies, the withholding at source shall be made by such entities.

6. The Civil Aeronautic Administrative Unit, for 100% of the tax on the sales originating from the sale of aerodynes. Paragraph 1°. The sale of goods or services made between sale tax withholding agents referred to in numbers 1, 2 and 5 of this section shall not be governed by the provisions in this section. Paragraph 2°. The National Tax and Customs Directorate may, by resolution, remove the sales tax withholding agent capacity from Large Taxpayers who are undergoing a debtor reorganization plan, mandatory liquidation, takeover or restructuring agreement negotiations, without affecting thereby their capacity of large taxpayers”.

Obligations

The essential obligations of withholding agents consist in performing the withholding, filing the withholding at source return, reporting the withheld value at the places and within the terms provided by the National Government and issuing the certificates of income and withholdings in the case withholding is applied to salaried workers.

Self-withholders

Definition:

In order to facilitate tax withholding at source as a mechanism of advanced collection from corporations whose economic stability allows and guarantees the payment of the withheld values, paragraph 1 of section 368 of the Colombian Tax Bylaws provides that “the Director at the National Tax and Customs Directorate shall be responsible for authorizing and designating the persons or entities which shall act as self-withholders, and suspending the authorization when in their judgment the payment of the self-withheld values is not guaranteed”. In furtherance of this section and with the aim of enforcing section 3° of the executive order 2509 of 1985, which establishes that “the National Tax and Customs Directorate shall indicate through a resolution the Corporate Name and the NIT¹ of the corporations which, in conformity with this section, are authorized to make the withholding at source on their income”, the Resolution No 04074 of 2005 was issued to indicate the authorization requirements, the diligence to obtain such authorization and the reasons for suspension of the self-withholder capacity.

Requirements

- Should be an artificial person (corporation)
- Should have recorded revenues in excess of six thousand (6,000) effective minimum monthly legal salaries for the gross sales of the year immediately before, or fraction of year, or as of the application date (for the year 2008 US\$ 1,350,000)
- If the applicant company credits gross sale revenues under number 2° of this section in excess of thirty thousand (30,000) effective minimum monthly legal salaries, it may be authorized to act as self-withholder without regard to the minimum number of clients required.
- If the applicant company has state investment and a net shareholders' equity in excess of ten billion pesos (\$10,000,000,000), it may be authorized as self-withholder, without regard to the revenues and the minimum number of clients required.

¹ Translator's note: Taxpayer's identification number.

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- If the applicant corporation has been declared a permanent Special Free-trade Zone, it may be authorized, without regard to the revenues and the minimum number of clients required.
 - Should have more than fifty (50) clients making withholdings, differentiated among corporations, *de facto* business associations and business individuals who meet the requirements of section 368-2 of the Tax Bylaws.
 - Should be registered in the Single Taxpayer Registry – R.U.T.
 - Should not be undergoing any liquidation process, debtor reorganization process or restructuring agreement.
 - Should be up to date with its tax obligations.
 - Should not have been penalized in the last year for default in invoicing and reporting duties, or for accountability misstatements, duly evidenced through a proper certification.

Control

Because it is a mechanism that facilitates the advanced collection of taxes, the tax administration must control that taxpayers who are thus categorized should assure the payment of self-withholdings. To this end, some reasons have been set forth which evidence the lack of assurance in the payment of withheld values, among them:

- a) Where the authorized corporation records overdue payments of tax, customs or exchange amounts which are late by more than one (1) month, as of the date such control is performed by the Sub-directorate of Collections;
- b) Where the authorized corporation has been taken over as a result of a merger;
- c) Where the authorized corporation has been split off, where the split-off results in dissolution;
- d) Where the authorized corporation is undergoing a liquidation process, debtor reorganization plan or restructuring agreement;
- e) Where the authorized corporation has been penalized for

accountability misstatements or irregularities in invoicing or reporting duties, duly evidenced through a proper certification.

The control exercised by the tax administration may conclude with the suspension or the continuity of the self-withholder capacity.

Special terms

Another mechanism used by the tax administration to facilitate compliance with formal and material obligations consists in granting authority to file and pay withholding at source and VAT returns within special terms provided by the national government to certain taxpayers who, given their number of branches or shops, are required to consolidate the reportable information.

2. MECHANISMS IMPLEMENTED TO ASSURE THE RECOVERY OF TAX DEBTS

Portfolio management process



National Collection Days

Within the frame of the Strategic Management and the objective of maximizing tax revenues, the National Tax and Customs Directorate (DIAN) advanced three National Collection Days in 2009 with the purpose of intensifying the actions regularly executed in the Portfolio Management process, particularly regarding persuasive and coercive collection.

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- As to persuasive collection, there were increased visits to taxpayers who were late in their payment of the taxes administered by the DIAN and persuasive notices were sent encouraging them to regularize their situation. Obligations in a coercive collection status were addressed by way of attachment and auction diligences, criminal complaints, lists of charges and closing-down of stores, thus encouraging the collection of delinquent taxes.
 - Specific dates for the payment commitments of delinquent taxpayers; setoffs of credit balances or the subscription of payment facilities (except for the withholding at source); notices of lists of charges and closing-down of stores.
 - The officers visited taxpayers at their domiciles according to the data recorded in the RUT, upon previously verifying that there was a clear, express and enforceable obligation; then located their property and persuaded them to pay off their debts as soon as possible.
 - The move was mainly targeted at withholding at source debtors, in the consideration that these resources should have entered the National Treasury but were not paid by a third party who is the withholding agent in this case, a conduct that has been criminally categorized. Real property confiscations were carried out in order to execute injunction orders.
 - Auction diligences.
 - The criminal units of Divisional Directorates participated reporting delinquent taxpayers.
 - The tax examination and liquidation divisions notified debt-related lists of charges.
 - With the slogan “default in the payment of taxes with the DIAN hurts you and Colombians alike”, the entity will continue to raise taxpayers’ awareness on the payment of their tax obligations and the impact thereof on the State’s resources intended to assure tax sustainability, which is DIAN’s mission.

Electronic payment

Given that the adequate tools for the electronic filing of obligations are in place, the need arose to incorporate electronic payment as a tax collection alternative concurrent with the formal reporting duty, which would in turn facilitate the timely compliance by clients. Throughout 2009, nearly 2% of tax revenues were collected through electronic means through the entities authorized to collect, by way of services offered on the Internet, Audio-Responses, ATMs, Points of Payment or Self-service Kiosks, all of which assured complete, safe and satisfactory operations to the parties.

SECTION 5, EXECUTIVE ORDER 1791 OF MAY 23 OF 2007

“The payment transactions of tax, customs and exchange obligations administered by the National Tax and Customs Directorate will be performed by taxpayers, liable taxpayers, withholding agents, declarants, customs users and the entity authorized to collect, and may be performed through personal or electronic channels at the option of the obligee.

a) PERSONAL CHANNELS. Assume the physical presentation of the payment document before the entities authorized to collect.

b) ELECTRONIC CHANNELS. Assume the presentation of payment-related electronic information through electronic means, which may be performed through the services offered on the Internet, audio-response, automatic teller machines (ATMs), points of payment or self-service kiosks, without the need to present the payment document physically, with assurance provided to the persons involved in the operation that the same is performed in full, safely and to everyone’s satisfaction. An operation tracking number or user authorization must be given in all cases.

To make payment through electronic channels, the information provided by DIAN’s electronic computer services will be used as related to the obligations fulfilled on-line before that entity.

Notwithstanding the safety rules that should protect present transactions, the transactions made through electronic channels should be subject to service, safety and validation conditions and rules defined for the financial sector, which must be previously communicated to the client by the entity authorized to collect, which

in turn should allow the obligee making payment to debit from their account and credit in the account of the entity authorized to collect, so that payment may then be transferred to the General Public Credit and National Treasury Directorate.”

Insolvency system for non-business individuals

Through the Act 1116 of 2006, known as Insolvency Act, the National Government established a procedure of Corporate Reorganization that contemplates the negotiation of obligations or the judicial liquidation by way of a fast and effective procedure. In light of the results thereof, it was important to develop a rule that would allow non-business individuals to resort to a legal procedure that contemplates the negotiation of their debts in an out-of-court conciliation hearing intended to agree on a payment schedule with creditors and thus be able to pay out their pending monetary obligations with disregard to their nature.

Act 1380 of January 25 of 2010

“The insolvency system is intended to allow the non-business individual debtor to resort to a legal procedure that may allow them to negotiate their debts in an out-of-court conciliation hearing and agree on a payment schedule with creditors, and thus be able to pay out their pending monetary obligations (excluding food)”.

Publication of State’s delinquent debtors (BDME, in Spanish)

It is a biannual publication of the National General Accountability Office which contains the names of natural and artificial persons that owe the public body and are late by a period in excess of six (6) months. The persons listed in the BDME cannot enter into contracts with state bodies, nor hold public office until they can provide evidence that they have paid out their obligations or produce proof of a payment agreement in force.

From August 1st of 2004, as established by

“the External Memo 057 of 2004, where an individual or corporate, in any capacity whatsoever, has as of any cutoff date a pending obligation with any public entity of any level, the amount of which exceeds five SMMLV and is late for over six months, shall appear listed in the Publication of State’s Delinquent Debtors”.

Criminal accusation

Since 1997, the DIAN offers the possibility to file a criminal complaint against the responsible for Withholding at source and the VAT who fail to deposit the collected amounts timely. This criminal classification has served as a coercive tool enforceable on delinquent liable taxpayers, who may be sentenced to prison or punished by fine. In 2009, the Auditor's Office received 1,237 complaints denouncing omissions by withholding agents.

Payment facilities

There is a legal procedure and an internal regulation that define the general conditions for the diligence and obtention of payment facilities.

Although the rule contemplates as viable security any one which is apt to back debt sufficiently to the satisfaction of the Tax Administration, the internal regulation has listed them specifically: constitution of a guaranty trust; offering property for seizure and confiscation; personal guaranty, security interest, bank guarantees or insurance company guaranty.

A client with a debt less than US\$ 37,000 can apply for a less-than-a-year term, may obtain a non-collateralized payment facility by presenting a description of their property for its later seizure and confiscation.

Definition

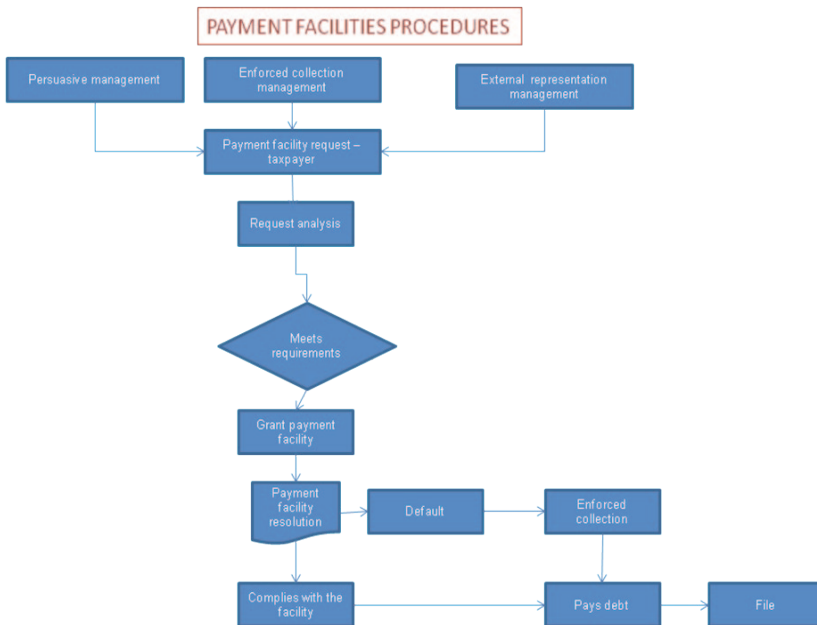
This mechanism established in the Colombian Tax Bylaws allows taxpayers to be provided with a term for the payment of their tax obligations under a payment agreement; the tax administration may grant a term of up to five years for the payment of debt related to income taxes, VAT, stamp taxes, withholding at source, penalties and interest. To subscribe a payment agreement, the taxpayer or a third party on their behalf must constitute a security interest, or personal or bank guarantee in order to back payment of the obligation, or may offer their property for seizure or confiscation. The administration may grant non-guaranty terms where such term is not in excess of one year and the debtor presents property for its subsequent seizure and confiscation.

Requirements

The following are the requirements provided by the Colombian Tax Bylaws to subscribe payment facilities:

- a) Cash payment of thirty percent (30%) of the total debt for tax and penalty for each period and item in respect of which taxpayer obtains the facility, with the following order of application: firstly taxes; secondly penalties, as updated; and lastly, interest.
- b) Request the payment facility in writing to the competent administration, by providing specifically the period of time requested and indicating the periods and items petitioned in the request, as well as the description of the guaranty supported by documents crediting its existence.

Procedure for awarding payment facilities



The internally regulated legal procedure defines the general conditions to obtain payment facilities through an administrative act, with a view to standardizing conditions and providing greater executory force to the parties' commitment.

The client (taxpayer, liable taxpayer, user) files a very specific request accompanied by all supporting documentation, indicating:

- Identification, representation and location data of both debtor and petitioner
- The amount of obligations
- The requested term, which may be up to five years; exceptionally, the Director may add two more years to that term
- The timing of installments required as per their economic situation
- Payment capacity
- Sufficient guaranties to back their obligation. Where the requested term is less than a year, guaranties may be dispensed with; in the rest of the cases, such guaranties may be:
 - Constitution of a guaranty;
 - Presentation of property for seizure and confiscation, which allows removing the business property avoiding the costs implied in a mortgage or pledge;
 - Personal guaranties, security interest, bank or insurance company guaranties;
 - Presentation of description of property where the debt is less than US \$37,000;

As a policy for the award of terms, the entity requests from client an initial installment of 30% of the obligation composed of by principal, penalties and late interest, but this value may vary according to each particular situation.

In the event of default, there is no specific penalty other than the internal policy of rejecting a new facility; however, as the request is filed through an administrative action subject to appeal, the client retains the opportunity to challenge the decision. Upon determination of the default, the entity proceeds to collect the guaranty and reinitiates the actions inherent in a coercive collection proceeding.

There have been no legal news on the subject, but the manner in which taxpayer is approached has changed, for in the last year the celebration of the National Collection Days allowed a direct approach and the possibility of reaching *in situ* agreements requiring only the formality of a signature of a short-term letter of commitment.

Control

In furtherance of the tax administration's self-control and quality management processes, the executive level exercises control over the procedures conducted on a local level. This task includes the continued monitoring of compliance with the payment of awarded payment facility's agreed installments. Should there be any default in the agreed conditions in the payment agreement, or in the payment of later generated tax obligations, the tax administration is entitled to terminate the facility and order the effective collection of the guaranty or adopt any necessary measures to obtain payment of the obligation out of debtor's offered collateral.

CLOSING SESSION

FINAL COMMENTS

Mr. Alberto Barreix
Lead Fiscal Economist
Inter-American Development Bank
(IDB)



Mr. Alberto Barreix

It feels nice to close on this rainy day, at home.

First of all, I would like to express my deep gratitude to CIAT, to the General Director of Income for this invitation.

When this meeting was being organized, several organizations, among them the IDB, asked Marcio for some topics; tax policy, or some other particular topic on tax administration.

But I forgot two pieces of advice. One is a North American advice which reads: "Be careful about what you wish". The second was that, being with Marcio, I forgot the advice given by my grandfather who had a farm at the border. He said: "Be careful when negotiating with a gaúcho", because I have been entrusted the closing comments and indeed, I have been the whole week preparing this. I learned much but kept little, because there are so many issues that it is difficult to assemble. So then I said: at least lets make a summary so that they may see that I read the material.

These are complex times for the tax administration.

In principle, the role of the tax administrations in the global crisis is somewhat, in these past years, an awakening. Since approximately 2003 onwards, Latin America experienced a boom of commodities, a significant growth of all the economies. We were growing very well and collections continued to increase. In addition, the modernization processes of the tax administrations were maturing until 2008 when, as a result of an imported crisis, the shelves, started to fall; they were less shelves than those of others throughout the world, but they did fall anyway.

Difference between the crisis of 29 and 2008 in tax terms

If we look at the first documents available, the crisis which apparently was overcome as we will see, involves some very relevant aspects.

And which is the first one? That following the crisis of 1929, the world changed. In 1929, the countries that collected more, collected 20% of the product. At the end of the World War, the countries collected 35% of the product of developed countries, and 25 years later they collected 55% of the product. The three most important taxes which in developed countries and even in Latin America represent almost 70% of collection, arose after the crisis. Modern social security imposed by Roosevelt in the mid-thirties, provided social security to 60% of the U.S. population in 1942. After the war, following the increase of individual income tax and its massive application, Great Britain and the United States collected income tax from more than 50% of the population, through every possible means; of course, there was no Internet. These two changes were consolidated and in the late forties there arose the VAT in France. Thus, within a period of 15 years, following the crisis of 1929, the entire world's tax structure was redefined with the same taxes that are in force, today, except for death and tariffs. Therefore, it need not only be an overall change in tax policy that generated an overall change in tax policy and obviously, in all of the state's functions. The State changed; in other words, the old, Neoclassic State passed away in 1930.

If one looks at this crisis, sincerely one does not find any of this. Actually what one finds and was seen in the CIAT presentations is a series of changes of relative importance in terms of operation, management of the crisis; but at least to date and perhaps it might occur when the debt crisis takes place in the developed countries, although we hope it will not reach us, there has been no qualitative change in the organization of the state, or its revenues or expenditures.

Having said this, CIAT and the Fund in their presentations tell us that the world of the future will be complicated in tax terms, especially because the debt and deficit will go to the developed countries: the famous twin déficits, fiscal déficits and especially the current account. Investing countries are the ones that have savings, that is incredible. Asia saves and invests. In the past, those who invested did not save and those who saved, did not invest. We are therefore, in a world where unbalances are not solved and probably that will lead us to not know what the future will be like. We hope there will not be a commercial war, but we do not know either what the financial future will be like within three or four years.

The tax structure in the region has not changed. It has not changed because of the crisis and we continue more or less with the same instruments. The developed world continues with the same instruments. We are shortly going to be looking at two graphs.

Effects of the 2008 crisis in the tax administration

And so, what have the tax administrations that have fortunately survived done? I say that the tax administrations have fortunately survived because even though the crisis pulled us backwards, I believe that what Latin America may learn from this crisis is, first of all, obviously its strong dependence on the commodities and international exchange, but secondly, that it is necessary to avoid the financial and exchange crises and especially the banking crises and tax crises at any price. Although we have a terrible dependence on the cycle, I believe that what we must learn is to manage the cycle. Managing the cycle in tax terms is very difficult because when in a continent 35% of the population is poor and 15% is indigent, there will never be enough money. Nevertheless, a solution must be sought because probably the next crisis will hit us harder and when we have a banking financial crisis or a tax crisis, the cost is very much higher due to the lack of discipline.

Then what did the tax administrations do? Well, they were on the defensive, what was done in the past: ensure compliance, try to help the taxpayer.

The financial sector crisis in the developed countries and information exchange

Perhaps one of the few changes was that in informality of planning of havens, fraud and the collection of the debt and which ended in the famous international collaboration. There was especially in some advanced administrations such as Mexico, Chile, etc., as was seen, an increase in risk analysis in terms of international collaboration. When there is an international crisis one must think that the three countries with the greatest banking influence in Latin America are: the United States, Great Britain and Spain. Of the three, two have had a financial crisis. Spain says it has not had one, but what does it have? International cooperation arises when the developed countries, following the crisis, become aware that they have an informality problem. Latin America has informality, we have the informality of the wretched, those who, because they are outside international trade survive by evading taxes in order to be able to eat every day.

Evasion, the greatest evasion in developed countries, besides having problems with individual and professional income tax occurs with the great capital on the other spectrum, in the more sophisticated spectrum. And what happens? It turns out that following a financial crisis, the Western world countries which are the dominant ones in the

financial system, become aware that they lose part, 10% of collection, 5% of their product; it is not well measured due to evasion for lack of international cooperation and the tax havens. The problem is not a fiscal one, but will become so in the future. The problem is that when the financial system in the developed countries fails, its main commodity, its main competitive product fails. The United States, Great Britain and Spain have banking and financial systems whose share in the gross product is greater than the share of commodities in Brazil, which is the country with greater production in the agriculture, livestock and mineral sectors.

Now what does this mean? That this is no longer a State problem, but rather a problem of competitiveness of businesses. When the U.S. stock exchange loses 30% and 6 trillion dollars and we know that only UBS has 2 trillion dollars in Switzerland, there is no longer a fiscal problem, but a business one. And when the liabilities of British banks throughout the world are four times the gross product of the United Kingdom, that is no longer our problem, but rather theirs. Likewise, when international transparency follows therefrom, which obviously is inherited by many of us, the positive solutions for improving tax transparency are also inherited. The problem is how can we adapt them to the transparency we actually require, so that it may be truly effective and will not only follow the interest of flows. I believe this is somewhat the problem currently existing in Latin America; namely: adaptation. Perhaps 30 or 40 years ago there was some think tank in Latin America –today, basically there are two in the world: the OECD and the Monetary Fund – that can adapt us to these circumstances and that we may obtain from these international flows something that may be really productive for us. And here I believe the role that CIAT can play as an institution is important; as the oldest institution, I think, on the subject of tax administration in the world.

I will go over very quickly. I simply made a summary of each of the papers presented, since I believe CIAT will publish them and therefore, it is not important that I go over them point by point.

Citizen trust and ethics in the tax administration

First, the strengthening of the citizen's trust which is always linked to the crisis. France practices accountability, society, the users' committees. We also saw, to some extent, in Fernando Díaz Yubero's presentation that Spain also has mechanisms for approaching society. That is fine, because when we lose collection, in general, people complain more about expenditures and say: I have no security in Latin America, I have no education, no health. But it is obvious that the management

objectives must be clear, that accountability must be transparent and must be presented in such a way that the citizen will understand that the tax administration is making an effort, that actually the tax administration is not totally responsible for managing taxes; that it is only a part and that the Judicial Body has its duty and that Cadaster has its duty, etc., as we will see in other presentations.

The Dominican Republic has gone a little further. There is a transparency portal which shows the net worth return, the income tax of the hierarchies and the remuneration of the officials. It is a very sound exercise, especially in times of crisis. It is indeed surprising because I have actually done some research but have not found any developed country with this level of public transparency.

Ethics and transparency: transparency is an anglicism which is difficult to translate. As a Uruguayan politician says, I prefer the word "clarity", but the problem is, as we saw in some presentations, countries with a high institutionality go as far as the moral aspects. For example, the importance of ethics was evident in the presentations by Canada, Portugal and by Raquel from CIAT, etc., etc. The problem is that the definition of ethics and its relationship to morals may turn out to be dangerous. Why? Because let us say that while the new school may go under the control of ethics, the old school believes in the conflict of interests. In sum, and I admit I am biased because I have been educated in the economic part, we always consider a market solution and the market solution is always one of conflict of interests. This is so because ethics and morals are linked to two things: first, to a vision of what needs to be done or what is the matter at issue: in this case, the tax administration and the second, the values. Now, values are not definitions per se, but rather instruments and at times our societies tolerate things that other societies would consider immoral. I believe the presentations are very clear. Also clear are the forms in which this is presented, as well as all the issues of relevance of transparency within the administration, which at times cannot be fully transparent with the taxpayer. And likewise, the taxpayer, whom I believe in some cases must be fully transparent with the administration with respect to which will be the guiding principle. The ethics principle, valid perhaps within, but outside, especially in Latin America, an undisciplined continent by nature, avoiding conflict of, something which is very simple for the Saxons, is not clear to us. All of the processes for doing so appear very clearly in the presentation by Portugal.

Collaboration with the private sector and technical collaboration between tax administrations

There is a trend toward collaboration. One is internal collaboration as presented by Spain, which are the Administration Councils. I believe they are not extending them to the tax advisors, which becomes even more difficult because the tax adviser makes a living by evading us, or rather, excuse me, by avoiding us. Then, it is obvious that mature societies can do it and do it very well. Probably a pure negotiation may be much more difficult in societies where somehow the legislation is not as complex, or where neither the administration or private sector have gone to levels that require having such a complex administration with these mechanisms. But undoubtedly they may serve and they may probably serve in issues as posed before, particularly by the French, for specific groups or sectors.

The other thing I wanted to mention is that there is collaboration against harmful tax planning. The problem is, and this is very clear, and the U.S. presentation was very clear: offshore banking and transfer pricing. The problem is that many times, that which is proposed to Latin America might not be adequate. What do I mean by this? The Continent, in 5 products sells 66% of its revenues. The most diversified country which is Brazil, if I add all the commodities it produces, it would be 55% of its exports. It makes little sense for that purpose to have a very complex application of industrial transfer prices. It might probably be useful for the services. Then it is admissible that Latin America might need more Sixth Methods (for controlling the export of commodities which AFIP from Argentina had) and less the traditional five of the OECD, except in the small integration processes where there is a greater exchange of intrasectorial goods. For example in Mercosur or CAN where there is greater sale of reciprocal manufacture, probably one may require what is traditional in imports. It is likewise necessary to adequately manage bank secrecy and exchanges in royalties or technical assistance. It might probably be necessary to "caribbeanize" what is somehow being proposed and imposed by the developed world, which does not cease to be valid and besides, on being imposed, one must accept it and try to modify it. I believe I already referred to Raquel's proposal regarding the evaluation of ethics in the administration, to try to systematize the analysis process that was undertaken in Uruguay and will probably be carried out in other countries.

Our appreciation to EUROsocial Taxation and also to the new German Project of tax collaboration. When one works in a multilateral, a significant part of what can be done in research is financed from abroad by the development agencies of the central countries. With a

ferociously bad tax situation in the developed countries, the Swedish Agency, the Dutch, the British and the Norwegians have left Latin America. We know that most of the assistance organizations are being restructured and to count on new aid is tremendously important and acceptedly very generous, particularly from Spain, which obviously has an interest in the region, and also from Germany. So they are more than welcome, because it is very clear that given that Latin America survived the 2008 crisis rather well and there are other regions in the world in greater need than Latin America, or in Latin America, with the case of Haiti, technical cooperation will be rather scarce. Perhaps what we will need to do is organize ourselves. We already have many organizations and in any case, it is good that we at least have funds for doing research because these will not abound in the region.

The macro effects on the Tax Administration, the cycle of commodities
The other issue raised by the crisis is that from a more micro vision of the tax administration, people are beginning to worry about the macro figures. That is because a significant part of the crisis that has to do with the decrease in collection or the levels of evasion, has little to do with the tax administration, as well as probably, in some cases, they had relatively little to do with the boom occurring when collection increased, obviously not in all cases. There are two things that definitely matter: whoever makes these estimates is relevant, especially in times of crisis, because it is easy to disseminate good news, but bad news are not always clearly presented by the press. The second is that we have great problems, perhaps not methodological, but rather of quality of data. And there is nothing worst than to submit a salad of numbers; and there is nothing worst than to present two or three different numbers for a single calculation. One loses much credibility when presenting estimates that are not consistent. I believe that the process of transparency, of clarity should be handled adequately and if there is an error, it should always be clear and in good faith. In the case of Mexico, which somehow does it independently through prestigious universities, there is credibility coverage, because if there is an error it has been incurred with universities of the highest level.

The other point is that it is obviously relevant to begin thinking in that relationship between the macro effects and collection, first, and an obvious point for managing the cycle. It is obvious that if one looks at the cycle, particularly, that of commodities which we do not manage and it is affected only by a negotiation basically between China and some countries of Southeast Asia and their purchasers in the Western world, it will be an ever shorter and ever stronger cycle. Secondly, how we can improve the quality of the tax system so that it will cover the cycle. Obviously, VAT linked to consumption, will have less variation

than income linked to the personal and commercial surplus, but perhaps we should start thinking about other taxes that have a much higher cost, such as property tax, etc. In other words, the crisis will lead us, not today, but within some time, to reconsider the tax systems. I will be very honest. Prior to the crisis, the number of tax reforms in Latin America had decreased considerably and you may see it in your own countries, where there were indeed, tax adjustments. In the 80s there were tax adjustments almost every year because we had to pay the debt, revenues had to increase and the decrease in tariffs had to be substituted with the commercial item. However, the battle now is much more complex because it involves the improvement of the tax system on the basis of the defined systems. It is like making second generation reforms to the tax systems and when stability is achieved following these five years of boom and these two years of descent, it will be necessary to seriously reconsider the quality of the tax systems. One important point is that South America again begins to talk about capital flight and that would seem from another planet in a continent that is receiving capital by shovelfuls but we must recall the crisis that we had before.

Compliance, amnesty and ethics

Measurement of tax expenditure: Luiz would have to talk about the measurement of tax expenditure since he has been working during the greater part of his professional career on said issue. Not only did he make an excellent presentation but combined it with Brazil where tax expenditure is much more difficult to measure because of the different government levels and their sectorial approach.

What is incredible is that several Latin American countries have been disseminating tax expenditure for a long time, and, nevertheless, this causes no concern to the population. Let's say that it is causing insensitivity; like, today there were 40 more deaths in Irak. Then, something is failing in tax expenditure. We are either not adequately identifying the beneficiaries of the expense or not measuring well. However, it is obvious that if methodologies are quite appropriate, there is something missing in order to close the gaps and improve the systems.

Regarding the strategies for tax and collection improvement, it is appropriate for the Oriental Strip that they come from Argentina to tell us about the dark side of the moon; because it is very honest to recognize that the levels of efficiency are very low; and there is not only the dark side of the moon but there are also issues that can no longer be taboo; for example: the labor regularization issues, the

moratorium issues, etc. I always thought because I was here for the 2001 Uruguayan reforms, for the administration's reform and in 2005, that the tax reform had to be given an opportunity and every time there is a change in the administration, a very significant change in tax policy, the taxpayer must be given the opportunity to get used to it. If the administration changes its patterns why can the taxpayer not do so? And if a new tax is applied, the taxpayers must be allowed to get used to it. I believe it is a relevant point of seeing, as Fernando Díaz Yubero says if we have to undertake moratoriums every 100 years or, perhaps, we would have to recognize with certain humility, that the taxpayer deserves forgiveness.

The other issues are compliance and taxation. When tax administrations have money and become very powerful, we saw it in Ecuador, in several places, they are even more advanced than the banking sector, which is the most technologically advanced one. Germania Montás was chosen one of the 5 star women in entrepreneurial activity in the Dominican Republic due to achievements in development. The problem is that we cannot forget that all of us linked to the public sector, when we talk to businessmen or groups of businessmen, then they say, those of you from the public sector and, indeed, I know Microsoft is not here. Then I believe we must make a *pari passu* between what one asks of society, not only in terms of compliance, but in terms of administrative capacity, which is what Toninelli was proposing today. And an administration cannot be too far advanced from its society, neither ethically or technologically.

Well, I already talked about the International Tax Dialogue, trying to relate what the G8 and G20 or a G180 want, because they are going to devote themselves to the developed, underdeveloped countries and they are more than welcome. I believe one of the problems we have with those organizations is that we would have to try to better coordinate the agendas, especially because I see a world of change and pressure on the tax systems and on public expenditure coming in the near future, with significant adjustments, beginning with the developed world.

Thank you very much. Let us discipline ourselves, since my time is over. Let us have tax discipline.

Thank you.

TECHNICAL PROGRAM

CIAT GENERAL ASSEMBLY
Montevideo, Uruguay
April 12 to 15, 2010

DAILY SCHEDULE OF ACTIVITIES

**MAIN THEME: “THE ROLE OF THE TAX ADMINISTRATIONS IN
THE GLOBAL CRISIS”**

Monday, April 12

Morning

- 09:00 - 09:30 Inaugural Ceremony
- 09:30 - 10:00 Official photograph and Coffee Break
- 10:00 - 11:00 The impact of the Global Crisis: Challenges and Appropriate Responses from the Tax Administration
- 10:00 - 10:20 **Speaker:** Márcio F. Verdi, CIAT Executive Secretary, CIAT (20')
- 10:20 - 10:40 **Speaker:** Juan Toro, Head of Revenue Administration Division, IMF, (20')
- 10:40 - 11:20 Debate (40')
- Topic 1: Transparency and ethics as condition for strengthening and improving institutional effectiveness**
- Moderator:** Germania Montás, Deputy General Director of Internal Taxes, Dominican Republic
- 11:20 - 11:50 **Speaker:** Linda Lizzotte-MacPherson, Commissioner and Chief Executive, Canada Revenue Agency, Canada (30')
- 11:50 - 12:00 **Commentator:** José António de Azevedo Pereira; General Director, General Directorate of Taxes. Portugal (10')
- 12:00 - 12:20 Debate (20')

1.1 The development and strengthening of citizen trust: the accountability mechanisms in the Tax Administrations

Moderator: Veimar Mario Cazón Morales, GRACO, Manager, National Tax Service, Bolivia

12:20 - 12:40 **Speaker:** Germania Montás, Deputy General Director, of Internal Taxes, Dominican Republic (20')

12:40 - 13:00 **Speaker:** Philippe Dufresnoy, Delegate of the General Director of Public Finances for the Eastern Inter-Region (20')

13:00 - 13:20 Debate (20')

13:20 - 14:30 Lunch

Afternoon

1.2 The Tax Administrations and the taxpayer's social responsibility: Strategies for combating harmful tax planning

Moderator: Michael Gitau Waweru, Commissioner General, Kenya Revenue Authority

14:30 - 14:50 **Speaker:** Fernando Díaz Yubero, Director General of the Department of Organizational Planning and Institutional Relations, State Agency of Tax Administration, Spain (20')

14:50 - 15:10 **Speaker:** Douglas O'Donnell, Director, Treaty Administration and International Cooperation Internal Revenue Service, U.S.A. (20')

15:10 - 15:30 Debate (40')

15:30 - 15:40 Coffee (10')

1.3 The promotion of ethics in the Tax Administrations: Strategies and programs for the promotion of ethics.

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- Moderator:** Jamila Isenia, Director, Inspectorate of Taxes, Netherlands Antilles
- 15:40 - 16:00 **Speaker:** María Raquel Ayala, Director of Studies and Training, CIAT (20')
- 16:00 - 16:20 **Speaker:** Anders Stridh, Head Office of the Swedish Tax Agency, Sweden (20')
- 16:20 - 16:40 Debate (40')
- 16:40 - 17:10 EUROsociAL (30')

Tuesday, April 13

2. The measurement of the tax gap and its impact on the efficiency and effectiveness of the tax administration

- Moderator:** Donato Raponi, Head Tax Administration, European Commission
- 09:00 - 09:30 **Speaker:** Jeffrey Owens, Director of the Centre on Tax Policy and Administration, OECD (30')
- 09:30 - 09:40 **Commentator:** Juan Pablo Jimenez, Economic Affairs Official, ECLAC (10')
- 09:40 - 10:00 Debate (20')
- 10:00 - 10:20 Coffee

2.1 Instruments and techniques for the measurement of evasion

- Moderator:** Francisco Fonseca, General Director General Directorate of Taxation, Costa Rica
- 10:20 - 10:40 **Speaker:** Gustavo González, Coordinator General Directorate of Taxation, Uruguay (20')
- 10:40 - 11:00 **Speaker:** Carlos Marx Carrasco, General Director, Internal Revenue Service, Ecuador (20')
- 11:00 - 11:20 Debate (40')

2.2 Instruments and techniques for the measurement and analysis of tax expenditure

Moderator: Matthias Witt, Head Public Policy Division, German Agency for Technical Cooperation, GTZ

11:20 - 11:40 **Speaker:** Raimundo Eloi de Carvalho, Fiscal Auditor, Federal Revenue of Brazil (20')

11:40 - 12:00 **Speaker:** Luiz Villela, Fiscal Economist, Inter-American Development Bank, IDB (20')

12:00 - 12:20 Debate (20')

2.3 Use of the results of tax gap measurement for structuring the risk map and designing control plans.

Moderator: Nahil Hirsh, National Tax Superintendent, National Superintendence of Tax Administration, Peru

12:20 - 12:40 **Speaker:** Stefano Pisani, Manager, Italian Revenue Agency (20')

12:40 - 13:00 **Speaker:** Randall Carolissen Group Executive: Revenue Planning, Analysis & Repo, South African Revenue Service (20')

13:00 - 13:20 Debate (20')

13:20 - 14:30 Lunch

Afternoon

Administrative Session

Wednesday, April 14

Integration Activities

Thursday, April 15

3. Strategies for improving voluntary compliance and the collection of taxes

Moderator: William Layne, Permanent Secretary of Finance, Ministry of Finance and Economic Affairs, Barbados

09:00 - 09:30 **Speaker:** Ruben Toninelli, General Director, DGI, Federal Administration of Public Revenues, Argentina (30')

09:30 - 09:40 **Commentator:** Carolyn Tremain, Deputy Commissioner, Internal Revenue Department, New Zealand (30')

09:40 - 10:10 Debate (30')

10:10 - 10:40 Coffee

3.1 Benefits and costs in the application of a segmented taxpayer approach in the Latin American tax administrations

Moderator: Viralee Latibeaudiere, Acting Director General, Tax Administration Directorate, Jamaica

10:40 - 11:10 **Speaker:** Ricardo Escobar Calderón, Advisor to the Internal Revenue Service Director and Ministry of Finance, Chile (30')

11:10 - 11:40 Debate (30')

11:40 - 12:00 ITC Presentation "International Tax Compact" (20')

12:00 - 13:00 Lunch

Afternoon

3.2 The optimization of tax records: debugging, updating and use

Moderator: Yolanda Alvarez de la Torre, Head of the National Tax Administration Office, Cuba

13:30 - 13:50 **Speaker:** Marian Bette, International Affairs, Tax and Customs Administration, The Netherlands (20')

13:50 - 14:10 **Speaker:** Francisco Fonseca, Director General of Taxation, Costa Rica (20')

14:10 - 14:50 Debate (40')

3.3 Effective mechanisms for the collection of taxes and the recovery of debts in times of crisis.

Moderator: Henry Almengor, Board Member, Superintendence of Tax Administration, Guatemala

14:50 - 15:10 **Speaker:** Alvaro Romano, Deputy Director General, General Directorate of Taxation, Uruguay (20')

15:10 - 15:30 **Speaker:** Néstor Díaz Saavedra, General Director, National Tax and Customs Directorate, Colombia (20')

15:30 - 16:10 Debate

16:10 - 16:20 Evaluation of the event

16:20 - 16:40 Coffee

16:40 - 17:30 Closing of the event

16:40 - 17:10 **Final considerations:** Inter American Bank-BID (30')

17:10 - 17:30 Closing ceremony (Continued)

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44th CIAT GENERAL ASSEMBLY

Montevideo, Uruguay

April 12 to 15, 2010

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