



# 45<sup>th</sup> CIAT General Assembly

“Tax morale as determining factor in improving the effectiveness of the Tax Administration”



Quito, Ecuador,  
April 4-7, 2011



**Inter-American Center of Tax Administrations – CIAT  
Internal Revenue Service – DGI**

## **45th CIAT GENERAL ASSEMBLY**



**TAX MORALE AS DETERMINING FACTOR IN IMPROVING  
THE EFFECTIVENESS OF THE TAX ADMINISTRATION**

**Quito, Ecuador,  
April 4 to 7, 2011**



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Inter-American Center of Tax Administrations - CIAT  
Executive Secretariat

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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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**Quito, Ecuador,  
April 4 to 7, 2011**

## **TOPIC 1**

### **DEFINITION, SCOPE AND OBJECTIVES OF THE TAX MORALE CONCEPT**



## **DEFINITION, SCOPE AND OBJECTIVES OF THE TAX MORALE CONCEPT**

**Carlos Marx Carrasco**  
General Director  
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(Ecuador)

***Contents:** Summary – 1. The social state – 2. The ethical trilogy of the tax citizenship: Tax morale - social pact - social cohesion – 2.1. Ethical action – 2.2. The fiscal pact – 2.3. Social cohesion – 2.4. Tax citizenship – 3. From fiscal citizenship to tax citizenship: The role of the tax administration – 4. Initial agenda: The ecuadorian case – 4.1. Ethical-moral principles – 4.2. Education and training of human talent in the institution – 4.3. Incorporating tax contents in elementary-middle school curricula and undergraduate and postgraduate courses at the national level – 5. Conclusions – 6. Bibliography – Annexes*

### **SUMMARY**

The Citizens' Revolution, such the name for the Project that the present Ecuadorian Government Administration has undertaken, is a turning point not only in terms of traditional management of the economic policy tools, but also, and most importantly, in the explicit acknowledgement of the human being as the subject and end of the State-Society relation.

According to this vision, the Ethics-Social Pact-Social Cohesion trilogy consolidates into a single notion, the Tax Citizenship. Firstly, this document seeks to reflect upon the interdependence in this potential trilogy to the point of redefining the Tax Citizenship as the 'conscious and voluntary attitude by women and men in their compliance with tax obligations, as a condition for the complete exercise of their rights'. The role of each social actor may be established in the development of a country's Tax Citizenship. For the Tax Administrations, a more accurate vision is the definition of the tax citizen, which better directs



each one of the tasks undertaken to promote voluntary compliance with taxes. The tax citizen is not only a taxpayer who knows and fulfills his tax obligations; he is the monitor of tax compliance by other citizens and the efficiency and transparency of the tax administration proper.

## **1. THE SOCIAL STATE**

Latin America and Ecuador have experienced the extensive evolution of the State role. At the end of the 19<sup>th</sup> century and during the first half of the 20<sup>th</sup> century, dominated by the paradigm of “comparative advantages”, the evolution of the primary exporting sector determined socioeconomic transformations, in the almost total absence of state policies. Although, at that time, modern capitalistic relations were introduced, with the payment of salaries and typical external capital, the results were the concentration of income and greatly vulnerable economies based on the exports of goods with high price elasticity.

In the second half of the 20<sup>th</sup> century, the Ecuadorian State, in pursuit of economic modernization, adopts the structuralist model of imports substitution. At that time, the role of the State was reflected on development plans prioritizing the supply of public goods and infrastructure as necessary conditions for the creation of the “industrial superstructure”. But the State, far from being the driver of development, enjoys the dawn of oil exploitation enabling to increase current expenditure and access foreign financing that results in a USD 261 million external public debt in 1971 and of USD 4.652 billion in 1980 (Correa, 1996). The effects of the “Dutch Disease” rippled and imports grew without meeting the objectives of the structuralist model.

But the Neoliberal State, driven from the Washington Consensus, which by prioritizing the means -inflation control-, rather than the ends -such as fair development- marks the rise of the Social State, where one of the most relevant features is the adoption of a vision of the economy transformed into an economy of social solidarity.

In this new Social State, the individual is envisioned as immerse in a concrete and complete collectivity, with a given profile, a vision of the world and behavior therein, according to which he repeats and learns. The citizen proper enjoys participation with autonomy, freedom and solvency. Power, democracy, and justice in a national or local project are present in what people feel, live, think, do, believe or expect. The essence of development is grounded on ethics as well as solidarity and, therefore, the pursuit of the common good. Nevertheless, to refer

to the citizen immersed in democracy is also to conceive structure and develop the State, as a consequence of a social pact of coexistence that is concurrently current and ever-evolving.

Different visions have left this humanism aside, which embodies what individuals think, aspire, and wish as protagonists of the national development. These visions frequently place more emphasis on the role of a single actor in the development process – whether the State or civil society itself. Relevant examples are the International Monetary Fund and the Inter-American Bank for Reconstruction and Development, which under the notion of Good Governance, set forth that a good government is capable of building peace, prosperity and democratic societies (De Miguel, 2007); or, the UNDP, which in the context of enduring human development, stresses the strengthening of civil society without exposing the relations and influences among the different social actors.

These ideas are not new, but as Augier (2004) points out, given the fact that democracy is not an exact science and not a science at all, and entails mastering competencies such as a critical spirit, autonomy, initiative capacity, negotiation capacities and the peaceful resolution of conflicts, delegation of authority and respect for differences (Augier, 2004). Proposals are required that define roles and outline compliance measurement systems for each responsibility and their contribution to the social objectives fulfilled.

The building structure for this alternative is based on the discussion of three notions of global responsibility in society. The first of them, Ethical Action is shown in morally admissible behaviors generating virtuous circles both in citizens' legitimacy of the policies adopted, as well as efficiency and effectiveness in the public and private institutions through the public and citizens' tax morale relevant to voluntary compliance. The second notion refers to the Social Pact, whose compliance is per se a form of strengthening citizens' ethics as the set of consensuses and synergies of responsibility. Additionally, it facilitates the tools to measure the scope of the development objectives in which the human being is the subject and end of the State-Society relation. The third one refers to Social Cohesion seen as the individual and collective awareness on the commitments and responsibilities within the community that stands as the fundamental pillar of the Social State. The Ethical trilogy of tax citizenship: - Tax Morale – Social Pact – Social Cohesion consolidates into a single notion of Tax Citizenship defined precisely as the "conscious and voluntary attitude of women

and men in compliance with their tax obligations, as a condition for the full exercise of their rights". The role of each social actor may be established with self-participation, to build the Tax Citizenship of a country, with focus on the tax morale.

The Tax Administrations play an important role in building the Tax Citizenship. For the Tax Administrations, a more accurate vision is the definition of the tax citizen. The tax citizen is not only a taxpayer who knows and fulfills his tax obligations; he is the monitor of tax compliance by other citizens and the efficiency and transparency of the tax administration proper and the State.

The roadmap of this document includes the initial agenda, undertaken by the Ecuadorian tax administration, to instill in tax citizens a set of perceptions, values and attitudes on taxes, based on the ethical trilogy of tax citizenship: - Tax Morale – Social Pact – Social Cohesion; awareness, responsibility and commitment that individuals obtain encoded through different means, but chiefly by way of civic-tax education that promotes participation, awareness and ends in voluntary compliance; facilitating control tasks for the tax administration since all citizens become allies and parties in the renewed administration.

## **2. THE ETHICAL TRILOGY OF THE TAX CITIZENSHIP: TAX MORALE – SOCIAL PACT – SOCIAL COHESION**

Building the tax citizenship is a challenge owing to its nature, which shall be shared systematically by different sectors with their own profiles, approaches and styles, they shall participate in the process of building the democratic, fair and duly cohesive society; this entails that the State shall also adjust to such new scenarios, with an open approach and convenient mechanisms enabling these types of unprecedented priorities and conditioning factors, which consolidates in agreement with the interests and approaches with freedom, humbleness and tolerance. Such complexity calls for objective conditions and concrete groundwork, adequate for cultural diversity, the multiplicity of races that make up Ibero-America and fit to meet all the phases and each one of the specific components involved. For example, it is a priority to create ongoing dialog spaces, binding in terms of the decisions of government officials, representatives and local government administrations, through channels that are established and acknowledged in practice; based on transparency and efficacy, enabling to prepare plans, evaluate and improve them.

Building the tax citizenship is part of a country project, which seeks to transform citizen taxation into voluntary taxation, on the basis of citizen confidence over efficient, transparent, fair and timely investment and government expenditure, in which individuals participate without the least difficulty and becomes the great catalyst in the social development achieved, the mirror of the “state of the Nation”.

According to Díaz Velázquez, citizenship:

[...] Shall be understood as the formal status (the set of civil, political and social rights that the laws vests upon the lawful members of a community) and the substantive condition (the acquisition and effective exertion of such rights). But such citizenship status is not only defined by the existence and exertion of rights, but is also a socially determined identity, an inherent social process enabling and defining certain opportunities for the participation of citizens and the social groups in these relational social practices that constitute citizenship in a concrete social context (Díaz Velázquez, 2009).

The identity referred by this author reveals that citizenship is made up by countless relations in which individuals, groups and institutions are immersed; and, within such relations, as a whole, we shall discover how the importance of the Ethical Action, the Social Pact and Social Cohesion are decisive factors that may strengthen the renewal of the State, as a committed Social State.

## **2.1. Ethical Action**

In Ecuador, the Tax Citizenship has been officially provided for in different legal instruments, but chiefly, in its overruling law: the Constitution. The mandate not only describes the role of the State, but also the degree of intervention of the different sectors in society and the institutional public and private structure. Presently, the relevant laws and regulations are drafted under this legal framework. Among others, new institutions, new mechanisms, and processes are designed. Citizens’ participation in the effective building of the utopia, calls for awareness in each individual, groups, institutions and the country overall and is centered in the social aspirations and expectations, incorporated in the government administration National Plan for Wellness.

The Constitution of 2008 embodies the renewed vision of the public sector, which establishes a commitment for national development, based on Ethical Solidarity. Ethical Action prospectively renders the tax morale into a practice resulting from voluntary taxation; and, its breach is also voluntarily subject to an inevitable sanction.

Most individuals tend to trust their peers, owing to their inherent nature and the ethical-affective determination in them; the ethical as an act of love. Therefore, they intuitively return to such ontological roots as a safe alternative of living with certainty, authenticity and harmony. The problem is that in the last decades, such human trend is being quickly weakened. That is to say, insecurity, corruption, violence and the irresponsiveness of many sectors seem to lead society towards chaos, and consequently, individuals in the opposite direction to the utopia of Wellness, as mentioned above.

Human behavior is complex and depends on many factors, especially the events in the early years of life; most of them are remarkably subjective; human behavior is also affected by the material conditions in life, the socio-cultural context, the communicational context, family processes, different beliefs, customs, visions and cultural practices. A fundamental factor is the psychological-affective one; in a different context, it is followed by education; in another, the organization of the social life (the State). If we analyze this notion we observe they intertwine: all the life-family education with situations, emotions, affections, impacts, experiences, knowledge; the material conditions of life, justice and social participation. Let us set forth that the ethical-affective aspect for the Latin American world enjoys the virtue of being a complex process of cultures of “high-context”, and at the same time, personal (internal) and collective (cultural), which shall evolve into a new entity with such features.

The tax citizenship conceived as a process to broaden individual and collective awareness, becomes a means of civic bond and change of unpredictable pro-activity; committed with the most intimate aspirations and expectations of individuals and social groups. The extent to which this openness is asserted determines the consolidation of mechanisms that enable fluent citizen reflections and the effective possibility of dialogs and inter-cultural exchange; local and national government administrations' capacity to intervene in decision-making and persevering in ongoing self-advancement processes. If such aware and committed participation is induced successfully, if it is built on the basis of well-established training and self-training initiatives, it

shall constitute a strategic aspect affecting the mentality, attitudes and feelings of individuals, and consequently, the “ethical citizen culture of the Nation”, in other terms.

The challenge for tax administrations is to face social distrust in public institutions in general and towards the capacity, honesty and commitment of public officials; to face such unfortunate trend imposed by the embracement of superficial ethics, sometimes false; purposeless, manipulative, demagogical, corrupt and fundamentalist practices; embezzlement and the personal interest of political representatives and other personal interests, sometimes disguised as impartiality or technicism.

Building a democratic and fair society calls for a vision, an ethical, scientific and technological approach, openness, responsibility and commitment; it is a humanistic, committed option, capable of conquering the enormous slope that leads us towards destruction, it entails swimming against the current, materializing a fair, effective and legitimate democracy that leaves no room for any attempt at a coup d' état or dictatorship, but is strengthened owing to the ongoing advancement of the tax citizenship (Botana, 2006).

The tax morale is part of the tax citizenship morale, the first element in its ethical trilogy that pursues social cohesion, as the pillar for a prosperous life through a Social State that is condescending. On such grounds, tax citizenship is defined as social awareness and strength co-responsible for ethical action in favor of the conformation of the new Social State, committed with the destiny of such reconstruction of the democratic, fair and cohesive society as part of the collective awakening of the world, and at the same time, democratic and participatory project, deemed currently existent on the Latin American continent. It constitutes a historical process towards the social pact ensuring social cohesion and, consequently, Andean, South American and Latin American integration and strengthening Ibero-American cooperation.

The recommendations from “EUROsociAL Taxation” for the EU-ALAC 2010 Summit, refer to the struggle for the improvement and stability of revenue; promotion of equity of the tax systems; detecting and correcting tax fraud; voluntary compliance with tax obligations; building the tax citizenship and the interregional dialog to strengthen and institutionalize efficient and inclusive mechanisms and organizations, close to citizens, towards a social pact ensuring social cohesion; this

scheme is basic and shall be considered at the time of implementing strategies; to pursue institutionalization in the decision-making logic, define objectives, priorities and expansion criteria, the beneficiary population, approaches and indicators that show the innovations in practice, that is to say, the impacts achieved (Franco, 1996).

In Ecuador, the first step set forth is to promote dialog, reflection and arrive at certain consensus. Hereinafter, we shall present a summary of a number of the “ethical-moral principles” as a general and basic Decalogue that is easy to access as a reference for other statements. The ethical principles and statements and their moral application are the pillars on which society is built; such pillars consolidate mutual trust. They underlie legal decisions, political approaches and development of utopias. All such notions underline the priority task for all: that the majority of citizens achieve such ethical-moral development in a consistent and appropriate manner and in the shortest period of time. A national underlying project is required, which in the Ecuadorian case are the constitutional principles consolidating the mandate of Wellness, the safe groundwork for ethical and social development.

[...]The ethics of the autonomy and freedom relies on the notion of authority based on trust. The authority does not need to intimidate, or exploit or threaten. [...]The notion of power changes significantly, becoming power that awakens the powers of the social actors; therefore, power shifts, it is temporary in nature, and constantly calls for active participation. Education becomes relevant, not as a process of subjection to authority, but as disclosure of the power that the authority of the educator seeks to exert on pupils. (Reballato, 2008).

The contribution by José Luis Reballato emphasizes a key notion: the essentially ethical and solidary authority is of equals; of a collective from a new ethical class, which does not need to intimidate, exploit, use or threaten; but is based on the active participation and shall even be present in the daily educational event, by which the educator guides and motivates an autonomous and free conscience, which advances the present towards the future, fully and creatively.

Removing the traditional tax schemes based on repetition and a million complex and cumbersome mechanisms is an indispensable step for the medium-term with the relevant caveats for the challenge.

In this scenario, and based on consensus, CIAT sets forth: achieving the expansion and consolidation of the 'tax morale' as determining factor in improving effectiveness and legitimacy of modern tax systems.

The tax awareness in the current constitutional project is built on tax ethics and tax morale marked by solidarity, responsibility and a holistic approach; it is valid for the tax administration and public institutions, for the State, for the tax citizenship and the Nation overall. The following thesis may be proposed on the latter: "That the axis on which to build the 'fair and democratic society' is citizens' tax morale, and that of public officials, who – overall- strictly oversee that public investment and government expenditure are efficient, with pertinent, responsible, transparent, equitable and fair execution". Such summons is a mechanism to manage research paradigms and hypotheses within the specific working processes, within the tax administration; with the education system and with local governments and other sectors. It is the benchmark against which to build the desired democratic and fair society, to creatively explore innovative working alternatives in tax administrations and to materialize in practice the scopes of the notion itself. Such proposition features a dose of utopia and represents an opportunity to develop the "ethical action".

## **2.2. The Fiscal Pact**

It implies active participation by civil society; the backbone of State development related with awareness, willingness and commitment towards a 'voluntary' economic contribution to finance public functions and ensure ongoing and systematic monitoring (Audits); that investment and tax expenditure be performed responsibly; that the commitment of State entities and public or private officials is to act appropriately and to the benefit of the community, the country, according to technical and professional competence.

In this context, the furtherance of the tax citizenship in Ecuador is intertwined with a broader and more complex process, geared at changing the profile, vision and structure of the State itself; it embodies the trend to recover the natural role and expand the magnitude of the State in society. We shall highlight the importance of improving the efficiency of government expenditure based on improved controls, transparency, results-based management and human resources management (Domínguez & Rueda, 2005).



According to the foregoing, the fiscal pact circumstantially becomes the axis for the process described, that is to say, it is the floor of such complex, dynamic structure constituting the tax morale, to build the tax citizenship, the social pact and social cohesion.

The fiscal pact is the framework for citizen participation and the social pact, since it ensures compliance from public officials, in all levels, institutions, systems or associates of the tax administration. Based on the fiscal pact, government administration in broadly commits to working transparently and with quality, and voluntarily decides to participate according to their 'social responsibility', supporting the original source of change. It stands as the strategic support of social development by conviction and awareness; the driver of a broader process, non-partisan, but essentially democratic; of a participatory dynamic process that leads to "voluntary tax compliance and government expenditure with accountability and excellence".

This is extremely complex, since ethical action through the tax morale, is expressed with differences, paces, approaches, commitments, visions and other features, according to the actors and scenarios (locations-regions or territories). The fiscal pact shall be rooted in authenticity, vitality, wisdom and courage, confirming its commitment and identity with daily actions and extending the contribution from the personal or individual level, with consensus, through the power of the collective entity; succeeding in the expected impact with very concrete action proposals involving the day to day efforts in the public institutions, social organizations, jurisdictions or working team.

The fiscal pact shall advance progressively, with perseverance, criterion, freedom and autonomy to validate or deny options and foster alternatives that shall become the habitual courses. One of the first key battles is to abandon the usual path marked by consumerism and build a new institutional and personal development path or, otherwise, pursuing quality, and the correct, fair, pertinent and timely, over quantity. The key is learning to learn from daily performance and learn to participate; learn to communicate with efficiency, respecting and serving the taxpayer or user with generosity.

If tax citizenship is conceived as a 'political subject' (Estévez & Esper, 2008), the scopes of the fiscal pact are marked by the same profile. Its political content, in the positive sense of the word, is a large group of citizens, who promise to meet certain values influencing specific strategic objectives and actions. The same applies to the institutional

fiscal pact, by which the citizens devoted to serving the State in different functions and different agencies assume a commitment towards a determined institutional vision and mission, with a similar commitment to the one of each citizen with his country. It is a path of radical innovation by which most citizens decide for change.

Strategically, we may highlight that the fiscal pact constitutes the groundwork and the first step in the relevant social structure and its evolution shall impact on numerous aspects of the social life, especially the consolidation and expansion of the ethical issue. A preliminary definition of the fiscal pact scopes is that it entails commitment at the national level from public officials. It may be even defined as the other side of the same coin in terms of the social pact (Estévez & Esper, 2008). We shall highlight that this challenge is immediate, but also for the medium and long term. Likewise, it is deemed beyond the institutional sphere; it is a public pact that shall be built on proposals, objectives, monitoring and achievement of goals, based on its incidence on the sustainable social and human development, in the present as well as the future. It is the embryo of change that legitimates a new State that stand in lieu of the previous one. It relates to citizens' perception of compliance or noncompliance, and thus, to citizens' trust that is deeply impaired by the lack of ethics. Mc Gee (2006).

Presently, we perceive the extreme waste and inappropriate use of goods that nature and human effort so generously provide. Trust is a collective development since rather than trusting the nature of individuals separately, we shall look upon the nature of the human being as a complex, free, unique and collective entity that enables to rely on the strength granted by intelligence and spirituality, the insight given by culture and sensitivity.

Thus, we shall achieve the dynamic and synergistic merge of a Fiscal-Social Pact that integrates into the collective imaginary as part of the fundamental cultural development (Rojas, 2009).

### **2.2.1. The Social Pact**

A tradition exists in South America, which attaches value and emphasizes human spirituality as diverse and intercultural, connected with nature. Cultural syncretism is acknowledged and is expressed with intensity, strength and on a daily basis, without consolidating as an original expression, and therefore, it has been defined as the exceptional spirituality based on the 'emergency morale' (Roig, 2002)

or “heroic morale” as J.C. Mariátegui mentions, relevant to concrete social processes. Latin American spirituality in its cultural diversity is linked to the sense of the collective appearing as a multicultural common denominator, with a long history from a very remote past marked by an array of oral traditions and icons present in its political and cultural traditions. Therefore, the different cultures embrace a communitarian sense enabling them to survive in very adverse times. Currently, such emergency morale or heroic morale of the Latin American people is known as a very significant advantage for their social development and as a strategic cultural element in the broader development of the future social pact. In other words, Latin American spirituality renders a determined profile upon the prevailing trend of the “social pact” with deeply holistic and multicultural content.

That fact that the social pact becomes part of the continental cultural drive entails moving towards integration and forming part of the social imaginary, which, in turn, expresses the perfection of spirituality and, therewith, the ethical development achieved that becomes part of the collective identity. This historical and social development depends on the consolidation of the political vision of the Nation, the progress of the vision of each citizen and everyone overall; and the progress of the educational process and its integral quality.

Two levels of development exist in the institutional social pact; a domestic and international one. The profile and history of the social pact in Latin America is not very far from what happens in the rest of the planet. Let us remember that the General Assembly of the United Nations –UNO– in 1966, adopted the so-called International Pact on Economic, Social and Cultural Rights as well as the Pact on Civil and Political Rights. Both, together with the Universal Human Rights Declaration of 1948, constitute the Charter of Human Rights, one of the fundamentals of the organization, creating objective conditions to generate and move forward towards common approaches and positions, merging them into new perspectives according to experiences or understandings, in order to find and build elements of a new democratic and fair society.

The social pact at the international level is a strategic instrument in the development of international coexistence. The United Nations Organization (UNO) and the United Nations Educational, Scientific and Cultural Organization (UNESCO), undertake initiatives to promote certain international networks such as the Regional Network for Educational Innovation for Latin America and the Caribbean, which conducts studies and publications on “the democratic coexistence,

social inclusion and a culture of peace'. We may highlight a study published in Santiago in 2008: "Democratic coexistence, inclusion and peace culture", which underlines the role of education in building a culture of democratic coexistence and peace, establishing a shared framework of reference on the guidelines to strengthen values and cultural diversity.

The social pact is the development of awareness closely related with the awareness of tax citizenship and tax morale. Therefore, they share a common element: individuals enter a cathartic process, of certain integral healing, becoming aware of their decisive role in the responsible development of a democratic and fair society; every individual becomes the essence of the new citizenship that promotes Citizens' State of Wellness. It is the awareness that every individual shall achieve freely and spontaneously to autonomously reflect, analyze, opt and commit towards being or not being, the protagonist of a deep change in society; defining the scope of his role and of the process overall. The same applies to the public officials of government entities. This shows us the complexity of the process, given the interconnections arising among the different actors and factors of the social life.

Citizens' awareness is based on two pillars: one, the intimate and personal process that each individual may assume and strengthen creatively, and the other, the impact of education in all its levels. Education as a self-transforming entity that becomes an "experience to generate and strengthen values, attitudes and socio-emotional and ethical skills sustaining social coexistence by which everyone participates, shares and develops integrally" (Blanco & Hirmas, 2008). Given the contingency of the period this is the fundamental aspect of every citizen and state activity. These strategic pillars of citizen development are aimed at society's ethical improvement. Therefore, the culture of the social pact is, above all, the improvement of values, attitudes and socio-emotional and ethical skills that openly sustain harmony in social coexistence with a critical spirit and tolerance. The social pact is the development of the social coexistence integrating affections, reasoning, reflections, moral behavior and personal identity as a unitary process embedded in the collective entity of the individual. It is the generation and improvement of the personal project interrelated with the local-regional-national and continental project.

It is the standing social or collective dialog, implying reflexive citizenship, critical in freedom and autonomy (Carrillo, 2001).

This dialog evolves in a positive and authentic environment, as a daily practice; as a permanent constructive process (Brunner, 1990). The social pact culture exists historically in the conscience of most cultures in the world. For Latin Americans, it is a latent element that has not been highlighted enough and lacks the adjustment required to harmonize it with current challenges. But, it exists, in certain cases in a more larval stage, in others in a more advanced one, but potentially, it is a resource on which Latin American countries may rely.

We shall protect, promote and establish an agreed plan to improve citizens' ownership of the social pact and thus build social cohesion as a direct outcome of the pact. We shall work to rely on philosophical fundamentals, notions, mechanisms and tools that make it a technical participatory group.

The step from such potential stage and from the remote traditions of the social community awareness requires a permanent professional and technical exercise for public officials; a technically fine-tuned process in the theoretical and technical aspect. It constitutes a task of the current social development period. Undoubtedly, the social pact receives great support from the "fiscal pact"; that the State sets the positive or negative trend for social development. Its advancement constitutes guidelines that present the alternative validated by consensus.

The social pact, the agreement based on the consensus of a given society, features established fundamentals, clear technical elements for its application, compliance, continuity and projection. It sometimes features long historic tradition. It is a historic event defined, discussed, compromised or adjusted to reach consensus and have such powerful strength to inspire the majority of citizens. It is a complex and dynamic event, which sometimes unexpectedly and unpredictably changes. It is a process with virtues, contents, weaknesses and threats. It is the commitment by individuals and institutions, which have become involved and committed towards a given goal, realization, function or task.

In order to consolidate a social pact, a number of previous stages shall be acknowledged. Firstly, it requires a strategic and tactical approach towards the national issues and significant progress in the development of the overall process. To such purpose, we introduced the "ethical trilogy of tax citizenship": the development of the tax morale, the fiscal pact, the social pact and social cohesion as a result of all the foregoing

and as the ground for the Social State. Acknowledging the process as a challenge for the country overall requires the willingness of the public sector, citizens and public entities. It requires information and diagnostics; creating and maintaining a participatory process to build consensus, synergies and agreements to a very broad extent. It shall rely on the perspective of monitoring the process from the development of the tax morale and the other components in a given period, articulated in line with the approved national and institutional plans. Establishing mechanisms and spaces for agreement, exchange, and consensus in predetermined areas is a requirement to work according to specific phases that succeed in identifying specific tasks that may be evaluated with the appropriate indicators.

### **2.3. Social Cohesion**

The Social State for Wellness is built with a citizen embracing solidarity, who embodies the utopia defined in the Constitution. This citizen features a commitment and responsibility to move forward in the medium-term for compliance with the precepts of the social pact, supported by the fiscal pact in the public sphere, establishing the principles, values, plans, processes, mechanisms and projects to build such society “ensuring holistic citizen development”.

Building social cohesion is the most complex task of the overall spectrum under analysis. It entails educating citizens, with many simultaneous tasks on different fronts and with different actors. In the educational area, for example, it shall not be limited to the classrooms but shall insist on the common responsibility. All individuals are co-responsible for the education and development of the new generations. The issue is how to enable such co-responsibility to be appropriately assumed, with efficiency and accuracy. Compliance is required to guarantee trust in all the aspects and actors involved in the process. In the educational area, we shall recover the educational role of parents, family-members; the role of seniors with pre-school infants, children and adolescents in certain cultures; establishing a new didactic approach that is libertarian and fundamental for team-work. Problem-based learning and learning based on the effective intervention of pupils themselves, not only with regards to the didactic approach, but in terms of opportunities for children and adolescents to early address their own actual and concrete issues; and thus, overcome the prevailing paternalistic overprotection of mediaeval origin.

The Program “EUROsociAL Taxation”, the technical cooperation initiative of the European Commission to promote social cohesion in Latin America, is based on the notion that the tax culture exists in the development process of most Latin American countries. Such tax culture appears in the framework of poor confidence in democracy, public institutions and the strong negative social perception on the allocation of government resources. This is the current evidence that requires creating and adjusting appropriate methodologies and approaches that are technically effective to address the difficult task of overcoming such lack of confidence based on appropriate, transparent and responsible tax compliance. Social cohesion as “social sensitization, awareness and action” is closely related to the consolidation of participatory democracy and the Social State.

Enhancing the tax culture requires consolidating the tax morale, building the social pact on which social cohesion is grounded. Therefore, building the tax citizenship requires inductively motivating and promoting active and responsible citizenship involved and aware of the social relevance of taxes and the transparency and efficiency of government expenditure to improve the distribution of income and guarantee adequate income to enable human development and social cohesion. It is exactly the result of tax citizenship awareness, strengthened with the tax morale in a step with political and cultural impacts and part of a broader and more complex path such as the Wellness system.

Social cohesion features great strength with a broad array of challenges. Therefore, it requires a coordinated process, at the national and territorial-local level; secondly, it shall be based on long-term strategic guidelines, in which to a certain extent, the tax administration is the binding element, originator of synergies, consensus and national concordance, consolidated with righteousness and tax responsibility.

It is interesting to underline that the Council of Europe for Social Cohesion defines social cohesion as the capacity of a society to ensure the wellbeing of all its members, minimize inequalities and avoid polarization: a cohesive society is a community of mutual support made up by free individuals pursuing such common objectives through democratic means (Hopenhagen, 2005).

On the one hand, social cohesion is the consequence of a long and complex process, as we have mentioned, pillar of the new Social

State and in the Ecuadorian case, it shall be capable of supporting the development of the Wellness system.

#### **2.4. Tax Citizenship**

The Tax Citizenship reflects and contains the progress achieved by citizens, in the form of awareness, commitment and proactive responsibility with a level of consolidation and validity.

In other words, each individual in the overall social context -based on the commitment capacity and responsibility- succeeds in defining a lifestyle, an imaginary and a genuine culture supporting the social innovation process we are addressing. The tax citizenship is determined with the incorporation of the citizen as an ally of the tax administration upon meeting voluntary taxation; it constitutes experiences, appreciations, answers, attitudes, actions and ideas that become the content of the tax citizenship. Tax citizenship implies embracing the step at which citizens assume ownership over a consensus approach and the banner of emancipation to assume a formal, subjective and collective commitment in pursuit of certain objectives in a given term. The tax citizenship becomes the synthesis of the process described, in which the activities of the tax administration elucidate the progress achieved.

The problem becomes more complex upon considering that all the notions described above depend on what has been collectively developed as culture, considering the multiple visions, diverse or closed, open, solidary or exclusive, participatory or technical, among others. This dilemma is inherent in practice at the level of collective awareness, customs and traditions as an intercultural entity, requiring the definition of strategic sectors for the development of this scenario in which democracy shall be consolidated according to the different cases.

Citizenship is an element with certain gravitational power, the fundamental notion that citizens are the only holders of Power and thus, theoretically, the sole owners of the government funds raised from taxes. In theory they are the sole owners since taxpayers finance the State.

The following axiom: the existence of a certain type of citizen depends on the educational, advancement, family, cultural, affective and communicational processes. The tax citizenship defined as



‘the conscience of individuals, groups and institutions, brings their responsibility and commitment closer to the development of a cohesive, democratic and fair society, by compliance with their tax rights and duties’.

The challenge of a civic or social State is relating to tax citizenship at the level of promoting awareness, a collective imaginary and identity, simultaneously and coherently. It is important to conduct an inclusion process, build the fiscal pact, renew the social pact and instill social responsibility in pursuit of voluntary compliance and, finally, analyze the impact of such processes on the social cohesion (to the extent the members of society perceive themselves), and the effect on their willingness to comply (Estévez & Esper, 2009); such notions are directly related with the current social imaginary, with the vision of reality, of identifying and deeply relating to the social awareness and each individual.

In the process of promoting the tax citizenship, the citizen shall find the mechanisms to enable to look after the excluded, to intervene, once again, individually and collectively, for them to recover their dignity, their ontological capacity of being, of expressing themselves with authenticity. They shall become drivers of the new State, which, according to the foregoing notions, in the Ecuadorian case, shall fulfill the relevant constitutional mandate: building a “society that respects the dignity of individuals and collectivities in all their dimensions” (Preamble of the Constitution). Such process originates in the form of thinking, living, administrating, organizing and perpetuating. Article N° 340 of the Constitution sets forth the creation of a “national social inclusion and equity system with an articulated and coordinated set of systems, institutions, policies, norms, programs and services that ensure the exercise, guarantee and enforceability of rights [...] [which] articulates in the National Development Plan and the national decentralized system for participatory planning [...] [including] [...] the areas of education, health, social security, housing, culture, communication, science and technology [...]”, among others. Such constitutional provision is enlightening and even applicable to the ideal meaning of the process to formulate, implement and evaluate the public policies aimed at social cohesion, as recommended in the regional cooperation Program with Latin America promoted by the European Commission and EUROsociAL Taxation.

The tax citizenship is sustained or required from a renewed State, that is to say, a State that is ‘focused on the human being and its holistic

development' of the Wellness system, challenged with the creation of new communication, dialog and participation structures. This openness is an ongoing stimulus making the tax citizenship a genuine culture medium for the new society, an effective mechanism that facilitates intense and efficient communications, consensus and open dialogs in the framework of solvency and certain prosperity. They are notions even related with the fundamentals of ethics: love, tolerance and the aesthetic-symbolic, based on the intentional and priority openness, to systematically and vitally assimilate and assume change. This is a motivation, especially, upon the emancipation of the ever-excluded sectors with their soul being the la tax morale, as the trigger for the long-term process that develops tax citizenship and social cohesion.

Tax citizenship as individuals' awareness is commitment and responsibility in assuming their tax rights and obligations. It constitutes an element of participation in building a democratic and fair society, duly cohesive; standing as a higher instance of citizen activity. Therefore, tax citizenship is the level of personal and collective awareness affecting society overall, including the State. It moves the most sensitive authorities and public officials; creating the possibility of strengthening the "fiscal morale", which constitutes the precedent of the fiscal pact asserting the integrity of public officials and the administrative public processes (Commitment and responsibility of the public official as an exemplary citizen); this formulation is the starting point of the road towards compliance with their duties and "strategic objectives".

It is worth recalling that the tax morale shall be sustained with the behavior of public officials as "exemplary citizens", the most sensitive role models who enlighten the rest of society.

[...] inefficacy, authority's lack of control, failure to fulfill administrative or legal proceedings or the inexistence thereof, the lack of legal certainty and citizen assistance, among others, are drivers of the lack of integrity in any organization whether public or private [...] The tax administration is not foreign to the phenomenon and suffers, owing to the nature of their function, the effects and consequences of the lack of integrity, in many cases even preventing and hurdling compliance with their strategic objectives (Ayala, 2009).

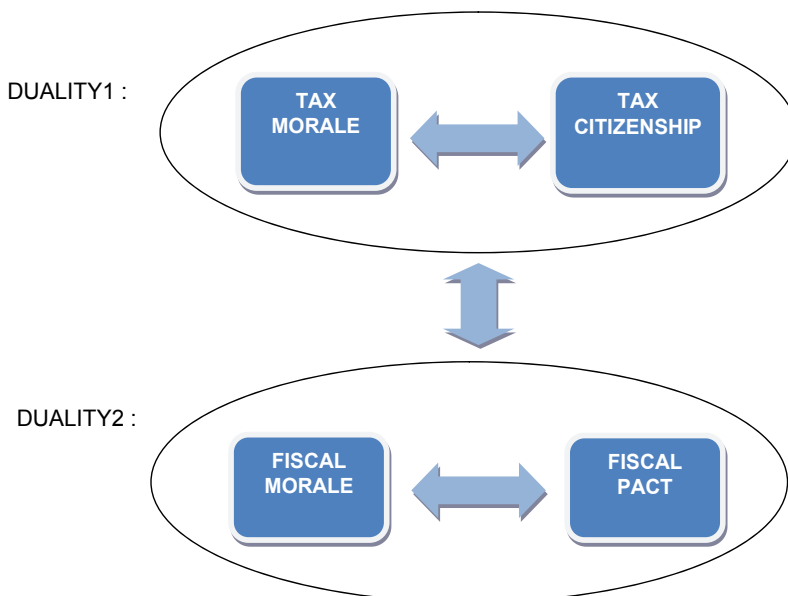
Building the Tax Citizenship is a priority task for the Internal Revenue Service (SRI) of Ecuador. Strategically, it shall be based on the effort underway in promoting the tax morale, as the "tax culture"; we

recommend the unity-duality approach between tax morale and tax citizenship (refer to Chart 1).

Strengthening the tax morale, interacting with the processes to build the tax citizenship becomes the pillar that, in turn, articulates with a second duality, as we may observe on the following chart, between fiscal morale and the fiscal pact.

If the Constitution of the Republic is the strongest groundwork for the Nation and the State, it is prudent to alert on the array of expectations and challenges that the new Ecuadorian Constitution poses, in line with the enormous dose of utopia and a historic enlightening event in contemporary history. This requires reflecting at length and with the immediate and solidary cooperation of the members of the Inter-American Center of Tax Administrations – CIAT- to design the national strategy to effectively fulfill the principles of the constitutional Preamble:

*Chart 1: Dualities 1 and 2*



*Author: the author.*

“We decided to build a new form of citizen coexistence with diversity and harmony with nature, to attain the Wellness”. This constitutional demand relates to the definition of tax citizenship by María Raquel Ayala D., CIAT Director of Tax Studies:

[...] Promoting awareness in a country's individuals on their commitment and responsibility in building a democratic and fair society, by assuming their tax duties, their knowledge in the existence and exercise of their rights and role as guarantor and monitor of the appropriate allocation of social investment (Ayala, 2009).

This statement defines the need to instill preventive and proactive behaviors, rather than corrective-repressive ones. It is the approach that considers the economics of efficacy and efficiency, in developing the tax morale, as the “commitment and responsibility of individuals in building such democratic and fair society”. Overall, it accounts for the strategic solution that shall fulfill the expectations of most Ecuadorian citizens, as the safe path of “social cohesion” by which, through the social pact, it is possible to succeed in building the State of Wellness.

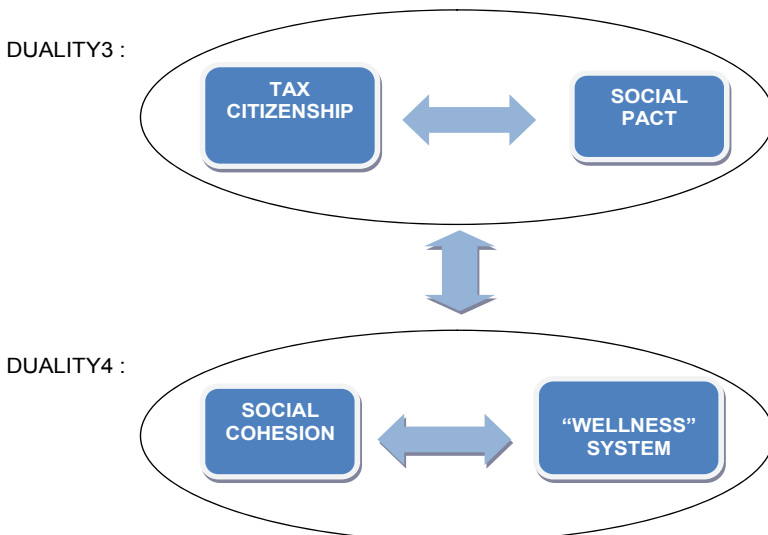
The Center for Tax Studies of Ecuador (CEF-SRI) has sustained the Tax Culture area, through which it has delivered numerous courses on tax culture and tax education. In certain cases, it has established specific target groups for professional training, such as the Basic Course for Professionals. It delivers tax education in primary school and Middle school; intensifies tax education at the three levels, with special focus on the higher level. Additional initiatives are the Taxation Review, communication Campaigns (Tents and Buses) with the tax citizenship brand, as foreseen in the 2011 OPERATING PLAN; and promotes other initiatives such as school contests and the tax lottery. Such elements come together as the basis or launch pad for the participatory development of the tax citizenship, which in turn is closely tied to the development of the tax morale of public officials, the tax administration and public officials overall.

The purpose is to consolidate a “Fiscal Pact of Integrity”, the second duality presented in the first descriptive chart of the process defined, which clarifies the effort to coordinate activities, events and approaches from the past, and the process itself subsequently, relating it with Chart (2).

We highlight the approach of relating the tax citizenship development process with the implementation of the Fiscal Pact directly impacting on citizens' confidence; tying this duality to the greater one that would occur between the social cohesion and the actual development of the Wellness system.

With a view to improving the institutional morale, we apply the information gathered in the 2010 SRI Tax Morale studies in Ecuador, and the “Self-diagnosis Project for the Promotion of Ethics” (Presented by the CIAT team on 27 September of 2010), to draw the first “SRI Ethics Promotion Plan”. The latter, aligned with the project relevant to the promotion of the Tax Citizenship, shall establish a baseline for the process, considering: determining factors, actors, roles, tools, and occasions, among others.

*Chart 2: Dualities 3 and 4*



*Author: the author.*

The Internal Revenue Service -SRI current vision and processes; the National Wellness Plan; the dualistic vision of the Andean world; the strategic perspective of meeting most of the objectives in building the Tax Citizenship in the forthcoming decade, towards 2021 (2021 Goals of the Education Ministries), constitute the operating mesh that fully integrates social development and the multidisciplinary cross-sectional development, prioritizing the notion of tax citizenship as the strategic national development framework.

This effort demands enthusiastic and generous cooperation and solidarity. Of all such efforts, we shall highlight the need to enhance and prioritize teamwork, at the national and even inter-American or international level. That is to say, it is fundamental to share contributions, know and accompany with experiences and reflections. With CIAT

support, we may even explore the possibility of joining efforts towards development at the Andean level or bi-national agreements and, likewise, at the continental level, whether through specific networks or cooperation projects even with other areas of the public or private sector and execute them through a participatory process that is socially accepted based on fiscal, social and integrity pacts.

The holistic approach is a potentially latent element in the hands and the heart of the country's citizens, it is a concern that the complexity of the times defines as a priority. In order to consolidate their participation and commitment, it may be a very useful element.

Commitment and responsibility mark unrestrictive compliance with processes of inclusion, equity, participation and solidarity to build a united, strong and proactive Nation, which owing to the responsible, equitable, transparent and decentralized government expenditure recovers the confidence of everyone in a given country and strategically improves its multicultural identity, its unity in diversity, its holistic integrality and solidary willingness for gradual continuous improvement with peers. Therefore, building the tax citizenship appears as a beautiful utopia, unattainable, failing to technically consider the factors of influence in their greater or lesser extent. In fact, the issue is complex, difficult, and shall be treated with a long-term approach. This implies harder prospective work and strengthening the relentless will to change.

Social cohesion is a consequence of empowerment and application of the principles and values of tax citizenship, enabling another level of strategic coordination between the significance of the tax citizenship and its incidence on the development of social cohesion. At the same time, the tax morale related with social cohesion merges or achieves its purpose with individuals' developed and consolidated awareness as well as groups and institutions; each and every one proactively assuming the development of a democratic and fair society.

In theoretical and practical terms, social cohesion constitutes the beacon of the progress achieved and enables, or should enable, to successfully face current complex challenges such as social imbalance, inequity, unemployment, low educational levels and citizen participation, high levels of corruption, the narco-economy and urban gangs, among other evident and complex social gaps that shall be countered on a daily basis, with high level of social awareness and participation.

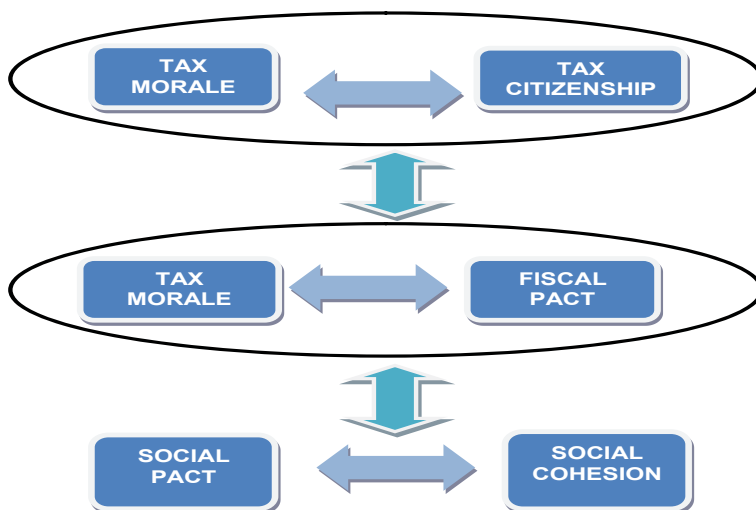
The notion of Social Cohesion is substantially strengthened since it is part of the European integration strategy and results in the current European development (Ballón, 2007); this consolidates and allows its international acceptance. This notion facilitates the understanding of the relationship that exists between the need to significantly reduce the social gaps and succeed in the consolidation of identity, unity, governance, the imaginary and all the civic bonds enabling the population to understand, assume and drive processes of change, with historic transcendental repercussions.

Based on the bonds defined we may establish the combination set forth in Chart (3). It presents a slight variant that strategically connects the Fiscal Pact and the Social Pact to work for the aspects that constitute the essence of social cohesion in harmony.

#### **2.4.1. The Fiscal Pact, the Social Pact and Social Cohesion**

One of the fundamentals for a stable democracy is social cohesion –the consolidation of the plurality of the citizenry and the reduction of inequalities and socioeconomic disparities and gaps in society. Social cohesion is positively consolidated with the relations and interactions of individuals in society, including the role of the citizenship. Democracy and social cohesion are supplemental components of the action to include the active citizenship in the public decision-making process, in terms of rights as well as responsibilities. All citizens shall enjoy the possibility of building a decent life within a political system that promotes fair social and economic compliance, guaranteeing the basic human rights and offering accountability in the political and judicial sphere. In order to achieve a balance between individual rights and collective responsibilities for a sustainable democratic society, it is necessary to address matters in relation with disparity, inequality and discrimination.

Chart 3: Combination between Tax Morale and Social Cohesion



Author: the author.

Democracy shall be undermined in societies with widespread poverty and growing gaps among social groups. Such issues are among the priorities on the current agenda of Latin America and the Caribbean (LAC). (Cuellar, 2009).

“The fundamental of democracy is social cohesion”, states Roberto Cuellar, current Director of the Inter-American Institute of Human Rights”. Such assertion is highlighted according to the notion that a democracy built on the “consolidation of the plurality of the citizenship and the reduction of inequalities and socioeconomic disparities and gaps in society”.

In “Education for Civic Life”, the IIDH ratified the notion and defines democracy as:

[...] Guaranteeing citizens’ conditions of equality, freedom and participation in the management of power. This entails that every democratic government shall assume the respect and validity of human rights and the principles of equality, freedom, independent powers, participation, dialog, pluralism, and tolerance, among others. (IIDH, 2003).



We may infer that the “fiscal pact, social pact and social cohesion” are dynamic elements of the democracy process. The IIDH, in Education for Civic Life, considers the key fundamentals of democracy as participation, dialog and solidarity, and emphasizes that citizenship is essentially a right and a responsibility assumed and incorporated as a cultural asset.

A key aspect is the relation between social gap reduction and the immediate consolidation of identity, unity, and governance, among other traits and features of change. Likewise, it is the result of a complex process for the medium-term starting with the consolidation of tax morale and tax citizenship. This approach to the notion includes a vision of integration, with social capital, which somehow resembles the centrifugal force of globalization and the lack of certainties that may unite individuals around shared behaviors and ideals. As socially motivating ethics, with subjects who learn how to relate to others, where public assets and general wellbeing appear as motivations, it supports the improvement of the fiscal morale and the Fiscal Pact and concludes with the Social Pact that is synthesized in the Social Cohesion achieved. This ensures the development of an equitable, solidary, intercultural, transparent and decentralized State that prioritizes social inclusion and Wellness.

### **3. FROM FISCAL CITIZENSHIP TO TAX CITIZENSHIP: THE ROLE OF THE TAX ADMINISTRATION**

Tax Citizenship is the set of perceptions, values, and attitudes of individuals with respect to taxes, obtained in an encoded manner through different means; and the set of practices that citizens undertake at the time of filing their tax statements based on such notions.

Institutions, systems or the tax administrations face the challenge of being ethically, professionally and technically efficient, earning society’s acknowledgment and standing as the example of efficiency, transparency and responsibility; this is largely the image of the Internal Revenue Service (SRI) of Ecuador. This challenge may constitute the strategy for social advancement in the development of the Wellness system. The Ecuadorian tax administration, just as every TA, seeks to achieve voluntary compliance and expects government investment and expenditure with responsibility and excellence. Such institutional efficiency may be qualified as leading-edge and influence the promotion of citizens’ awareness, individually and collectively and impact on other institutions and also stand as a key element

in developing the notion. That is to say, it defines whether the tax citizenship is based on “individuals’ awareness of their responsibility in building a democratic and fair society”, which attains results based on processes of ethical-moral and technical-professional development, with teamwork, knowledge and communication that simultaneously affect different actors, social levels, spaces and times, with different cultures and imaginaries. This recognizes diversity and consolidates a course of action, a specific ethical commitment and the expectation of recovering from the prevailing lag of the past.

Tax evasion spurs a perverse circle of inefficiency in the economy and erodes the deepest bases of the political, legal, and social structure of a country, especially affecting ethics (Morales, 2005). The current social life is marked by what the tax administration does or ceases to do; it is a core area of the State, and permanently determines the fate of a country.

This is the basis for the importance that the tax administration acquires on a daily basis in the countries of the world; this specific weight depends on the TA management capacity, in understanding the complexity of emerging societies in a globalized world like the present one.

Cultural diversity impacts on the strategic goal of achieving “voluntary taxation”; it shall be considered from a strategic and therefore, prospective approach, with careful attention on the cultural diversity, especially at the time of systematizing, structuring and organizing the notions, principles, paradigms and ethical propositions; ethical innovation and the qualitative improvement of our behavior, of establishing rules and mechanisms for taxation, acknowledging that all processes are related and conditioned by the cultural context. The process shall ensure this aspect in the medium-term, and consider with emphasis such cultural differences in a multi-cultural country, the common trait across Latin America.

It is worth considering that citizenship implies political rights and obligations, but also tax ones. Therefore, compliance with tax obligations is crucial since it constitutes the initial and most active form of exercising citizenship.

Building the tax citizenship through participatory self-education by the political citizen, - aware and committed with a State that considers him an inherent and vital entity for its survival- goes beyond the notion

of “good citizen”. The clarifying element for this advancement is the assumption of the civic social responsibility, based on trust sustained by public investment and expenditure socially responsible and with excellence. If all is aligned to the respective national, institutional, strategic and operating plans, it becomes a formal, institutional and clear commitment, which shall be confronted at the personal and collective level, on a structured and permanent basis. It shall feature high level of exchange of experiences and consulting; especially with education and research sectors in the public as well as private spheres.

Compliance with such virtues shall be ensured through communication, transparency and the massive dynamization of audits from the local-territorial to the national level. The ethical element stands at the forefront and the concrete changes achieved have the power of expanding their incidence and grounds among different social sectors, even with traditionally antagonistic interests.

The tax order considered in the light of ethics, originates the so-called fiscal morale or tax ethics, understood as the set of norms established and regulating taxes or levies and ethical development. The notion of tax awareness arises from such definition, understood as the examination of individuals’ moral conduct with respect to the system. Robert McGee, states that tax compliance is influenced by the perception that society has with respect to taxation and government spending.

McGee describes two main types of behavior: one refers to societies with the concept of the contract, which consider tax compliance as an ethical behavior. Consequently, this produces a fiscal morale and the breach thereof promotes the feeling of repentance or guilt. In the second type, under certain circumstances, noncompliance is no longer deemed incorrect and even becomes the expectable and socially accepted behavior. This occurs in a society with low fiscal morale. It should be admitted that the decision that the taxpayer adopts is not influenced by emotions or instincts, but results from a cold comparative process between the calculation of the advantages and disadvantages of acting in one way or the other: to comply or not comply (González Cano, 2001).

Likewise, we may refer to the theory by Kohlberg (1981), which points out the stages of moral development: the first one is aimed at obedience and punishment, which prevailed until approximately 9 years ago. The second one reaches adolescence and admits more than

one approach to the issue and implies exchange and individualism, with conducts based on identity and triggering a vision of fairness. The third one is the stage in which they abide by what family and the community expects and the intentions and feelings of the acts are perceived, pursuing good interpersonal relations. In the fourth stage individuals are concerned over society as a whole and attach value to legal compliance, the social order and security. The fifth stage is marked by deeper concern, where rights and values are considered to preserve society with greater freedom and relativism; principles and values matter, the notion of justice is more universal and corresponds to the ethical-moral awareness of the great advocates of humanity; this scientific theory sets forth the complex influence of the legacy and acquired elements marking the different stages of moral development.

The determining factors of the tax morale are on the one hand: appropriate, transparent and responsible compliance by the State, in terms of investment as well as government expenditure and citizen trust, which influences the culture of ethics in each country; conditioned by the vision and perspective of each individual in his context, that is to say, in the cultural, decentralized and local sphere. If the State experiences a time of improvement in their commitment and responsibility, it fulfills the recommendation that Adela Cortina sets forth: “respects and protects the moral order of society as one would like society to respect and protect your autonomy”; taxpayers’ confidence increasingly results in voluntary compliance, but also, in improved consolidation of the tax structure legitimacy as the backbone of the system that is condensed in the State. If otherwise, greater lack of confidence and increased evasion shall be detected. Additionally, times of crisis weaken the state apparatus and imply greater inconsistencies. Therefore, the importance of TA performance in times of change and crisis increases.

Surveys have been conducted on citizens’ perception of tax morale, which determined that it is first attributed to government officials; it depends on the responsibility and transparency of public functions and officials. On the theoretical models studying the issue, the tax morale becomes a genuine parameter or catalyst of the system and the satisfaction of citizens with their government administration. Arias et al. (2008).

Should the basic determining factors of the tax morale be genuine compliance by the State and citizens’ confidence, the observation reveals the direct link between citizen awareness as the tax citizenship

with an inalterable duality: the duality between tax morale and tax citizenship stands as the fundamental clarifying element for the development of the conceptual framework that defines the tax morale as well as the tax citizenship.

Citizens' confidence is the key determining factor of the tax morale and is based on effective, responsible and transparent compliance of the State functions, especially public investment and expenditure; on the inter-American map we may identify cases in which the TAs make a vital contribution in this sense. In such cases the tax administrations are the arm of the State that more clearly embrace the virtues set forth: efficacy, responsibility and transparency; this is the case of the Internal Revenue Service (SRI) of Ecuador.

It is worth considering that the strategic consensus-based decision of the members of the Inter-American Center of Tax Administrations (CIAT) has presented in recent years the initiative to strengthen this approach: effective, responsible and transparent State compliance in the sphere of taxation.

The second determining factor of the "tax morale" is the strengthening of citizen awareness in line with the tax compliance culture and the collective ethical development, which are part of the same process. This determining factor requires a space for social advancement and another one for social consolidation in the medium and long term. They depend on the changes in tax education, the development of the collective imaginary, the social organic experience, the degree of citizen participation and the confidence in the State, among other aspects.

The third determining factor is detected upon the notion that in times of economic crisis, the State and the control of tax compliance are weakened. Consequently, tax evasion increases and citizen confidence in the State drops; therefore, "socioeconomic stability and employment growth" are also decisive elements in the scenario of the determining factors of the tax morale.

Justice is a quality inherent in democracy. Genuine democracy does not exist in the absence of fairness. This fundamental aspect and component shall be incorporated in the collective imaginary. It is a fact whose explanation presents its essence: the ethical content. Without justice equity does not exist; without well-grounded ethical values

such justice is not feasible. Therefore, a fundamental value of the conscious citizen and public official is being fair and democratic, and to a certain extent, strengthen their ability to struggle on a daily basis with the opposite. This is a vital ethical principle, which shall be upheld with conviction; to be achieved through participation and accepted by tradition and identity, to protect and sustain what is fair with will and courage. It shall be strengthened in all scenarios, at all times and levels of institutional development, in every process considering its social impact, with special consideration for educational centers. It is a vital element in the new institutionalism, based on consensus and rooted. It forms part of the strategic determination as a country or collectivity, of the national project embodied as the “State policy”, which exceeds the scope of the government administration in office -the Sumak Kawsay- shared with certain Andean countries and with a somewhat continental repercussion.

The “country project”, is the strategic determination, the ontological, axiological and epistemological ambitious project, somehow embodying the popular expectations expressed on the streets and the ballot box, calling for such a utopia to be binding and become the “State policy” in the medium term.

In Ecuador growing concern exists owing to the rising level of existing inequalities and this directly impacts on the possibility of promoting sustainable change. The analysis of the current situation and the potential changes in citizenship directly relate to the political nature of the social issues such as: equity, justice, exclusion, democracy, participation, hunger, unemployment, among others. Such needs call for intensive, priority and extensive development of the tax citizenship according to its definition.

An elemental axiom of the new citizenship is that we are all equals in terms of rights and obligations; equal opportunities are central to this principle, equality for all and among all. As an equitable, timely and quality development, in all aspects of life, from education and health to food safety, it directly impacts the economic-political aspect and is unattainable in the short-term. The situation is so critical that it may be qualified as a cumulative and pervasive crisis that prevails. Failure to address it shall hurdle any progress in terms of quality of life.

The same applies to vital routines, social relations, democratic participation, collective psychological statuses, violent trends, addictions, corruption and fraud, among other issues.

We may assert that if deepened, it may become a sort of “complex pandemics” expanding and becoming more complicated; creating similar situations to those making fear prevail on the planet, with the H1N1 pandemics, the recent economic crisis (2008), preceded by AIDS, and generalized insecurity and the current nuclear threat in Japan. In the face of this complicated framework, sustaining an optimistic proposal constitutes a genuine “act of faith”; the complexity of the challenge demands a radical stance, technically, humanly and scientifically grounded answers, relevant and supporting the integral healing process. The strategy defined pursues three key aspects: integral education, development from the local sphere and conscientious efforts for continental integration and Ibero-American cooperation.

#### **4. INITIAL AGENDA: THE ECUADORIAN CASE**

Tax citizenship is a strategic path to be adopted since it is appropriate when it refers to awareness on the responsibility and commitment for a new society, which is democratic, cohesive and fair. Such awareness in society seeks to strictly sustain changes in visions, values, attitudes, and even the adoption of a new radical ethical initiative: a different lifestyle, a historic advancement by each individual per se. Individuals adopt the practice of such values consciously as a right and obligation, which shall become an asset for all; a dynamic and perfectible element that is open to the collectivity, as a priority and object of discussion with will, commitment and open-mindedness, comparing it to other suggestions, ideas, proposals, and principles arising from a different sphere, interests, approaches and cultures and thus, adopt it by consensus and improve it.

The notion of tax citizenship implicitly points out that it is a dynamic process, with specificities according to the country, and, within each country, according to the relevant region or social sector. The fundamental aspect in the notion is that it relates to the individual and collective awareness of the civic commitment and responsibility and materializes in a collective objective. To such end, a national concert, approval or consensus is indispensable, according to the social pact.

The notion of tax citizenship arises as a growing notion of radical renewal and, as initially set forth:

[...] the right and will to participate as an action governed by social laws, which is inclusive and responsible, in order to optimize public

wellbeing –and with responsible awareness of individuals in their society, by promoting voluntary commitment towards the correct and ethical exercise of their tax rights and obligations, based on the effectiveness of the Tax Administration and confidence in fair and transparent government expenditure (CEF-SRI).

The 44<sup>th</sup> CIAT General Assembly, held in Montevideo, in April of 2010, highlighted the strategic role of the TA in strengthening citizens' confidence. Among the topics of the conference were the importance of strengthening and improving accountability; enhancing taxpayers' social responsibility, promoting ethics, close monitoring of the tax gap as a means to improve efficiency and efficacy of the tax administration, adequately establishing risk maps and control plans; developing strategies to improve voluntary compliance and tax collection, especially considering the segmented approach for taxpayers in the TAs of Latin American.

The notion is closely related to the progress in terms of effective, responsible and transparent State compliance. The baseline of the tax issue we are addressing is summarized in the ethical-moral notions<sup>1</sup> and the development of commitment, responsibility and citizen awareness in the form of "tax citizenship"; implying ethics as the theory and morality as the practical side, an indivisible supplemental duality. The 2010-2013 Institutional Strategic Plan of the Internal Revenue Service of Ecuador, is the benchmark of the new management model to adjust the processes to strengthen human talent. It adopts the idea of promoting specialization of human skills through education, training and ongoing research, for public officials as well as citizens and taxpayers; fostering and disseminating tax research, promoting spaces for academic discussion in the tax sphere, promoting a training and education program aligned with the improvement of the technical and organizational competencies of public officials, promoting the development of employees in line with equity, wellbeing and performance; standardizing and automating the human resources' sub-systems and improving internal institutional communication.

The plan is strengthened with planning and human resources' management. The management model is enhanced with the Management Improvement Program -PMG, which establishes an integral system for continuous improvement of processes, based on specific projects: standardizing procedures, establishing performance measurement systems and process automation. It establishes the prioritization of high-impact processes and achievement of goals



with the expected outcomes; the value chain analysis is used as an alternative enabling a clear view of the status quo, the goal and the form of overcoming the critical bottlenecks and ensuring streamlined key processes based on teamwork and cooperation.

Corporate security has been approached as the strictest custodian of taxpayer tax information. It occurs in the framework of risk management, improvements in the contentious and collection proceedings. It identifies, quantifies and acts on the evidence of tax evasion, tax avoidance and tax fraud, with preventive, concurrent, reactive and punitive actions based on the risk profile and tax relevance of the taxpayer (Internal Revenue Service- SRI, 2010).

The tax citizenship awareness in line with the tax morale, enable to meet the principles of progressivity, efficiency, equity, transparency and sufficiency in the collection proceedings of the Ecuadorian Tax System to achieve voluntary compliance based on taxpayer confidence arising from the acknowledgement and approval of the SRI and that government investment and spending are sufficient and of excellence. To this purpose, it is vital to rely on “appropriate, integral and timely actions” from different fronts, which carefully provide for “high levels of poverty, inequitable distribution of income and the lack of access to health, education and work for the majority of the Ecuadorian population”.

(Internal Revenue Service - 2010). The initiatives to promote voluntary compliance with tax obligations are centered on the control coverage on the group of taxpayers who show or indicate that they opted for noncompliance or just comply upon coercive and enforced proceedings, based on the classification by segments.

#### **4.1 Ethical-Moral Principles**

The strategic development of the tax morale indicates that the transformation of the traditional State requires making ethics a central element of public functions embodied in specific individuals, who, given their human condition, present weaknesses, dissatisfactions, fears and other psychosocial statuses that bear a daily impact on their behavior. Improving the personal and collective ethical self-critical examination is a key aspect requiring an enabling instrument, and such may be the essence in these principles.

An exceptional momentum to social communication in all its forms, levels and expressions in the participatory development of the tax citizenship may be relevant to reflect upon the prevailing values that we are called to embrace.

Establishing or learning about the ineluctable bond between ethics and intercultural development, theory and practice, reason and emotion, is a sensitive but very constructive exercise. Likewise, incorporating the holistic, lay, religious, ancient and scientific approach and openness in the day to day events is deemed important; ensuring a different kind of human development and rescuing ancient or basic values in the wisdom from all times, which become fundamental and are linked to love, beauty, freedom, justice, solidarity, and service; in line with authenticity, honesty, truthfulness, respect, teamwork, transparency, shared enjoyment, among other essential aspect of human life.

In this complex process for the medium and long-term, the suggestion of “ethical-moral” statements presents an immediate and practical option for reflection.

Ecuador is a constitutional State of rights and justice, which is social, democratic, sovereign, independent, unitary, intercultural, plurinational and lay. It is organized as a Republic with a decentralized form of government.<sup>1</sup> In the course of its political history, Ecuador has wrongly interpreted the foundational sense embodied in the fundamental institutional postulates: republic and democracy. An endless number of scholars have made attempts at explaining and re-directing the vulgar and official definitions of such terms, according to the context, with little success.

The versatile environment generated by the globalization phenomenon, which became more evident in the course of the 21<sup>st</sup> century, has lead the different governments, intellectuals and researchers worldwide, to argue the sense of democracy. Its strict meaning has been transcended - the form of government- and the specific features of their sense of the collective have been analyzed, in other words, democracy has been defined as the mythical articulation enabling the development of life in society.

Within this context, the Center for Tax Studies (CEF) of the Internal Revenue Service (SRI) of Ecuador –with a view to the 45<sup>th</sup> CIAT General Assembly to be held in Quito under the theme “Tax Morale

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*1 National Assembly, Constitution of Ecuador, 2008*

as Determining Factor in improving the effectiveness of the Tax Administration”– has undertaken the project by the name of Tax Citizenship, which seeks to define it within our context and disseminate the meaning thereof. Tax Citizenship is the awareness of individuals, groups and institutions, regarding their responsibility and commitment in building a cohesive, democratic and fair society, based on the exercise of their tax rights and obligations.<sup>2</sup>

In the initial outline of this project, the working group faced the difficult task of analyzing their society, and at that point, multiple questions arose regarding the complexity of society -Ecuadorian society in particular-, since it is vital to consider the historic processes inherent in their culture.

As an initial step towards an answer, society was classified according to categories, based on respect, inter-cultural development and a plurinational approach, combined with the objectives of the Tax Citizenship project enabling to present this idea to the population.

In order to acknowledge the complex effort entailed in classifying a group of individuals, who, at a first glance, do not require classification, we wish to emphasize that this classification is not based on qualities or features inherent in individuals. To the contrary, it is a map, the recognition of subject and social universe, enabling to perform the activities that are relevant to the Tax Administration in building the Tax Citizenship in Ecuador.

Citizenship, rather than destroying the natural balance and the social pact, substitutes moral and legitimate equality that nature may have endowed upon men with physical inequality, which render men equal by convention and law, although being unequal in force and creativity. Rousseau (2004).

Historically, citizenship is understood as the group of individuals belonging to a political community, that is to say, a State. The citizen, the civic-being, responds to different features that legitimate the ideological-political order in effect in a given territory.

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<sup>2</sup> *This definition was developed in the previous document “Tax Citizenship in Ecuador”. Herein, we specify that tax rights guarantee that government expenditure is pertinent, responsible, fair and transparent and that tax obligations constitute the moral obligation of citizens and the collectivity to contribute to support the State of Wellness.*

In modern times, the meaning of citizenship acquires a different significance than the one in ancient societies, which indicated possession of certain property of an elitist nature, only recognizing a group within the population. Such notion implied that not all subjects enjoyed the citizen status. After the Independence of the United States of America and the French Revolution, the interest, from the standpoint of citizenship, became specifically centered on man, rejecting the pre-established cultural differences and also acknowledged equality by assuming the human aspect as the starting point.

Thus, the birth of this new paradigm gave way to citizen actions as a political being and active participant in the political contract. Therefore, the convention by which citizens assumed the commitment of turning their personal interests towards the general wellbeing was legitimated, to allow individuals a different way of living, in line with the philosophical advances of the time. All such innovative changes in the 18<sup>th</sup> century transformed the customary understanding of politics, and paved the way for civil and political rights, as well as duties of subjects, redefining the sense and the role of the citizenry. Although all such postulates are adopted quite simply at the institutional level, they take much longer to become functionally rooted in the culture of a society. Nevertheless, we may assert that citizenship, in the modern sense, establishes and seeks, at all times, an institutionally organized society, enabling the coordination of the overall social group, based on the understanding of men as peers, as citizens as well as subjects of rights and obligations.

In spite of such political-theoretical changes, the struggle to dignify and expand the meaning of citizenship towards the people overall, continued well into the 20<sup>th</sup> century. The philosophical discussion became disputed since, although the notion of citizen had enabled great progress in terms of equal rights, many sectors of society remained marginal to the collective and, even worse, a large number of nations sustained, in practice, the traditional replication of such fragmentary citizenship in response to elitist and ideological interests.

Thus, a large number of discussions attempted to change and re-direct the foundational sense of the citizenry. A very general effort was made to channel the meaning of citizenship within a democratic trend that accepted new and different dynamics, which Habermas defined as "life-world". Currently, the social dynamics are recognized to respond to private interests, and, therefore, we seek to attach new value to the meaning of democratic citizenship, which goes beyond the universal vote, towards citizen participation, in which social practices,

especially the development of the public space, are the task of the overall collective, through communicative consensus that oversees and pursues the common good. Vieira (1998).

Thus, citizenship is deemed the possibility of transforming society, in which the role of the individual is inherently participatory and, therefore, re-dignifies the value of democracy, through an institutional policy of group inclusion and expansion of rights, by which we imagine civil society within a homogeneous and politically egalitarian public space.

All Ecuadorians are citizens and shall enjoy the rights established in the Constitution. The Ecuadorian nationality is the political legal bond between individuals and the State, without detriment to the original peoples coexisting in the pluri-national Ecuador.<sup>3</sup>

The objectives of building and institutional adoption of the Tax Citizenship in Ecuador require re-asserting a social commitment, which sees a path of solidarity in the Ecuadorian collective. Reconsidering the civic-democratic postulates is vital to bring together the state and private spheres, understood as the overall diversity of peoples and visions of the world.

Therefore, such commitment that we all endorse through the Ecuadorian nationality, arises from a political-moral understanding of democracy, which, at this historical time in our national reality, might become the new social organization paradigm: a new form of living in harmony, not without arguments or ideological divergences, but in a context embracing the basic and fundamental theory including every individual on the national territory –the Wellness, the Sumak Kawsay–.

This postulate shall transcend the traditional conception of democracy (understood simply as the general capacity of access to voting rights), and distinguish the symbolic content in which we all enjoy the right, and, to a certain extent, the obligation of knowing how to govern and be governed. It is worth clarifying that this dynamic is not imposed by the system, but is a constant renewal of social needs, always arising from interests of collective importance rather than private, willful and fruitless benefits. Thus, life in solidarity emerges with urgency as the capacity of individuals to adopt an altruistic representation within their behavior and their social inter-subjective actions. It is not a matter of having the good of the other prevail at a high level of social tiers, but rather it is about redirecting and understanding the otherness as a

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<sup>3</sup> *National Assembly, Constitution of Ecuador, 2008.*

proper and mutual recognition, with prevailing reciprocal needs that sustain correspondence among individuals. That is to say, it requires considering others as citizens equal to us.

The Social State and its public administration shall not be conceived as something severed from civil society. To the contrary, it is worth emphasizing that they are made up by citizens whose decisions pursue the wellbeing of the citizenry, who legitimates them politically and economically. There has never been in Ecuadorian history an ethical or responsible management of public policies, since the State was never considered a part of the whole in society, which impaired the generalized direction of the political capital. We believe that the transformation of our society may stem from the renewal of the citizenry, within a context of political participation understanding and assuming the new postulates of the Constitution, as well as the dialectic unity of such importance embodied in the State and the people, as well as the political and economic sphere.

Taxation does not stand to the side of the political debate of democracy, as it is commonly assumed. In fact, as mentioned before, it is a fundamental part of the legitimacy that the people convey upon the State –both citizen spheres–. We shall emphasize that the democratic and representative government necessarily depends on the economic sustenance enabling to carry forward the strategic plan to the benefit of the citizenry. This political-economic project shall encompass the different powers present in society, and these, in turn, shall work in order to secure the stability of the social system, oversee the goods and services pertaining to the people, and enable to guide the social collective towards economic and cultural development.

The Tax Citizenship implemented in Ecuador, which actively adopts the overall political, economic and social debate, shall arise from two maxims:

1. Understanding that citizenship comprises tax citizenship and all tax matters as political legitimating entities.
2. The tax citizenship and tax requirements shall not be understood outside the democratic citizenship, as mentioned.

Such postulates enable us to understand the nature of this whole discussion. This is clearly defined in the Constitution:

“The tax system shall be governed by the principles of generality, progressivity, efficiency, administrative simplicity, currency, equity, transparency and sufficiency. Direct and progressive taxes shall be prioritized.

The tax policy shall promote redistribution and employment, the production of goods and services, and responsible environmental, social and economic behaviors.”

Upon being Ecuadorian, we acquire the nationality and immediately recognize ourselves as citizens, subjects entitled to rights, and in turn, as Tax Citizens, bearers of obligations. It shall not be otherwise. Living in democracy, in a representative State, requires us to acknowledge authority, upon whom we convey our political-economic legitimacy through a pact—with the authority and the rest of the citizens— by which we accept the administration of the public institutions in exchange for an ethical administration that pursues Wellness.

**Resuming the definition of tax citizens:**

Tax Citizenship is the awareness of individuals, groups and institutions, with regards to their responsibility and commitment towards building a cohesive, democratic and fair society, by exercising their tax rights and obligations.

Among the fundamental postulates of the Tax Citizenship we find two well-defined spheres enabling to understand the dynamics in any contract: rights and obligations. In this specific case, we are referring to the tax rights and duties. The tax rights guarantee that government expenditure is pertinent, responsible, fair and transparent. Tax obligations are the moral obligations of citizens and the collectivity of contributing to the support of the State of Wellbeing.

Chart 4: Components of progressivity



*Author: the author.*

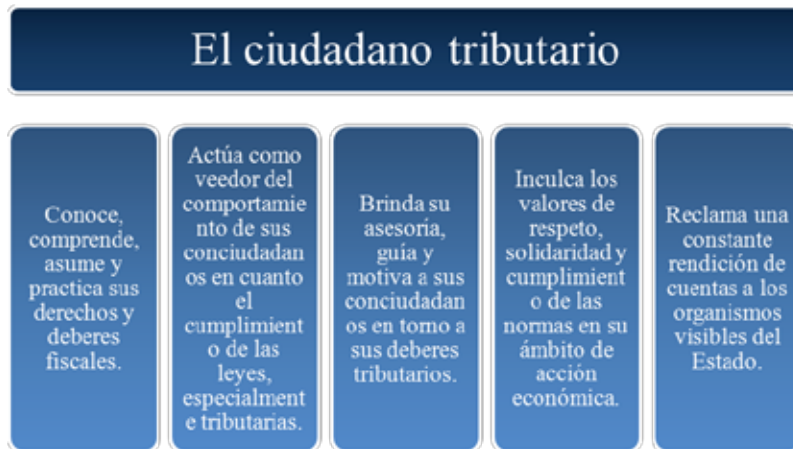
In terms of Tax Citizens' rights, in addition to the benefits that they shall enjoy from an appropriate tax policy, a very strong sense of correlation with their obligations appears, rendering it impossible to understand each field separately. To the contrary, they shall be only understood as a supplemental and mandatory unit intertwined with the citizen. Consequently, the Tax Citizen shall be understood as such to the same extent by which a tax system demands compliance with the constitutional-democratic purposes, paying his taxes in line with the legal provisions of the Administration and demanding that his peers follow suit. Timely and transparent compliance enables to guarantee the principle of progressivity of the tax system (see Chart 4).

Consequently, the definition of the different classification criteria previously requires the Description of the Tax Citizen (see Chart 5).

The classification of Tax Citizenship is directly tied to the democratic citizenship, by which no subject remains excluded from the implicit Wellness project. Therefore, no strict classifications apply to the Tax Citizenship. To the contrary, owing to its nature, we find several classification criteria that help to visualize in practice the scope of action of the Tax Administration.



Chart 5: the Progressivity components.



Author: the author.

The first classification criterion is determined by the age of citizens and the different activities in which they participate. Upon referring to the tax content inherent in citizenship it is evident that there is a minimum basic awareness of the citizen, which is tied to the knowledge and acknowledgement of the State, as well as the belonging thereto. Therefore, although the understanding of the Tax Citizenship phenomenon may vary according to age, the basic notion shall be clearly identifiable and evident for individuals. In the first instance (2-5 years), when an individual meets the State for the first time, he shall learn the quality of the State defined as the administrative entity granting a series of benefits and services, in exchange for his or, rather, his parents' political and economic legitimacy thereof. Despite the lack of clear and specific understanding of such theories, he realizes that he is receiving something in exchange for something on his side. We shall highlight that the family shall instill this first notion as a fundamental task, since it is the first institution to which an individual belongs, and the attitude and stance on the issue of taxation shall be decisive in the future exercise of the Tax Citizenship. In the second instance (6-25 years), we find a very important stage, since to a great extent, the position assumed at the time of paying taxes (in the third instance, specifically), shall depend on the intellectual development acquired in this time period. In the different ages comprised in this timeframe, it is assumed that the majority of boys/girls and youths are undergoing the stage of continuous education. Consequently, it is the time to provide education that comprises the overall issues pertaining to the

democratic citizenship discussed herein. This guarantees, at least in theory, that a new generation shall embrace these discussions, and, moreover, be understood as Tax Citizens with rights and obligations in the political and economic tax sphere. To such purpose, the State shall be aware that since they are still individuals who do not necessarily pay taxes, the results are not short-term. To the contrary, the results expected shall be few, to the extent the family baggage that these subject carry is of utmost importance, even more than the tools the State may employ.

Finally, we find the last social group (26 years and above), the one comprising more taxpayers. Nevertheless, even within this segment, there is no full understanding of what taxes are and imply. In spite of the fact that certain individuals are fully compliant with their tax responsibilities, they are not still conceived as Tax Citizens in the full sense of the word. This is mostly due to the lack of knowledge on the relation between the political debate and the economic or fiscal sphere.

Now, this classification criterion arises or is determined as the duty of being, which is not necessarily tangible in our social reality. In the light of such issues, we set forth the second criterion based on Tax Citizens' legal obligations. Within such sphere, we find two well defined groups: on the one hand, all the individuals still not required paying taxes or who do so automatically, such as the case of adolescent students; and on the other, all the individuals conducting economic activities who cause a series of taxes. This classification criterion enables to gather situations inherent in our society, as the fact that a great majority of individuals become employed once they complete their secondary education, in the best case scenario. Therefore, we shall emphasize the notion of tax behaviors; to the extent the Tax Administration would have less time to deploy tax education strategies (to the pre-employment stage).

It is worth highlighting that the SRI has clearly and precisely identified the individuals it shall deal with in the sphere of tax behavior –the compliance pyramid- and, therefore, this tool becomes relevant since it reflects the purpose of the Administration. Thus, the third criterion is the compliance willingness (Internal Revenue Service - 2010). In general terms, we may describe this pyramid as a scheme of attitudes of the different taxpayers towards taxes, where two well-defined groups may be distinguished: one that cooperates with the tax system and another one who acts against it. Within the first group, we find

all the individuals who are willing to comply and, above these, those who make the attempt, but not always succeed. In the second group, we find individuals who do not wish to comply in the meantime, but, with the surveillance of the tax administration, would do so. Finally, we find the group in which the population has made the final decision to breach the tax system.

Since the fundamental goal is to achieve voluntary compliance by the majority of taxpayers, the tax administration designs and applies the strategic tools to guide individuals towards the base of the pyramid. Nevertheless, we shall emphasize that the tools employed by the SRI in order to exert pressure in their pyramidal classification, shall not be solely aimed at increasing collection, but explaining and understanding that the Tax Citizenship is the basis for taxation, and enables Tax Citizens' self-motivation with awareness, to the extent it promotes a good understanding and comprehension of this overall dynamics within taxpayers' families and surroundings.

The classifications set forth herein are not strict, rigid or inflexible categorizations; to the contrary, they are a form of conceiving and representing the different tax citizens in the social mesh. The classification is presented as a theoretical aid by which to initiate the tax citizenship in Ecuador, subjected and conditioned to future changes, which shall arise as a healthy and fruitful tax culture is established and adopted.

Strategically, the relation of the TA with respect to the educational process in all levels stands as a fundamental condition for the medium-term development of the tax morale as well as the tax citizenship. On such grounds, the SRI, greatly values promoting, encouraging, and supporting the incorporation of contents on tax awareness, the tax morale, the tax citizenship, the fiscal pact, the social pact and social cohesion as elements and factors of the Wellness system and elements of the TAX EDUCATION. Its impact is its acknowledgement as strategic determining factor of tax ethics and the tax morale; therefore, the incorporation of citizen education, as well as compliance by the State, taxpayers' social responsibility, ethical values and principles, the promotion of personal responsible reflection, as the precise moment of citizens development; voluntary compliance and citizen participation in following investment and public spending, are, among others, issues favoring citizen education intensively and with priority; from the most basic educational levels to the most advanced ones.

In line with the educational effort centered on tax education and incorporating the tax citizen approach as the heart or sense of the new integral Nation-State (with civil society), is a challenge involving all the components of academic activity, a collective and systematic momentum shall be given to social communication in all its forms, levels and expressions, articulating with the educational process, according to the development of the tax morale as the axis around which the tax citizenship and social cohesion are built.

Establishing a clear fundamental on the ineluctable relation between ethics and intercultural development is another fundamental determining factor for ethical-moral development; an element in improving citizen awareness, equal to the tax citizenship.

Finally, and as a potential starting point, we may refer to the incorporation of a holistic, lay and scientific approach to human development embodied in every ethical improvement, with the importance of rescuing the fundamental values: love, freedom, justice, full enjoyment, especially aesthetical enjoyment, solidarity-service, authenticity, honesty, truthfulness, respect, teamwork and transparency.

The relation between tax morale and tax citizenship sets forth that the Ecuadorian TA, for the 2011-2021 decade, shall be the binding structure of processes and a strong benchmark of public development, in order to meet the strategic guidelines of building the tax citizenship. A three-phase approach is suggested for the period: firstly, "Tax Education" through the overall educational system; secondly, "Relation with Local Governments" and thirdly, "Continuity and Improving the Tax Citizenship and the National Integration" and one year to evaluate the decade.

In 2011: intensify the education Programs, MEC, Children, Tax-Civic Portal, Middle Education and Higher Education; External Campaigns and events; CIAT General Assembly, Taxation Review, communication campaigns (Tents and Buses) with the tax citizenship brand, tax investigation and the tax lottery; tax education and training with master's courses, programs for Certified Public Accountants, tax consulting for corporations and SMEs, letters of understanding with informal citizens and good practices with the international cooperation of the Ibero-American tax administrations.

The relation with education in all its levels and modalities and the tax culture, renders fruit to the extent the agreements between citizens and the State (fiscal pact and social pact) become more transparent and clearer, and above all, effective. It requires the confidence from individuals and, consequently, the political will of the government in office to cooperate in supporting its community. Approaching the issue of involving the promotion and consolidation of the tax culture is a central matter in the personal process of students, in such a way that it becomes an autonomous process relevant to the motivations, knowledge and activities of each individual, but also a process relying on the solidary willingness of peers, teachers and other relevant specialists with efficiency.

The main hurdle is the limited number of human resources in most government administrations and local-regional and territorial processes. In this regard, we shall focus the great effort of synergies and commonalities in the potential National Coordination Plan for the Development of the Tax Citizenship, educating with dignity and respect the human talent that regards the local identity as well as the cultural diversity with great care and establishing a national operating strategy to train and support the development of this human talent required to conduct the cycle described.

The strategic guidelines being considered for the forthcoming years are centered on the continuity of the “self-diagnosis project to promote ethics”, which is carried out with the participation of the CIAT team, under the leadership of Mrs. Raquel Ayala. This program shall enable to draw the relevant ethical development plan and achieve a “stable integrality model” for the institution. The second fundamental guideline is tax education, to be addressed hereinafter in detail, and the third strategic guideline is centered on the education of human talent with cooperation from the national university system, under the framework of “tax equity”.

Since 2006, the National Higher Education Council (CONESUP, as per the Spanish acronym) has been promoting a national consensus process encompassing three key elements: ethics, culture and academia, calling upon higher education institutions, civil society, trade organizations, the State, NGOs, among others (known as the Ethical, Cultural and Academic Concert –ECA, as per the Spanish acronym). It understands that one of the keys in national development is consolidating alliances, synergies and the broad articulation centered on strengthening national coordination around ethics, culture and

academia. Ethics is deemed the binding axis, communication as the fluid that enables process execution and education as the beacon of a broad and participatory process. This evidences that different sectors have been exploring aspects relative to the topic under discussion today.

The alliance between education and the tax administration, rather than a bet or a contextual option, is a strategic objective on which international consensus is being achieved and is currently promoted by the Inter-American Center of Tax Administrations (CIAT) as quoted hereunder:

“Inefficacy, lack of control from authorities, noncompliance with administrative or legal procedures or the absence thereof, the lack of legal certainty and taxpayer assistance, among others, promote the lack of integrity in any organization, whether public or private.

The tax administration is not foreign to the phenomenon and suffers, by the nature of its role, the effects and consequences of the lack of integrity, in many cases even preventing and preventing the achievement of its strategic objectives.

Based on such reality, the TAs, with the support of CIAT, have been developing for a number of years, strategies, instruments and tools to promote ethics in their organizations, based on prioritizing preventive and proactive behaviors rather than corrective actions. Among other objectives, they seek to build the “Tax Citizenship”, such the name of a notion encompassing not only improving and controlling processes, but also tax education as the basis and support for the organization and the citizens”. (Ayala, 2009)

Education and tax morale emerge as intertwined entities in the heart of the process known as: “Tax Citizenship”, owing to the joint and persevering effort of CIAT and in pursuit of a final solution to the issues described. Evidently, the scope of the issues facing the tax administrations frequently makes their goals exceed their own responsibilities and functions.

Therefore, certain challenges shall be necessarily approached with synergies, alliances and agreements with other areas, institutions or sectors of society, with the alternative of inducing the fiscal pact towards the social pact.

## **4.2. Education and training of human talent in the institution**

In 2008 the Internal Revenue Service creates the Center for Tax Studies of Ecuador –CEF (launched on 21 July), which constitutes a landmark in institutional development, a decisive step in developing education and training initiatives of the institution's human talent, which has become a national model in terms of public administration development owing to its success.

In the current stage, the State may represent in the medium-term the decisive instrument in attaining a democratic and fair society. The reform of the State is a crucial step that shall be taken according to a strategy, plan, and institutional strategic map, in line with the political will that shall rely on a homogeneous skilled and knowledgeable force, willing to face the hurdles that may arise, defined as the institutional human talent.

Firstly, the CEF shall internally acquire such strengths, in order to share them thereafter. It shall pursue the specialization of a motivated institutional human talent, with great professionalism and sense of ethics as fundamental elements for the efficiency and effectiveness of their contribution to the qualitative improvement of the tax administration in the country. To such end, ongoing classroom and virtual academic activities are implemented.

The Center for Tax Studies - CEF, has undertaken diverse actions in terms of human resources training and ongoing research of tax issues, from which we may highlight a broad array of human resources' education actions and ongoing research of tax topics. The following are amongst the most important: "Until 2009, 63 research tax projects were undertaken with different institutions. During that year, 126 classroom courses were delivered for a total of 3,206 participants, four education events on the virtual platform reaching all the institution's public officials and five international events featuring exchange of experiences among the Tax Administrations. In 2010, human resources were trained for the self-diagnosis process to promote ethics at the institutional level and prepare, with the assistance of the Inter-American Center of Tax Administrations a "Plan for the Promotion of Ethics". "The CEF also opened the Master's Course on Tax Administration, in collaboration with the National Institute for Higher Education".

Building the tax citizenship is a priority and strategic objective for the TA of Ecuador, it constitutes an element in the initiative to expand

the New Tax System, part of the new State Economic Policy in guaranteeing national development, especially in the social sphere. In order to strengthen this initiative, the TA is considering the designation of an ad hoc team that becomes the originator and leader of the overall institutional deployment in such respect. The alternative under consideration is that the issue becomes a new working area in the Center for Tax Studies - CEF, establishing a triangulation with the studies, analysis and research on tax issues and with academic work, for the institution's public officials as well as taxpayers.

#### **4.3. Incorporating tax contents in elementary-middle school curricula and undergraduate and postgraduate courses at the national level.**

Tax contents have been incorporated in the elementary and middle school curricula through different processes, including:

- Basic education book (2 volumes).
- Baccalaureates" Book.
- Informational brochures (involving the full taxpayer cycle, in addition to other topics such as ICE, rural land, among others).
- Special guide on formal taxpayer obligations.

With regards to the incorporation of Tax Administration topics in undergraduate and postgraduate courses, we have devised a MANDATORY TAX CULTURE COURSE FOR GRADUATE PROFESSIONALS of the higher education courses, which account for approximately fifty-thousand professionals yearly (22 hours plus the corresponding examination). The Specific Objectives are:

1. Validating the tax knowledge of all future professionals with a minimum score.
2. Verifying that the knowledge gap is bridged prior to initiating their professional practice.
3. Making the future professional aware of the importance of the tax culture.

Contents on the Tax Education Course have been developed. Basic material is available on the Tax Education Course for university students in the following careers: Engineering, Economics, Medical School, Architecture and Administration. Certain higher education institutions in the country offer specific careers in the tax sphere, and likewise, also deliver courses on the topics mentioned.



This year, 1,846 students from 43 schools of the province shall participate in the Tax Education and Training Action Camp. This year's participant outnumbered those in 2009, with 1,600 students. In this area, each student studies and learns about the tax culture, in order to convey the knowledge to close relatives and friends, attaching a multiplying effect to the process.

For schools, the courses are delivered on Saturdays at the SRI facilities, where most of the attendees are students from the Accounting and Administrations schools. Also, the institution trains schoolteachers on tax matters and provides a workbook for Elementary Schools.

## **5. CONCLUSIONS**

Tax Citizenship emerges in Ecuador as a potential solution to the eternal political problem we have become accustomed to. It is not a matter of thinking about different notions, but of devising a new paradigm combining the cultural baggage, which we know and belong to, to transform it into a modern- communitarian sphere in which, holistically and dialectically, all social groups present in Ecuadorian society shall access the advantages foreseen from the citizen-State.

The idea is not to homogenize a Nation marked by the peculiarities and differences. The central idea of establishing the Tax Citizenship is to recover the postulates of citizenship and democracy, to gain ownership over them and build a State in which, on the basis of the strong heterogeneity, we learn to recognize ourselves in the other, within the covenant that citizenship implies –the latter being the catalyst of the political, economic and tax spheres.–.

On the other hand, we wish to highlight that all such discussions are inherent in society, and that no sphere is excluded therefrom. Consequently, the key parameter for the classification herein was the innate quality of tax citizens. Overall, the classification set forth herein seeks to facilitate the role of the Tax Administration in the institutional embracement of the Tax Citizenship, always in pursuit of Wellness.

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**ANNEX 1****1. INTER-INSTITUTIONAL COOPERATION PROGRAM ON TAX EDUCATION 2011: "TAX MORALE AND TAX CITIZENSHIP"****1.1 ELEMENTARY AND MIDDLE SCHOOL:**

- 1.1.1 Unify at the inter-institutional level criteria, trends and strategies in the INTER-INSTITUTIONAL COOPERATION PROGRAM ON TAX EDUCATION – PICEF/1 (MEC)
- 1.1.2 Agreements on inter-institutional cooperation mechanisms at the national and territorial-local level - 2020.
- 1.1.3 PLANNING: Developing the Strategic Map PICEF/1: strategic axes, objectives, programs, actors, results, duration, institution responsible for execution; monitoring and evaluation plan. First quarter of 2011.
- 1.1.4 Execution for 2011, results, responsible parties, terms.
- 1.1.5 Monitoring and evaluation, results, responsible parties, terms.

**1.2 HIGHER EDUCATION:**

- 1.2.1 Unify at the inter-institutional level criteria, trends and strategies in the INTER-INSTITUTIONAL COOPERATION PROGRAM ON TAX EDUCATION –PICEF/2. (Higher Education System. Former CONESUP).
- 1.2.2 Agreements on inter-institutional cooperation mechanisms at the national and territorial-local level - 2020. Suggested for 2010 (Higher Education System. Former CONESUP).
- 1.2.3 Strategic Map PICEF/2: strategic axes, objectives, programs, actors, results, duration, institution responsible for execution. First quarter of 2011.
- 1.2.4 Execution for 2011, results, responsible parties, terms.
- 1.2.5 Monitoring and evaluation, results, responsible parties, terms.

## **Methodology**

Strategies, mechanisms, planning and exchange programs and internal and inter- institutional support.

To promote a high level of exchange of experiences and consulting, especially for education and research sectors, in the public as well as private sphere. To ensure compliance based on knowledge, transparency and massive dynamization of audits in the local-territorial and national level. It considers the concern that changes expand their incidence through communication, cooperation and exchange based on all social sectors, even the traditionally antagonistic, creating trends that converge in a legally more stable social situation, with better security and equity, which is strengthened in the collective and flows with the spirit of solidarity, which is transmissible. The support of educational institutions in all their levels is central to this process as well as the solidary participation of citizens with the personal and collective responsible reflecting (RPR).

Strategy: performance criteria to build the tax morale and the tax citizenship; developing strategies; clarifying objectives; commitment of relevant actors; contact, relation and exchange strategies internally and externally (Information management); operating and inter-institutional coordination strategy (Alliances and networks); strategy to design and execute joint project and programs.

Internal coordination activities: minimum coordination unit (2 or 3 individuals); coordination network: minimum structure with two units; communication channels; alternatives for institutional supplementation; prioritization and focus of activities; concentration on continuity tasks; analysis of the immediate surrounding; strategic cyclical study; impact studies and government capacity; participation promotion strategies; production, analysis and systematic selection of initiatives; participatory adjustment and execution measures.

Immediate tasks: improvement in communication efficiency (channels, speed, supplemental objectives); shared ongoing self-education capacity; integral management processes; improvement of communication channels; prioritization and focus of activities; change, roles and responsibilities analysis; focus on immediate continuity tasks and strategic continuity applied to the development of tax education. Inter-institutional cooperation: strategic cooperation guidelines; strategies with public sector, private and other actors (NGOs);

promotion of decentralized processes; promotion of active exchange events, good practices in building the tax morale and tax citizenship as part of the tax education initiative; consensuses on the 2011 goals for coordination and cooperation activities, joint and inter-institutional projects and assessment of the lessons learned; adjusting and approving goals, actors, terms, resources, funding sources and others. Territories: systematic expansion of the TA progress and experiences in the country and the hemisphere; consulting and exchanges for 2011; priority analysis of the planning processes by sectors, monitoring, support and incentives; available paths and alternatives; stations, visits or exchange cycles, communication, monitoring and continuity; shared development of capacities and competencies (Observation, receptivity, communication, analysis, collective production of proposals, cooperation, team decision-making, negotiation, conflict solution, practices, continuity and evaluation).

## **ANNEX 2**

### **National Campaign “Tax Morale and Tax Citizenship 2011” Identifying Execution Actors**

Internal circle of actors involved: identifying, determining profiles, roles and responsibilities, communication, exchange, cooperation and joint work mechanisms.

External circle of beneficiary actors involved: identifying, determining profiles, roles and responsibilities, communication, exchange, cooperation and joint work mechanisms.

External circle of beneficiary actors not involved: identifying, determining profiles, roles and responsibilities, communication, exchange, cooperation and joint work mechanisms.

#### **Project launching:**

Coordination with the “Ethical, Cultural and Academic Concert Agreement” (extending the one signed in 2006; special agreement with the media), inviting individuals, groups, public and private institutions, the media, international agencies and NGOs, to participate in the campaign.



## THE STRATEGIC PLANS AND TAX MORALE

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*Contents: Introduction – 1. SAT work philosophy – 1.1 Mission – 1.2 Vision – 1.3 Values – 1.4 SAQB'E – 1.5 SAQB'E as the SAT work philosophy – 2. Tax Compliance in the Institutional Strategic Plan for 2011-2013 – 2.1 Improving tax compliance and reducing tax evasion "Taxpayers' payment shall be accurate." – 2.2 Improving the quality of taxpayer service "Good, Fast and Easy Service" – 2.3 Improving institutional effectiveness "Effective, Integral and Transparent SAT" – 3. Final remarks – 4. Bibliography*

### INTRODUCTION

In Guatemala, the Political Constitution of the Republic governs the principle of tax legality with the purpose of avoiding arbitrariness and abuse of power, and regulating the Tax Administration-taxpayer relationship appropriately.

In Article 239, the Magna Carta sets forth:

**"The principle of legality.** It constitutes the exclusive power of the Parliament of the Republic to decide on regular and special taxes, local taxes and special contributions, pursuant to the needs of the State and in compliance with tax equity and tax justice, as well as to determine the grounds for taxation, especially:

- a. The generating event underlying the tax relationship;
- b. Exemptions;
- c. The relevant taxpayer and joint responsibility;
- d. The tax base and the type of taxes;
- e. Deductions, discounts, reductions and penalties; and
- f. Tax breaches and sanctions.



The provisions ranking below the law, which contradict or mischaracterize the legal norms that govern the tax bases, are deemed null ipso jure. Regulations shall not modify such bases and shall strictly govern matters relative to administrative collection and establishing the procedures to facilitate tax collection.”

Although the principle of legality set forth in the Constitution does not explicitly refer to the tax morale understood as the intrinsic motivation to meet tax obligations, Article 135 defines, among others, the **following** civic rights:

“**Civic duties and rights.** The Guatemalan people hold the following rights and duties, in addition to those set forth in other norms in the Constitution and laws of the Republic:

g. To contribute to government spending as provided for by law;”

Likewise, sub-section three of the Organic Law of the Superintendency of Tax Administration (Parliament Decree Number 1-98), sets forth:

“It is compelling to promote compliance with tax obligations, to be achieved by combating tax evasion, tax fraud and contraband, simplifying procedures, with improved effectiveness of the systems employed in collection and better taxpayer service, in order to raise the tax morale of responsible taxpayers who meet their obligations.”

With the experience gathered in twelve years of operation and in line with the international research trends that study the grounds for tax compliance and non-compliance in depth and their relation with tax policy, the Tax Administration of Guatemala has phased-in action courses in its working and operating style. Such courses, in addition to applying the usual coercive mechanisms, promote the development of the tax morale among the population.

This document seeks to describe the effort by the SAT of Guatemala to permeate citizens’ conscience regarding their rights and obligations as taxpayer and tax bearer. To such end, it presents a brief overview of the main legal principles governing the tax administration-taxpayer relationship, followed by the description of the work philosophy of the institution and provides an in-depth analysis of the SAQB’E as an integral system of the methods that SAT employs in performing its functions and delivering the services to taxpayers. Subsequently, it presents the content of the Institutional Strategic Plan for 2011-2013

to promote tax compliance as a pivotal pillar for agency performance, and concludes with specific remarks on the expected outcomes of the actions undertaken by SAT of Guatemala on the promotion of the tax morale in the current and potential taxpayer.

## **1. SAT WORK PHILOSOPHY**

In SAT, as well as in other organizations, the principles that drive planning and performance are chiefly the mission, the strategic vision and the institutional values.

### **1.1 Mission**

“To collect the funds required for the State to render the vital services and offer Guatemalans better advancement opportunities, by obtaining the maximum yield from taxes; to enforce the tax and customs legislation with fairness and to the fullest extent; and to facilitate citizens’ voluntary compliance with tax and customs obligations”.

“To collect the taxes enforced by the State effectively”.

### **1.2 Vision**

“To stand as a modern institution, prestigious and credible, which manages the tax and customs system effectively and with transparency, applying the best tax performance and administration practices, producing value for citizens, taxpayers and its officials and employees”.

“Paying taxes easily and accurately”

### **1.3 Values**

Pursuant to tax laws and in line with the contents set forth in the institutional vision and mission, all SAT officials and employees shall abide by a set of principles and values deemed vital to honor the commitment towards taxpayers, users and the population overall. Such values comprise:

**1.1.1. Responsibility**, all the functions and tasks that the tax administration officials and employees shall undertake are carried out effectively and timely with discipline and esprit de corps.

- 1.1.2. Transparency**, all the attitudes and actions of SAT officials and employees are aligned with the moral and social norms of conduct governed by ethics.
- 1.1.3. Productivity**, all the attitudes and actions of SAT officials and employees are aimed at making the best use of resources, to ensure the appropriate use of work material to achieve the expected results.
- 1.1.4. Integrity**, all the functions and tasks assigned to SAT officials are carried out with honesty, irreproachable behavior, and consistency in thoughts, expressions and actions.
- 1.1.5. Professionalism**, all the functions and tasks assigned to SAT officials and employees seek to duly apply knowledge with skill and effort until the expected results are achieved, with passion for excellence.

The mission brings the institution closer to the State, while the vision brings SAT closer to Guatemalans and the values are necessary to achieve the objectives.

In summary, SAT holds an economic commitment towards the State, a moral commitment towards Guatemalans and a human commitment towards values.

#### **1.4 SAQB´E**

In 2006 and with the support of the Inter-American Center of Tax Administrations (CIAT), SAT developed a new technological tool in order to align performance to fulfill the institutional mission, achieve the vision and strengthen the institutional values.

This tool integrates digital document administration and workflow management into one platform. The new platform was originally implemented in 2007 for the customs sector.

During the development and implementation process, an internal contest was organized to give a name to the set of tools.

The successful name was **SAQB´E**, which in several Mayan languages means **“White and Transparent Path”**.

In SAT and in line with the foregoing, SAQB´E represents a new work philosophy, arising from the internal development of SAT, aimed at collecting the resources required for the State, while facilitating

Guatemalans' compliance with tax obligations, with transparency and efficiency in its operation.

### 1.5 SAQB'E as the SAT work philosophy

The SAQB'E philosophy sets forth that the Tax Administration shall meet the objectives of fulfilling its mission of collecting the resources required by the State and the vision of paying taxes easily and accurately, based on its institutional values and by always pursuing excellence in any internal and external administrative proceeding it undertakes.

#### 1.5.1 Direct and indirect benefits:

By relying on the SAQB'E work philosophy, SAT expects to reap the following benefits:

- a. **TO PROJECT** the philosophy upon the whole institution in order to position and disseminate the results from the institutional projects aimed at making the Tax Administration more transparent and efficient.
- b. **TO GENERATE** reasonable and realistic expectations among the public opinion.
- c. **TO CONTRIBUTE** in strengthening the SAT image and enhancing its credibility.
- d. **TO POSITION** the institution as the pioneer in Public Sector Modernization and Transparency.
- e. **TO RENDER** SAT as the first Public Sector Institution that relies on a work philosophy.
- f. **TO ESTABLISH** a defined course of action, transcending the years.

#### 1.5.2 Concrete implications of SAQB'E in SAT

SAQB'E is a path, the white path, which is correct, transparent and efficient. Just as any path, SAQB'E requires several fundamentals in its development. Such fundamentals are grouped under four pillars:

- a. **Human resources.**
- b. **Security.**
- c. **Infrastructure.**
- d. **Processes.**

Overall, the changes and improvements in each of these four pillars shall lead along the road of SAT where institutional values are experienced and perceived in the internal as well as external sphere; where increasingly greater excellence and transparency is pursued in furthering the mission and fulfilling the vision of an Easy and Accurate SAT.

Notwithstanding the foregoing, a critical success factor in building a solid path that prevails is that any effort shall be carried out in the framework of quality performance.

The SAQB'E philosophy pursues quality performance in all the tasks of the tax administration, to meet internal as well as external expectations regarding facilitation, standardization, excellence, efficiency and thorough compliance with the regulations in effect.

According to this quality performance, the organization shall shift to the process-based performance approach, with continuous improvement, working with a systemic and holistic approach in the operational evolution, based on the available technologies and research on best practices.

For quality performance and the process-based performance approach to become rooted in the institution, an institutional methodology shall be maintained and applied, which enables the administration and development of processes and quality performance.

**a. The human resources' pillar**

The SAQB'E philosophy seeks professional human resources with commitment towards the mission, vision and institutional values of SAT.

In that sense, the following are expected:

- Personnel shall be reliable, since they have passed reliability tests. They shall be hired, evaluated and assigned functionally pursuant to the procedures established and in line with the administrative career path.
- Personnel shall feature a service-centered attitude towards internal as well as external customers, act in compliance with the code of ethics, the institutional values, and the procedures and norms in effect, and be mindful of their personal image and, above

- all, show professionalism as well as kindness and respect.
- Personnel shall feature technical qualifications or professional specialization, according to the businesses' requirements, enabling them to perform their functions appropriately and with authority.
- Personnel shall earn compensation, according to the career plan, performance and compliance with institutional objectives; with internal equity, consistent with the labor market. Career path participation and permanence in the institution is promoted.

**b. Security pillar**

The SAQB'E philosophy is based on Security mechanisms that promote the sense of certainty regarding the proceedings conducted under SAT jurisdiction, to guarantee the operational continuity of the Institution and contribute to creating and maintaining an appropriate working and service environment, in line with the SAT mission and vision, and according to institutional values.

Within the security sphere, we must apply:

- Security protocols for individuals' access and permanence in SAT facilities, as well as to protect the assets of the Institution.
- Industrial safety protocols, according to the industrial safety standards in effect, enabling to keep facilities safe.
- Mechanisms that enable SAT personnel to be identifiable inside facilities.
- Policies that govern access to information and such access shall be recorded and restricted according to the access level profile of individuals and the type of information.

Likewise, the use of technology shall consider data security and transaction traceability, as well as recording and detection of anomalies, with the lowest degree of disruption for users.

**c. Physical and technological infrastructure pillar.**

The SAQB'E philosophy seeks to operate in appropriate and equipped facilities that provide for high level of service according to the institutional vision and values. To such end, the following are deemed relevant:

- A suitable, comfortable, accessible and standardized environment to render the service, for our personnel as well as customers.

- In Customs, a common area for SAT and the other entities that must render services in our facilities, under the vision that all actors operate jointly under the notion of land port.
- Equipment to facilitate communication and interaction between our personnel and customers.
- Infrastructure supporting the degree of systematization and/or automation for the institutional operation.

**d. Process-based performance pillar**

The SAQB'E philosophy entails shifting the business towards process-based performance. To such end, the following three key elements have been identified for performance improvement:

1. A systemic approach.
2. The importance of identifying, defining, documenting and updating processes.
3. Business processes are developed by applying the workflow management tool and the available technology, provided it has been approved by the institution.

Processes are developed according to the following key criteria:

- Compliance with legislation.
- Simplification and standardization, pursuing greater use of the Internet.
- Avoiding discretionary behavior and increasing transparency.

With a view to having sufficient resources, according to the business requirements and the maximum timeframes to process the different formalities in SAT, the operation is monitored with performance indicators incorporated in the technological platform.

The process automation with the platform enables the following:

- An integral tool that does not require logging in and out of different applications, with information accessible from a single location.
- Streamlined and expeditious formalities, with simplified processes and automated controls, with information-crossing among systems.
- It facilitates performance indicators' monitoring to improve the service level and efficiency of our operations.

- It reduces the discretionary behavior of our personnel, consequently improving our working environment and enhancing confidence for our customers.
- It enables working with uninterrupted flows and electronic processing of internal files, avoiding the need to move physical documents.
- It allows users to monitor their formalities via the Internet, thus increasing transparency.
- It facilitates more Internet-based formalities with SAT, gradually leading users towards the virtual SAT.

Pursuant to Superintendency resolution No. SAT-S-456-2008, the governing entity for the process-based performance platform -SAQB'E- is made up by the following three bodies: the General Secretariat, the IT Department and the Planning and Institutional Development Department.

## **2. TAX COMPLIANCE IN THE INSTITUTIONAL STRATEGIC PLAN FOR 2011-2013**

Based on the end and purpose set forth in the institutional mission and vision, SAT incorporates and explains the objectives and means by which they shall be attained on the Institutional Strategic Plan.

For the purpose of this paper, we shall highlight the actions in each one of the key elements of the Plan, since each one of them and the operation of the whole shall enable us to fulfill the strategic objectives of the three-year period.

### **2.1 Improving tax compliance and reducing tax evasion. "Taxpayers' payment shall be accurate."**

From the standpoint of SAT *raison d'être*, this objective bears the greatest impact with regards to substantial results, and relates to the actions undertaken to achieve an improvement in taxpayers' level of tax compliance and, therefore, a reduction in tax evasion.

It seeks to increase collection to the fullest extent possible by having taxpayers pay the applicable taxes; increasing risk perception and the possibility of detecting and punishing noncompliance.



### **2.1.1 Increasing taxpayers' risk perception.**

The aim is to increase awareness among taxpayers and the overall population regarding the possibility of being detected as noncompliant with tax obligations. Therefore, specific actions have been considered to redefine the risk analysis policy by incorporating new risk management models, focusing on selective audits, and informing the population of the results of implemented actions.

The key projects and actions defined to achieve this objective are the following:

- Improving security of the electronic VAT form, and reviewing the forms for the year that is filed.
- Compelling taxpayers who file statements with a payment amount equal to zero to use electronic media.
- Redefining the strategy of joint efforts and tax audits.
- Redefining the Ex-post Control Model.
- Systematizing risk analysis in customs areas, incorporating fixed rules for customs proposals.
- Coordinating risk management at the inter-institutional level, to promote integral audits by all the entities involved.
- Focusing selective tax audits on the most recent fiscal years.
- Promoting/driving the approval of legislation enforcing customs penalties and apply temporary regulations in the meantime.
- Forming an institutional working group with the main role of coordinating tax intelligence between internal risk management and foreign trade efforts.
- Defining the grounds for internal economic tax studies and foreign trade studies, by activity or group of taxpayers according to the risk profile.
- Including risk in multinational corporations on the risk management models.

### **2.1.2 Increasing tax compliance and timely compliance.**

This objective seeks to incorporate new effective taxpayers into the tax base. It identifies and demands compliance, within the term established by tax legislation, from individuals who are registered for different taxes and fail to file their statements and pay their taxes.

The key projects and actions defined to achieve this objective are the following:

- 
- Requiring and/or verifying the use of electronic media from specific groups of taxpayers.
  - Establishing criteria for the mandatory use of the electronic invoicing system for special taxpayers.

### **2.1.3 Improving the effectiveness of enforced proceedings.**

It is aimed at improving the effectiveness of enforced proceedings.

The key projects and actions defined to achieve this objective are the following:

- Filing high-impact cases in Court.
- Implementing the electronic attachment System.
- Providing legal assistance and ongoing training in the following stages: registration, massive audit and control, administrative collection, taxation and audits' resolution, and in the foreign trade sphere, in processing allegations.
- Strengthening the process to unify institutional criteria.
- Classifying the portfolio according to the collection potential, to prioritize court proceedings.
- Redefining the strategy and enforced proceedings' efforts; expediting internal processing timeframes, implementing performance controls – including the coercive economic proceedings, contentious-administrative proceedings, criminal proceedings, etc.
- Coordinating the creation of an Institutional working group whose main role is to identify loopholes or legal vacuums and the promotion and advancement of tax reforms.

### **2.1.4 Improving the effectiveness and broadening the scope of tax audits.**

The aim is to improve effectiveness of taxpayers' audits and controls, by broadening their scope upon increasing foreign trade audits.

The key projects and actions defined to achieve this objective are the following:

- Increasing the use of information-crossing initiatives based on internal and external sources (forms, electronic invoices, *reten/SR*, *asistelibros*, etc.).
- Increasing foreign trade audits.

- Prioritizing quality instead of quantity in the execution of selective audits.
- Incorporating fields on the existing forms enabling the control of payments from actions in the first instance of the audit proceeding.
- Creating a working team to conduct expeditious audits and develop a brief procedure to collect differences.
- Strengthening regulations and the procedures to determine the source of tax credits' refunds.

### **2.1.5 Improving the effectiveness and the scope of audits and controls in the administrative collection stage.**

This new objective seeks to improve effectiveness in the administrative collection stage, in order to increase tax collection in the short-term and reduce tax omissions in the long term.

The main action defined to achieve this objective is the following:

- Improving control mechanisms to authorize documents and to enable taxpayers to settle pending situations.

### **2.1.6 Broadening customs performance control processes and extending their scope.**

This objective pursues greater effectiveness in customs controls enabling stronger controls and broadening customs scope of performance.

The key projects and actions defined to achieve this objective are the following:

- Redefining the action strategy of the Inter-institutional Commission for Prevention and Combat of Contraband and Customs Fraud. It includes the promotion of the actions executed, and strengthening audits in maritime customs.
- Redefining the strategy for customs compliance supervision and the enforcement of customs proceedings.
- Completing the implementation of the customs traffic control initiative based on satellite devices.
- Redefining the customs dispatch control logistics centered on deploying more personnel for immediate controls.
- Completing the implementation of the Safe Customs initiative in the three maritime customs.

- 
- Establishing an assessment base for the goods based on inputs from internal and external sources.
  - Establishing procedures and regulations arising from the new insurance act (substituting bonds with insurance).
  - Improving controls in the systems for grace periods and exemptions.
  - Defining and implementing a strategy enabling to increase the effectiveness of controls in customs facilities and their systematization.

## **2.2 Improving the quality of taxpayer service. “Good, Fast and Easy Service”**

The success of the tax performance greatly depends on the communication, relation and service towards taxpayers, users and the general population. This objective entails implementing a quality of service management model, by which the taxpayer is acknowledged as a Tax Administration and Customs Administration Customer.

### **2.2.1 Simplifying tax and customs compliance.**

The aim is to continue with the actions to simplify and expedite the main proceedings relative to internal and foreign trade taxes, and achieve significant improvement in quality of service as well as assistance and guidance for taxpayers, based on the organization of the information available on the portal for taxpayers to query and minimizing the discretionary approach towards the enforcement of procedures and requirements.

The key projects and actions defined to achieve this objective are the following:

- Forwarding information to taxpayers by target group employing all the available means, including voice messages.
- Creating the Training Portal.
- Completing the implementation of the alternative option to *BancaSAT* to file and pay taxes, without requiring a bank account *-DeclaraGUATE-*.
- Expediting customs proceedings and dispatching formalities.
- Expediting tax registration procedures and registration of vehicles with the tax authority.
- Electronic communication of procedures and requirement for compliance with tax obligations (internal taxes and foreign trade).

- Implementing an electronic accounting system for Micro, Small and Medium-Sized Enterprises (*Cuenta Cabal*).
- Systematizing customs relief procedures.
- Continuing with the implementation of the Authorized Economic Operator.
- Training taxpayers and registered individuals by prioritizing the use of virtual media.
- Analyzing and organizing the information available on the SAT portal, and drafting regulations to update and standardize the information.
- Assessing the effectiveness of the implementation of *INFOCENTROS* and if considered functional, installing *INFOCENTROS* in the San Rafael Tax Agency and the venues of the Northeastern Regional offices (Zacapa) and Southern offices (Escuintla).
- Implementing a platform enabling the online assessment of the service rendered by technical experts and professionals through the SAT windows.
- Measuring at the national level the degree of taxpayer satisfaction with the service rendered.
- Minimizing discretionary application of the procedures and requirements in all the SAT service and customs offices.
- Assessing the feasibility of extending the office hours in SAT and customs.
- Implementing the Human Resources Organization System in Tax Offices.

### **2.2.2 Promoting the tax culture.**

This program seeks to create awareness in potential taxpayers, chiefly children and youths, by instilling a positive attitude towards the civic duty of paying taxes. To such end, the guiding principle is that the State requires resources mainly arising from the taxes paid by taxpayers, in order to meet its constitutional mandate of ensuring the common good and providing the population with the basic services it requires.

Taxes may be paid by using coercion or appealing to reason. Force is set forth in laws and their mandatory compliance, while reason may be driven only by Tax Culture with solid grounds.

Undoubtedly, a significant incentive (or disincentive) for taxation is the management and use of public funds, in addition to the fact that, for many citizens, paying taxes is a discretionary act, in line with their positive or negative perception of the use of funds.

One of the tax education objectives is precisely to break that vicious circle and create awareness on the fact that taxation is not just a legal obligation, but a duty of each individual before society. Likewise, citizens shall be convinced that meeting such responsibility confers the moral authority required to demand that the State makes the appropriate and transparent use of public resources.

In order to strengthen the Tax Culture (understood as the set of values, beliefs and attitudes shared by a social group with respect to taxation and its governing laws, which leads to permanent compliance with tax duties), the population is required to learn about the issue and understand the importance of their tax responsibilities.

Such understanding shall be based on timely information and appropriate education, which shall lead to the acceptance arising from awareness. It is vital to achieve strong and sustainable collection in the middle and long term, to facilitate honoring Peace Agreements and the Fiscal Agreement commitments.

In summary, the central axes involved in promoting the Tax Culture are information, education and awareness, which are articulated around reason as the desirable fundamental driver of the act of paying taxes, and they are incorporated in a communication strategy with the key message:

“In order for the State to meet its obligations, I, the citizen, shall assume my responsibility of paying taxes, since in doing so, I am supporting Guatemala.”

In this context, for 2011-2013, we seek to promote and deepen the tax culture in the population, by extending and strengthening the actions to sponsor and disseminate the tax culture.

The key actions defined to achieve this objective are the following:

- Extending and strengthening the actions to sponsor the tax culture in the education system.
- Strengthening the programs for tax culture dissemination and promotion of civic values.

### **2.3 Improving institutional effectiveness. “Effective, Integral and Transparent SAT”**

In order to improve tax compliance and the quality of taxpayer service, it is vital to enhance institutional effectiveness by means of efforts to improve organizational, management and information systems, as well as the physical infrastructure and the equipment of the tax and customs administration facilities.

#### **2.3.1 Strengthening the human resource capital.**

This objective seeks to continue with the actions enabling to strengthen and develop SAT human resources.

The main projects and actions defined in attaining this objective are the following:

- Establishing a human resources policy that supports the implementation of the institutional strategy of integral control.
- Deploying the appropriate number of individuals to all the Institutional processes, prior evaluation of workloads, considering the reallocation of positions.
- Designing and executing effective training and specialization programs, focused on the development of competencies.
- Strengthening results' evaluation criteria (including performance assessment, merits and demerits).
- Assess the salary structures at the institutional level in 2012, by job family.

#### **2.3.2 Promoting the quality and control of information systems.**

This objective seeks to pursue the improvement of the quality of the information available to SAT, including the aspects relative to information collection, processing, quality, and its use.

The key projects and actions defined to achieve this objective are the following:

- Updating and disseminating the IT Strategic Plan.
- Refining the information on the current account and extending its scope.
- Defining the needs for interconnection of computer applications and priority assistance thereof.

- Evaluate and stabilize the SAQB'E system.
- Evaluate the option to improve the current RTU system or the creation of a new Unified Tax Registry system.
- Implement the ITIL methodology on service level management procedures.
- Enter into an agreement with RENAP for regular updates of the list of deceased citizens for SAT.

### **2.3.3 Improving and maintaining the infrastructure and the physical, technological and operational security.**

This objective seeks to provide SAT with physical, technological and operational infrastructure that meets the minimum requirements to provide efficient service for taxpayers, facilitate minimum conditions for officials and employees, and to rely on mechanisms that secure physical, technological and operational security.

The key projects and actions defined to achieve this objective are the following:

- Reactivating and strengthening the Infrastructure Committee.
- Updating and prioritizing the Infrastructure Investment Plan, pursuant to the execution feasibility and the availability of the budget.
- Evaluating the implementation of the manual to assist in case of emergency and other contingencies.
- Certifying the Chemical Fiscal Laboratory (ISO 17025).

### **2.3.4 Developing an organizational service culture.**

The aim is to pursue a service-centered culture, for internal as well as external users.

The key projects and actions defined to achieve this objective are the following:

- Defining, developing and evaluating a Customer Service Training Program.
- Updating and implementing the internal and external communication plans.



### **2.3.5 Redesigning critical processes and improving the planning and performance control culture.**

This objective seeks to redesign the key institutional and support processes, and improve the planning and performance control culture.

The key projects and actions defined to achieve this objective are the following:

- Promoting the operation of the Auditing Committee, in order to meet the internal control regulations.
- Systematizing and improving internal processes and acquisitions and hires.
- Defining the ERP implementation strategy in SAT.
- Reviewing and updating the joint planning and budget procedure.
- Completing the pilot plan for implementation of the quality management system in customs.
- Updating the records' management system.
- Defining the internal control model under generally accepted standards.
- Developing and implementing a program to redesign critical processes.
- Strengthening the backup procedures for institutional documentation.
- Creating an Institutional committee that monitors or verifies compliance with the recommendations arising from allegations and potential irregular actions.
- Implementing the electronic notifications tool.

### **2.3.6 Adjusting the internal organization for the purpose of decentralization.**

It seeks to develop and implement customs operations and legal affairs in a decentralized structure through the Regional Management offices and the respective agencies.

The key projects and actions defined to achieve this objective are the following:

- Defining and executing the plan to decentralize the legal affairs' operative functions to the Regional Offices.
- Defining the middle and long-term vision in customs and preparing and executing the plan to decentralize the operative functions.

### 3. FINAL REMARKS

The Tax Administration of Guatemala is aware that the progress made in promoting initiatives to instill the tax morale in the Guatemalan people has been greatly based on enforcing coercion, increasing risk perception of taxpayers with regards to tax audits, more than on creating awareness on the responsibility of fulfilling a civic duty set forth in the Political Constitution of the Republic. The purpose of SAT is to achieve a higher sense of tax morale.

Therefore, it is vital for SAT officials and employees to keep in mind the institutional vision and mission as a means that conveys among taxpayers the perception that our treatment is equitable. Additionally, by the attitude towards taxpayers and as a direct effect of the specific tax culture programs, we wish to help the population to understand the purpose of paying taxes and the negative consequences of tax evasion.

The effective interaction among education, service and compliance activities is crucial for SAT, since reinforcing taxpayers' willingness to meet their tax obligations largely depends thereupon.

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## THE STRATEGIC PLANS AND TAX MORALE

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***Contents:** Summary – 1. Strategic plans and overall goal – 2. What drivers influence compliance? – 2.1 Contribute to inner motivation - our findings – 2.2 Trust – 2.3 Communication – 2.4 Procedural justice – 2.5 The distinction between the case and the person – 3. The public opinion about the Swedish tax agency – 4. Understanding the taxpayer situation – 5. Conclusion*

### SUMMARY

Tax morale is about taxpayer's inner motivation to pay taxes. It is about what someone thinks is the right way to handle a situation. As a consequence, it is not possible to force someone to have a certain morale regarding tax issues.

What we as tax administrations can do is however to create an environment and a relationship that contributes to voluntary compliance based on knowledge about what motivates taxpayers to comply. It is in this sense; we in the Swedish Tax Administration have built our strategies.

We have a vision "A society in which everyone is willing to pay their fair share" and goals regarding trust and a good taxpayer relation. We aim to get it "Right from the start".

There are a lot of drivers affecting taxpayer's compliance behaviour and a recent published OECD note gives a broad overview of research done in this area. The findings indicate that there are a lot of circumstances that affect the taxpayer's behaviour, like deterrence, norms and fairness.

Our findings in The Swedish Tax Agency are that we have realized that we in the past underestimated the importance of perceived fairness and trust when it comes to tax morale and inner motivation. We were too focused on what we were doing and did not reflect enough on how we carried out our activities and how our actions was perceived by the taxpayers.

We believe we can contribute to a pro compliance environment and increase inner motivation to comply by understanding things from a taxpayer perspective. In this sense we focus on issues like trust, the way we communicate and procedural justice.

The way that agencies carry out their work affects people's perception and trust of the agency. It's not the case that agencies like the Swedish Tax Agency who takes money from people are less popular compared to agencies that gives money in form of different contributions. In Sweden the result is the other way around, the Tax Agency is far more liked compared to the National Insurance Agency who provide different kind of monetary support.

In a survey carried out by an external research institute where people ranked 14 agencies in the Swedish society based on their own experience, The Swedish Tax Agency was in last year's ranking the highest ranked agency by the Swedish public among the police, universities, The National Insurance Agency and others.

To adopt knowledge is a challenge in itself because compliance behaviour is about human behaviour which is far more complex than just a response to deterrence. Our findings have made us rethink and review our strategies focusing a lot more on the outcome of our activities. Trying to understand and see things from a taxpayer's perspective.

We know that our way of doing things has a big impact on taxpayer's motivation. It's not possible to say that the legislation is too complex or that the taxpayers should know better. As we see it, it's our responsibility to make it as easy as possible to comply and to treat taxpayers with respect.

## **1. STRATEGIC PLANS AND OVERALL GOAL**

### **Introduction**

Most tax administrations aim to increase the level of compliance. In order to succeed with this it is of great importance to make sure that the activities carried out promotes a compliant behaviour in reality and not just is based on hope and good intentions.

Tax morale is something that concerns a person's inner motivation. It's not possible to force someone to have certain morale and most people consider themselves to have a high morale. Nevertheless, we believe that we, as a tax administration, can motivate taxpayers to comply by understanding their situation and help to create a pro-compliance environment. Inner motivation is one of the most important contributors to a compliant behaviour but there are of course other drivers as well.

Knowledge about what affects compliance behaviour, as well as non-compliance, behaviour is crucial in order to prioritize the actions. We have, in the Swedish Tax Administration, focused a lot the last decade on understanding drivers from a taxpayer's perspective. This has been a challenge and still is. Another challenge is to adopt the knowledge within our own organization. This has not been easy because it has changed and is still changing our own organizational culture.

To do the right things and to do them in the right way are equally important in order to achieve an outcome where taxpayers are motivated to comply. However, our findings in this area points out that there is no "silver bullet" solution.

### **Vision and mission**

In The Swedish Tax Administration, we have a vision "A society in which everyone is willing to pay their fair share". We also have goals regarding trust, a good taxpayer relation and minimizing the tax gap.

The strategic plans consist of our policies and actions combined with our vision and goals. They have a long term perspective. Building trust and good taxpayer relations take time and has to involve the whole organization.

Plans are just papers and what counts is the result of the plans and not the plans themselves.

We try to build solutions and carry out activities in cost effective ways, both from our perspective as well as from the taxpayer's perspective. Our strategic approach is in to get things right from the start. With a trustful relation between us and the taxpayers we get the best conditions to have an early dialogue and sort things out. This is a win – win situation because audits are much more expensive and compliance costs can also be reduced.

On a strategic level, we try to work in a broad sense, including policy for setting salaries, how we measure the outcome of our activities, how we communicate to our staff and to the taxpayers.

The work is a lot about changing and maintaining a good organizational culture focusing on the effect of our work instead of just number of audits.

Our way forward has been to understand what drivers contribute to and influence a compliant behaviour. We have also focused a lot on understanding situations and motivation from a taxpayer perspective by commissioning extensive studies concerning different groups of taxpayers and situations. We have used the result for discussions within our organization in order to broaden our own perspective.

The way we measure our result has also changed. We are now more focused on taxpayer's perception of our service and audit activities. For example, if the taxpayers think we don't treat them well during audits, we have to improve. It's the taxpayer's perception that counts.

We strive for a cooperative approach instead of a "we against you"-mentality. From a strategic point of view, cooperation with other organizations like industry associations is the way forward. Dialogues with these organizations help us find the right actions. The more cooperative approach helps us to solve the tax situation in an early stage which increases the possibility to get things right from the start.

## **2. WHAT DRIVERS INFLUENCE COMPLIANCE?**

Even if there is substantial scientific research done on tax compliance and taxpayer behaviour, it is a relatively new area. The OECD information note<sup>1</sup>, published in November 2010 gives a broad overview of research done as well as a description, based on research, of how

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<sup>1</sup> *OECD, Information Note, Understanding and Influencing Taxpayers Compliance Behaviour, November 2010*

different drivers influence compliance behaviour. The drivers described in the OECD report are:

- Deterrence, e.g. audits, perceived risk of detection and severity of sanctions;
- Norms, both personal and social norms;
- Opportunity, both to be compliant (e.g. low compliance costs, easy rules) and to be noncompliant (e.g. opportunities for evasion);
- Fairness, related to outcomes and procedures, and trust, both in the government or tax authority and in other taxpayers; and
- Economic factors, containing general economic factors, factors related to the business or industry and amount of tax due.

There are of course many circumstances affecting the behaviour and they are also interlinked with each other. The result pinpoints the complexity of human behaviour but also underline the important of basic human reactions like consequences of feeling distrusted.

Even if human behaviour is complex and compliance depends on different factors as described in the OECD note we think the findings indicates that a tax administration must have a broad understanding, taken in consideration different drivers and perspectives. In the Swedish Tax Administration, we now understand that we relied too much on deterrence as our main tool in order to maintain and increase compliance, sometimes even without knowing the effect of our activities.

## **2.1 Contribute to inner motivation – our findings**

We have realized that we in the past underestimated the importance of perceived fairness and trust when it comes to tax morale or inner motivation to comply. We were too focused on what we were doing and did not reflect enough on how we carried out our activities and how our actions was perceived by the taxpayers.

## **2.2 Trust**

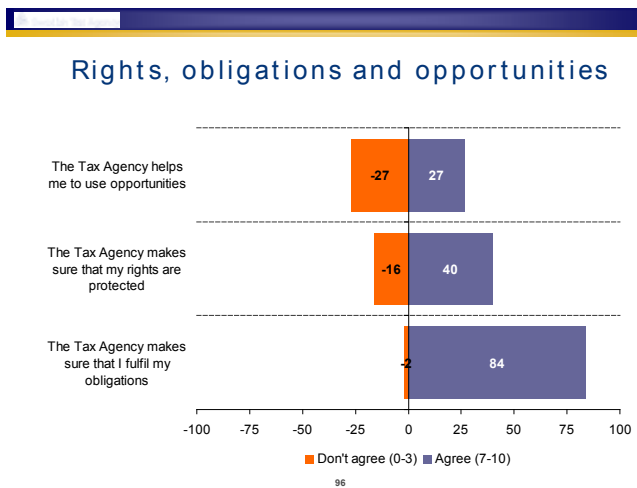
The majority of the Swedish taxpayers trust the Swedish Tax Agency and less than 10 per cent distrust the agency.

Taxpayers who have trust in the Swedish Tax Agency are more willing to comply than those who distrust us. 12 per cent of the Swedish taxpayers who trust the Swedish Tax Administration state that they would evade tax if they had the possibility compared to 28 per cent concerning those who distrust the agency.

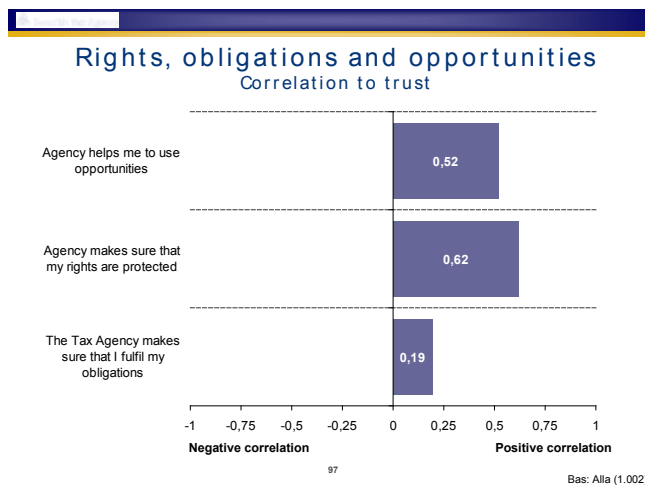


Trust is something that is earned and cannot be taken for granted. We can clearly see that our actions, on an individual level can affect the trust between us and the taxpayers.

Our surveys show that taxpayers think we are very good at making sure they fulfil their obligations, but when it comes to their rights and opportunities they don't think we are as contributing. This shows clearly in a survey commissioned by the Swedish Tax Agency concerning small and micro businesses.



The correlation to trust, in the same survey, indicates that focusing on the taxpayer's opportunities and rights are areas of improvement.



Most taxpayers in Sweden are willing to comply as long as everybody else or the vast majority complies. The comparison with others is very important. Our studies show that most taxpayers in Sweden think it's wrong to cheat with taxes; only five percent thinks its ok. However, a lot more states that other taxpayers probably think its ok to cheat with taxes. We think that the picture given by mass media in many cases describes a darker view than what is true. We know that approximately 90 per cent of the total tax is paid and declared right from the start.

### **2.3 Communication**

Communicating the right image and strengthen the view that most people are compliant contributes to a more compliant environment.

One example is communication of results of audit activities. Do we communicate in a way that supports and encourage compliant taxpayers or not? At one time we communicated the message that there was a lot of tax evasion in the taxi business. Some taxpayers contacted us and they were irritated and disappointed. One taxpayer said "I have worked in the taxi-business for over 30 years and always paid my tax, I really support your audits activities, but why do you point us all out as cheaters?" We have now changed the way we communicate and now we are trying to strengthen the compliant taxpayers by using supportive messages like "we do not think it's acceptable that taxpayers who pay their tax can't compete in a just way because of tax evasion in the taxi business."

It is our task to administer the tax system in an efficient way and taxpayers have the right to receive communication that is easy to understand. These citizens' rights concerns all agencies in Sweden and is written in The 1986 Administrative Procedure Act. In extract from this act it states clearly that it's the agencies responsibility to be easy to deal with.

#### **"Section 4**

Each authority shall provide information, guidance, advice and similar assistance to all persons concerning matters falling within the scope of its functions. The assistance shall be given to the extent that is deemed appropriate with regard to the nature of the matter, the person's need of assistance and the activity of the authority.

Enquiries made by people shall be answered as soon as possible.

If someone by mistake refers to the wrong authority the authority should set him right.”

*“Section 7*

*Each matter to which a person is a party shall be handled as simply, rapidly and economically as is possible without jeopardising legal security. In its handling of matters, the authority shall avail itself of the opportunity of obtaining information from and the views of other authorities, if there is a need to do so. The authority shall aim at expressing itself in an easily understandable way. The authority shall also by other means make matters easy for the people with whom it deals.”*

But what is easy to understand? Our studies show that we are not always perceived to be easy to communicate with, even if some of our staff thinks so.

The result of a too bureaucratic way of communication can create a distance between the agency and the taxpayers. A distance that may result in decreasing trust and decreasing motivation to comply. Communication that is easy to understand and that opens to answer any further questions can strengthen the relation. If we send a letter concerning the tax return, most taxpayers want us to describe what it's all about in the beginning of the letter. They want to know who they can talk to if they have questions, what to reply, what to pay and when? However, we used to begin the letters with a reference to the law which very few citizens care about. They say that if they want to know what's written in the law, they prefer us to write it in the bottom of the letter or on another page.

If they have any concerns they want to feel welcome to contact the tax administration.

## **2.4 Procedural justice**

Making the right interpretation of the law is of course important, but it's not enough. The procedure in it self is also something that have to be carried out in a professional way.

Procedural justice concerns the perceived fairness of the procedures (how cases are being handled). People tend to judge the authority based more on procedural justice than the outcome.

A survey, commissioned by the Swedish Tax Agency, concerning how trust is affected by audit activities showed clearly that a respectful attitude from the officer is important in order to maintain and increase trust.

The correlation between taxpayers perception of fair treatment and taxpayers opinion of that the tax administration has made the right decision is very strong. The correlation between trust and perceived justice is also strong. The most important factor for increased trust was the attitude of the tax administration.

This survey underlines the importance of the way tax administrations carry out their work. It's not enough to do the right things, it's also important to carry them out in a professional and respectful way.

## **2.5 The distinction between the case and the person**

Taxpayers in Sweden can see the difference between the tax system and the tax administration. Most people accept the legislation and they understand that taxes are needed in order to get society to work. They also accept the consequences of the legislation as long as they perceive they get a fair and just treatment.

Even taxpayers who evade intentionally deserve a professional treatment. The punishment for evasion should be what the law says, not a disrespectful attitude from the staff of the tax administration.

The impact of sanctions is described in the report "Right from the start"<sup>2</sup>

"Sanctions and expressions of disapproval can be conveyed so that they are either directed at the individual ("you are a bad person") or at the act ("your action was wrong"). Sanctions are rehabilitating if they punish the act instead of the individual, and stigmatising if they punish the individual instead of the act.

This reasoning is plausible since personal stigmatisation impacts on an individual's self-respect. In order to avoid such a negative emotion, the individual puts the blame instead on the person who imposed the sanction. The individual then sees himself as a victim, which makes it right to defy the authority and instead become a rebel, which can give rise to feelings of pride. Instead of seeing oneself as a failure one sees

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<sup>2</sup> *Right From The Start, Research and Strategies, Report 2005:1B, Swedish Tax Agency*

oneself as a hero, which is naturally positive for one's self-respect. Continuing to defy the authority confirms the individual in the hero's role. And so the inclination to commit crime is increased.

If sanctions can be imposed in a way that the perpetrator perceives as legitimate, fair and respectful, they will have a positive effect. Sanctions must, therefore, be imposed so as to permit the perpetrator to retain his or her self-respect. This is perhaps not always easy to do, since there may be a natural unwillingness to treat a criminal with respect: one may need to have the temperament of an angel. In the final analysis, however, it should be a question of professionalism. Professional behaviour on the part of the authority should achieve the optimum result and the results will be better if the perpetrator's self-respect can be maintained. The sanction must be aimed at the act and not the individual.”

Our conclusion is that the way we pose and address penalties has a great impact on trust which affects the individual motivation to comply or not.

### **3. THE PUBLIC OPINION ABOUT THE SWEDISH TAX AGENCY**

A professional attitude from our staff has been one of our challenges the last years. We have moved from a “we against you” – mentality to a more cooperative and open mentality. People in Sweden understand that agencies follow the legislation, but this can be done in different ways.

The way that agencies carry out their work affects people's perception and trust of the agency. It's not the case that agencies like the Swedish Tax Agency who takes money from people are less popular compared to agencies that gives money in form of different contributions. In Sweden the result is the other way around, the Tax Agency is far more liked compared to the National Insurance Agency who provide different kind of monetary support.

A survey<sup>3</sup> was carried out by an external research institute where people ranked 14 agencies in the Swedish society based on their own experience. The base in the survey is interviews with 8 500 people who have had contact with agencies in a more extensive way than just filing a tax return. The result is a Customer Satisfaction Index.

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<sup>3</sup> EPSI rating, *Customer Satisfaction Index, Government services 2010*

The Swedish Tax Agency was in last year's ranking the highest ranked agency by the Swedish public among the police, universities, The National Insurance Agency and others.

In another survey focusing on the small and medium sized company's opinion of the relation with agencies in Sweden, The Tax Agency was the second most popular agency after the Swedish Companies Registration Office.

#### **4. UNDERSTANDING THE TAXPAYER SITUATION**

We can clearly see that there is a difference between how taxpayers perceive the relation with The Swedish Tax Agency and how we think we are perceived. This difference is of greatest concern because it misleads us in our actions and conclusions. We have therefore emphasized a lot on carrying out surveys which on one hand increases our knowledge and on the other hand is a great tool in order to educate our staff and change the culture within the organization.

One example is a survey commissioned by the Swedish Tax Agency in order to get a better understanding of taxpayer's situation by doing in-depth interviews with businesses. These were filmed and the films were shown to all tax officers working with businesses. The purpose was to educate the staff and give them a better understanding of the taxpayers and their perceptions of taxes and the tax agency. Films have a much greater impact and present the reality much better than a written report.

Making it "right from the start" requires a cultural shift, for our staff, in the traditional way of working and thinking. It is a shift from working in the past to working in the present; from working mostly with individual cases to addressing patterns of behaviour among groups of taxpayers; from mostly a one-tool approach towards a multi-faceted treatment strategy using a combination of different methods; and from working alone to exploring synergies and possibilities for co-operation. This requires us to better understand taxpayers and the means of influencing them. It also put strong emphasis on the importance of measuring outcomes.

#### **5. CONCLUSION**

There are many different drivers that affect taxpayer behaviour. Tax morale is, as we see it, about inner motivation. In order to prioritize

the right actions it's important to have knowledge about what affects taxpayer behaviour.

To adopt knowledge is a challenge in itself because compliance behaviour is about human behaviour which is far more complex than just a response to deterrence. Our findings have made us rethink and review our strategies focusing a lot more on the outcome of our activities. Trying to understand and see things from a taxpayer's perspective.

We know that our way of doing things has a big impact on taxpayer's motivation. It's not possible to say that the legislation is too complex or that the taxpayers should know better. As we see it, it's our responsibility to make it as easy as possible to comply and to treat taxpayers with respect.

We can contribute to a pro-compliance environment by increasing trust and motivate taxpayers or we can increase the distance between us and the taxpayers by being seen as the enemy resulting in decreasing motivation.

The way forward is a lot about changing the culture within our own organization and promoting cooperation with other organizations. We have taken some steps in this direction but we realise that we still have a lot more to understand and improve.

## METHODOLOGIES FOR MEASURING TAX MORALE WITHIN THE TAX ADMINISTRATIONS

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**Contents:** 1. *The Italian constitution* – 1.1. *The duties of the citizens* – 1.2. *The duty of loyalty to the Republic and observance of the laws* – 1.3. *The duty of contributing to public expenditure* – 1.4. *The ethical minimum* – 2. *Ethics in the Guardia di Finanza* – 2.1. *The mission of the Guardia di Finanza* – 2.2. *Comments on the interests being protected: the financial interests of the State and economic public order* – 2.3. *References to the military values system* – 2.4. *Public ethics* – 2.5. *Military Discipline* – 2.6. *The Oath*.

### 1. THE ITALIAN CONSTITUTION

The characters of ethics are found in the Constitution, in its rules there is the lay translation of normative ethics addressed both to the legislator and the citizen, inspired by the principles of the first and by motivating the profound reasons of the latter's participation in national society.

The ethics of the citizen are contained in the duties prescribed by the Italian Constitution and, complementary to the rights, they represent the support to the political community.

Generally speaking, the word "duty" is meant to indicate the unfavorable position of a subject on whom the law imposes a conduct to the benefit of another subject<sup>1</sup>.

The constitutional duties, defined as "imperative" as no one can be exempted from their observance, go even beyond such a restrictive

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<sup>1</sup> The word duty, both as a noun and as a verb, derives from the Latin word *debere*, composed of *de* that stands for *from* and *habere*, that means *have*, with the associated meaning of *get, obtain something from someone that will have to be returned*.



definition because they represent in reality the foundation of a pacific and constructive cohabitation and translate into collective situations of mutual and reciprocal benefit.

### **1.1. The duties of the citizens**

The parameterization of the rules of ethical provisions for the citizen are to be sought inside the constitutional provisions, particularly in the so-called “imperative duties”. Such duties are called “imperative” because no one can be exempted from their observance; the key to the interpretation of all constitutional duties is laid down in art. 2 of the Constitution (which, as mentioned before, imposes imperative duties of political, economic and social solidarity).

Other duties, which also contribute to preserving peaceful cohabitation and social and economic development, are stated in the form of the so-called “civic” duties, that are intimately associated with the duties and are part of the individual requirements needed to belong to the established community and to its government.

### **1.2. The duty of loyalty to the Republic and observance of the laws<sup>2</sup>**

Loyalty means “constant compliance with loyalty granted by others or with a commitment freely undertaken”<sup>3</sup>.

The duty of loyalty to the Republic and of observance of laws implies absolute loyalty to the founding principles of the republican State and the consequent observance of the provisions of the Constitution and the laws.

Loyalty to the Republic is intended also as loyalty to the Institutions that represent the State and that fulfill their responsibilities in the form and limitations provided for by the Constitution.

Loyalty to the Republic is therefore intended as a constitutional duty of juridical respect for the fundamental principles of the constitutional system on the one hand and the whole range of public institutions on the other, in terms both of their essential data and their functioning, as they are elements that are necessary for the system to pursue it

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<sup>2</sup> Art. 54, Const. “*All citizens have to duty to be loyal to the Republic and to observe its laws. The citizens holding public assignments have to duty to fulfill them with discipline and honor, pledging allegiance in the cases provided by the law*”.

<sup>3</sup> Devoto G. e Oli G.C., “Vocabolario della lingua italiana 2009”, Le Monnier, 2008;

pre-established constitutional objectives. In other words, the duty of loyalty implies an undeletable link of each citizen with the principles at the basis of the Constitution and also with public institutions founded by the Constitution.

Indeed, the duty of loyalty expresses the duty of political solidarity stated in art. 2 of the Constitution: this means that an intimate or spiritual agreement with certain values or idealistic principles is not imposed on the citizens, but, through the legal prescription of certain material conducts (as observance of the law), a way to preserve the necessary conditions and the constituent elements of the political community, is formulated.

### **1.3 The duty of contributing to public expenditure<sup>4</sup>**

The duty of the citizen to contribute to public expenditure is comprised in the range of economic solidarity duties.

According to authoritative scholars, art. 53 of the Constitution "... first of all plays a civil rights protection role, in limiting contribution to public expenses to facts that are a sign of "taxpaying capacity", that is to say economically assessable"<sup>5</sup>. Furthermore, art. 53 of the Constitution is a "specification of the duties of social solidarity"<sup>6</sup>: indeed, the duty to contribute to public expenses is independent of the fact that the taxpayer receives more or less what he expects of the State in terms of public services.

This same interpretation pattern should also include reference to the progressivity principle. Art. 53, when read in the light of the principles established by art. 2, has identified the substantial reason of the tax responsibility in the duty that binds to common good the possibilities of every subject belonging to a community.

On the other hand, the duty to contribute to public expenses on the basis of taxpaying capacity represents the application of a justice criterion according to which capacity governs application of the tax, whereas need is the basis for the service provided by the State. In other words, in dividing the debt among the citizens there is no measure that can be determined in relation to the public service rendered to each

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<sup>4</sup> Art. 53, Const. "Everyone shall contribute to public expenditure according to their taxpaying capacity. The tax system is based on the criterion of progressiveness."

<sup>5</sup> Così Raffaello Lupi in: *Diritto Tributario, parte generale*, quinta edizione, Giuffrè Editore, Roma 1998 pag. 17.

<sup>6</sup> Cfr. Raffaello Lupi, *op. cit.*

individual, but only the identification of a goal of common interest that favors progress of the whole community.

Hence the link to social and political solidarity and the imperative duty to pay taxes, considering that this is related to the actual survival possibilities of the same community.

Lastly, the ethical meaning of the provision surfaces also in the combination of the taxpaying capacity principle with the general tax equality principle (art. 3 Const.), on the basis of which the provision differentiates the tax treatment by taking into account only the economic facts and positions (so the tax law will treat in the same way the economic facts that express the same taxpaying capacities, and differently those that identify different taxpaying capacities).

#### **1.4 The ethical minimum**

We have noted how the legal system has the aim of regulating relations between individuals and with the subjects placed above them.

This regulation takes place under rules of various level dictated by the legislator. Sometimes these rules are exclusively “inventions” of the legislators (for example: one cannot drive without a license); in other instances they are based on sub-layers of various nature (ethical, natural, religious, customs) that the legislator acquires as a whole or in part.

The observance of legal rules by the members of society can be due to their obligatory nature (and so by fear of consequent penalties), or by spontaneous compliance with rules of other nature, among which those suggested by ethics, in the perspective of a correct choice between good and evil.

The citizen that limits himself to a mere, even if punctual, observance of legal rules has his conduct inspired by a standard that could be regarded as the “ethical minimum”.

The good citizen though does not simply comply with the norms, but he also acts in order to pursue good, cultivate social life and search for truth.

Respect for life, nature and other members, the search for truth and, above all, living to achieve good and repudiate evil, goes well beyond the mere observance of the rules stated in the legal system.

It follows that to put into practice the ethical rules, that is those that go beyond mere compliance with legal provisions, entails sacrifice.

## **2. ETHICS IN THE GUARDIA DI FINANZA**

The ethics of the Guardia di Finanza is the result of the particular legal status of the Corps' members, which is not comparable to the other armed forces and police forces or to the civilian officials and employees of the Italian State.

In order to identify the system of values and criteria that must inspire and guide the finanzieri in their duty and, in general, in their acts, one must understand the goals of the duties performed by the Guardia di Finanza, and comprehend its institutional identity, which is necessary to understand and share the particular responsibilities and to direct their conduct in accordance with the institutional goals.

The starting points of these reflections are given by the institutional mission of the Corps and the analysis of the Supreme Court ruling no. 70 of 25 March 1976.

### **2.1 The mission of the Guardia di Finanza<sup>7</sup>**

The Guardia di Finanza Corps is a police force that fulfills a general responsibility in economic and financial matters on the basis of particular powers conferred by law. It is placed under the direct authority of the Economy and Finance Minister.

It is also **an integral part of the armed forces of the State and police** forces and has the following tasks:

- prevent, search for and report financial evasions and violations;
- conduct surveillance at sea for financial law enforcement purposes and contribute to the services of maritime police, assistance and signaling;
- enforce regulations of political and economic nature within the limits established by the single laws;

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<sup>7</sup> Law 23.04.1959, no. 189 and d.lgs. 19.03.2001, no. 68;

- contribute to the political and military defense of the frontiers and take part in military actions in case of war;
- participate in maintaining public law and order;
- perform other surveillance and protection duties that are assigned to it by the law.

## **2.2 Comments on the interests being protected: the financial interests of the State and economic public order**

As noted, the Guardia di Finanza's priority mission is economic and financial law enforcement, which differs from security police tasks which concern public order and safety and are assigned to "general" Police Forces, and from the tasks performed by the civil Administrations operating in the tax field; this difference allows to introduce and define the concept of economic public order.

"Economic order", effectively defines the "good functioning of the national economic system intended as a very vast area in which interests of various nature meet and clash, many of which deserve energetic protection"<sup>8</sup>.

Therefore "economic public order" ultimately can mean "the good functioning of the national economic system (composed of enterprises, consumers and also the State, which in turn, intervenes with different roles and methods)", intended as a very vast area in which interests of various nature meet and clash, "having exclusively or mainly public relevance and, as such, placed under the sole oversight and protection of public entities/institutions or concessionaire subjects and safeguarded by statutory penalties that, in order to be applied, do not require to be balanced with private interests."<sup>9</sup>

To safeguard economic public order there are a number of Agencies and oversight bodies (with which the Corps cooperates), which however have responsibilities that are different from typical inspection or police actions; the Guardia di Finanza is the only police force having a general responsibility in economic and financial matters.

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<sup>8</sup> Pedrazzi, "Economia pubblica, industria e commercio (delitti contro)", in Enc. Diritto pag. 278 e seguenti;

<sup>9</sup> Ferraro Angelo, "Globalizzazione, criminalità e sicurezza economica", op. cit.

## **2.3 References to the military values system**

### **General notes**

In history and international law the military present a close and prevailing association with the use of armed force during conflicts, whereas this aspect does not prevail any longer in internal law.

Infact, in our Country (this happens also in other states) internal law entrusts the military with other shared tasks of direct and indirect support and assistance in maintaining public law and order, and often also to the benefit of populations hit by natural disasters.

These activities are not exactly associated with combat, but, as they are performed by armed forces, they fall within the definition of the term “military”.

So, to speak about military ethics is to include in a single definition not only what pertains to the use of armed force in an armed conflict, which is historically a strictly military matter, but also aspects which pertain to the other activities that today are the institutional responsibility of the military.

That being stated, rather than speaking about “military” ethics, perhaps today it is more appropriate to speak about ethics “of the military”, defined as a set of values and principles that inspire and guide the single members of the armed forces in discharging their institutional duties; they include the traditional “military” task of employing the armed force but also other shared duties that are normally performed by non military bodies.

### **2.4 Public ethics**

So, in addition to every citizen’s duty to be loyal to the Republic and to obey its Constitution and laws (article 54, first paragraph, of the Constitution), there are the duty to fulfill ones responsibilities with discipline and honor, by taking an oath in the cases provided for by the law (article 54, second paragraph, of the Constitution), the duty to be at the exclusive service of the Nation (article 98 of the Constitution), the duty to ensure the good functioning and impartiality of administration (article 97 of the Constitution).

The actual implementation of these principles goes through the comprehension and overcoming of situations of potential incompatibility deriving from the possible overlapping of the private sphere and the service sphere and of administration and politics.

To overcome the first problem, it is required, through the solemn promise of the oath, to pledge to be at the “exclusive” service of the Nation; in the second case, in addition to the pledge required through the oath, the Constitution expressly provides for the possibility to set limitations, for certain categories of public employees and officials, to join political parties.

This public function represents the fundamental structure on which to define, by virtue of its peculiarities, the military public function which, precisely in the wording of the oath required of service members, shows profiles of specialty compared with the function established for public servants.

The latter, in particular, give an oath with the following wording: «I swear allegiance to the Republic, to loyally abide by the Constitution and the laws of the State, to fulfill the duties of my office in the interest of the Administration for the public good» (article 2, D.P.R. 19.04.2001, n. 253).

Whereas the members of the military swear their oath reciting: “I swear allegiance to the Italian Republic, to abide by the Constitution and the laws and to fulfill with discipline and honor all the duties of my status for the defense of the Homeland and the safeguard of the free institutions.” (Article 2, Law 11.07.1978, n. 382)

The essence of the difference lies in the particular juridical effect, and not just ethical, resulting from the oath given which, unlike other public officials and employees, goes as far as establishing the duty to expose oneself, if necessary, also to the risk of sacrificing one’s life by virtue of the purpose of one’s activity (article 9 of the Regulations of Military Discipline).

In the case of military personnel, the duty to expose oneself, if necessary, to the risk of sacrificing one’s life, undoubtedly does not amount to the duty of sacrificing it, but anyhow entails a commitment, this time entirely within the secular horizon of the law which, having it become normal to accept the possibility of the sacrifice, characterizes in terms of absolute peculiarity this function compared with that of the

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other public servants and binds it, legally, manifestly and indissolubly to the concept of common good.

The legal emphasis of the pledge made through the oath, set forth in article 9 of the Regulations of Military Discipline, extends the duty to operate not just with total allegiance to the Republican institutions but, most of all, with discipline and honor, with sense of responsibility and conscious participation and, more, "...sparing no physical, moral and intellectual energies ...".

Such an extent, intensity and depth of the duty to discharge one's "... institutional tasks..." characterizes the military public function not just in its original and priority dimension, namely the legitimate use of military force, but also, and "by right", in all its other forms of expression.

In a context thus outlined, the problem of the accurate compliance with the legal duty of sacrificing one's physical, moral and intellectual energies for the Country and braving, if necessary, also the risk of sacrificing one's life, does not present itself any longer in terms of (ethical or juridical) justification, but rather of internalization of this juridical duty in such terms as to have its fulfillment become so immediate and "instinctive" as to appear as the result of an independent and innermost conviction that it is necessary.

This result, however, cannot be achieved by staying within the dimension, juridical yet narrow, of the fulfillment of a duty in light of a reward-punishment logic.

## 2.5 Military Discipline

The term "discipline" derives from the Latin *discere* which means to learn and, in Roman times, used to indicate exercise, training, to learn the military trade. The purpose of the training was that of "... giving the Roman soldier superiority over the barbarian in the course of the battle...", with consequent benefits also from a psychological standpoint as it reduced the fear of combat.<sup>10</sup>

In this sense, **obedience** was considered a consequence, an effect of military training and not a synonym for discipline.

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<sup>10</sup> Le Bohec Yann, "L'esercito romano. Le armi imperiali da Augusto alla fine del terzo secolo", op.cit.;



Intended as such, discipline formed an object of devotion and was worshipped with the construction of altars in the encampments.

The current Regulations of Military Discipline (article 2) defines military discipline as the "...conscious compliance with the rules pertaining to the military status in relation with the institutional tasks of the armed Forces and the demands that result from them. It is fundamental rule for the citizens in arms as it constitutes the main factor of cohesion and efficiency ..."<sup>11</sup>.

The definition given by the current Regulations of Military Discipline has the virtue of steering the notion of discipline towards a search for specific professionalism to be accomplished, however, in a particular organizational context, characterized by the hierarchical-functional

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<sup>11</sup> *In the Regulations of Military Discipline of 1964 (D.P.R. 31.10.1964) military discipline was illustrated in 5, in a structured manner:*

*"1. All the duties of the service member derive from a single principle, which is the same upon which the Armed forces are founded, i.e. the necessity in case of necessity of the use of force for the defense of the honor and independence of the Homeland, the institutions and the national laws.*

*2. The necessity of the use of force requires the unification of all the individual wills comprising the armed Forces, under the supreme will of the one in command: unity of action and efforts, unity of guidance and command.*

*This results in, first of all, the necessity of subordination, chain of reporting whereby from the supreme commander one moves down to the private; and then of obedience to superior orders, basis for any military system. In subordination and obedience truly lies the essence of military discipline. To have the latter stable and secure when the need comes, it is necessary to maintain it at all times with the same vigor.*

*5. In the discharge of their task, in peace and war, service members are differentiated according to the scale of responsibility; but, in discipline, all are equal before duty and danger. The various individual operations are all therefore harmonized and coordinated to an end: and such a cooperation in agreement engenders the confidence of each in their own selves and their peers, subordinates and superiors.*

*6. To the unity of action and efforts powerfully contributes the morale of the troops, i.e. the agreement of wills and sentiments which results, in all members of the armed Forces in general and of each corps in particular, from the common objective aimed at, from the belief in its greatness and relevance, and from the race which inspires all Corps to its achievement. Herein lies the great importance of esprit de Corps as an element of strength.*

*7. For the armed Forces to be established, exist and operate, a prerequisite condition is, in any time and place, order.*

*8. Also the duties shared with other citizens acquire in the member of the military a particular vigor, the same being able to enforce and uphold the laws by force.*

*9. In the exact and conscientious discharge of these duties, not for fear of punishment or hope of reward, but for innermost belief in their intrinsic necessity consists discipline. It is due to discipline that the armed Forces acquire soul and life, and form a solidly established whole; whereas, without it, there would be nothing but a band of men, which would collapse under the first impact.*

*10. Discipline must become an habit which, kept by the citizen upon returning to civilian life, always informs his conduct with sentiments of orderliness, solidarity and duty.*

*Thus the armed Forces, expressed by the people, become a school of honor and virtue";*

model, where the "order" is the operational tool governing the activity, as functional to an unique purpose: the legitimate use of the armed force.

The precise reference to "...conscious compliance..." moreover emphasizes the need for an active, qualified and propositional contribution of all military personnel, each at their own level.

It follows that, today, the essence of military discipline no longer resides as a priority in **subordination** and **obedience** (articles 4, 5, 25 and 26 Regulations of Military Discipline). Instead, they have become an instrument for and a consequence of the service activity ordinarily performed, yet consciously and responsibly executing the duties which must characterize the action of the organization in order to achieve the institutional aims.

**Professional preparation** and namely **training**, comprehension and acceptance of the rules of functioning of the military structure and responsible integration within the same, allow to increase one's self confidence and acquire that strength of spirit and determination which build the necessary **courage** to fulfill ever with "honor" one's duties also in the cases when it appears difficult to take a stand.

In the action of the Guardia di Finanza, all members of the Corps must bear in mind that their service fulfills an important and sensitive function, namely that of ensuring regular compliance with the law and regulations in the interest of public finance and national economy (article 160 **Guardia di Finanza Service Regulations**, 1959 draft).

The relevant operational ambit, however, often consists of the property of the private subjects being controlled, and it forms the subject matter of the service activity. Not just putting at risk, but often the mere questioning of the extent of the property of a person, sometimes entails causing unforeseen and unforeseeable reactions aimed at modifying or coercing the will of the Guardia di Finanza member, his integrity and his capacity to thoroughly enforce the law, "...because men more quickly forget the death of their father than the loss of their patrimony ..."<sup>12</sup>

<sup>12</sup> Macchiavelli Nicolo', "The Prince", Einaudi publishing house, 1984, Chapter XVII.

The entire period reads as follows: "Nevertheless a prince ought to inspire fear in such a way that, if he does not win love, he avoids hatred; because he can endure very well being feared whilst he is not hated, which will always be as long as he abstains from the property of his citizens and subjects and from their women. But when it is necessary for him to proceed against the life of someone, he must do it on proper justification and for manifest cause, but above all things he must keep his hands off the property of others, because men more quickly forget the death of their father than the loss of their patrimony ;;

Only a constantly practiced military discipline, with its system of values and correlated virtues, made of total allegiance, sense of legality, solid and updated professional preparation, attendant self-confidence and therefore courage, allows to always accomplish one's duty without hesitation.

The attack against the financial interests of the State, although being a conduct whose negative effects concern the community as a whole, and in particular the less wealthy and the needy, has historically never been experienced and perceived by public imagination as a particularly despicable activity.

When on duty, Guardia di Finanza members must be aware that they confront daily this paradox which involves law, history and culture: their service, on a par with Homeland defense, is essential for the life of the Republic. Still the public imagination does not consider the economic-financial offences that they tackle all that serious, nor the persons committing them all that villainous.

To learn the historical and cultural existence of this paradox and strengthen one's awareness that only by complying with and enforcing the law one is on the "right" side (which by definition can only be the legal side), means to consider the possibility of being "alone" and to be able to overcome the discouragement which may arise when the community fails to appreciate our work.

Gaining an awareness of one's status, achieving an adequate strength of spirit, the clear understanding of the external psychological context, may bring a member of the Guardia di Finanza to appreciate the extraordinary descriptive and expressive power, the meaning itself of the dedication: **"tireless sentinels of the border – the most advanced and the most solitary – always – because this is the command – the oath – the prize."**

## 2.6 The Oath

The oath for members of the military is provided for by articles 54, second paragraph, of the Constitution and 2 of Law 382 of 1978.

Historically<sup>13</sup> the practice of requiring the oath of soldiers dates back to the Roman era and took the name of sacramentum, unlike the official oath of public law which was called ius iurandum.

An obligation of obedience to a chief was undertaken in both cases but, while in the case of the ius iurandum the obligation was founded upon rules of public law, in the case of the sacramentum the obligation had a sacral origin and constituted pledge to obey the imperium of the military commandant which had a sacred origin.

Currently, the ceremony of the military Oath is governed by article 6 of the Regulations of Military Discipline and is described in its execution by article 138 of the Regulations of territorial and defense service.

The oath is sworn solemnly, in the presence of the flag and of the commander of the corps. Officers and non-commissioned officers swear an individual oath while the other service members, including the trainees, normally do so collectively.

In military oath ceremonies, both individual and collective, in addition to the flag and the commander of the corps, always present are a representation of hierarchical superiors of the service members who are taking the oath and of members of the Unit with a role of witnesses of sorts.

In the cases of breach of the oath, the maximum status penalty is inflicted, which is the loss of the rank by “demotion”, which constitutes one of the causes of cessation from service.<sup>14</sup>

In this sense, therefore, the breach of the commitment undertaken through the oath represents a fact of serious legal relevance, to the point of justifying an expulsion from the military community.<sup>15</sup>

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<sup>13</sup> Tokmakov Valerij N., “Disciplina militare e la situazione giuridica dei milites nella Roma della prima età Repubblicana”, in Tradizione Romana n. 4-2005, from the site [www.dirittoestoria.it](http://www.dirittoestoria.it);

<sup>14</sup> See Law 113/1954 for officers; Law 599/1954 for non-commissioned officers; Law 833/1961 for lance-corporals and guardsmen;

<sup>15</sup> Article 3 of the Regulations of Military Discipline of 1964 previously in force stated, at the second paragraph, that, “the oath must be kept at any cost: the oath-breaking service member is covered with shame”..



## METHODOLOGIES FOR MEASURING TAX MORALE WITHIN THE TAX ADMINISTRATIONS

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*Contents: Introduction – 1. Ethics in the tax administration – 2. The uruguayan case. Background. – 3. Tax morality in the tax administration. Diagnosis and self-evaluation of ethics and integrity – 4. The external perception of tax morality in the administration*

### INTRODUCTION

For more than 2,500 years, ethics has been one of the key issues in Western Philosophy. The terms ethics and morality are frequently used synonymously. Nevertheless, their meanings are different.

Based on its etymology, ethics comes from Greek ethos that has two meanings. The first and most ancient indicates residence, dwelling, place where one inhabits, in the Aristotelian tradition it adopts the meaning of form of being and character, which is acquired and incorporated in existence. The second meaning of the word ethos is habit, custom.

While morality refers to guidelines, values and norms within groups, societies and certain cultures, ethics studies the fundamentals and explanations that different cultures and communities have provided themselves, in order to organize their own functions, establishing points in common and differences among all the systems of norms<sup>1</sup>.

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<sup>1</sup> *Ethics, Transparency and Combat against corruption in the Public Administration. Manual on the performance in public office, published by the Anticorruption Office, Ministry of Justice and Human Rights of Argentina, 2009. Also refer to Acosta Casco, Natalia, "Principles of Public Ethics", published by the Transparency and Public Ethics Board, Ministry of Education and Culture of Uruguay, 2010.*

Morality and ethics, while deemed disciplines (opposite to exact sciences) are always linked to certain perspectives. In that sense, it is worth pointing out that in this paper, the notion of ethics is the one articulating with human rights and in line with the approach by which political morality oversees, as its fundamental role, the protection and wellbeing of individuals<sup>2</sup>.

In recent years, above all beginning in the 90s, great emphasis has been placed on the imprint of ethics on government administration, as well as the need for its transparency.

Government administration reforms (in a broader sense, the reform or transformation of the State) as well as tax reforms, have played a very significant role on the public agenda, in the different social discourses, (in the political as well as the business sphere), becoming a topic on the international public agenda<sup>3</sup>.

Both notions are linked to this dawn of public ethics' awareness in the last decades, tied to the need of strengthening our democracies by, on the one hand, eradicating or combating the scourge of corruption and, on the other, strengthening our tax administrations not only by reforming the tax systems and improving agencies' performance in terms of efficiency and efficacy, but also by involving citizens and promoting a new Tax Administration-Taxpayer relation<sup>4</sup>.

Tax ethics is by no means different from public Ethics<sup>5</sup>, but its name serves to restrict its study and regulation purpose, applying it to the tax administration owing to its specificities. It is worth recalling that in his Financial Law System, Sainz de Bujanda called for a deeper study of the issue, defining Financial Ethics as a "philosophical discipline, of a regulatory nature, which studies the moral criteria of appraisal for the legal rules or the behaviors integrated in the area of the financial activity of public entities", clearly stating the existence of different moralities, objective and subjective: tax morality and public credit morality, revenue morality and expenditure morality, tax officials' morality and taxpayers' morality<sup>6</sup>.

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2 Raz, Joseph, *Ethics in the public sphere*, Gedisa Publishers, Barcelona, 2001.

3 *The applicability of such assertion arises from, for example, the document of Ibero-American Public Administration for the 21st Century, approved by the XL Regular Meeting of the Executive Council of the CLAD held in Santo Domingo, Dominican Republic, November 8-9, 2010.*

4 *The interest on ethical issues relative to the economy introduced by the work of Amartya Sen, Nobel Prize in Economics, is not foreign to such phenomena. Refer to, for example, On Ethics and Economics, Alianza Editorial, Madrid, 2001.*

5 *Public ethics reflects the morality of the human acts performed by all those in public office.*

6 Refer to Sainz de Bujanda, F., *Financial Law System*, I, Vol. °, Law School of Complutense University, Madrid, 1977.

On the other hand, Tipke defines Tax Ethics as “the theory studying the morality of tax proceedings undertaken by the branches of government– Legislative, Executive and the Judiciary- and by the taxpaying-citizen”<sup>7</sup>, and warns that this is an under-analyzed subject owing to its special difficulties, which Herrera Molina defines as follows: “The naturally competent individuals to analyze the moral issues are philosophers. And, notwithstanding, it is impossible to analyze the moral issues pertaining to taxes, if its procedures, interpretation and problems are not known in depth”<sup>8</sup>.

It is worth adding to the foregoing difficulties, the performance proper of the Tax Administrations, whose mission is to secure the collection of State revenue by the effective enforcement of the norms relative to the internal taxes under their authority, promoting voluntary compliance by taxpayers, in a framework of respect for their rights, acting with integrity, efficiency and professionalism<sup>9</sup>.

The lack of integrity in a tax administration may affect equity in the distribution of the tax burden, distort the conditions of competition and resource allocation, reduce the required resources to meet government spending and undermine the confidence of society in the government, which, overall, entails a detriment to citizens’ wellbeing<sup>10</sup>.

As it may be inferred, and considering that the purpose of this paper relates to the implications of Tax Morality in the Tax Administration, the relevance of approaching topics of this nature is explained by the foregoing considerations and by the growing importance of collection in meeting the purposes of the State and the strengthening thereof in particular.

## 1. ETHICS IN THE TAX ADMINISTRATION

In such respect, and according to Tipke, the official of the Tax Administrations appears as the trustee of the unified community

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7 Tipke, K., *Tax morality of the State and the taxpayers*, Marcial Pons, Madrid- Barcelona, 2002, p.21, translation by P.M. Herrera Molina, quoted by Sánchez Blázquez, V.M., “X. Organizational issues in the Tax Administration: Law deficiencies and solutions through ethics”, in *Tax Ethics*, Document N° 10/2004, Institute of Tax Studies, page 97, available at: [www.ief.es](http://www.ief.es)

8 Herrera Molina, P., “VII. Approach to Tax Ethics”, in *Tax Ethics*, Document N° 10/2004, Institute of Tax Studies, page 77, available at: [www.ief.es](http://www.ief.es)

9 Mission Statement of the General Tax Directorate of Uruguay established on Decree N° 192/006 of 21 June, 2006.

10 See the Executive Secretariat Preamble to the Self-evaluation Guide for the Tax Administrations.



integrated by all taxpayers. The interest of the Tax Administration shall not be to collect to the greatest extent possible or close its records with the highest amounts, but to oversee equality and justice in the enforcement of tax laws. Professionalism and the study of affairs constitute, per se, ethical demands<sup>11</sup>.

Such ethical demands are warranted by the special and specialized nature of the Tax Administration, inherent features that have clearly materialized in recent years. In particular,- in the Uruguayan case –marked by two great landmarks such as the reform of the Tax Administration conducted in 2005 and the reform of the tax system enforced in 2007- in line with the full-time employment of tax officials (and appropriate remuneration) and, consequently, a complete system of carefully defined restrictions and incompatibilities<sup>12</sup>.

On the other hand, the Inter-American Center of Tax Administrations has defined the analysis of this issue as a priority for decades.

Particularly, since 2003 a number of tools have been designed to support actions that promote ethics in the Tax Administrations, as a means of preventing and anticipating the actions that may impair their efficacy.

Said initiative (undertaken by a group of experts and featuring the special participation of the Canadian Revenue Agency) served as a precedent and benchmark for the pilot experience in the Tax Administration of Uruguay in 2009, to which we shall subsequently refer.

## **2. THE URUGUAYAN CASE. BACKGROUND.**

Prior to analyzing the pilot experience in Uruguay, it is interesting to provide the underlying context.

The reform of the Tax Administration was a vital landmark in said context, according to Article 2 in Act N° 17.706<sup>13</sup>, of 4 November, 2003, regulated

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<sup>11</sup> See Herrera Molina, P., “VII. Approach to Tax Ethics”, in *Tax Ethics, Document N° 10/2004*, Institute of Tax Studies, page 81, available at: [www.ief.es](http://www.ief.es)

<sup>12</sup> See D. N° 166/2005 as amended.

<sup>13</sup> Article 2°. (*Improvement of the General Tax Directorate performance*). - *The Executive Branch shall prioritize the improvement of the performance and the equipment acquisition of the General Tax Directorate. To such end, and in the amount strictly required, said Directorate shall allocate up to 25% (twenty-five percent) of the actual collection growth, to increase their budget. The Directorate shall report to Parliament, and the latter shall report to the Treasury and Budget Committees in both Houses.*

*We hereby establish a full-time employment system, bonuses and incompatibility provisions for officials of the General Tax Directorate, which shall be regulated by the Executive Branch,*

by Decree N° 166/2005, of 31 May, 2005, which provided for all the aspects relative to the new functional system defined, and by Decree N° 192/2006, by which a new organizational structure was approved, in line with an updated definition of the strategic objectives, seeking to adapt the traditional Administration modality to an objective-driven administration, centered on performance-results.

In line with the purpose of this paper, we may mention three key features of said reform:

- i. Regulation of the functional performance system: a full-time employment system was established, defined as the integral dedication to the functions of the position, banning any other employment, whether in the public or private sphere<sup>14</sup>. The general incompatibilities were defined<sup>15</sup>, the exceptions thereto<sup>16</sup> and the exceptions to the full-time employment system<sup>17</sup>.
- ii. creation of an internal control body: as part of a strategy to promote ethics-, the Internal Auditor's Office was created, with the purpose of:
  - a. controlling the appropriate enforcement of procedures and controls of the incompatibilities and full-time employment system;
  - b. investigation of alleged accusations and violations to the full-time employment and incompatibilities' system, as well as, if applicable, advising on the enforcement of sanctions;
  - c. investigation and detection of irregularities, or illegal acts involving officials, with proposals on the actions applicable;
  - d. requests for reports and administrative investigations, and;
  - e. Controlling that officials submit their certified employment statements.

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*banning the performance of activities deemed incompatible, which shall be gradual and optional, directly in line with the actual increase in collection stemming from the better performance of the Body. The applicable budget allocation shall be made to such ends.*

*The Executive Branch shall also establish an optional performance system, not requiring full-time employment and general incompatibilities for the officials of such Directorate, not comprised in the foregoing sub-section.*

*In both cases, the provision shall supersede the systems currently in place on the matter for said officials and this shall be reported to Parliament.*

*The regulation of the systems set forth in this article shall be deemed effective upon thirty days from the respective communication to Parliament.*

<sup>14</sup> See article 11 in D. N° 166/005, 31 May, 2005

<sup>15</sup> See article 9 in D. N° 166/005, 31 May, 2005

<sup>16</sup> See article 10 in D. N° 166/005, 31 May, 2005

<sup>17</sup> See article 12 in D. N° 166/005, 31 May, 2005, as amended by article 3 in D. N° 333/2008, 14 July, 2008.

The internal control at the level of the Tax Administrations, in addition to being an essential part of their functions, goes beyond the purpose of controlling performance, to the extent it enables to determine and, above all, prevent the inherent risks that may impair such performance to a greater or lesser extent, and establish the applicable corrective actions.

- vi. Advancement of the Figari Project (Institutional Strengthening for Revenue Allocation and Administration): the functional design of this modernization project originated with the commitment of the General Tax Directorate in line with its structural reform and subsequent changes in the organization, working methods and procedures to improve the DGI efficiency and efficacy, and relied on financing from the European Union. It was an integral management model to manage revenue and resources, based on an integral and integrated IT system that would require expediting and simplifying procedures and imply the organizational and process reengineering that would affect detection and reduction of tax fraud as well as the modernization and rationalization of administrative processes and the reduction of bureaucracy.

On such grounds, the Figari Project has been a very effective instrument to regulate the performance of tax officials, harmonizing procedures in order to expedite them and enabling better control thereof.

### **3. TAX MORALITY IN THE TAX ADMINISTRATION. DIAGNOSIS AND SELF-EVALUATION OF ETHICS AND INTEGRITY.**

#### **3.1. Background.**

The 2005-2009 Strategic Plan included, among its strategic objectives, promoting officials' professional development and wellbeing and ensuring control of their ethical behavior, pursuant to the following action courses:

- implementing the functional career;
- promoting systematic and specialized training;
- conducting performance evaluations taking into consideration compliance with objectives;
- controlling ethical compliance.

As regards the last item, in addition to the above-mentioned monitoring and control efforts, according to Resolution N° 1809/2006, of 29 December, 2006, the Code of Ethics was approved for officials of the

General Tax Directorate<sup>18</sup> and in 2009, we conducted a diagnosis and self-evaluation activity on ethics and integrity, to which we shall refer subsequently.

### **3.2. Brief description of the methodology.**

The end of the self-evaluation process is the regular analysis of processes and performance-results by organizations themselves, with a view to identifying the strengths and weaknesses and defining the improvement plans required.

The methodology employed arose after a process of adaptation to our country's reality of the methodology that the Inter-American Center of Tax Administrations suggested – Self-evaluation Guide for Tax Administrations – and the Model for Assessment of a corporate ethics and integrity program (EVAM).

### **3.3. Implementation process**

The first step was the selection of facilitators (seven, in the first stage), conducted by the General Tax Directorate among officials from all the Divisions of the agency, promoting the active involvement of the organization's Directors in the process and securing the resources required for the appropriate execution thereof.

In order to achieve broad and plural integration, we pursued members with different professions who participated in the different substantial functional areas, excluding members of senior management.

The selection criteria were aimed at identifying officials with an extensive track record in the Administration, deep knowledge of their working area, acknowledgement of their career behavior, by peers and their seniors, leadership features, flexibility and a proactive spirit.

The following table defines the profession and area specific to each team-member.

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<sup>18</sup> Notwithstanding, officials are also governed by the broader Norms of Conduct for Public Office, approved by Decree N° 30/2003, 23 January, 2003.

## TOPIC 1.2 (Uruguay)

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PROFESSION	POSITION	AREA
Lawyer	Head of Department	Administration Division
Accountant	Chief of Auditors	Audits' Division
Teacher	Procedures' Specialist	Internal Division
Accountant	Head of Call-Center	Collection Division
Programming Analyst	Head of the Development Section	IT Division
Technical specialist	Auditor	Audits' Division
Computer Analyst	IT Auditor	Internal Audits

After selecting facilitators, the training program was organized and the internal and external DGI environments were analyzed.

This enabled to identify eight aspects of the internal environment and the needs and expectations of the interested parties (external environment), which were organized according to four dimensions (FODA): strengths, opportunities, weaknesses and threats.

With regards to the specificities of the Uruguayan organization, the EVAM methodology was adapted (Model for Assessment of a corporate ethics and integrity program) to the agency's possibilities.

Specifically, the number and array of officials participating in the assessment was increased<sup>19</sup> and questions were reformulated to consider the regulatory development and the creation of certain bodies. To such purposes, the most relevant issues for each axis in the model were defined: "Leadership and commitment", "Management and processes", "Individuals and Alliances" and "Security and Control".

At this stage of the process, it was determined that the group of facilitators did not rely on sufficient information on the strategic guidelines of the agency, which required extending its structure to incorporate the Internal Auditor and the Administration Director.

Additionally, the most functional evaluation modality for the result pursued was to hold focus groups in workshops according to three tiers: (1) Division Directors and Advisors, (2) Heads of Department and (3) Heads of Section and Operational Staff.

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<sup>19</sup> The EVAM methodology considered only the participation of management. Since in the DGI there are few members in that tier, the scope was extended to incorporate middle managers and operational staff.

The workshops were held with the focus on gathering perceptions and emphasizing quality rather than quantity thereof.

The result of the evaluations was analyzed and the Assessment Report was drafted.

The selection of the officials consulted was not random but discretionary. It was based on the cross-sectional criteria according to age group, role, insight on the section and the organization in general, degree of objectivity, geographic location, availability and interest, skills for human relations and communication.

Forty-seven officials were selected (47), from a total 1256 from the country's capital (where the DGI activity is mainly concentrated) as well as the interior (where collection tasks are carried out).

The process took nine months:

- a meeting was held in Panama on 20 July, 2009 in order to define the objectives and coordinate activities from the CIAT Program on Ethics, the schedule for self-evaluation and implementation, support to CIAT-Secretariat, Facilitators' Training, facilitators' profile, self-evaluation of ethics and sub-committee on Ethics' Management;
- a training course on ethics for facilitators was held on September 14-18, 2009, based on the documents "Self-evaluation workshop of the CIAT ethics' program in the tax administration. Guide for facilitators and the enforcement team. May -2007" and "Model for the incorporation of a program on Corporate Ethics and integrity. Pilot experience in Uruguay. September - 2009";
- the operational environment was assessed on 23-27 November of 2009;
- group interviews were held on 1-4 December of 2009;
- the final report was drafted on 7-11 December of 2009;
- the final report was submitted on 8 April of 2010.

The process developed swiftly and without resistance within the administration. Nevertheless, as defined in the foregoing paragraphs, adjustments were required on the methodology: adjusting the questionnaire on the Administration's possibilities and broadening the group of facilitators, given the need to learn about strategic guidelines reserved to management. Likewise, visits were made to different sectors in the agency to gather evidence to supplement the information obtained as a result of the workshops held.

## Recommendations

Out of the focus groups' interviews during the workshops, the results obtained enabled to draw the recommendations summarized hereunder:

### Critical areas for improvement

- **Awareness on the Control function:** awareness activities were required to help all the DGI officials understand and embrace the need of undertaking the control function, in operation and management activities as well as in terms of compliance with the regulatory framework governing such activities.
- **Strengthening the Planning and Control functions:** it is vital that all the Planning areas of the Administration rely on the resources, procedures, organizational structure and other necessary inputs to conduct such important functions.
- **Completing and updating the definition of all the key processes:** it is necessary to complete the process "map" and its detailed description, the specific, clear and detailed procedures, and the assessment and control mechanisms that apply in all cases.
- **Adjusting the administrative career system:** The assessment of the "Results" axis shows the impact of the deficiencies in the administrative career system on other axes, such as, for example, the legitimacy of supervisors who were not hired via a public call, the lack of motivation from the absence of promotion possibilities, and improvements in remuneration.
- **Improving the performance-assessment system:** The lack of homogeneity among the different supervisors in the assessment of officials, the loss of significance of the assessment for the supervisor as well as his direct report and its irregular execution erode the effectiveness of an important component of human resources' management: officials ignore the value of their work and the skills they should improve or sustain in their performance.
- **Strengthening training plans and internal communication:** with regards to training plans, such efforts should be conducted more regularly and with universal access. Regular courses on the "System of Incompatibilities and Full-time employment", "Rights and Obligations for DGI officials" and "Code of Ethics: scope and application".  
As regards internal communication, improvements are required for central and ancillary procedures, establishing communication procedures, systematizing the use of fast and universal communication media (Intranet, e-mail, etc.) as the sole official media.

- **Enhancing IT security:** the application of manual and automated controls, responsibility and behavior of users with respect to information assets and information itself, the value of evidence and leads from audits shall be contained in clearly documented and communicated policies and procedures.

In order to sustain the dynamics generated by the related interviews and activities, the group of facilitators in agreement with the General Directorate also set forth a sub-set of **fast implementation initiatives**:

- Elaboration of the **DGI Services' List or Letter** and its distribution among officials and taxpayers.
- Elaboration of a **Taxpayers' Rights and Obligations Catalogues** and dissemination among officials and taxpayers.
- Creation of a **taxpayers' "Complaints and Suggestions' Box"**, enabling taxpayers to set forth their claims and proposals to improve performance.
- Creation of a **"Suggestions and Initiatives' Box" for officials**, to submit proposals and initiatives to improve performance.

### 3.4. Review and adjustments

After the self-evaluation was completed, it became necessary to define and materialize a Program of Ethics and Integrity, based on the recommendations made on the Final Report of the self-evaluation stage, prioritizing the areas for critical improvements and good practices that are fast to implement.

To such purposes, the Steering Committee on Ethics and the Executive Committee on Ethics were created by Resolution N° 1525/2010, dated 30 July of 2010.

The Steering Committee on Ethics is made up by a delegate of the General Directorate, the Director of the Administration division, the Director of the IT division, the Coordinator of the Planning, Organization and Control Advisory Office, the Internal General Auditor and a delegate from the Association of Tax Officials; this Committee is called to meet at least once a month and make its decisions by 2/3 of the votes. Its objectives are:

- Drafting the definitions of the Program on Ethics and Integrity of the General Tax Directorate that shall include the Institutional Policies on Ethics, which shall be submitted to the approval of the General Directorate;



- Elaborating a preliminary Action Plan on Ethics and Integrity, aligned with the Strategic Performance Plan and the Code of Ethics of the General Tax Directorate, for approval by the General Directorate and subsequent inclusion on the annual Operating Plans;
- Supervising the Executive Committee tasks and receiving information on the effective implementation of the Program, the progress and the potential difficulties;
- Approving communications policies of the matters relative to the Ethics Program, in coordination with the Administrative Technical Support Department of the General Directorate;
- Approving specific training courses and workshop plans with case studies featuring ethical dilemmas, in coordination with the Department of Training of the Administration Division;
- 
- Analyzing proposals to strengthen and improve the efficiency of the internal security and control systems of the General Tax Directorate;
- Reviewing the results of the measurements of the public perception on the organizational ethics' culture and administration performance;
- Drafting the Internal Rules of the Steering Committee and the Executive Committee on Ethics.
- On the other hand, the Executive Committee on Ethics is made up by a delegate from each of the divisions and their respective deputies, and is required to meet at least every fifteen days, with the following responsibilities:
- The implementation, operational supervision and monitoring of the Action Plan, by gathering the information required from the areas in charge of compliance with the activities included therein, in order to register their progress and for the early detection of potential diversions;
- Informing the Steering Committee on Ethics of the progress in the implementation of the Action Plan and the diversions, if any, and proposing corrective actions as required;
- Fulfilling the remaining activities commissioned by the Steering Committee on Ethics according to the internal rules.

Currently, the undertakings of the Steering Committee on Ethics have resulted in the definition of the main **Strategic Guidelines of the Ethics and Integrity Program of the General Tax Directorate**. In sum, such Strategic Guidelines comprise:

- **Strengthening the Leadership and Commitment** in the sense that in order to achieve a healthy and efficient tax administration the

senior officials of the institution are required to lead processes that guarantee the integrity and fairness of the institution, appropriate continuity and taxpayers' trust.

- **Relying on a Clear and Simple Regulatory and Procedural Framework** in order to ensure unified criteria in the organization and the generation of legal certainty in officials as well as taxpayers.
- **Guaranteeing Equity** in the treatment of all taxpayers, facilitating compliance with their tax obligations, assisting them and guiding them, communicating and delivering timely and truthful information as required; likewise, they shall provide systems and mechanisms that enable the objective and transparent discussion of the actions of the administration.
- **Promoting Effective Management of Human Resources** based on an effective administrative career in line with the existing regulations, based on merit, clear and accurate rules on conditions and requirements for their mobility, fair and transparent recruitment and selection processes; education and training programs focused on individual development and improvement according to the organizational needs, policies and priorities; an equitable performance-assessment system, an objective, fair, transparent and effective administrative discipline procedure, and the promotion of a healthy working environment and spirit.
- **Developing Information Technology and Management procedures** in order to
  - a. rely on the appropriate technology infrastructure enabling new services and communication channels with taxpayers,
  - b. meet security and data back-up standards required by the established norms and procedures and the pertinent national and international good practices;
  - c. lead the demands of society and the globalized world, facilitating public access to information but safeguarding citizens' information, as required by law.
- **Delivering timely, transparent and truthful information**, in order to strengthen tax awareness in society, social acceptance of taxes and consolidation of the tax administration image as an entity respected for its professional, efficient and transparent development.

It also pursues continuous improvement of the internal communication that delivers sufficient and timely information regarding the mission, vision, values, strategies and action guidelines of the organization, as well as the motivation to obtain the collaboration of personnel in conveying the institutional messages to society.

- **Promoting Tax Administration Social Responsibility** relying on policies and procedures that promote awareness and corporate

responsibility pertaining to their activities, consistency between the interests of society and sustainable development, supported by ethical and integral behavior of their members and the institution in general with measures such as accountability, active and voluntary transparency of their members, protection of the environment, security and occupational health.

- **Developing Tax Awareness among citizens** by strengthening the current tax education program, along with the design and implementation of a strategy aimed at making citizens aware of the importance of meeting tax obligations, the role of the tax administration in financing State expenditure and the responsible use of the resources required in order to protect the environment and the population in general.
- **Promoting Ethical Values in the institutional sphere** by pursuing day-to-day compliance and permanent commitment to the principles and values enshrined in the institutional Code of Conduct.
- **Strengthening Performance Control**, relying on effective mechanisms enabling to
  - a. follow and verify compliance with processes;
  - b. identify and detect potential risk, areas for improvement and individual behaviors that entail diversions from laws and norms of ethics;
  - c. effective interaction with external control bodies.
- **Promoting the Relationship with Strategic Partners**, by developing initiatives that achieve national and international inter-institutional cooperation relations on common issues, in pursuit of enhanced performance to the benefit of the State and society.

The following stage, currently underway, is to define the specific activities to be pursued in the framework of each strategic course. The execution of this Plan shall be the role of the overall institution based on the **implementation, operational supervision and monitoring by the Executive Committee on Ethics**, as mentioned before.

Strongly in line with these strategic guidelines is the adoption of a set of measures that are already in effect:

- In the framework of an improvement in the planning and control functions, the Planning, Organization and Control Advisory Office was strengthened, consolidating such advisory role by the incorporation of qualified human resources, in line with the creation of the Head of Department position in the organizational restructuring project currently under consideration of the national authorities.

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- With the purpose of adapting the administrative career system, for the first time in the history of the DGI, a call was held to fill all the vacancies for Head of Department and Head of Section, which already feature an established schedule and shall be decided in the course of this year.
  - In order to strengthen and systematize the training of officials, new momentum was given to the Center for Tax Studies – created by Article 173 of Act N° 18.362, dated 6 October, 2008- which grants legal status and commissions the responsibilities of advising, research, training and education in tax and public finance matters, pursuant to Article 284 of Act N° 18.719, dated 27 December, 2010. Additionally, such norm established that said Center shall be governed by principles of Private Law, feature technical autonomy and report to the Executive Branch through the Ministry of Economy and Finance.
  - A consultant was hired for the external communication affairs, media management and monitoring, evaluating public surveys and communication campaigns' development; plans are in place to call for bids for new agencies that conduct public opinion surveys.
  - “Ethics and Values” courses were held, whose content consisted in a theoretical and practical course on Ethics and Values in the Organization.
  - The Charter of Taxpayers' Rights and Obligations was drafted and a compilation with the rights and duties defined in current regulations, both of which were launched –together with the announcement of other measures presently under the consideration of Parliament, which include the creation of a text on taxpayers' tax and duties – upon the closure of the 3<sup>rd</sup> Taxation Workshop (an academic event held by the General Tax Directorate with the active participation of all the recognized universities in the country and foreign experts). They are available in print as well as on the Web page of the General Tax Directorate.
  - A claims and suggestions' box was enabled, with an e-mail address (carta@dgi.gub.uy) to which taxpayers may forward their queries and suggestions, which originate in the competent offices in order to provide answers or adopt measures, as applicable.
  - The IT systems were adjusted as well as the procedures to manage information in order to provide for the self-evaluation recommendations, but also meet the Personal Data Protection Laws (Act N° 18.331) and the Public Information Access Act (N° 18.381). To such ends:
    - The available information was classified as confidential, reserved or secret;
    - Procedures were defined to secure that the information deemed public is disseminated and updated, focusing on

- activities based on the principles of freedom, transparency and responsibility;
- Procedures were defined to ensure that the information deemed public is managed on the basis of the principles of availability, efficiency, integrity and conservation.
- A project on the adoption of information management and control policies was defined, following the principles of truthfulness and accuracy,
- Procedures were defined to process, treat, store and preserve information;
- The implementation of information security management policy that considers:
  - Information security responsibilities;
  - Awareness and education of personnel in order to secure the security chain;
  - Appropriate processing of the organization's applications (validation controls);
  - Management of technical vulnerabilities (for example: good information assets' inventory and sources of technical information reporting on the vulnerabilities discovered);
  - A formal and documented process that guarantees the continuity of the organization's activities, identifying the impacts of potential incidents that threaten an organization in order to develop expeditious and effective responses;
  - Information security incidents' management.

#### **4. THE EXTERNAL PERCEPTION OF TAX MORALITY IN THE ADMINISTRATION**

Uruguay has been marked by ranking in the lowest levels of corruption in Latin America, with a very good status relative to the rest of the world.

From the Global 2009 Report of the Corruption Perception Index (TI), Uruguay ranks in the 24<sup>th</sup> position (from a total of 178 countries surveyed)<sup>20</sup>. In Latin America, it ranks second, and it has constantly improved its position.

In the last few years, the DGI has monitored the institutional image among users and the public opinion in general.

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<sup>20</sup> The Corruption Perception Index measures the level of perception of corruption in the public sector in a given country, based on surveys from informed observers of the public sector and politics.

Although, as we have already stated, corruption is not a pervasive issue in the country, ongoing monitoring is deemed necessary.

Such activity is conducted by hiring independent organizations that conduct public surveys among taxpayers and also the general population.

The surveys indicate that participants consider that the institution has evolved very positively in general terms and, particularly as regards transparency in the last few years.

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## METHODOLOGIES FOR MEASURING THE TAX MORALE OF TAXPAYERS AND THE RESULTS ACHIEVED

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**Contents:** *Introduction – I. Historic basis for the morality notion, in line with a relationship of trust with users – 1. Morality highlights the constitutional principles defining taxpayers’ rights and duties – 2. The constitutional changes were supplemented with the pursuit of a relationship of trust with users – II. The definition of tax morality and the key performance-management indicators that apply – 1. Definition of tax morality – 2. Tax morality measurement indicators – III. Results within the framework of the performance-management policy – 1. Legal framework – 2. Objectives-based performance – 3. The performance dialog – IV. Results’ analysis – 1. Results with respect to collection obligations – 2. Indicators of the combat against tax fraud – 3. Indicators for «promotion» of tax compliance – V. Implementation of administrative action adjusted to improve taxpayers’ tax morality – VI. Application of a policy to promote tax morality – 1. Consolidating actions already implemented with the strength of a new merged tax administration – 2. Extending actions to enable better user access to the service – 3. Facilitating tax understanding to offset complexity – 4. Greater data breakdown to relieve filing and payment formalities – 5. A mediation agent: the tax mediator*

### INTRODUCTION

According to a literal definition, morality is the set of ethical values of individuals, expressed through their attitude and behavior.

If applied in the tax sphere, it certainly constitutes an essential factor in improving the effectiveness of the tax administration.



This paper shall address the methodologies to measure taxpayers' tax morality based on the results of the administrative policy driven by objectives measured in figures.

The paper is centered on the following topics:

- A description of the historic context that includes tax morality as a principle of the republican agreement;
- The key measurement indicators of tax morality;
- The objectives defined in a context of performance-based missions;
- Results' analysis;
- Cyclical corrective measures implemented by DGFIP to improve tax morality;
- The long-term structural consolidation of the quality of service to users.

## **I. HISTORIC BASIS FOR THE MORALITY NOTION, IN LINE WITH A RELATIONSHIP OF TRUST WITH USERS**

### **1. Morality highlights the constitutional principles defining taxpayers' rights and duties.**

Tax constitutionality comprises three provisions that stem from articles 13 and 14 of the Declaration of the Rights of Man and of the Citizens (DDHC), which is set forth in the preamble of the Constitution of October 4<sup>th</sup>, 1958, the founding text of the Fifth Republic.

Let us remember that this founding text of the republican institutions originates in the French Revolution of the 18<sup>th</sup> century, one of whose causes was the completely unfair and inequitable nature of taxes.

The three principles of the fundamental of taxes are the following:

- The principle of **necessity** stemmed from Article 13: «a common contribution is vital in order to sustain public forces and administration expenses».
- The principle of **equality** before the tax, also stemming from Article 13 «the common contribution shall be equitably distributed among citizens based on their powers». Thus set forth, the principle of equality is the translation into tax law of the broad principle of equality among citizens.

- The principle of **consent to taxes** contained in Article 14 of the Declaration: «all citizens are entitled to determine, per se or through their representatives, the tax rate, the tax base, the collection means and the validity of taxes».

This power of the Legislative branch to enforce principles is reasserted in the current Constitution. No autonomous texts are admissible, other than the wording of the law, except for those relative to the organization of the tax administration, which, as we shall address, has undergone deep changes in recent years.

## **2. The constitutional changes were supplemented with the pursuit of a relationship of trust with users.**

The supplements to the constitutional principles are the result of a set of actions driven by the administration.

Such actions are defined in a specific Administration document.

To such purpose, a letter from a taxpayer published in 2005 summarizes clearly and accurately the rights and duties of taxpayers with the tax administration.

This document seeks to find a balance between:

- Responsible users that respect their duties as citizens;
- And the responsible administration at the service of users, which bases its relationship on three fundamental values: simplicity, respect and equality.

**The actions included in this document have been considerably developed by the improvement in the quality of service attained in recent years (cf § VI supra).**

## **II. THE DEFINITION OF TAX MORALITY AND THE KEY PERFORMANCE-MANAGEMENT INDICATORS THAT APPLY.**

### **1. Definition of tax morality**

The notion makes reference to norms that determine citizens' virtuous behavior with respect to their obligations towards the State; such norms include the set of duties that taxpayers bear in the framework of laws and norms that constitute the fundamentals of tax legislation.

## 2. Tax morality measurement indicators

These are the central axes of the administrative policy whose strategy is based on performance-management.

Performance indicators measure the integral nature of the actions in the chain of tax transactions. Three types of transactions apply:

- the obligation to file returns;
- the payment obligations;
- Audit-related actions.

### a. Indicators for the obligation to file returns

They are dependent on two categories, based on professional or individual taxpayers.

- Measures that apply to professionals:

They refer to:

- The sector of professional users who make their payments within the legal timeframe in relation with their obligations to file VAT returns (**CIV1** indicator), arising from the computer system that manages the relevant population.

This indicator measures **on a monthly basis** the proportion of taxpayers who fulfill their obligation to file their tax returns as required.

- The delinquency rate vis-à-vis corporate tax returns (indicator **DEF1**).

This indicator measures **on an annual basis** voluntary compliance with the obligation to file income tax returns by users under the scope of services for management of professionals on the territory.

- Measures applicable to individuals:

- They pertain to individual users who meet their obligations to file income tax returns (CIV 2).

This is an annual indicator that calculates the percentage of individual taxpayers who have filed their tax returns, compared with the population of taxpayers subject to the obligation to file tax returns.

b. Tax payment measurement indicators:

They include both individual and corporate taxes.

They comprise:

- The index of direct taxes collected from individuals, calculated **on a monthly basis** based on the amount of taxes paid voluntarily and compared with the volume of the expected tax plus the enforced collection amount;
- The portion of taxes paid voluntarily by corporations (CIV3R). Calculated annually, this indicator, expressed in terms of indexes like most indicators, seeks to assess the timely payments arising from returns, made by taxpayers who undertake a professional activity;
- The corporate tax enforced collection index (**DEF2**). This monthly indicator measures the percentage of net collection on the overall pending claims, unpaid by taxpayers.

c. Audit measurement indicators:

In essence, they constitute a percentage of audits exclusive of the most serious breaches (CF1R).

This **quarterly** indicator assesses the business volume that was the basis for penalties that exclude good faith or the penalty for the failure to file tax returns after notification, and compares with the set of transactions from onsite audits.

On the other hand, it is worth highlighting that the collection index for taxes after notification following an audit also requires monitoring.

**3. The administration implements actions aimed at promoting taxpayers' civic compliance.**

Voluntary actions are undertaken based on objectives set forth in figures that the administration sets for itself and constitute an object for measurements as well.

Such action pertains to the relationship of trust that the administration permanently seeks to establish with users.

Such actions may be described according to two types:

**A set of service commitments** by the tax administration in favor of their users through the program «Tax facilitation». All the indicators for quality of service are monitored **quarterly** based on results' objectives defined for each base service.

The program spans a complete series of commitments: the telephone calls' index, the reception confidentiality, the identification of the agents who assist users, forms forwarded within 48 hours.

Likewise, customer-assistance offices may be subject to a certification process whose qualification attributed by an external agency is subject to annual compliance controls.

This certification is based on benchmarks, such as customer assistance in the public finance offices. Quality standards pursue good practices and provide the quality- monitoring framework, which, if otherwise, would make quality difficult to assess.

**The setback** is the relative burden implied by monitoring benchmarks – in particular for heads of service – as well as the quality of service issue that calls for renewal of the actions towards users.

- **Actions** aimed at enabling users to benefit from their rights as soon as possible.

Such last actions chiefly cover:

- The VAT credit refund requests and corporate tax refunds that the administration processes to the benefit of corporations within a term not exceeding 30-days. The objective for processing services is to follow the 80% rate;
- The index of contentious proceedings filed by individuals pertaining to income tax claims and real estate tax claims processed within 30-days.

### **III. RESULTS WITHIN THE FRAMEWORK OF THE PERFORMANCE-MANAGEMENT POLICY.**

#### **1. Legal framework**

- - New budget governance

The implementation of the performance culture arises from the Organic Law relative to the Finance Legislation (LOLF) adopted in August 2001

that defines a general and renewed framework for the State budgetary and accounting process.

This new budget governance relies on the results-centered culture and pursues a twofold objective:

- It extends the powers of Parliament by delivering more information on the performance of the administrations in the framework of a clearer and more transparent framework;
- It assigns responsibility to public officials.

For clarification purposes, the State budget is currently submitted by **public policies** named «missions» (one per ministry), structured according to **programs** with a global and restrictive credit treatment. The purpose of credits in each program is defined by the **actions** approved by parliament.

- The Annual Performance Project (PAP, as per the French acronym)

For each program, the PAP defines the following:

- A strategy;
- Actions implemented;
- Objectives pursued;
- The results achieved and the expected results for subsequent years, measured with accurate indicators.

A document with identical structure to the PAP, as attached, is also included in the text of the Finance Law: the Annual Performance Report (RAP, as per the French acronym) indicating the performance achieved in the preceding year with respect to the objectives, indicators and values defined in the PAP for the same fiscal year.

PAPs are developed based on the **programs' operating budgets (BOP, as per the French acronym)**.

- The Program Operating Budget (BOP)

The operative implementation of this document, based on two key notions –means and performance – depends on the responsibility of the DGFIP units.

The BOP 2011 comprises 20 indicators whose national objectives translate the strategic DGFIP priorities described in the PAP; the level by objective has been defined jointly with the Budget Ministry Directorate, in charge of providing the human and financial resources to the administration.

Among the objectives defined in the Finance legislation, we may mention the following:

- Objective N°2 : favoring voluntary compliance with tax obligations ;
- Objective N°3 : facilitating taxes;
- Objective N°4 : strengthening efforts against tax fraud;
- Objective N°7: reducing the timeframes to make tax payments.

## **2. Objectives-based performance**

Objectives-based performance is based on the engagement rationale defined at each level of responsibility.

### **Definition of objectives between the central and the departmental level.**

It applies in the framework of a dialog between the inter-regional Delegates and the operational head of department.

As representatives of the Director General before the local DGFIP heads, Delegates act on the basis of the performance scope and the monitoring requirements, guaranteeing a functional role differentiated from the operational role, guaranteed by the heads of department.

The process to define objectives by departments is an overall growing trend at the inter-regional level. The heads of department set forth objectives, through the inter-regional Delegates, subsequently consolidated by the Directorate General that ensures the proposals' consistency with PAP objectives.

The objectives set forth are mostly validated by the central level; if otherwise, owing to insufficient proposals, a «second round» is held, which leads certain departments to define better objectives with respect to the first proposal.

The set of objectives is formalized on the departmental BOPs. These elements that are related to figures are then applied at the sub-departmental level in each one of the operational services, always based on the contract between the local Director and each head of service.

### **3. The performance dialog**

Upon obtaining validation for departmental BOPs, the performance dialog is structured around a twofold mechanism:

- The «incoming» performance dialog between the Delegate and the head of department within a term of 6 months from the time a new local director is hired;
  - The submittal of an annual performance report.
- The «incoming» performance dialog

The conference with the Delegate is the occasion to conduct an analysis on the departmental implementation of the strategic guidelines and on the evolution of the results, which also constitutes the validation of the principle for the strategic action plans set forth by the Director with full responsibility.

It is supported with a file forwarded to the Delegate by the newly appointed responsible individual, which shall, at least, address the indicators issued by the PAP and arising from the local BOPs.

- The performance report

The annual performance report constitutes, above all, a milestone that marks the degree of completion of the priority action programs defined by the Director to meet the objectives of the departmental BOP.

Each local head shall forward this performance report to the Delegate. The latter evaluates whether a meeting with the local head is relevant in order to elaborate on certain issues, chiefly in the situations reflecting a shortcoming of the results achieved in the framework of the departmental BOP.



## IV. RESULTS' ANALYSIS

The implementation of performance-management indicators enabled to improve the effectiveness of the tax administration and measure its evolution accurately.

The index of voluntary compliance with VAT returns has increased considerably in the course of the last few years, from 84% in 2003 to 92% in 2010.

### 1. Results with respect to collection obligations.

The payroll tax compliance index grew from 97% to 99% in the period between 2003 and 2010.

The voluntary compliance index for self-assessed taxes (**CIV3R**) remained more stable but is already at a high level, close to 98%. It stood strong in 2009 in a very unfavorable economic context, with the crisis facing corporations.



It is worth highlighting that the trend of the curves shows that this improvement is not infinite and we may empirically conclude that once the 98% threshold is reached, it becomes increasingly difficult to make significant progress. Therefore, the results achieved shall be consolidated.

### 2. Indicators of the combat against tax fraud.

They progress sustainably and significantly in the period between 2005 and 2010.

Example: the percentage of audits that exclude the most serious fraud cases grew from 18% at the end of September 2008 to 19% two years later.

And the same applies for the tax collection index after an external tax audit.

Example: between September 2008 and September 2010 the index for payments of fines grew from 75% to 80%.

### 3. Indicators for «promotion» of tax compliance

They rank high and remain consolidated for the overall period.

Example: from 2008 to 2010, the segment of individual users who duly pay income tax evolved between 98.61% and 98.66%.

☞	Although the implementation of a system of performance measurement indicators has enabled better results for the missions, <b>the mechanism features certain limits</b> . A clear consequence is the administration of the mission only according to the result expected, to the detriment of quality and an overall vision of operations.
☞	<b>Outlook as from 2011:</b> the local heads shall receive new instructions. Such instructions shall limit the number of indicators by keeping objectives at their current level, in a context of staff reduction.

### V. IMPLEMENTATION OF ADMINISTRATIVE ACTION ADJUSTED TO IMPROVE TAXPAYERS' TAX MORALITY.

Although performance is very good at the national plan level, certain departments may feature lower-level results, which may eventually pose a negative risk to the overall level.

In the face of a downturn in the level of the objectives achieved, action plans are required. Such plans entail adopting prevention measures towards a better reaction to the shortcomings and they shall be inherent in the organization of the role.

For example, in the case of a downturn in **indicator CIV1, which measures the degree of compliance for professionals**, the improvement levers might be the following:

- Mandatory monitoring of noncompliant taxpayers, with friendly telephone calls or letters at the beginning of each month. On the other hand, an IT application is underway to support such operations;
- Strict enforcement of penalties for chronic noncompliance cases;
- Official notifications to said noncompliant taxpayers in the shortest timeframes;

- Preserve the quality of the records for the delinquent population (systematically delete delinquent taxpayers who have closed their business).

● **In the face of a reduction in the number of individuals who meet their tax-filing obligations**, beyond enforcing penalties upon noncompliant taxpayers, the external communication shall be extended in order to create awareness among certain groups with respect to their duties: foreign students' population, with specific bilingual assistance and good surveys during the annual filing season.

● A reduction in collection indicators shall serve as the basis for a specific policy based on the nature of noncompliant taxpayers. In the case of debtors facing temporary financial distress, the payment deadlines may be extended, by applying late interest and under the promise of meeting the installment facilities granted by the administration.

With regards to chronic noncompliant taxpayers, a firm sanction policy shall apply, based on important penalties enforced without extensions, up to enforced proceedings in the contentious sphere.

## **VI. APPLICATION OF A POLICY TO PROMOTE TAX MORALITY.**

### **1. Consolidating actions already implemented with the strength of a new merged tax administration.**

The creation of the General Public Finance Directorate (DGFIP, as per the French acronym), in 2008, originated from the merger between the General Tax Directorate and the General Public Accounting Directorate has enabled **a qualitative leap in improving the relationship between the public service and users.**

Notwithstanding all the efforts carried out until that time, the two former administrations were not fit to overcome the serious setback for users from the onset, based on the fact that the two organizations shared the tax and collection base for individuals.

When taxpayers wished to submit a formality, query or objection, they had to infer the correct service in which to file their request (the tax office responsible for the all tax bases and the collection of professional taxes or the office in charge of collecting taxes from individuals).

Frequently, the difference was not clear and numerous users filed with the wrong service. In many cases, it became necessary to file with both services, for example, in the case of a formal objection followed by a request for extension of the Income Tax deadline.

The creation of a one-stop shopping window for individuals constitutes the heart of the reform by the creation of the single directorate.

With this new one-stop shopping window, the individual taxpayer no longer wonders about the competent service to process his request. The unified service is competent on all matters.

The one-stop shopping window is marked by two aspects:

**a. Creation of tax services for individuals**

The tax service for individuals is a single service that serves the overall tax base and sees to the overall collection from taxpayers, regardless of their geographical area. It was created in all the communities in which a tax office and a treasury office operated before, owing to the merger of the two services and the unification of their agents.

From now on, the complete record for a taxpayer is carried in the same service. If the user makes a phone call or visits the window, he shall find a qualified agent to answer his questions. If the request relates to administrative and collection issues at the same time, it shall be processed in the same service.

**b. Implementation of tax assistance facilities in the proximity**

After the creation of all the tax services for individuals in the urban areas, 55% of users shall be covered. Therefore, in the small communities, the rural communities or peripheral urban communities, in order to provide a complete service to users, all the treasury offices guarantee assistance for users not only vis-à-vis collection issues, but also tax assessment matters. This is the notion of **1<sup>st</sup> level of tax assistance in the proximity**.

This new service enables the user to obtain the answer to most administrative matters from the treasury office. In the case of a more complex question or a contentious proceeding, the user is not required to file a new proceeding. The treasury takes over the record, delivers it to the back office and monitors its evolution. The user relies on the

same timeframes to receive an answer as those applicable for the administrative service.

Upon the creation of the tax services for individuals and the treasury offices in the proximity, the DGFIP adopts a strong approach to improve users' service. From now on, the content of the service delivered at each site increases.

Likewise, the DGFIP extends its fiscal proximity network by adding treasury offices (over 3000 centers) in the rural areas.

The tax services for individuals are deployed expeditiously, with 260 SIP in 2009, 608 at the end of 2010 and 698 at the end of 2011, amounting to 90% of the overall services to be implemented.

Proximity tax assistance was implemented across the whole territory in September of 2009 and its creation was mentioned on tax notifications. In spite of the limited communication, proximity tax assistance has been a true success, which was included in the last Income Tax season. It immediately facilitated supplemental service to users and has only increased since then.

## **2. Extending actions to enable better user access to the service.**

The DGFIP seeks to be increasingly accessible to users in order to deliver the quality of service they expect.

### **a. Multi-channel access.**

The DGFIP seeks to multiply the access channels to the administration based on the multi-channel access policy. A user is currently enabled to obtain information via the Internet, make a call, visit the window or enjoy the postal or e-mail service.

### **b. On-line services**

Users are no longer required to move or depend on office hours owing to the availability of online information. On the Internet portal «impots.gouv.fr », taxpayers may directly find the information and contacts they require, download documents, assess their Income Tax, make payments and query their tax account with all the information on their tax returns.

The portal is a true success, with 54 million hits in 2009 and 25 million online Income Tax calculations for a population of 32 million taxpayers.

The portal «cadastre.gouv.fr» enables users to query the cadastre system and download forms. Also, the portal had 7.3 million hits in 2009, 76 million pages queried and 76,000 form downloads.

### **c. Telephone service**

Telephone access was completely renewed with significant investment in telephone equipment for better traffic management.

At the same time, national telephone service centers were implemented with calls at the price of a local call, to answer users' questions.

These «tax service centers» answer all the general questions on allocations and collection for individuals and professionals, until 10:00 p.m., including Saturdays.

The «taxation centers» process users' requests regarding their payment agreements and monthly installments.

The «tax service centers» and «taxation centers» serve a genuine need since they have processed 7 million calls in 2009.

### **d. Information from the window**

Service-related processes were also subject to deep transformation. The service hours have been extended and the administrative services are available every day. The visits to service offices are widespread. For improved access, the addresses of the service offices are noted on all the documents forwarded to taxpayers.

In order to better serve taxpayer needs, the DGFIP also adopts an organization in line with the service area to receive tax returns in May/ June, the peak demand time for such services, with 3.5 million visits per window.

During this time, an important media campaign is also conducted to inform taxpayers at the national as well as local level. Special attention is placed on population groups with special needs such as the visually and hearing-impaired, who receive special assistance in certain areas.

If assistance is an integral part of the services' mission, **it shall move forward with greater professionalism from the agents involved.**

**e. E-mail**

Users may also forward their queries via e-mail. The administration assumed the commitment of answering e-mails within 48 hours. The e-mail address of the services is systematically featured on all the documents forwarded to taxpayers.

Close to two-million messages have been received via e-mail in 2010.

**3. Facilitating tax understanding to offset complexity**

For the last few years, the DGFIP has been undertaking very important efforts vis-à-vis the content and presentation of the documents forwarded to taxpayers.

**a. Returns**

With respect to tax returns, every finance law introduces amendments and adds supplemental information. Every year, the DGFIP reviews the contents of tax returns, which are increasingly dense.

In order to offset this evolution, the administration adopted a system of special returns according to users: simplified returns for the most common categories and complete returns for the most unusual or complex returns.

This process is appropriate for the income returns for individuals and is in the process of extending it to the returns of professionals.

**b. Information transparency**

An important factor for transparency and facilitation of relations is the appropriate identification of interlocutors. The reference for the services is systematically featured on the administrative notifications, just as the data of the person processing the record. Likewise, clear information is rendered on the mechanism to file claims.

### **c. User guides**

Simplified guides are made available for users regarding the most frequently asked questions.

From the time they register with the services, the new professional taxpayers systematically receive the tax book with the explanation on their tax system and their obligations.

### **4. Greater data breakdown to relieve filing and payment formalities**

Improving tax morality implies facilitating the management of the returns and payments that taxpayers make. Beyond the formal complexity of the tax, the formality shall be as simple as possible and the administration shall reduce the complexity for the user to the minimum extent possible.

#### **a. Individuals**

The largest share of taxes from individuals relies on new processes to facilitate taxation.

With the pre-completed return, the income information known by the administration is pre-printed on the income return sent to individual taxpayers or pre-completed on the electronic return. Since the incorporation of income from personal property last year, over 90% of returns enjoy the pre-completed information function.

For many years, individuals have been able to file electronic returns and this feature is being adopted. The DGFIP received over 9.7 million electronic returns in 2009.

To a great extent, the procedure has improved. All users may file electronic returns, even new taxpayers and those whose family situation has changed in the course of the year. From now on, electronic returns may be filed without certificates from any computer.

In order to simplify the process even more, taxes may be paid with new electronic means of payment. Taxpayers enjoy the option of debiting the tax on the payment deadline or making the online payment, which saves 10-days in processing time by the treasury office. They may also choose to pay on monthly installments.



Such payment means are increasingly successful: 51% of direct tax payments and 78% of Income Tax payments are electronic.

### **b. Professionals**

Professional taxpayers also rely on new electronic procedures.

Businesses with business volume in excess of 500,000€ HT are required to **file their returns and make payments via electronic means**. As from October-2011, the threshold shall drop to 230,000€.

Other businesses are free to choose between the electronic VAT return and the online VAT payment. Likewise, they may pay the Corporate Tax, Payroll Tax, or the new corporate value added premium electronically. A total 800,000 businesses use the TeleVAT (TéléTVA) and 82% of VAT collection is electronic. Additionally, 48% of the Corporate Tax and 31% of the Payroll Tax is paid online.

Businesses may also choose to file their income or VAT by sending files from their accounting software: 500,000 businesses have chosen this formula for VAT and more than 2 million businesses file electronic income returns, over a total of 3 million.

This online procedure was specifically adjusted for Accountants who process returns for their clients.

### **5. A mediation agent: the tax mediator.**

The department has designated a tax mediator per department across the territory. The underlying philosophy in this institution is finding solutions based on compromises to minor disputes.

Taxpayers may resort to such agents for all disputes against the administration relative to administrative or collection matters, or the services, to find amicable solutions.

## METHODOLOGIES FOR MEASURING THE TAX MORALE OF TAXPAYERS AND THE RESULTS ACHIEVED

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***Contents:** Abstract – 1. Introduction – 1.1 The State – Citizen Relation – 2. What do we know about tax morality? – 2.1 Taxpayer reputation and morale – 2.2 State co-responsibility – 2.3 Tax Administration risk and confidence component – 2.4 Socioeconomic and demographic factors – 3. Seeking in practice what is explained in theory. From the general model to the inclusion of morale – 3.1 Data – 3.2 Tax morale proxy – 3.3 Values – 3.4 Co-responsibility of the state. Reciprocity – 3.5 Risk, payment facility and knowledge of the tax system – 3.6 Socio-demographic and socioeconomic data – 3.7 Model specification based on an “Ordered Probit” – 4. Results – 5. Public policy recommendation – 6. Bibliography – Annex*

### **ABSTRACT**

Tax Administrations require that beliefs, values and norms determining the actions of citizens and taxpayers be consistent with their own convictions (moral and ethical) as well as those established by society. This paper addresses the key theoretical considerations on tax morale, emphasizing those that determine an influence on taxpayers' attitude and compares results with empirical data on Ecuador. The tax morale of society in Ecuador is a function of citizens' opinion on the use and allocation of taxes, their fear of risk in the form of a moral or monetary sanction, payment facilities and simplicity, and their personal and social values. The results also enable to establish a baseline for the appropriate formulation of policy and performance in the Tax Administration.

N.B.: The opinions set forth herein are the authors' exclusive responsibility, and may not necessarily coincide with those of the

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Key words: public treasury, public opinion, attitudes, taxpayer, government expenditure, taxes, tax morale, perception, tax compliance, democracy and welfare policies, JEL: H2, H390, A14, D72, H00.

## 1. INTRODUCTION

Moral behaviors and attitudes may strengthen or hinder democratic processes. To Kliksberg (1999, 2002) the culture and values have decisive weight on development. Societies that promote values in favor of the social pact and reflect them in the tax systems improving services (for example, health and education) facilitate their economic and technological progress and their competitiveness. But if the prevailing values fail to counter phenomena like tax evasion and tax fraud, we may expect the weakening of the social mesh and even reversals in the social cohesion resulting in more complex structural problems.

We may assume that democracy places the tax policy as the axis around which the relation between citizens and the State revolves; on the one hand, it is the bond at the time of making an onerous contribution to the state, and on the other, the delivery of public goods and services.

But a vicious circle exists in the tax legitimacy of the State: since its economic capacity is reduced owing to the tax potential that has been eroded by tax evasion, it is not in a position to supply the public goods and services that society demands. On the other hand, the limited capacity of the public or private institutional role is sometimes aggravated by immoral public behaviors, which hinders citizens' commitment towards sustaining the State with their taxes.

The features of the State – citizens' relation largely define the tax behavior. The key actors in the tax relation (taxpayer and tax authority) state their views on the morale of others and qualify themselves as ethically moral or immoral based on fundamental parameters and principles. Paying taxes depends not only on the net income expected, by which the likelihood of detection and the penalty amounts are key elements, but also on qualitative and intangible variables such as: the socio-demographic factors, knowledge of the tax system, personal

and civic values, the sense of belonging, the perception of reciprocity, solidarity, among others.

But, is it possible to determine correlations and causality between tax evasion and lack of tax morale? ¿Does tax evasion occur owing to the lack of tax morale, that is to say, by the absence of norms or socially accepted values establishing that noncompliance is incorrect? Which are the key factors that influence the promotion of the tax morale within society? Is it possible to identify specific strategies and build a fiscal pact that strengthens the tax morale in society?

This paper seeks to answer these questions, by identifying the different degrees of tax morale in Ecuadorian society and understanding the factors that influence its behavior; only by doing so it will be possible to design specific policies for each segment.

### **1.1 The State – Citizen Relation**

In order to secure collective wellbeing by fulfilling social demands, the State decides on the public goods and services to deliver to citizens and how to distribute among them the cost of the goods and services delivered (Sevilla, 2004). This relation or “social contract” established reciprocity bonds between the State and its citizens, embodying the fiscal pact, which, according to Martner (2008) is the fundamental socio-political consensus that legitimates the role of the State and the field and scope of their responsibilities in the economic and social sphere. A social pact entails the creation of an organized structure in the community and determines, as the counterpart, who bears the cost of financing it (Estévez & Esper, s/f).

The State – Citizen relation is not marked by perfect harmony, but shall be legitimated by a political process by which citizens know and express their confidence in the State tax policy. According to Sevilla, 2004, this legitimacy is even more important when the perception exists that the tax payments from citizens is inconsistent with what they receive in goods and services delivered by the State.

Legitimacy pertains to tax matters as a reflection of the confidence that individuals place in the work of the State. It constitutes a “feeling” tied to ethics and morale, where the thoughts generated based on the State economic and tax capacity are very sensitive to the final destination of the resources collected. Tax evasion erodes the tax

capacity, reducing the opportunities of offering the goods and services that society demands. Once the social pact is breached and with insufficient resources, authors like Estévez & Esper point out that tax noncompliance grows as a form of settling matters. Overall, the perception of the actions by the State governs the idea of 'compliance' or 'noncompliance' with the social pact and affects the will of citizens to cooperate with their effort to the general wellbeing.

Legitimacy has broad implications, including the collective acceptance of institutions, public agents and the services they provide, transparency, ethics and the inherent values defined by society. The State-Citizen relation goes beyond a simple services' contract. The State-Citizen relation is centered on tax matters, as a channel to achieve the distributive fairness -as defined in Nicomachean Ethics ([circa SIVadC] 2007) - by which citizens perceive the payment of taxes in line with their moral values, as a contribution to the common good and shall act honestly by contributing with their share, even if they do not receive the goods and services expected from their contribution (Estévez & Esper, 2009).

## **2. WHAT DO WE KNOW ABOUT TAX MORALITY?**

The theory of taxation in classical economics examines tax compliance as the rational behavior motivated by the self-interest of individuals in different situations. For example, Adam Smith (1776), sets forth four maxims to define citizens' behavior towards taxes: fairness (referring to tax equity and the effort that each citizen shall bear to contribute in supporting the Government), certainty (implying that they should not be discretionary or arbitrary to enable every individual to understand the way in which they are determined), convenience (timely collection) and economy (deriving in lower costs of compliance for the "citizens' pocket" and not incur in unnecessary costs that are not directly reflected in revenue for the State). Likewise, Stuart Mill (1856) asserts that "Englishmen dislike the act of paying rather than the payment, they dislike the face of the tax official, and being subjected to his peremptory demand", to highlight that the taxpayer's attitude is reactive to the coercive act of the authority and the costs derived from tax collection, including reputation, upon being subject to a collection action.

For years, the studies on tax evasion focused on the punitive aspects of tax behavior. In such models, an individual decides to pay or evade his taxes according to the expected benefit from such actions

determined by the likelihood of being detected, the penalty amount, tax rate and risk aversion. Every individual maximizes his benefit without the intervention of aspects in relation with values, ethics, or other matters relative to taxpayers' moral considerations (Allingham and Sandmo (1972)).

The literature supporting this vision features Yitzhaki (1974) and McCaleb (1976) who elaborate on micro-economics; Sandmo (1981), Greenberg (1984), Mookherjee and Png (1989) a game-theoretic approach and the principal – agent issue; Cowell (1985) compiles data from surveys on taxpayers' attitudes, Usher (1986) and Mayshar (1991) examine the matter from the standpoint of costs, Spicer and Becker (1980), Kaplan and Reckers (1986) and Franzoni (1999) with experimental studies relating 'tax evasion and inequity'. Interestingly, although theoretical papers abound, empirical ones are rather scarce. In Ecuador, an empirical application exists in the General Tax Balance Model, developed by the Internal Revenue Service (2007).

Paying taxes is more than a combination of probabilities between sanctions and audits. The process starting with the tax statement and its audit, up to the punishment of evaders is long and complex. The process actors are also multiple (Tax Administration, courts, tax advisors) and their different roles (interviews, audits, appearance in court, etc.). Institutions and procedure impose indirect costs on taxpayers and affect their attitudes as well as the outcome of the court proceeding itself. And the quality of institutions reduces the possibility of punishing an innocent individual (type-II<sup>1</sup> error), and diminishes the degree of "hostility" in taxpayers' perception of the tax system (Klaus Tipke (2002) calls the latter the morale of the State).

The lack of knowledge on tax regulations or the high costs in relation with the payment of taxes frequently arising from complex laws, may not only shift the cost-benefit ratio towards tax evasion, but also generate resentment that shall weaken taxpayers' moral awareness, even pushing them to evade as a way of "punishing" the Tax Administration (Tipke, 2002). According to several studies, the indirect costs for taxpayers in industrialized countries may be as high as 10-13 percent of the overall tax debt from Income Tax and VAT (refer to the works by Sandford, 1973; Sanford et al, 1986; Slemrod, 1989; Pitt and Slemrod, 1989; Sandford, Goodwin and Hardwick, 1989; Blumenthal

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*1 According to data, a nullity hypothesis may appear to be valid even if false, based on chance (this is known as type – II error). The inability to reject the nullity hypothesis does not mean it may be confirmed, and that the difference between one and the other bears decisive influence on the conclusions potentially derived from a study.*

and Slemrod, 1992, and Sandford, 1995a). In Ecuador, according to studies from the Internal Revenue Service, the indirect cost of tax compliance for 2008 could amount to 1.6% of the total revenue.

The limitations in this classical approach are increasingly evident. For example, it does not explain the direct relation between the levels of tax evasion and the likelihood of an audit (in certain societies tax evasion is low even when the likelihood of an audit is limited, or almost null). It neither explains the reason why certain individuals experience “guilt” when they do not pay their taxes and others do. Thus, it is clear that other non-economic variables and determining factors exist, of an economic, sociological, political, administrative, cultural and moral nature, foreign to the maximization of the benefit expected from the net income (Fatás & Roig, 2004). Tax compliance and noncompliance were no longer considered a function exclusively dependant on objective variables.

## **2.1 Taxpayer reputation and morale**

Curiously, one of the first papers introducing the “morale” variable as determining factor in tax evasion and tax compliance was written by Allingham and Sandmo (1972). These authors formalize the individual attitude of the taxpayer in his decision to meet or not meet tax obligations, introducing for the first time a representative parameter of the moral factor: ‘guilt for evasion and the social impact of detection on his reputation’.

With reputation as a variable that generates a benefit for individuals, the marginal benefit from the net income decreases, and, reputation and income become essential substitutes. In other words, when tax evasion affects individuals’ social reputation, the improvement in tax compliance is expectable. Since then, multiple papers have approached the morale issue as a vital determining factor in the citizens’ tax behavior.

In 1976, Spicer and Lundstedt analyzed the incidence of the social reputation on individuals’ tax attitude. The data gathered from surveys conducted in Ohio, United States show that the option between evading and paying is a decision comprising other notions such as the coercive capacity, the equity of the system and the attitude of society towards those who fail to pay. Song and Yarbrough (1978) try to measure society’s ethical predisposition to pay tax obligations, that is to say, the extent to which individuals considered tax evasion as a criminal

or amoral behavior. The results indicate that taxpayers with higher income and greater degree of education featured better tax morale, while those who felt affected by the policies of the State, featured low tax morale. Lewis (1971, 1982) looked into the relation between guilt, shame and tax evasion and concluded that guilt appears when individuals understand that they behaved irresponsibly and violated a social rule or norm that they had internalized as correct.

Beginning in the 1990s the “morale” variable becomes a common factor in economic literature upon the analysis of the causes leading taxpayers to pay their taxes and others to evade them. In 1994, Erard and Feinstein call to integrate the moral feelings in the theoretical models to provide a reasonable explanation of taxpayers’ tax behavior. Two old theories appear again: the first approach based on the altruistic principle by which the individual decides his tax behavior not only based on his own wellbeing but the social wellbeing, whereby the decision to evade or pay is explained by the individual’s knowledge that failure to pay impairs the delivery of goods and impacts the social wellbeing. The second approach, based on the Kantian principle of morale related with its definition, by which taxpayers consider that a tax is fair when it is fair for all other taxpayers, and that tax evasion may affect their image before others. Erard and Feinstein conclude that in order for taxpayers to make the decision to evade, the benefits of doing so should outweigh the moral costs they face, thus reasserting the original idea by Allingham and Sandmo (1972). Nevertheless, an aspect that the authors point out is that the moral cost shall only appear when taxpayers consider that the tax rate is “fair”, suggesting a purely subjective component that bears no incidence on the tax morale as such, but on the individual’s behavior above it.

The individual and the social morale are related. Both interact and become one, through a tradeoff between taxation (by the enforcing party) and acceptance (by the bearer). Both types of morale participate in a race in which reformulation and acceptance iterate, until a social agreement or consensus is reached on the tax, at which point the citizen ‘accepts and legitimates’ it with his payment; or ‘rejects and de-legitimates’ with the failure to pay or a claim.

## **2.2 State co-responsibility**

Tipke (2002), in his book “The Tax Morale of the State and of the Taxpayers”, strengthens the notion of tax ethics from the standpoint of law and the performance of the State as a counterpart of the tax



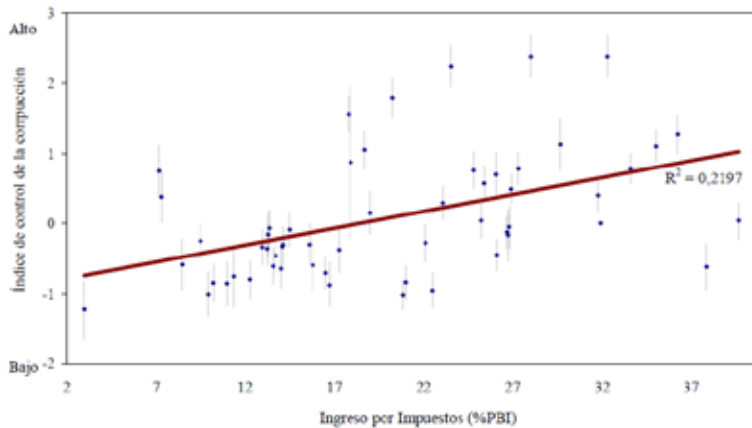
morale of the citizen. According to this vision, should the State intend to demand tax compliance, it shall abide by moral, ethical, transparent and efficient behavior in its own actions. When it comes to the morale of the State, the co-responsibility over taxes, tax collection and allocation is deemed a requirement.

The social capital of taxation is what the citizen and taxpayer receives or perceives he receives from the State through public services and/or social investment. The motivation to pay depends on the quality of the public services and the performance of the State, as well as the knowledge or perception of society with respect to such government spending. Under such conditions, information, transparency and accountability become an integral part of the tax behavior model.

The relations between the 'morale of the government official, and social ethics' and the taxpayer behavior are subject to study in the Economics of Corruption. Tanzi (1998) refers to corruption as "any act by government authorities, whether policy-makers or bureaucrats, which divert from the purpose of delivering greater social wellbeing motivated by the pursuit of personal profit or the benefit of relatives or friends". At the empirical level, countries with lower control of corruption feature lower revenue as a percentage of the GDP (Chart 1). Gupta, Davoodi and Alonso-Terme (2002) sustain that in the face of higher corruption levels, tax collection drops since it facilitates tax evasion. The cost of opportunity for the tax evader shall be lower to the extent he may incur in corruption to avoid punishment.

Similar studies such as the one by Haque and Sahay (1996), Tanzi and Davoodi (1998, 2000), Chand and Moene (2002) and Ghura (2002) find empirical evidence on a negative relation between corruption and government revenue in the less developed countries. Additionally, Hindriks, Keen and Muthoo (2002) set forth that corruption generates regressive effects on the tax system, since the higher- income population benefits from tax evasion by the fact they risk a large portion of their income, contrary to the lower- income population whose tax contribution is smaller.

**Chart 1**  
Revenue vs. Corruption



Source: Saki Bigio, Sergio Ramírez *Corruption and Development Indicators: empirical review from the Central Bank of Peru, Working Paper (2006) based on World Development Indicators and "Governance Matters IV: Governance indicators for 1996-2004"*.

Note: the blue dots represent the corruption control indicators in 2004. The vertical lines represent standard deviations around such indicators for each country from the world sample.

### 2.3 Tax Administration risk and confidence component

Torgler, 2005, points out reciprocity as another key factor in compliance. Should individuals notice that others are honest, their will to pay taxes shall improve; while, oppositely, upon perceiving that other members of society evade taxes, their tax morale is affected and they shall be motivated to evade (the moral cost is less and, consequently, their compliance is so as well).

When confidence exists in institutions like the Tax Administration, citizens and taxpayers' behaviors shall pursue compliance. But confidence in government administration is a component directly tied to the effectiveness of the Tax Administration performance in detecting and punishing tax evasion. This institutional feature of the tax administrations is not an exogenous but an endogenous variable created according to background and good reputation. In the view of Cummings et al. (2006) "if the Tax Administration is perceived as honest, fair, open and acting to serve the taxpayer, and not as an authority in a hierarchical relation, taxpayers shall have strong

incentives to honestly pay taxes". When the majority of taxpayers fulfill their tax obligations, the incentives to copy fraudsters are weaker, and therefore, one of the incentives for tax evasion is reduced (Bergman & Nevarez, 2005).

#### **2.4 Socioeconomic and demographic factors.**

Socioeconomic and demographic factors appear as determining factors in citizens' behavior and, consequently, their tax morale. Torgler (2002, 2005) studies the way in which factors such as age, gender, and education influence tax behavior. The same applies to variables such as marital status, employment, religion or economic status, although the results are not conclusive and depend to a large extent on the country under analysis. The positive effects of the tax morale on the payment of taxes have been defined for Costa Rica by Torgler (2003), for Argentina by Giarrizzo and Ivori (2004) and Antequera and Florensa (2008).

Torgler (2004) not only presents a causal relation for several countries in Latin America, but also points out several additional components in the tax morale. The lack of institutional strength and corruption, as well as the pervasiveness of the informal economy are factors attributable to noncompliance. An interesting aspect that the author highlights is that "if people believe that the majority abides by the law, an intrinsic motivation shall exist to improve the payment of taxes; therefore, government policy shall sustain a high degree of social capital..."

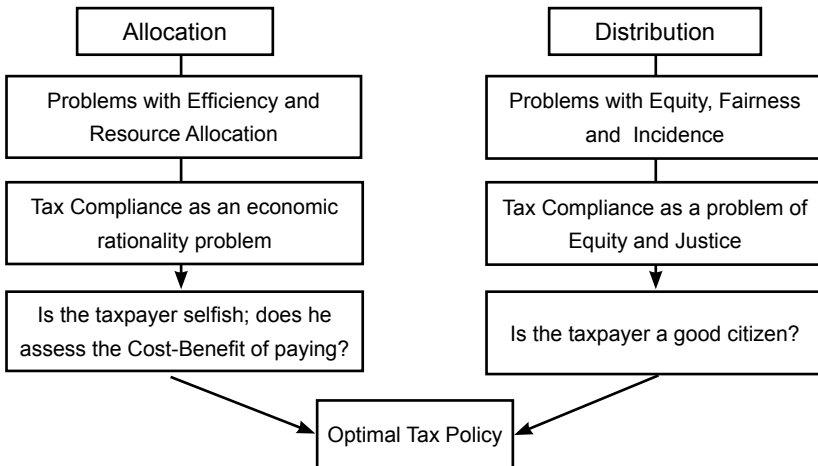
With regards to the high indices of the informal economy, as mentioned in Franzoni (1999) according to an econometric study by Weck (1983), a negative correlation exists between tax morale and the informal economy (the better the morale the lower the informal economy and vice-versa). It is interesting to highlight that, compared to other variables tax morale appears in these studies as the one largely explaining the informal economy.

Upon relating the socioeconomic and the sociopolitical aspects, the classification rendered by Musgrave (1959), provides a useful framework that combines the standpoint of the behavior and the form of defining an appropriate government policy based on three aspects: allocation, distribution and balance. The first two are vital for the tax morale. From the standpoint of "Allocation", citizens maximize their benefit from the net income earned, from the taxes and sanctions and makes decisions based on this rationality component; from the

standpoint of “Distribution”, citizens are more than utilitarian entities since they envision themselves as part of society in which the level of payment is subject to their level of social interaction (similar to the social capital) and make decisions strongly based on moral convictions (refer to Table 1).

In order to find an appropriate government- policy framework that enables to understand citizens’ behavior, both visions shall be considered in order to adjust the actions of the Tax Administration and the government administration towards enhanced tax compliance.

**Table 1**  
 Different economic approaches towards tax compliance  
 Rationality of Government Sector Expenditure and Taxes



*Source: Simon James, Taxation, Ethical investment, and tipping, Handbook of Contemporary Behavioral Economics, 2006*

**3. SEEKING IN PRACTICE WHAT IS EXPLAINED IN THEORY.  
 From the general model to the inclusion of Morale**

Allingham and Sandmo (1972) (AS) set forth a tax evasion model in which the taxpayer decides on his obligation to file taxes based on the likelihood of detection.

$$EU(Y, X) = (1 - p)(Y - \tau X - \mu Y) + p(Y - \tau X - \mu Y - \delta(Y - X)) \quad (1)$$

In this classical decision with uncertainty, we see that in the function of expected benefit from net income ( $EU(Y, X)$ ), the marginal benefit

is strictly positive and strictly decreasing (proving the individual's aversion to risk);  $P$  is the probability of an audit,  $\delta$  is the punishment rate applied in a taxpayer audit,  $Y$  is actual income,  $\tau$  is the tax rate,  $X$  is the income filed,  $\mu$  is the indirect compliance cost or the indirect tax pressure (the former being positive and an additional factor directly affecting the expected benefit, assuming that the decision to misrepresent income might be affected by lack of knowledge on the norm, the payment costs, among others).

If the objective is to analyze the tax morale as determining factor in the tax behavior, the AS model requires broadening certain notions.

$$EU(Y, X) = (1 - p)(Y - \tau X - \mu Y) + p(Y - \tau X - \mu Y - \delta(Y - X)) + f(\theta_1, \theta_2, \theta_3, \theta_4)$$

In  $f(\theta_1; \theta_2; \theta_3; \theta_4)$  the lagged dependent variable  $MT = f(\cdot)$  is a proxy of tax morale reflecting 'tolerance towards noncompliance' as a function of:

$\theta_1 =$  Values

They comprise non-economic factors, convictions or beliefs that lead taxpayers to behave in one way or another towards taxation. They may be personal or depend upon the group or social environment.

$\theta_2 =$  Co-responsibility of the State. Reciprocity.

These are factors relative to the perception of the purpose and use of Taxes and the identification of the notion of legitimacy of the tax system, knowledge of the actual allocation of revenue, the beneficiaries as seen by individuals, the use and effective use of public goods. It constitutes the perception of equity of the tax system, intuition of fairness in tax legislation, perception of compliance by others, priority in the payment of taxes and the feelings arising in the face of noncompliance by evaders / avoiders.

$\theta_3 =$  Risk factor, terms of payment and knowledge of the tax system.

They entail elements of knowledge of the tax system, levels of difficulty, operational or logistic dissatisfaction in complying with tax obligations and, additionally, learning about the means employed by the individuals who file taxes, the frequency, and whether the costs arising from paying taxes are significant enough to warrant noncompliance. It relates the payment to risk perception (sanctions and fines).

$\theta_4 =$  Socio-demographic and socioeconomic factors

They comprise the household identification data: place of birth,

nationality, gender, marital status, education, occupational group, economic activity, labor status, income level, social security affiliation, among others.

An appropriate analysis of the factors of influence on the tax morale shall enable us to achieve the appropriate taxpayer segmentation. As a framework of reference, Aloys Prinz (2010) sets forth the existence of an interdependent relation between the State and the taxpayers made explicit in their attitudes towards the payment of taxes internalizing the notions of the individual and social morale. This vision is relevant and shall be considered for our study, since it places morale as determining factor in the decision of taxpayers towards compliance or tax evasion. Aloys Prinz proposes the existence of at least three types of behaviors assumed by the State, which are reflected on the moral behavior of taxpayers: the State that 'maximizes wellbeing (from the standpoint of the economics of welfare quoted by Pigou (1946), Buchanan and Musgrave (1999)); the State as Leviathan (as defined by Brennan and Buchanan (1977, 1980) where the sole objective is maximizing revenue); and the State as an instrument of opportunistic politicians (by which the selfishness of politicians and their pursuit of being elected leads them to opportunistic behavior before their voters).

The moral attitudes of taxpayers parallel to such behaviors by the State are: Acceptance, which considers taxes an instrument to deliver public goods and services and redistribute revenue; Opportunism, which seeks to accept taxes but is aware that they may be evaded without feelings of guilt or shame; and, Resistance / Rejection, by which taxes are not considered legitimate instruments to improve wellbeing (refer to Table 2).

**Table 2**

Vision of the State, attitudes towards taxes and types of taxpayers

Vision of the State	Moral attitude towards payment of taxes			Type of Taxpayer
	Acceptance	Opportunism	Resistance	
Maximizing Wellbeing	Yes	No	No	Loyal taxpayers (moral)
Opportunistic (1)	Yes	Yes	No	Loyal and Opportunistic
Opportunistic (2)	No	Yes	No	Taxpayers Disloyal and Opportunistic Taxpayers
Leviathan	No	Yes	Yes	Disloyal Taxpayers

Source: Prinz, Aloys, "A moral theory of tax evasion", 2010.

Pursuant to their moral attitudes according to their vision of the State, taxpayers are considered 'Loyal taxpayers' if they accept taxes and internalize in their benefit function the feelings of satisfaction with respect to compliance, and guilt with respect to tax evasion; 'Loyal and opportunistic taxpayers' if they feel satisfaction from compliance and guilt only upon being detected in tax evasion; 'Disloyal and opportunistic taxpayers' if they feel dissatisfied with compliance and upon being detected as evaders, and; 'Disloyal taxpayers' when they feel satisfied with evasion, regardless of being detected or not.

The definition of distinct groups of taxpayers pursuant to their 'moral' behaviors enables to study tax morale as a factor of influence on their tax behavior. If taxpayers conceive the State from such standpoints, it implies that they are 'morally more sensitive' to react in the face of elements that affect their attitudes towards the payment of taxes. Tax morale would thus be a function of elements such as the use and allocation of taxes, compliance costs, the opportunity of incurring in tax fraud and their inherent values. Such moral behaviors shall be also considered to understand the attitudes towards tax compliance.

### **3.1 Data**

The data were taken from the database of the Tax Morale Survey - 2010<sup>2</sup>. It compiles 4,160 observations gathered from households in the urban area of 11 cities: Quito, Guayaquil, Cuenca, Ambato, Riobamba, Machala, Manta, Portoviejo, Babahoyo, Santo Domingo and Loja<sup>3</sup> (refer to Table 3).

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<sup>2</sup> *The database gathers the results from the consulting work that the SRI hired for the "Design, survey and plotting of tax morale surveys" conducted between January and May of 2010.*

<sup>3</sup> *The survey rendered a level of confidence of 95%, an error margin of +/- 4.6% for Quito and Guayaquil, and 5.1% - 5.2% for the aggregate results from other cities. The aggregate results at the national level rendered 96% confidence level and an error margin of +/- 3%.*

**Table 3**  
Sample design  
'Tax Morale Survey'

CITY	FREQUENCY	PERCENTAGE	ACCRUED
Quito	460	11.06	11.06
Guayaquil	460	11.06	22.12
Cuenca	360	8.65	30.77
Machala	360	8.65	39.42
Ambato	360	8.65	48.08
Riobamba	360	8.65	56.73
Loja	360	8.65	65.38
Portoviejo	360	8.65	74.04
Manta	360	8.65	82.69
Santo Domingo	360	8.65	91.35
Babahoyo	360	8.65	100.00
<b>TOTAL</b>	<b>4,160</b>	<b>100.00</b>	

Source: Final report 'Tax Morale Surveys'

Authors: the authors.

This questionnaire was specifically designed to measure factors such as: the perception of equity and social justice, the moral rules and feelings, the actions of the State (as a credible, democratic and participative authority), the factors in the economic trends and compliance costs, among others; and relates it with 'risk perception' and 'perception of benefit' arising from the 'social agreement'. Citizens' conceptions on the 'social pact' relate to the tax behaviors of Ecuadorian society.

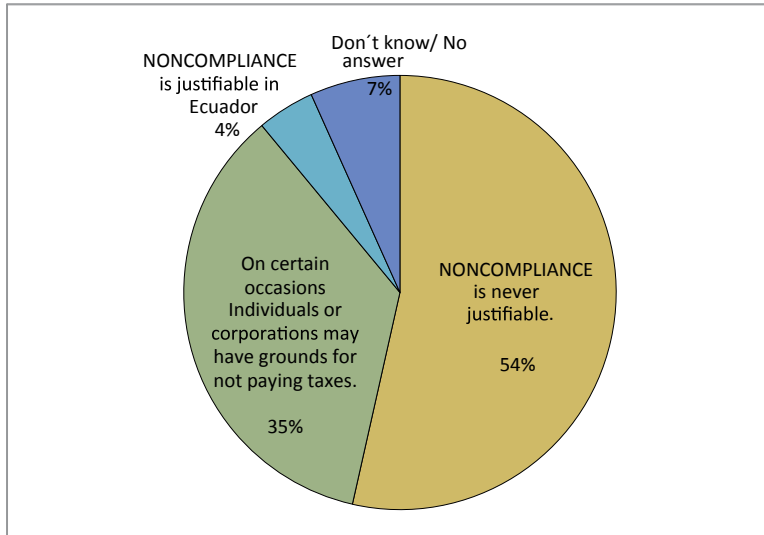
### 3.2 Tax Morale Proxy $MT = f(\cdot)$

Tax morale requires defining the set of values determining adequate behavior of citizens with respect to their obligations with the State (Tipke, 2002). Thus, in order to identify 'moral tax behaviors', question C10 was considered for households: "Which of the following positions do you agree with?" and the options were: 1) "Noncompliance is NEVER justifiable"; 2) "On certain occasions individuals or corporations may have grounds for not paying taxes" and; 3) "NONCOMPLIANCE is justifiable in Ecuador" (refer to Chart 2).



**Chart 2**

C10. Which of the following options do you agree with?



*Source: Database from the Final report 'Tax Morale Surveys  
Authors: the authors.*

The remaining factors shall be measured against this question reflecting Tax Morale in Ecuador. Additionally, this statement is comparable to the arguments in the World Values Survey (WVS) performed in several countries around the world (especially OECD countries), which evaluates the moral trends towards the payment of taxes and are the proxy used in identifying the levels of tax morale internationally.

Thus, a categorical variable is built, according to three levels (refer to Table 4):

- A. The respondents stating that “Noncompliance is NEVER justifiable”, that is to say 54%, is the ‘high tax morale’ category and they are assigned a 3;
- B. The respondents stating that “On certain occasions individuals or corporations may have grounds for not paying taxes”, that is to say 35%, is the ‘middle tax morale’ category and they are assigned a 2;
- C. The respondents stating that “NONCOMPLIANCE is justifiable in Ecuador”, that is to say 4%, is the ‘low tax morale’ category and they are assigned a 1.

**Table 4**  
Frequency distribution for the Tax Morale Category

ORDER	TAX MORALE	FREQUENCY	PERCENTAGE	ACCRUED
3	NONCOMPLIANCE is never justifiable.	2,227	53.53	53.53
2	On certain occasions individuals or corporations may have grounds for not paying taxes.	1,474	35.43	88.97
1	NONCOMPLIANCE is justifiable in Ecuador.	179	4.3	93.27
9	Don't know/ No answer	280	6.73	100

Source: Database from the final report 'Tax Morale Surveys'  
Authors: the authors.

Based on these categories, an ordered probit model is established that will relate the tax morale with the values, the social and economic perception, reciprocity, risk, payment facility and knowledge and, finally the socio-demographic and socioeconomic features. The results of these ratios shall be presented subsequently<sup>4</sup>.

### 3.3 Values ( $\theta_1$ )

In most studies on 'tax compliance' and 'tax evasion', the chief determining factors on the behavior of citizens and taxpayers are the differences in their institutions, their Tax Administration, their attitudes towards government, among others. Nevertheless, very little has been discussed on the inclusion of values and culture as potential determining factors in the payment of taxes. This is chiefly due to the fact that culture and values are difficult to measure since they relate to

"...ideas, beliefs, perception models and mental structures in the brain of every individual ... and may be learned from others by imitation, observation, interaction or discussion ..." (Heinrich et. al, 1999).

In order to incorporate these variables in the study, a module was designed relevant to the culture, the social norms, moral feelings and

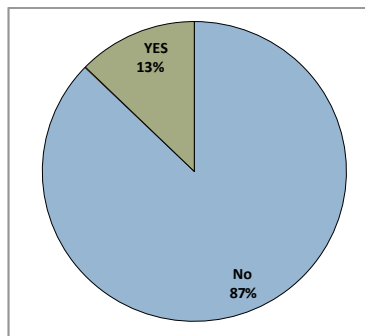
<sup>4</sup> Upon screening the database, irrelevant answers such as 'don't know/no answer' were excluded and in certain cases, the category 'others'.

the values, individual as well as collective, which may exist in society. The behaviors considered referred to: honesty-integrity, patriotism, sociability, respect and feelings such as guilt, shame and indifference. According to Scheler (2001), values may feature polarity based on whether they are positive or negative, and hierarchy to the extent they are superior or inferior. Thus, from respondents' answers we may identify the trends towards tax compliance. For example, those deemed less honest or likely to behave dishonestly, might be expected to incur in tax evasion, which in terms of tax morale, would reflect 'low morale'.

Initially the general question posed was: in the face of a difficult situation, is it correct to breach the law? This is aimed at understanding the trends among respondents towards compliance. 87% answer NO, it is not correct to breach the law and 13% answer YES (refer to Chart 3).

**Chart 3**

F2. Do you believe that in the face of a difficult situation it is correct to breach the law?



Source: Database from the final report 'Tax Morale Surveys'  
Authors: the authors.

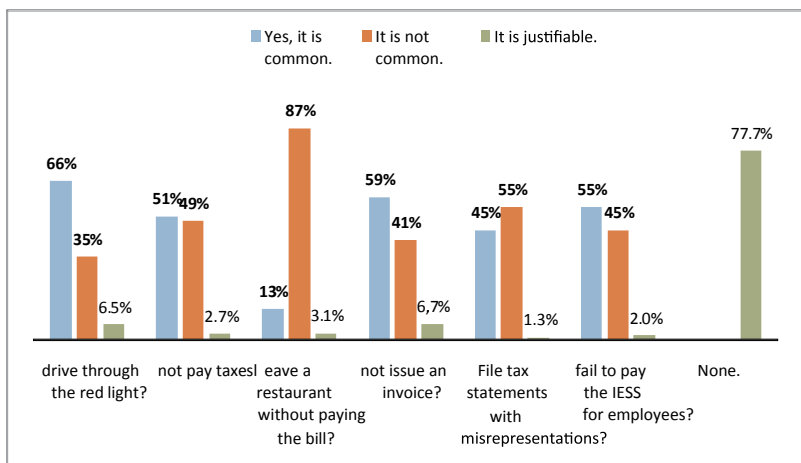
Subsequently, individuals were placed in the role of auditors of others and the question posed is: how common is it to find individuals with behaviors such as: crossing a red light, not paying the bill at a restaurant, not issuing an invoice, not paying taxes, among others? Finally, they were asked: which of these actions could be justified?

Although 77% of respondents asserted that these actions are not justifiable, it is possible to observe how common it is to incur in such behavior, the most common one being 'crossing a red light' with 66%.

This is followed by 'not issuing an invoice' with 59% and 'not paying the IESS to employees' with 55% (refer to Chart 4).

**Chart 4**

F3a. How common is it for individuals to...?

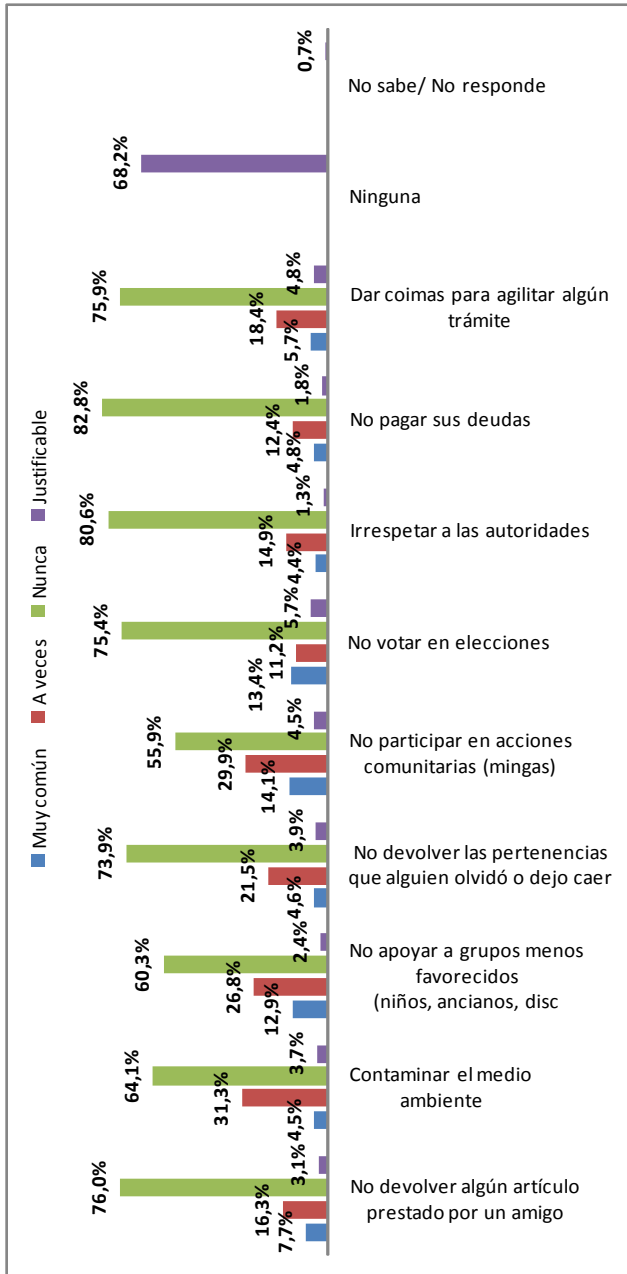


Source: Database from the final report 'Tax Morale Surveys'

Authors: the authors.

In order to measure personal actions, each respondent was asked: how common is it for you? And a list of activities was provided, among them: not voting in elections, not paying their debts, not supporting less favored groups, polluting the environment. Not surprisingly, over 50% claimed they never incur in such actions, since what is morally perceived as inadequate or improper features a high component of secrecy to avoid being judged. What is interesting is to identify that 77% are broken down into 40% who 'do not support the less favored groups', 35% who 'pollute the environment' and 26% who 'do not return belongings to someone who dropped them'; only 68% answer they do not justify such actions, nine percentage points less than 77%. This shows that when behaviors refer to their own (self-evaluation), the morale thresholds drop (refer to Chart 5).

**Chart 5**  
P1a. How common is it for you to....



Source: Database from the final report 'Tax Morale Surveys'.  
Authors: The authors.

Finally, two questions were made to confront the individual moral judgments and the collective (social) moral judgments. Such questions relate to the ‘spreading’ or ‘influence of others’ behavior’ on the individual compliance behaviors.

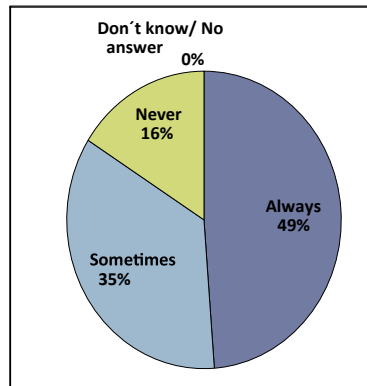
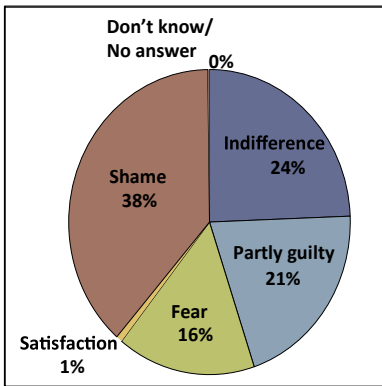
When respondents were asked: what do you feel if someone in your home decides not to pay taxes?, 25% feel ‘indifferent or dissatisfied’, 21% ‘feel partly guilty’, 38% ‘shame’ and only 16% ‘fear’. On the other hand, for the question: when do you consider it appropriate to report those who fail to pay their taxes? 49% answered ‘always’, 35% ‘sometimes’ and 16% ‘never’.

It is worth noting that although a large percentage - 25% - feel indifference or satisfaction, only 16% stated they would never report those who fail to pay their taxes. On the other hand, 85% think that they shall ‘always or sometimes’ report, and 75% feel ‘shame, guilt or fear’ (refer to Chart 6).

**Chart 6**

F4. What do you feel if someone in your household decides not to pay taxes?

F5. When do you deem it appropriate to report those who fail to pay taxes?



Source: Database from the final report ‘Tax Morale Surveys’  
 Authors: the authors.

The answers to such questions enable us to identify the perceptions of the values and the social norms as potentially significant factors in defining morale. In this regard, important variables are those relevant to ‘honesty’ and the capacity of individuals in determining thresholds between what is ‘correct - justifiable and incorrect-unjustifiable’.

### 3.4 Co-responsibility of the State. Reciprocity ( $\theta_2$ ).

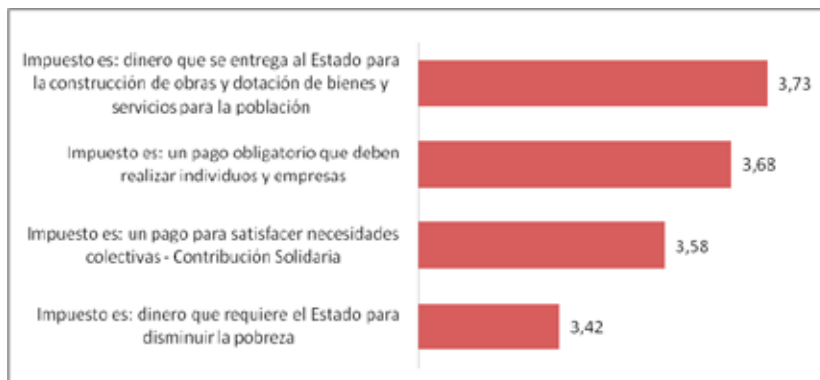
One of the key factors relevant to the level of tax morale is citizens' confidence in government decisions, and the credibility in the actions conducted thereby with the proceeds from revenue (Torgler and Schaltagger, 2005). Individuals perceive their relation with the State, not only from the standpoint of coercion, but also from exchange under the premise that taxes correspond to a payment for the goods and services that the State delivers to society.

When goods and services are considered the desired ones, and the decisions regarding their delivery are transparent and fair, compliance tends to improve. Thus, if all citizens, especially taxpayers, perceive that their interests (preferences) are appropriately represented in political institutions and also receive an appropriate combination of public goods and services, they shall increase their willingness to pay (Cumings, Martinez-Vazquez, McGee & Torgler, 2006).

This module examined households' view on the use of taxes and the general performance of the tax system. From the results gathered, it may be observed that on a scale in which 5 represents 'truly agree', certain statements on the allocation of taxes are qualified with values above 3. It is clear that what individuals largely relate to is the allocation of taxes to deliver public goods and services (3.73), satisfaction of collective needs (3.58) and a tool to reduce poverty (3.42). It is also evident that everyone understands that taxes are an obligation (3.68). (Refer to Chart 7).

**Chart 7**

On a scale from 1 to 5, where 1 is I absolutely disagree and 5 is I truly agree:  
B4. To what extent do you agree with the following statements?

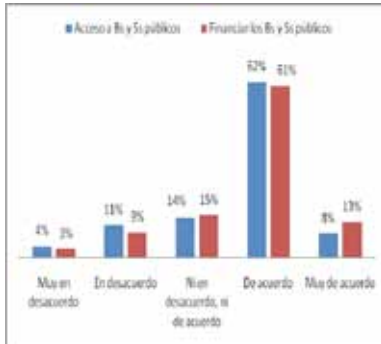


Source: Database from the final report 'Tax Morale Surveys'  
Authors: the authors.

Over 60% of respondents agree to the statement that taxes enable individuals to access public goods and services, which are also financed thereby. This marks knowledge and confidence in the allocation and use of taxes. Likewise, 74% perceive that the services that have improved owing to taxes are education, health and housing (refer to Chart 8).

**Chart 8**

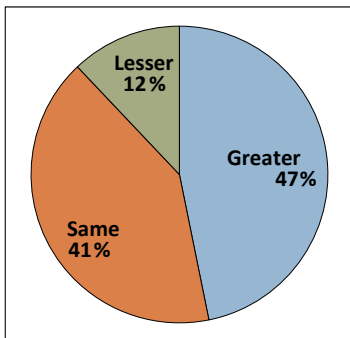
E1. To what extent do you agree to the taxes collected in Ecuador?



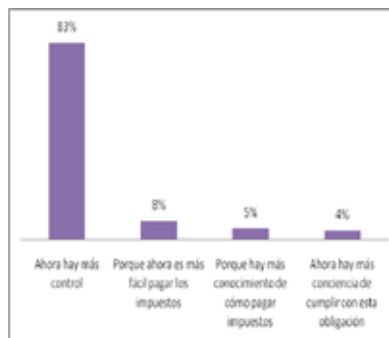
E4. From the following services, which do you believe have improved by the payment of taxes?



E2. Do you think that tax payments are presently being met to the same, greater or lesser extent?



E3. Why do you think that tax compliance has presently increased?



Source: Database from the final report ‘Tax Morale Surveys’  
 Authors: the authors.



Torgler (2005) argues that the tax policy requires high levels of social capital, since, if people believe that the rest are more honest, their taxpaying willingness improves; to the contrary, if they are aware that other members of society incur in tax evasion, their tax morale diminishes. Consequently, tax noncompliance would be caused, among others, by the perception of an unfair tax system, corruption, lack of transparency in expenditure and the contagion effect when a certain attitude is shared by the rest of society. (González, 1999).

According to the survey results, 41% currently perceive that the level of tax compliance in society is the same, 47% of individuals consider that compliance improved and only 12% consider it dropped. When those who believed that compliance had improved were asked for the grounds, 83% answered that it was due to better controls and the remaining 17% was distributed among better knowledge, greater awareness or more payment facilities. We may still note that tax culture and tax morale are chiefly influenced by the risk of sanctions. The challenge for the Tax Administration is to strengthen taxpayers and citizens' assistance and service strategies.

According to these data, the answers employed qualify the current economic and political situation overall, security, railroad, street and road construction and maintenance, and the delivery of public goods and services (education, health and housing). Additionally, conditions are fostered that imply 'improvements in services' by way of revenue, the idea of the 'collective benefit' as a result of taxes and a variable in line with 'knowledge by the communication on the media' of the works performed.

### **3.5 Risk, payment facility and knowledge of the tax system ( $\theta_3$ ).**

The studies conducted (Torgler, 2005; Torgler & Schneider, 2002; Prinz, 2010; among others) on how the social and moral norms influence tax compliance, largely conclude that the transparent performance of Administrations and clear and simple regulations, facilitate collective actions that improve compliance (Cummings, 2005). Nevertheless, although tax evasion and tax fraud are topics discussed at large inside and outside of the government administration, very few studies directly correlate tax evasion / tax fraud with tax morale.

The results of the survey enable to identify a number of perceptions with regards to compliance, based on those for which it is possible to establish an equivalence with respect to the categories identified

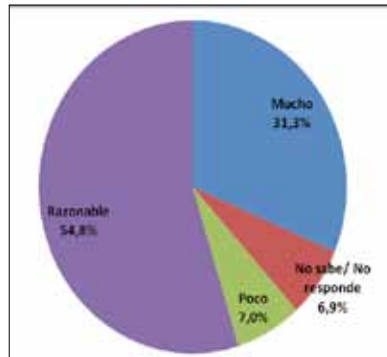
as ‘high’, ‘middle’ or ‘low’ tax morale. From the overall sample in the question: individuals who pay taxes do so because...?”, 43.2% assert that they pay taxes to fulfill their obligations, 20.9% to avoid fines and only 6.7% to avoid closures. The answers to “Considering the public services delivered by the State, would you say that THE TAX AMOUNT YOU PAY is.....?”, 61.7% of the sample considers that the tax amount they pay is Reasonable (54.8%) or Insufficient (6.9%) (Refer to Chart 9).

**Chart 9**

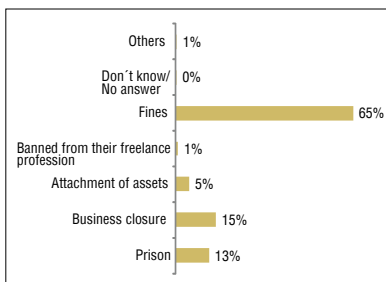
C1. Individuals who pay taxes do so because...?



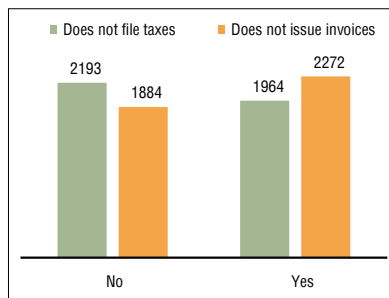
C2. Considering the public services that the State delivers, would you say that THE TAX AMOUNT YOU PAY is...?



C5. What is the applicable sanction for those who fail to pay their taxes?



6 – C7. Would you report somebody who...?



Source: Database from the final report ‘Tax Morale Surveys’

65% from the national total agrees that the sanction for those who fail to pay taxes should be 'fines', 15% 'business closure' and 13% 'prison'.

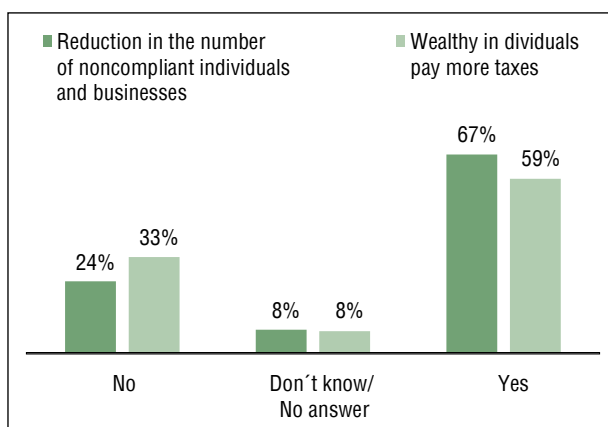
The latter percentage is surprising, since it seems that citizens are willing to accept more severe sanctions. Likewise, the question was posed regarding the willingness to report individuals who fail to file their taxes and those who do not issue invoices. 55% would not report somebody who fails to file their taxes, but 57% would be willing to report those who fail to issue invoices. It is evident that individuals have internalized the obligation to issue invoices more than the obligation to file taxes.

Respondents were also consulted on the perception regarding legal modifications and the effects thereof, and the majority considered that legal modifications have resulted in improved collection and equity. 67% asserts that the modifications in legislation have reduced the number of noncompliant individuals and businesses and 59% that the changes require those with higher income to pay more taxes.

Additionally, in terms of fraudulent behaviors, individuals with tax experience (those who filed taxes at least once in their lifetime) were asked about the main reasons for noncompliance. 57% of the total are broken down according to 'financial distress' - 25%, 'forgot/carelessness' - 19%, and; 'ignorance of the date and venue' - 13%. These data enable to devise the strategies that the Tax Administration could adopt in the tax services' area (see Chart 10).

**Chart 10**

C11. The modifications in tax legislation have enabled:



## D7. What would be the MAIN REASONS for noncompliance with your taxes?



Source: Database from the final report 'Tax Morale Surveys'

Authors: the authors.

This factor also encompasses the so-called compliance costs. An optimal tax system shall be simple and easy to understand (Stiglitz, 2003). Indirect tax pressure, understood as the costs that taxpayers incur in meeting their tax obligations (costs of the form, transportation, banking transactions, among others) may constitute a factor determining compliance. Likewise, the complexity of the tax system or regulations may result in unintentional noncompliance, or reduce the moral costs of evasion, generating costs for those who pay. Based on how high the complexity is perceived, the higher or lower shall tax morale and tax compliance be (Torgler and Schaltagger, 2005).

Out of 100% of respondents, 49% mentioned they were not taxpayers, and they were not asked about compliance costs. From the remaining 51%, who were actually taxpayers, 59% complete their own tax statements and barely 2% hire the services of a tax advisor. 34% face no hurdles in filing their statements. Nevertheless, 29% indicate that their main difficulty is the long queue to pay and insufficient customer assistance windows. (Refer to Chart 11).

**Chart 11**

D4. In your case, who fills the forms for your tax statement?



D5. What are the main difficulties you face when filing your taxes?



Source: Database from the final report 'Tax Morale Surveys'  
Authors: the authors.

On a 1 to 5 scale, where 1 represented 'very low' and 5 'very high' respondents were asked to define: "With regards to YOUR INCOME, what is your view of the costs implied in FILING YOUR TAX STATEMENTS?" According to this scale, 35% of the taxpayers ranked in the middle of the scale with 2.93; 27% ranked in level 2 'low' and 10% in level 5, 'very high'.

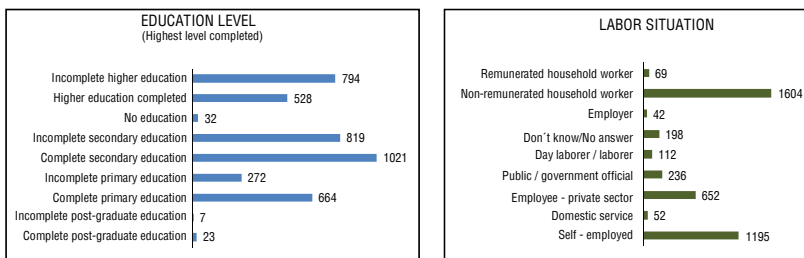
The answers obtained from the survey were the basis to develop indicators enabling to observe: the perception regarding ‘payment facility’ through the different service channels, the ‘risk of detection’ that individuals feel from the Tax Administration background, the relevance of ‘sanctions (chiefly fines and closures)’, the ‘complexity of the laws’ and the ‘simplicity of the tax system’.

### 3.6 Socio-demographic and socioeconomic data ( $\theta_4$ )

“The socio-demographic factors are important determining factors of behavior and also the tax morale” (TORGLER, 2005). This category describes the profile of respondents: age group, education, economic tier, and economic activity. In all the questions, a proportional number of respondents were maintained to avoid biases. In the gender distribution, for example, a total 2075 women and 2085 men were interviewed, accounting for 49.88% and 50.12%, respectively.

According to the sample distribution, 51% of respondents belong to a low socioeconomic tier, 40% to the middle tier and 9% to the higher socioeconomic tier. The tier is a predetermined variable according to the 2001 census. Likewise, out of the total sample of respondents, only 32% feature higher education of some sort, 44% secondary education and 23% primary education. It is worth highlighting that from the total sum of these percentages, 45% stated not having completed their education at these levels, by which it may be pertinent to divide respondents between those who completed their education under ‘complete education’ and those who did not under ‘incomplete education’ (refer to Chart 12).

Chart 12



Source: Database from the final report ‘Tax Morale Surveys’  
 Authors: the authors.

Out of 68% of respondents, 27% are homemakers, 15% are in the trade business and 26% in services. 65% of homemakers define

themselves as non-remunerated household workers, 45% of those in the trade business are self-employed, and those in the services' sector are mostly distributed between public-government officials- 87% or private-sector employees-72%. For the subsequent analysis, the 'self-employed' definition may be deemed important since evidence exists that asserts that self-employed individuals feature lower tax morale than employees (Torgler, 2005).

In this factor, the social tier, marital status, survey location, gender, age, education, labor situation, taxpayer status and role in the household are deemed relevant. All these items were processed and tested in the model.

- Social tier: predetermined variables with three levels: higher, middle, lower, based on parameters from the Population and Household Census of 2001.
- Marital status: in spite of including all the types of marital statuses (single, married, widow, common-law partnership, among others) a dichotomic variable is developed, assigning 1 to the 'single' and 0 to 'all the rest' comparable to the results from the tax morale theory.
- Survey location: although certain categories are tested (by regions, cities), the final decision is to work in the largest cities in the regions of the sierras and the coast.
- Gender: a dichotomic variable is developed, 1 for 'female' and 0 for 'male'.
- Age: the age groups are defined as follows: 18 – 25; 26-39; 40-54 and over 55. These categories have been proven by other surveys like those conducted by the National Institute for Statistics and Censuses (INEC, as per the Spanish acronym) and the Institute for Tax Studies (IEF, as per the Spanish acronym) of Spain. The Age<sup>2</sup> variable is also generated to eliminate the growing trend inherent in the variable and assume a normal distribution.
- Education: two categories are established. Complete and incomplete education. For each one there are three levels ranging from primary education to post-graduate education.
- Labor situation: according to the type of activity, there are numerous types of labor situation. For the purpose of this study, workers shall be divided according to a dichotomic variable, 1 for 'self-employed' or 0 'all the rest'.
- Taxpayer status (registered in the RUC, RISE): it is vital to identify whether respondents are registered taxpayers. They are classified with 1 for 'taxpayers' and 0 for 'non-taxpayers'.
- Head of household: in order to identify any relation between the role in the household and the tax morale.

### 3.7 Model specification based on an “Ordered Probit”

The following proposition is based on the foregoing items:

$$MT = \theta_1 + \theta_2 + \theta_3 + \theta_4$$

$$\begin{aligned} \text{Tax Morale} = & \text{values} + \text{Co-responsibility and reciprocity} + \text{risk} \\ & + \text{Socio-demographic/socioeconomic factors} \end{aligned} \quad (2)$$

For the empirical analysis of the determining factors of the tax morale, an “ordered probit” model was suggested, since it enables to analyze variables with discrete variables that may be ordered naturally in descending order. Nevertheless, since it is not a linear model, only the sign on the coefficients may be interpreted and not their magnitude. In order to calculate the marginal effects that determine the change in taxpayers’ morale, the coefficients shall be replaced in the probabilistic function.

In order to verify the weight of the results, we employed heteroscedasticity-corrected errors. To avoid bias and inconsistency in the results, we maintain the variables that are not statistically significant. (Refer to Long, 1997). In addition, sensitivity tests were conducted with different specifications to evaluate the consistency of the main variables.

Annex 1 features a detail of the results obtained based on different specifications.

## 4. RESULTS

The studies on Tax Morale (e.g. Andreoni et al., 1998; Knack and Keefer, 1997; Torgler and Schneider, 2002; Torgler, 2005, 2007, among others) show that the values, moral feelings, the reciprocity in the State-Citizen relation and the socio-demographic factors, and the risk and payment facility, are relevant determining factors in tax-compliance decisions. Empirical evidence gathered in countries like Switzerland, England, Botswana, South Africa, and Costa Rica proved the theses established in theory.

The results of the ‘Tax Morale’ survey in Ecuador reveal interesting data on the current situation and perception of citizens and taxpayers with respect to the tax system and the payment of taxes. Descriptive statistics enable to infer the potential relations between variables and



their potential behaviors in the overall population, while the model shows empirically how such factors influence the Ecuadorian tax morale.

Considering the typology defined by Prinz (2010), we may assert that 'Loyal Taxpayers' amount to 57.4% with respect to the State that maximizes wellbeing and the so-called 'Disloyal and Opportunistic' taxpayers amount to 41% in a Leviathan State; they do not accept the payment of taxes in spite of the great risk of detection and sanction. It is more complex to define the segment of 'Opportunistic' taxpayers, who may be 'Loyal' and 'Disloyal' depending on the factors affecting the tax morale.

Through the presentation of the statistics obtained in the survey, it is complex to establish the relation between the values and tax compliance with certainty. Contrary to other study factors, it is not very common for citizens to keep consistency between their moral considerations and their actual behavior with regards to paying taxes. Nevertheless, the model defined sets forth strong interaction between values, personal and civic, and the tax behavior. The outcomes of this component are consistent with the theoretical prediction, showing a significant and directly proportional relation - 99%- and with a positive sign (+) between this factor and the tax morale.

From the results, we may conclude that "loyal taxpayers" perceive the positive relation between tax evasion and crime since when there is less willingness to report, the tax morale diminishes, and vice-versa. Nevertheless, it is also possible to argue that values may be relative depending on taxpayers' characteristics, such as their income level or age, and, moreover, their taxpayer status.

As regards citizens and taxpayers' preferences, at least 50% of respondents express a favorable opinion with regards to the tax system, its use and allocation, especially in the delivery of goods and services (health, education and housing).

The model evidences results with positive sign (+) and significant by 99% for the variables on the perception of collective needs (whether individuals consider that taxes meet the needs of society), the common good (whether paying taxes is expected to improve the common wellbeing) and the improvement of services (confirmed in descriptive statistics).

In the definition of the Morale of the State, certainty on the allocation of expenditure is fundamental, by which appropriate disclosure of government expenditure administration positively influences Taxpayer Morale, based on the results obtained.

We may broaden the notion of Transparency and Disclosure according to Anglo-Saxon terms under the notion of Accountability, which requires government officials to report, explain or warrant their actions to society. In this sense, citizens who positively perceive the allocation of their contribution are more likely to pay their taxes, as an act of co-responsibility. Only the result of the security variable is contrary to the theoretical forecast. With 95% significance and a negative sign (-) we may define as an accepted hypothesis that the greater perception of insecurity affects the tax morale, and it shall be considered a contextual aspect in the period under analysis.

The information delivered to respondents was managed in such fashion that the participation of the Internal Revenue Service was almost imperceptible in order to avoid biases based on fear of the tax authority. Therefore, we may assert that the results are quite impartial. It is likely that certain individuals biased their opinions upon perceiving that the questions referred to taxes.

The variables deemed Endogenous in the Tax Administration are among the components with highest significance: Control and Assistance. In broad terms, all the variables relative to services, assistance, training and simplicity in the payment of taxes are significant variables with high impact on the payment probability.

The variable 'Confidence in the SRI', is statistically consistent in the model and reflects the good perception in the tax administration, by which it also supports the idea that efficient, transparent and effective administration influences the good behavior of taxpayers and also promotes the risk of detection, as it is evidenced in the consistency and sign of the variable 'risk of detection'.

Once again, this differs from the socioeconomic variables that bear a negative effect on the tax morale. For example, it is evident that in certain cities there is less likelihood of voluntary compliance with taxes, which also differs if individuals are 'taxpayers' and self-employed.

An interesting variable that requires deeper analysis is 'education' since a lower tax-compliance probability becomes evident, presumably

as mentioned by Cummings et al. (2006), because the better educated individual knows the forms of avoiding taxes in greater detail, which together with the income level, may constitute an important analysis factor at the time of designing tax control programs.

The tier, age, and the perception relative to tax compliance are significant, and they all match the sign forecasted by the theory. An inversely proportional and negative (-) relation exists for those in the higher tier as well as in the lower tier. This implies two situations: those with higher income could feature higher noncompliance if this correlates with their knowledge on how to evade; those with lower income would feature lower morale based on ignorance or simply because they are not taxpayers. With respect to age, the theory explains that the relation is direct and positive (+) since more senior individuals become more reluctant to risk and improve their compliance. Although theory makes certain assertions on gender, the results are not significant in any of the model specifications.

Finally, the positive results of the variable 'Tax payment' are worth highlighting. This proves the thesis that suggests that if individuals perceive that the majority currently meet their tax obligations, their motivation to pay taxes improves.

## **5. PUBLIC POLICY RECOMMENDATION**

The results obtained from the Survey as well as in the Tax Morale model developed herein, constitute a relevant contribution to the economic literature on tax behavior in Ecuador.

In general terms, public policy and tax policy, in particular, still pose difficulties in the Allocation and Distribution of resources. Based on the results, in the sphere of Distribution there is evidence that society contributes equitably and jointly to the payment of taxes when it perceives the quality of government expenditure and observes that more individuals are meeting their tax obligations. It is evident that this factor, plus the individual values and the socio-economic factors, directly influence the development of the social capital in a country.

In this respect, public policy shall improve information channels and Accountability towards society, which shall promote greater revenue and voluntary compliance among taxpayers.

With respect to Allocation, the Tax Administration shall focus its efforts on two main action courses. First, it shall improve the selection of taxpayers subject to controls in the framework of appropriate segmentation that succeeds in influencing ‘opportunistic taxpayers’ to find sufficient incentives to become ‘loyal’. Secondly, to strengthen taxpayer services in order to reduce compliance costs to the minimum and, at the same time, broaden and specialize training in line with society’s demands.

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**ANNEX 1: Econometric results**

First specification (socio-demographic values and factors)

Tax Morale	Coefficients	Standard deviation	z	P>z	[95% interval]	Confidence
Values	0.13	0.01	12.83	0.00	0.11	0.16
Gender	-0.02	0.04	-0.60	0.55	-0.11	0.06
Age <sup>2</sup>	0.01	0.00	1.73	0.08	0.00	0.01
Higher tier	-0.12	0.08	-1.48	0.14	-0.29	0.04
Lower tier	-0.25	0.04	-5.56	0.00	-0.33	-0.16
Taxpayer	-0.10	0.05	-2.09	0.04	-0.19	-0.01
Solidarity	0.09	0.04	1.99	0.05	0.00	0.17
Reporting	-0.13	0.03	-4.67	0.00	-0.18	-0.07
Moral feelings	-0.01	0.01	-0.85	0.39	-0.04	0.01
Legal threshold	0.07	0.05	1.33	0.18	-0.03	0.17
<b>/cut1</b>	<b>-2.01</b>	<b>0.13</b>			<b>-2.26</b>	<b>-1.75</b>
<b>/cut2</b>	<b>-0.44</b>	<b>0.13</b>			<b>-0.69</b>	<b>-0.20</b>

Second specification (reciprocity)

Tax Morale	Coefficients	Standard deviation	z	P>z	[95% interval]	Confidence
Collective needs	0.13	0.03	5.24	0.00	0.08	0.18
Tax payment	0.04	0.02	1.62	0.11	-0.01	0.08
Security	-0.07	0.02	-3.05	0.00	-0.12	-0.03
Common good	0.20	0.04	4.63	0.00	0.12	0.29
Improvement in services	0.14	0.04	3.29	0.00	0.06	0.23
Disclosure of works	0.18	0.05	3.93	0.00	0.09	0.27
<b>/cut1</b>	<b>-1.09</b>	<b>0.11</b>			<b>-1.32</b>	<b>-0.87</b>
<b>/cut2</b>	<b>0.43</b>	<b>0.11</b>			<b>0.20</b>	<b>0.65</b>

## Third specification (risk and compliance convenience)

Tax Morale	Coefficients	Standard deviation	z	P>z	[95% interval]	Confidence
Taxes/Income	-0.07	0.03	-2.46	0.01	-0.13	-0.01
Facilities	1.33	0.16	8.54	0.00	1.02	1.63
Misrepresentation	-0.12	0.03	-3.66	0.00	-0.18	-0.05
Education	-0.06	0.02	-2.68	0.01	-0.10	-0.02
Risk of detection	0.22	0.11	2.07	0.04	0.01	0.43
Taxpayer	-0.17	0.07	-2.64	0.01	-0.30	-0.05
Sanction relevance	0.11	0.07	1.65	0.10	-0.02	0.24
Confidence in SRI	0.08	0.03	2.76	0.01	0.02	0.14
System simplicity	0.06	0.07	0.87	0.38	-0.07	0.19
<b>/cut1</b>	<b>-1.44</b>	<b>0.18</b>			<b>-1.80</b>	<b>-1.08</b>
<b>/cut2</b>	<b>0.14</b>	<b>0.18</b>			<b>-0.21</b>	<b>0.50</b>

## Fourth Specification (socio-demographic factors and reciprocity)

Tax Morale	Coefficients	Standard deviation	z	P>z	[95% interval]	Confidence
Gender	0.00	0.05	-0.09	0.93	-0.10	0.09
Marital status	-0.01	0.02	-0.52	0.60	-0.04	0.02
Quito	-0.23	0.06	-3.61	0.00	-0.35	-0.11
Guayaquil	-0.37	0.07	-5.46	0.00	-0.50	-0.24
Age <sup>2</sup>	0.01	0.00	1.97	0.05	0.00	0.02
Higher tier	-0.20	0.08	-2.34	0.02	-0.36	-0.03
Lower tier	-0.28	0.05	-6.10	0.00	-0.36	-0.19
Self-employed	-0.08	0.05	-1.68	0.09	-0.18	0.01
Complete education	-0.03	0.02	-1.77	0.08	-0.06	0.00
Education	0.01	0.02	0.94	0.35	-0.02	0.05
Head of household	-0.01	0.05	-0.10	0.92	-0.11	0.10
Registered in RISE	-0.03	0.02	-1.89	0.06	-0.07	0.00
Taxpayer	-0.12	0.05	-2.33	0.02	-0.23	-0.02
Security	-0.07	0.03	-2.87	0.00	-0.13	-0.02
Basic services	0.01	0.03	0.23	0.82	-0.05	0.06
Tax payment	0.07	0.03	2.98	0.00	0.03	0.12
Political situation	0.03	0.02	1.16	0.25	-0.02	0.08
Railroads and roads	0.00	0.02	-0.07	0.94	-0.04	0.04
<b>/cut1</b>	<b>-1.94</b>	<b>0.16</b>			<b>-2.26</b>	<b>-1.62</b>
<b>/cut2</b>	<b>-0.41</b>	<b>0.16</b>			<b>-0.72</b>	<b>-0.09</b>

## Fifth Specification (Complete model)

Tax Morale	Coefficients	Standard deviation	z	P>z	[95% interval]	Confidence
Gender	0.06	0.08	0.75	0.45	-0.10	0.22
Marital status	0.00	0.03	0.00	1.00	-0.05	0.05
Quito	0.12	0.10	1.22	0.22	-0.07	0.32
Guayaquil	-0.50	0.13	-3.90	0.00	-0.76	-0.25
Age <sup>2</sup>	0.01	0.01	2.05	0.04	0.00	0.03
Higher tier	-0.15	0.13	-1.16	0.25	-0.40	0.10
Lower tier	-0.12	0.07	-1.69	0.09	-0.27	0.02
Self-employed	-0.09	0.08	-1.16	0.25	-0.24	0.06
Complete education	-0.04	0.03	-1.50	0.13	-0.09	0.01
Education	-0.04	0.02	-1.78	0.08	-0.09	0.00
Registered in RISE	0.02	0.03	0.90	0.37	-0.03	0.08
Security	-0.03	0.04	-0.63	0.53	-0.11	0.05
Basic services	0.02	0.04	0.51	0.61	-0.06	0.11
Tax payment	0.05	0.04	1.26	0.21	-0.03	0.12
Political situation	0.00	0.04	0.08	0.93	-0.07	0.08
Railroads and roads	0.00	0.03	-0.04	0.97	-0.06	0.06
Taxes/Income	-0.06	0.03	-1.72	0.09	-0.12	0.01
Facilities	1.23	0.17	7.44	0.00	0.90	1.55
Misrepresentation	-0.10	0.04	-2.79	0.01	-0.17	-0.03
Detection risk	0.24	0.12	2.04	0.04	0.01	0.48
Taxpayer	-0.05	0.08	-0.61	0.54	-0.19	0.10
Sanction relevance	0.08	0.07	1.08	0.28	-0.06	0.21
Confidence in the SRI	0.00	0.03	-0.08	0.93	-0.07	0.06
System simplicity	0.01	0.07	0.21	0.84	-0.13	0.16
Values	0.12	0.02	6.41	0.00	0.09	0.16
Solidarity	0.06	0.07	0.83	0.41	-0.08	0.21
Reporting	-0.22	0.04	-4.85	0.00	-0.30	-0.13
Legal threshold	0.17	0.10	1.71	0.09	-0.03	0.37
Collective needs	0.10	0.04	2.44	0.02	0.02	0.18
Common good	0.27	0.07	3.79	0.00	0.13	0.41
Services improvement	-0.03	0.07	-0.37	0.71	-0.16	0.11
Disclosure of works	0.17	0.08	2.23	0.03	0.02	0.32
<b>/cut1</b>	<b>-1.128002</b>	<b>0.3610996</b>			<b>-1.83575</b>	<b>-0.42026</b>
<b>/cut2</b>	<b>0.5727232</b>	<b>0.3638152</b>			<b>-0.14034</b>	<b>1.285788</b>

Models' comparison (\* p&lt;0.05, \*\*p&lt;0.01, \*\*\* p&lt;0.001)

		REG1	REG2	REG3	REG4	REG5
Tax Morale	Theoretical	Values	Co-responsibility Reciprocity	Risk Facility	Socioeconomic Socio- demographic	Complete Model
Values	(+)	0.1347***				0.1246***
SE		-0.0105				-0.0194
Gender	(+)/( -)	-0.025			-0.0046	0.0625
SE		-0.0418			-0.0498	-0.0829
Age <sup>2</sup>	(+)	0.0068			0.0089*	0.0143*
SE		-0.0039			-0.0045	-0.007
Higher tier	(-)	-0.1237			-0.1973*	-0.1483
SE		-0.0835			-0.0843	-0.1281
Lower tier	(-)	-0.2457***			-0.2755***	-0.1234
SE		-0.0442			-0.0452	-0.0729
Taxpayer	(+)/( -)	-0.1006*		-0.1747**	-0.1230*	-0.046
SE		-0.0481		-0.0662	-0.0529	-0.0755
Solidarity	(+)	0.0858*				0.0619
SE		-0.0432				-0.0744
SE						
Reporting	(-)	-0.1271***				-0.2169***
SE		-0.0272				-0.0447
Moral feelings	(+)	-0.0107				
SE		-0.0126				
Legal threshold	(+)	0.0706				0.1709
SE		-0.0531				-0.1
Collective needs	(+)		0.1312***			0.0993*
SE			-0.025			-0.0408
Tax payment	(+)		0.0364		0.0747**	.
SE			-0.0225		-0.0251	.
Security	(+)		-0.0732**		-0.0749**	.
SE			-0.024		-0.0261	.
Common good	(+)		0.2008***			0.2678***
SE			-0.0434			-0.0707
Service improvements	(+)		0.1424***			-0.0258
SE			-0.0432			-0.0705
Disclosure of works	(+)		0.1772***			0.1712*
SE			-0.0451			-0.0768
Taxes/Income	(-)			-0.0729*		-0.0578
SE				-0.0297		-0.0336
Facilities	(+)			1.3297***		1.2284***
SE				-0.1557		-0.1652
Misrepresentation	(-)			-0.1167***		-0.0985**
SE				-0.0319		-0.0353
Education	(+)/( -)			-0.0569**	0.0148	.
SE				-0.0212	-0.0157	.
Risk of detection	(+)			0.2233*		0.2443*
SE				-0.1078		-0.1196

TOPIC 1.3 (Ecuador)

		REG1	REG2	REG3	REG4	REG5
Tax Morale	Theoretical	Values	Co-responsibility Reciprocity	Risk Facility	Socioeconomic Socio- demographic	Complete Model
Sanction relevance (-)				0.1089		0.0754
SE				-0.066		-0.0697
Confidence in the SRI (+)				0.0828**		-0.0028
SE				-0.03		-0.0336
System simplicity (+)				0.0593		0.0149
SE				-0.068		-0.0719
Marital status (-)					-0.0081	0.0001
SE					-0.0155	-0.027
Quito (+)/(-)					-0.2295***	0.1216
SE					-0.0635	-0.0994
Guayaquil (+)/(-)					-0.3715***	-0.5042***
SE					-0.068	-0.1292
Self-employed (-)					-0.0839	-0.0888
SE					-0.0498	-0.0768
Complete education (+)/(-)					-0.0287	-0.0388
SE					-0.0162	-0.0259
Head of household (+)/(-)					-0.0055	-0.0413
SE					-0.0536	-0.0871
Registered in RISE (+)					-0.0336	0.0238
SE					-0.0177	-0.0265
Basic services (+)					0.0062	0.0222
SE					-0.0272	-0.0434
Political situation (+)					0.0286	0.0032
SE					-0.0247	-0.0385
Railroads and roads (+)					-0.0015	-0.0011
SE					-0.0204	-0.0322
<b>cut1</b>						
<b>_cons</b>		<b>-2.0079***</b>	<b>-1.0939***</b>	<b>-1.4384***</b>	<b>-1.9367***</b>	<b>-1.1280**</b>
		<b>-0.1311</b>	<b>-0.1131</b>	<b>-0.1833</b>	<b>-0.1625</b>	<b>-0.3611</b>
<b>cut2</b>						
<b>_cons</b>		<b>-0.4427***</b>	<b>0.4258***</b>	<b>0.1439</b>	<b>-0.4052*</b>	<b>0.5727</b>
		<b>-0.1254</b>	<b>-0.1136</b>	<b>-0.1793</b>	<b>-0.1615</b>	<b>-0.3638</b>
<b>N</b>		3512	3372	1497	3312	1455
<b>r2_p</b>		0.0431	0.018	0.0541	0.022	0.1184
<b>chi2</b>		233.3179	90.0265	124.8938	114.978	268.0491
<b>LI</b>		-2,740.08	-2,689.65	-1,131.49	-2,628.22	-1,027.36
<b>Aic</b>		5,504.16	5,395.30	2,290.21	5,296.43	2,124.72
<b>Bic</b>		5,578.12	5,444.28	2,343.32	5,418.54	2,309.62

## **TOPIC 2**

**BUILDING TAX MORALE. WHO SHOULD PARTICIPATE IN THIS PROCESS? THE ROLE OF THE PUBLIC AND PRIVATE SECTORS**



## **TAX MORALE AND THE TAXPAYER'S BEHAVIOR**

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**Contents:** *I. General framework – I.1.- The first pillar supporting our argument for tax morality is the ethics of the Tax Administration: the public authority responsible for efficient and effective enforcement of a tax system – I.2. The second pillar of the system we are proposing is taxpayer ethics, which should be based on taxpayers' knowledge of their tax-related duties and obligations – I.3. As a third pillar of the notion of morality, which supports administrative morals in general and which, in our particular case, we can apply to the tax field, we should briefly mention the professional ethics of civil servants – II. Actions carried out by TAs to promote tax ethics, both in tax administrations and taxpayers' proceedings – II.1. External surveys – II.2. The Tax Agency's opinion polls – II.3. Tax statistics – II.4. Tax administration actions aimed at ensuring taxpayer rights – II.5. Tax administration actions aimed at improving cooperation with taxpayers – II.6. The work of tax administrations in preventing tax fraud – II.7. Tax administration actions aimed at tax education – II.8. Tax administration actions aimed at promoting civil servants' ethics – III. Final conclusions*

### **I. GENERAL FRAMEWORK**

When speaking about tax morality, the terms “tax ethics” and “tax morals” are sometimes used alternatively as synonyms.

Previous presentations have already discussed the notion of tax morality. For purposes of this presentation, and with a view to providing a context, tax morality will be defined as the degree of commitment with or adjustment of tax actions undertaken both by the Tax Administration and the taxpayers vis-à-vis the ethical principles and fundamentals contained in the norms and practice of Tax Systems.



Thus, the argument for tax morality can be based on three pillars:

- The ethics of the Tax Administration, in its capacity as public authority responsible for efficient and effective enforcement of a tax system,
- Taxpayer ethics, based on knowing their tax-related duties and obligations, and
- The professional ethics of civil servants, who in their statutory position undertake a series of duties and obligations vis-à-vis the Tax Administration and citizens.

**I.1.- The first pillar supporting our argument for tax morality is the ethics of the Tax Administration: the public authority responsible for efficient and effective enforcement of a tax system.**

The Tax Administrations, in charge of effectively enforcing the state and customs system, have the main mission of assessing and collecting taxes, in accordance with the basic tax principles of equality, equity, economic ability, proportionality, etc. recognized by Constitutional Law and the legislation.

In exercising their functions, they use a series of public powers and prerogatives under principles such as legality, the general interest, citizen service, efficacy, hierarchy, etc.

All of these have the purpose of continuously improving their efficacy and efficiency in areas where human and material resources are limited and, thus, lead to a tax control model that must combine in-depth actions based on selection criteria and other more superficial ones based on extensive selection criteria.

Consequently, these actions may be grouped in two areas of activity under their strategic policies: on the one hand, combating tax fraud and, on the other hand, the incentive for voluntary taxpayer compliance.

**I.2.- The second pillar of the system we are proposing is taxpayer ethics, which should be based on taxpayers' knowledge of their tax-related duties and obligations.**

The taxpayer enjoys a number of rights, set forth in the different regulations, relative to the actions carried out by the Public Treasury in enforcing the Tax System. However, they must also face material and

formal obligations, which necessarily lead to incurring both direct and indirect compliance costs.

Non-compliance with these obligations and duties is in itself illegal and, therefore, morally and ethically reprehensible.

Taxpayers' non-compliance with obligations is not always the result of attempted tax fraud or avoidance. It may sometimes derive from lack of knowledge or the complexities of the assessment method.

For example, in the Spanish tax system, one should note that taxpayer compliance is based on submitting self-assessments. This assumes that the taxpayer construes and applies the tax regulation applicable and further assesses and pays the amount of the main tax obligation.

These circumstances show an interconnection between the ethics of the Tax Administration and that of its taxpayers, which imposes on the Tax Administration the moral obligation of providing every support and assistance to taxpayers not only to facilitate adequate compliance but also to reduce associated indirect tax costs.

**I.3.- As a third pillar of the notion of morality, which supports administrative morals in general and which, in our particular case, we can apply to the tax field, we should briefly mention the professional ethics of civil servants.**

There are certain general principles applicable to all civil servants: they should perform their tasks diligently, pursue the general interest in observance of the Constitution and laws, work according to the principles of objectivity, integrity, neutrality, responsibility, impartiality, confidentiality, service dedication, etc.

In addition to these principles, all Tax Administrations should further have a general catalog of basic duties based on ethical principles and rules of behavior, which make up a true code of conduct.

These rules are educational and orientating, but have the added purpose of serving as a limit to lawful activities, since breaching them determines the requirement for administrative accountability, given that the capacity of a civil servant implies specific responsibility and duties vis-a-vis citizens and the Administration. This code of conduct reflects that civil service is based on a set of values which the Administration should maintain and ensure.

The corporate identity of each Tax Administration is based on adequate information, training and motivation of the people who are part of it. In the Spanish case, one of the lines of the communication policy is "The Tax Agency is an organization committed to the people who are part of it". The intent is for those who work in the Tax Agency to share the work the Agency does for the benefit of society and to engage with its objectives in order to reinforce their sense of belonging.

Building on this three-fold vision or perspective from which tax morality or ethics may be analyzed, we present the most relevant aspects undertaken by Tax Administrations in the area of promotion and development.

## **II. ACTIONS CARRIED OUT BY TAs TO PROMOTE TAX ETHICS, BOTH IN TA AND TAXPAYERS' PROCEEDINGS**

In designing strategies and instruments to enforce integrity programs one should note that the image that the Public Administration in general and the Tax Administration in particular project to society influences citizens' tax awareness and, thus, conditions the success of organizational missions.

As citizens perceive higher efficacy and professionalism in citizen service and fraud prevention proceedings by the Tax Administration their trust increases and collective tax awareness is enhanced.

Fraud Prevention Plans should consider that to strengthen tax awareness among citizens it is advisable to carry out institutional communication programs which favor voluntary compliance and discourage fraudulent behavior.

Communication proceedings should take place which not only maintain and reinforce the outreach of services provided by the Tax Administration in facilitating tax compliance but also favor fraud prevention.

Citizens and businesses should perceive that the Tax Administration facilitates and simplifies their duty to pay but, at the same time, they should also perceive intensified combat against fraud as a positive step in their own best interest.

In deploying both strategic lines, it is essential to promote and develop the new ICTs, where the Internet may be the most relevant

communication means with citizens, as well as to promote external alliances which enable the Tax Administration to reach closer to society through social collaborators and improved taxpayer services.

To plan institutional communication programs jointly, it is important to implement a Communications Strategic Plan with a single coordinating body which sets out the general goals to be achieved and defines action lines, including how to manage them and their cost.

The ultimate communication goal of the Tax Administration is to remind the public opinion about sustained fraud prevention and control actions, as well as to pass on the idea to citizens who comply with their tax obligations that the Tax Administration serves them with more and better means to reduce the cost of compliance with their formal obligations.

However, there are other factors on which the Tax Administration has less influence and which also contribute to raising collective tax awareness, such as the perception citizens have relative to the fairness of the tax system and their degree of satisfaction with the public goods and services financed by taxes.

Although these factors are not directly related with the Tax Administration's proceedings, they should be reckoned with in its communications strategy.

Through the communications actions, citizens and businesses should see a socially responsible and committed Tax Administration. The fight against drug trafficking, environmental concerns – by controlling the traffic of protected animals -, their contribution to promoting lawful trade – by controlling goods at customs -, the sensitivity toward people with disabilities, citizen-tax education, promoting gender equality, etc., are clear examples of said image.

In the Spanish case, the Tax Agency plays a decisive role in advancing the information society by the gradual migration to electronic relationships between citizens and the Tax Administration, engaging different social agents – professional associations, trade organizations, financial institutions, Public Administrations, etc. – which enter into social cooperation agreements and thus enable citizens to benefit from the advantages of new technologies in their interactions with the Tax Administration.

A specific instrument which helps to broaden communication avenues from the Tax Administration to the citizens is the Service Charter, which represents the unique commitment to each potential recipient and reflects the acknowledgement of the moral duty of each Tax Administration to provide full support and assistance to citizens and reach higher quality levels in tax proceedings.

Furthermore, this instrument reinforces tax morality and implies an assurance, since it provides, among many other things, a catalog of the rights acknowledged to the taxpayer and the main enforcement rules of the tax system, with references for their ready tracing.

The Spanish Tax Administration Service Charter is published on the Tax Administration's website and, to render this instrument effective, a specific oversight and review system has been enabled to monitor current commitments via specific follow-up indicators.

To know how society perceives the Tax Administration's image which, as mentioned earlier, influences citizens' tax awareness and conditions the success of its mission, it is important to have tools to measure citizens' points of view and perception, such as external surveys and opinion polls, to enable on-going improvement of services and citizen satisfaction.

In Spain, the Tax Agency has a series of external surveys which are part of several studies conducted by external public entities, such as the Tax Studies Institute's tax barometer reports and the surveys of the Sociological Research Center. In addition, the Tax Agency performs its own polls.

Both types are research analysis and studies on the issues relative to public revenues and spending from the methodological standpoint provided by Sociology.

## **II.1 External surveys**

### **A) The Tax Studies Institute's tax barometer**

The purpose of this Barometer is to study the evolution of the Spanish people's tax opinions. To that end, an annual survey is performed on a random sample of 1,500 citizens of over 18 years of age, scattered across 5 segments – businesspeople from different industries, farmers, professionals, employees and retired people) and selected

by gender, age, education level, habitat and social/economic category. In the past, a parallel survey was conducted on a strategic sample of 125 qualified informants.

The variables analyzed make up four major set thematic blocks, which are iterated every year to follow-up on their evolution (citizen care, information and assistance services, combat of tax fraud, public services, social services, tax payment and public resource management), to which other thematic blocks may be added for every specific year, based on the aspects deemed worthy of scrutiny at any given juncture.

The results of the last edition are contained in the IEF's Document series under the title "Tax opinions and attitudes of Spaniards in...". In addition to that year's data, there is comparative data with previous years.

The diachronic reading of the past ten years suggests a doubtful popular perception and one that is somehow contradictory relative to taxpayers' compliance. Most of the population has had a perception of positive evolution regarding tax compliance over recent years, while the perception in terms of tax fraud reduction has been lower.

Regarding the Tax Agency's corporate image, two thirds of the citizens interviewed are aware of the Tax Agency's services and one third uses them. In addition, citizens who know about these services continue to have a clearly positive perception of them, with the vast majority valuing positively the TA's problem-solving skills.

Asked specifically about given services, opinions are clear: all of them are rated as either good or very good by the vast majority of respondents. By way of example, the service with the highest rating is the electronic signature, followed by the AEAT's website and the communication of tax data. Next comes officials' care to those who approach the AEAT's offices, as well as the draft IRPF (individuals' income tax return), the last place being occupied by the telephone service.

A clearly positive rating is also given to citizen assistance from the officials working in said services.

## **B) Studies from the Sociological Research Center**

The Sociological Research Center performs scientific analysis and study of the Spanish society by conducting qualitative surveys and studies, either on the entity's own initiative or by agreement with public or private non-profit institutions.

It annually performs a nation-wide public opinion research study called "Public Opinion and Tax Policy" on a sample of 2,500 personal interviews at households.

This study deals with information on the degree of citizen satisfaction with the performance of the different public services, an assessment of the amount of resources the Government earmarks to fund these policies, and includes a number of issues relative to the Tax Administration's activity (fair distribution of tax payments, fair tax collection and tax pressure among high, medium and low income segments, valuation of the Administration's efforts in combating tax fraud, etc.).

Specifically, the 2010 report "Public Opinion and Tax Policy" attaches a very high value to the Tax Agency's information and assistance services. This is also the case for the item "satisfaction" relative to service received at the Tax Agency's premises. In 2009, 81.8% of respondents stated they were satisfied or very satisfied with the service and treatment received in the Tax Agency's offices.

### **II.2 The Tax Agency's opinion polls**

In the Tax Agency's website there is a survey section where citizens who have used the electronic filing system of Individuals' Income Tax Returns may fill out an opinion form including issues relative to the degree of difficulty in obtaining the Income Return Help Program (PADRE, as per the Spanish acronym), or the preparation of the return, the degree of overall satisfaction with the Internet filing system and with the five services provided by the Tax Agency which they consider most useful.

Once all the annual tax forms have been processed, the results are posted on the Survey Summary Section of the Website, which is available to the general public.

As an example of the usefulness of the system, in the 2008 Income Campaign results, carried out during 2009, 77.9% of respondents showed very high satisfaction with the Internet filing system.

The five services users have considered most useful in the 2008 survey are: filing of return, queries on rebates, transfer of data available relative to the Individuals' Income Tax, the request, review and confirmation of the Income Draft, and downloading the help program.

### **II.3 Tax statistics**

Once the social perception about the Tax Administration's performance is known, the TA should continue the communication exercise with society by passing on elaborate information enabling further dialog.

Still using the example of Spanish, in the Tax Agency's website there is a section on Tax Statistics which includes Publications, Statistics Reports, Statistics on the electronic window and the annual outreach Calendar of statistical outputs (reports and publications).

Under Publications, reference can be made to the **Individuals' Income Tax Return Statistics**, based on the returns which correspond to the statistics tax year of reference. This publication gathers detailed information on the main items contained in the D-100 model return sorted from different perspectives.

Another very useful statistics is **Economic and Tax Results for VAT** – a census piece of data based on the information provided by economic agents through the “Annual Summary”, aimed at offering a rigorous compilation of economic and tax figures.

Statistics provide the main components of purchases, sales, EU imports or intra-community purchases, the tax variables which determine the VAT balance per return and the main tax parameters for VAT: the result of the return, mean type of sale and purchase, pro-ratas, etc., variables which jointly explain the tax due, rendering it a collection analysis tool.

The **Statistics Reports** section shows the monthly Collection reports, the Reports on Sales, Employees and Wages for Large Corporations and Annual Tax Collection Reports.



The section on the **Electronic Window** contains, among others, information relative to Internet Returns and Call Center Statistics.

#### **II.4 Tax administration actions aimed at ensuring taxpayer rights**

In addition to inquiring into the image the Tax Administration projects onto society and giving this information back to citizens (including a possible analysis shown on its website), the Tax Administration should continue its effort to get closer to society and public transparency.

One should bear in mind that the rights of taxpayers are also part of tax morality and should be protected separately.

##### **A) The Taxpayer Advocacy Council**

A very useful action in this connection might be the creation of a body which advocates for taxpayer rights.

This entity has the purpose of protecting taxpayer rights, responding to grievances resulting from governmental enforcement of the tax system and making suggestions and proposals in accordance with the procedures established.

The Council not only helps to work closer to taxpayers or reach a better understanding between taxpayers and the TA, which reduces conflict and, thus, claims and grievances, but also to inspire improvements to the TA's work and, ultimately, new tax norms.

It could further be considered as an observatory of the Tax Administration's work, since grievances and suggestions from citizens will provide insight on the degree of acceptance and social satisfaction with the tax system.

In Spain, the **Taxpayer Advocacy Council** is a collegiate body reporting structurally to the Ministry of Economy and Finance, but with expressly granted functional autonomy. Said autonomy is ensured by equal representation of the Tax Administration and professional sectors involved in the tax field.

Citizens may submit grievances and suggestions to a specially designed area in the Tax Agency's website. The logistics and support in processing these requests are provided by the Agency via the Internal Audit Service.

The Council publishes its Annual Report and the Council's activity raises a series of normative proposals focusing exclusively on substantial issues relative to inadequacies or flaws in current norms detected repeatedly in the cases processed through the Council.

## **B) Reducing taxation disputes**

On the other hand, when referring to taxpayer rights, we could also mention the issue of taxation disputes, which indicates disagreement or discrepancy between the Tax Administration and the taxpayer.

It is the result of developing tax ethics, understood as the enforcement of the tax system in specific, individualized cases. It is an undesirable phenomenon; yet, it exists; therefore, it should be studied in order to find its root causes and adopt relevant corrective measures.

For the Tax Administration, in the best case scenario it implies deferral of the tax payable for a long period and, in the worst case scenario, the acknowledgement of incorrect enforcement of the norms, criteria or principles of action and the ineffective use of its resources.

As to taxpayers, they may have a negative perception of the Tax Administration's performance, feel that their rights are not being respected, in addition to having to bear the economic cost for the duration of the conflict.

For this reason, the Administration is compelled to acknowledge this is a major issue and adopt the necessary corrective measures.

Tax Fraud Prevention Plans may take into account this phenomenon and determine palliative measures for any conflicts arising from tax administration actions, such as the regular issuance of reports on tax conflict for each territorial Unit and for the whole of the Tax Administration.

These reports will enable recommendations and proposals for improving the different Units with a view to reducing conflict rates and/or improve their results.

After preparing the report and proposals, results should be assessed which ultimately could give rise to motions to the liable functional bodies with the purpose of expanding them to the Tax Administration

as a whole. This will translate into enhanced tax morality within the Administration.

## **II.5 Tax administration actions aimed at improving cooperation with taxpayers**

However, in addition to protecting taxpayer rights, the Tax Administrations should take one step further and establish new communication and exchange spheres which will not only reduce conflict rates but also enable a meeting point between the TAs ethics in its capacity as the public authority responsible for effective and efficient enforcement of a tax system but also taxpayer ethics based on their knowledge of their tax duties and obligations.

Before establishing cooperation or control actions to be performed by the Tax Administrations, TAs should perform risk assessment, control and follow-up that may seriously impair the completion of corporate goals.

This implies identifying these risks, making a previous analysis and subsequent assessment of those which should be mitigated to reduce their likelihood of occurrence while finding ways to reduce their negative impact on corporate goals.

With active involvement from all Departments and Services of the Tax Administration, Risk Management Plans and Maps serve to improve the operational management and further strive, among other things, to achieve integrity in civil servants' conducts.

There are many types of manageable risks, but those related to irregular conducts or deviations from ethical and professional values can be limited by means of proactive and preventive process control mechanisms and by developing rules and procedures.

Once this analysis has been performed, Tax Administrations should seek different mechanisms of dialog and cooperation in the spheres detected as favorable to this type of dialog.

### **A) Large Corporations Forum**

In Spain there has been a recent step toward building a better relationship between the Tax Agency and large taxpayers by enabling

a new type of cooperative relationship with a small number of large businesses in a two-phase process:

1st phase –creating a discussion forum with large taxpayers where the major issues arising between large businesses and the tax administration are discussed either in joint or sectorial meetings and the extent of the cooperative relationship model is assessed.

2nd phase – implementing a special framework through which the Administration shall provide an opinion regarding the tax consequences of their business operations within a timing which is appropriate for corporations in exchange for absolute transparency on them, provided that the businesses which voluntarily chose the special framework offer all the information required by the Agency with a view to determining its opinion.

The Large Corporations Forum was established in July 2009 to enforce the first proposal. This entity promotes a cooperative relationship between AEAT and a total of 27 large Spanish businesses to promote further cooperation based on the principles of transparency and mutual trust, by communicating and sharing the issues that may arise in enforcing the tax system.

Noteworthy among the issues put forth for discussion at the Forum are those relative to the establishment of expeditious communications channels to improve the widespreading of general interest interpretation criteria reached by competent bodies (of the administrative, economic-administrative and legal fields), analysis of steps to simplify tax compliance, promoting e-invoicing or establishing more secure communication means for businesses while minimizing disputes.

Likewise, the Forum enhances and values general interest normative projects.

The Large Corporations Forum works through the Plenary and Working Groups, and agreements take the shape of reports or recommendations relative to the issues discussed therein, as a result of which they shall not be legally binding.

At present, there are three Working Groups on:

- the preparation of a Good Tax Practices Code,
- the analysis and reduction of Indirect Taxes, and
- Transfer Pricing

The **Working Group on the Preparation of a Good Tax Practices Codes** has finished its work by adopting a language at the Plenary Forum of July 2010.

The goal of this Code is to improve mutual cooperation between companies and the AEAT based on the principles of good faith and mutual loyalty, the enforcement of responsible tax policies by corporations and transparency and legal security and predictability in rule enforcement.

The starting point is to acknowledge the importance businesses have in society, not only as employers and wealth creators but also as agents for the development of the communities they are in. Businesses are aware of this and have for years tried to strengthen their social responsibility by making an active and voluntary contribution to social, economic and environmental improvement.

Social responsibility includes wide-ranging aspects (environmental, cultural, social cooperation, etc.). However, in recent years reducing tax risks has been a predominant area.

In turn, one of the strategic goals for the TA with regard to tax morality is promoting voluntary compliance with tax obligations by all taxpayers. In the case of businesses, meeting this goal calls for greater proximity, better knowledge of their actions and, especially, providing the maximum legal certainty and predictability to enable better and more efficacious fulfillment of tax obligations.

The Good Tax Practices Code seeks to attain these goals. Businesses mainly undertake to promote tax risk reduction and prevent the conducts that are liable to create risks. The Tax Agency undertakes to increase legal certainty and predictability of businesses, by assisting them in meeting their tax obligations. Both parties commit to reduce disputes in their relations and any conflicts derived from the interpretation of applicable rules.

For the Tax Agency, this Code of Good Practices shall imply enhanced efficacy and efficiency of tax control. On the one hand, for businesses adhering to the Code (23 at the present time) its use will avoid tax non-compliance and costly tax disputes. On the other hand, it will allow for more resources to be used for combating fraud.

## **B) Tax administration services provided to taxpayers**

Tax Administrations are aware of their duty to perform actions aimed at taxpayer information and assistance.

Citizens are offered multiple means of communication – Internet, telephone, written material (letters, brochures, handbooks, etc.) and personally throughout their office network.

In addition, both tax education campaigns on tax fraud and taxpayer information campaigns are held by the main communication means (press, radio, TV), especially in connection with the annual payment of Individuals Income Tax.

Noteworthy among these actions by virtue of its high interest and results, and as an example derived from the Spanish Tax Administration, is the INFORMA software, which consists of a database of tax questions and answers that may be queried over the Internet.

In addition to the already mentioned services, aimed at providing information to citizens, the Tax Administration should promote voluntary tax compliance by different actions. By way of example, in the Spanish Administration we can mention the following:

### **1. Sending a draft Individuals' Income Tax Return and relevant tax data**

The Tax Agency provides IT software so that taxpayers may prepare their own return. It also helps them directly in preparing the return, either in their own offices or through cooperating entities.

Likewise, the Tax Agency provides taxpayers with tax data to prepare the Income Return and sends the draft income return to their homes if applicable and so requested.

Confirmation and changes to the draft received may be made in different ways (by telephone, Internet, SMS, etc.)

A relevant piece of data which shows the importance of this action is that, in 2009, over 20 million communications were sent out to taxpayers.

## **2. IT help software**

Returns for most of the major taxes can currently be prepared with the help of IT software, which are used to create most of the returns received, both on paper, CDs and over Internet.

## **3. Personal appointment service to prepare returns**

## **4. Call center**

The Tax Agency has a Call Center and an automated voice recognition service working 24 hours to help taxpayers in meeting their tax obligations.

## **5. Electronic filing of returns**

The use of new technologies has become one of the main issues a Tax Administration should face.

For this reason, the Tax Agency devotes much of its efforts to promoting electronic filing of returns by using some of the ID systems provided for by law.

Currently, over 66% of all returns are submitted in this fashion.

Conversely, taxpayers may appoint a proxy or authorize a social collaborator with a contract signed with the Tax Agency to act as proxy in submitting the different tax returns. The Tax Agency has undersigned over 3,900 Contracts or Adhesion Protocols authorizing social collaborators to file returns on behalf of third parties.

## **6. Expediting customs clearance**

To prevent customs declarations from becoming an obstacle to trade, and without detriment to efficient customs controls, Tax Administrations should implement IT software to avoid delays resulting from public

service hours. In Spain, the system has been designed with the purpose of providing service 24X7X365.

As a result of this initiative, the mean time for customs clearance proceedings has been reduced from 63 minutes in 2008 to 36.49 minutes in 2009.

## **7. Early assessment agreements**

This mechanism allows taxpayers to request of the Tax Agency a binding tax assessment provided specific assumptions are met.

### **II.6 The work of tax administrations in preventing tax fraud**

While performing actions aimed at strengthening citizens' tax awareness, Tax Administrations are aware of their role as monitors of taxpayers' tax morality, understood as the degree of commitment or conformance with tax proceedings, the ethical principles and fundamentals contained in the norms and practice of Tax Systems.

In this regard, there is a series of activities which Tax Administrations should perform to verify conformance and prevent and correct tax fraud.

In the area of control actions, both extensive and selective checks may be performed.

Extensive actions are those affecting a large number of taxpayers and using the information the Tax Agency has on all returns and, particularly, during the annual payment periods for all tax modalities.

Conversely, selective and investigative actions are projected on groups of taxpayers posing higher risk of non-compliance based on objective criteria.

The Spanish Tax Agency has a planning instrument – the Overall Tax Control Plan – within its strategic priority baseline of combating tax fraud.

In terms of the selective control of taxpayers deemed to pose higher tax avoidance risk, and in an economic and social context characterized by economic crisis, the Plan sets forth the following priority action lines for 2011:



- Work on sectors where there is a higher perception of fraud (professionals, subcontractors, external staff, etc.).
- The underground economy.
- Work on tax engineering or abusive tax planning.
- Transfer pricing.

In addition to these specific actions, on-going work is performed to ensure adequate generic compliance with the tax system according to the relevance of given sectors and activities.

These basic and priority control actions are closed with proceedings aimed at securing effective collection of the taxes assessed by specific actions such as collection risk assessment during the auditing phase; systematic failure to comply with tax payments; follow-up of apparent insolvency cases, etc.

## **II.7 Tax administration actions aimed at tax education**

Finally, once the iteration process has been put in place with society and having adopted the measures and procedures enabling compliance with the mission, as per the highest standards of tax morality, Tax Administrations have a specific social responsibility.

They are called upon to create tax awareness among future taxpayers in such a way that they embrace tax responsibility as a value supporting co-existence in a democratic society and identify tax compliance as a civic duty.

One of the clearest pieces of evidence of this commitment with the citizenship are **civic-tax education programs**, mostly aimed at children and adolescents in the national territory, which should be part of the measures contained in Tax Fraud Prevention Plans.

In Spain, the program has been implementing a series of activities, such as Open Door Dates and School Visits, undertaken by voluntary teacher teams and collaborating staff in all Delegations of the Tax Agency.

With the purpose of deepening this effort, activities have recently broadened to include new tasks such as delivering courses and holding various activities with Primary and Secondary teachers, as well as delivering courses to Teacher Training and University students.

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## II.8 Tax administration actions aimed at promoting civil servants' ethics

The third pillar of the notion of morality mentioned at the beginning is the professional ethics of civil servants, which underlies administrative morality in general and, in this particular case, may be applied to the tax field.

To ensure voluntary tax compliance, it is essential to earn taxpayers' trust relative to the integrity and ethics of the Tax Agency's employees. It is equally important to ensure there is a positive social perception regarding the honesty, integrity and equity of officials in charge of enforced tax collection.

Tax Administrations should develop **control and supervision systems** to prevent and detect irregular behaviors which, in addition to having an internal function, may be an indicator of the Tax Administration's ethics vis-a-vis the public opinion. To that end, it is advisable to create a cross-cutting entity -- an Internal Audit Service -- to perform the following functions:

- a. The exercise of internal control and oversight of all services by designing on-going control instruments to assess efficacy and efficiency.
- b. Advice and assistance to ruling bodies in all issues required.
- c. Support and advice in all aspects of continuous improvement in service rendering and quality standards.
- d. Revision and assessment of internal security and control, as well as prevention, detection and, if applicable, investigation of irregular behaviors.

In the Spanish Tax Agency, the Internal Audit Service conducts actions such as:

### 1. Managing single users

It consists of checking the adequacy, control and follow-up of the control points which enable access to data required strictly for purposes of fulfilling officials' tasks.

## **2. Tax Database access control**

Checking information access systems, their adjustment and rationale.

## **3. Controlling civil servants' restrictions**

Detecting possible non-compliance with state as well as specific Tax Agency regulations regarding Public Administration staff restrictions.

## **4. Corrective actions and investigation of irregular behaviors**

These actions are carried out based on AEAT's databases and general registries, among others.

Action is prompted by either public or private claims or upon request by official entities such as AEAT departments or the Taxpayer Advocacy Council.

## **5. Detection**

This type of action is based on risks selected previously by the AEAT.

## **6. Technical assistance and consultancy on combating corruption and promoting organizational ethics with EU and IDB funding. In addition to control or oversight systems, we should underscore the importance of the Tax Administrations' educational activities,**

Which focus on raising awareness among officials with management functions at the Tax Administration and others who perform executive functions in the areas of management, assessment, auditing and collection, both of excise taxes and customs duties, on principles and values such as institutional loyalty, professionalism, appropriate taxpayer service, etc., which characterize the organization's corporate responsibility.

## **III.- FINAL CONCLUSIONS**

Tax morality or ethics is a wide-ranging notion which should involve an analysis of different aspects which have been listed and briefly described earlier.

All of these aspects are essential and should not be treated separately but lead to a more integral understanding of tax morality.

All Tax Administrations plan their policies by focusing on effective fulfillment of their ultimate objective or mission, but policies face difficulties which sometimes prevent their goals from being achieved.

Some of these difficulties are structural flaws of the organizations, often linked to working visions, processes and methods which are engrained in excessively bureaucratic, inflexible rather than innovative ideas.

We should also mention the lack of integrity in a few civil servants' behaviors, both in cases of clearly criminal behavior or conducts which are contrary to administrative rules and also in cases of behaviors which are not illegal but undesirable since, once perceived by taxpayers, they would affect the credibility of Tax Administrations and have an undesirable impact on tax compliance.

Thus, ethical promotion policies should work closely with the different areas of the corporate government of the organization responsible for enforcing the tax system.

Promoting, encouraging and designing action plans and policies in line with the highest integrity standards implies working simultaneously and in coordination on different aspects, the most noteworthy of which are:

### **1. Leadership**

The highest authority of the Organization and Senior Management should have a strong leadership role and show an unmistakable and clear position regarding the factors which influence organizations' ethical infrastructure.

### **2. Legal framework**

The legal framework should be seen from a broad perspective, which includes not only substantial tax regulations or procedures but also other administrative provisions which, although unrelated to taxation, serve to regulate relationships between officials and their taxpayers in order to process the grievances and suggestions on the use of public services.

### **3. Equity**

This is an essential aspect to ensure the legitimacy of the system vis-a-vis the taxpayer. Legislation which is perceived as inequitable, even if administered efficiently, will inevitably lead to less trust and respect from the taxpayer and this in turn will lead to further non-compliance.

Laws should be equitable, but so should the way in which they are administered. Citizens must be certain that the Tax Administration will take every step needed to ensure that everyone receives equitable treatment.

### **4. Transparency**

Transparency is another essential part of Tax Administration ethics. Taxpayers have the right to demand high levels of clarity in their interaction with the Tax Administration. This objective can only be achieved if laws, regulations and procedures and tax guidelines are communicated openly and readily to the public and are enforced steadily and consistently.

### **5. New technologies**

Although we are aware of the potential of IT and electronic means in helping Tax Administrations to be more efficient, it should be recognized that automated systems may be vulnerable to manipulation both from inside and outside the organization. For that reason, it is important to ensure that appropriate security controls are in place, and that oversight and accountability systems are established.

Access to the information contained in tax databases and all applications defined as support to tax enforcement should be allocated responsibly and consistently with the degree of responsibility within the organization.

### **6. Institutional autonomy**

It is important to ensure the absence of political influence in specific and individual cases of tax enforcement.

Organizational regulations and those which rule processes should reinforce institutional autonomy in performing the most relevant functions of tax enforcement.

Furthermore, greater budgetary and personnel autonomy contributes to this objective.

### **7. Effective control and accountability mechanisms**

Using internal and external oversight and control mechanisms is essential. An internal control and auditing unit is an important component of an efficient tax administration and should be responsible, among other things, for carrying out investigations in claims of alleged corruption or irregular conduct.

### **8. Human Resource policy**

Finally, Human Resource management policies and procedures have a very important role in promoting ethics within a Tax Administration. The most noteworthy aspects are:

- Staff selection and promotion processes which ensure objectivity, transparency and impartiality, as well as an administrative and professional career.
- Training programs, both for new entrants and current staff members.
- Remuneration policy based on performance and responsibility.
- Performance appraisal systems, both for management and operational staff.



## **TAXPAYER ATTITUDES VIS-À-VIS THE TAX ADMINISTRATION: DIFFERENTIATE AND CLASSIFY TAXPAYER BEHAVIORS**

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*Contents: Summary – 1. Introduction – 2. Development – 2.1 Context for the Brazilian tax system – 2.2 Tax Administration Federal Context– RFB – 2.3 Tax morality, voluntary compliance and the taxpaying-capacity principle – 2.4 Classification of taxpayers’ behaviors from the standpoint of tax morality – 2.5 Specific RFB program – 3. Conclusions*

### **SUMMARY**

This paper presents the experience of the Federal Revenue Secretariat of Brazil (RFB, as per the Portuguese acronym) in the implementation of the New Taxpayer Assistance Model for Individual Income Tax, which spurred the reflection on the importance of classifying taxpayers according to the tax morality criterion.

Firstly, we briefly explain the Brazilian Tax System, whose complexity generates the most diverse taxpayer profiles.

Then, it focuses on the Federal Tax Administration, under the authority of the RFB, highlighting the assessment modality adopted by this Administration – the “Self-assessment” – which requires better taxpayer assistance and leaves certain room for discretionary behavior to the taxpayer at the time of drafting tax documents.

Following, we elaborate on the importance of the taxpaying-capacity principle in promoting taxpayers’ tax morality and voluntary compliance with tax obligations, chiefly with respect to determining the ceiling for each citizen’s contribution.



Subsequently, it presents a proposal to classify taxpayers according to the tax morality criterion, considering two standpoints: willingness to reveal the taxable event (seven types identified), and the willingness to pay the applicable tax (five types identified). Thereafter, the paper shall refer to the dynamics among the different types.

Finally, we set forth the experience from the implementation of the new model for individuals' assistance, which shows that the RFB is gradually overcoming old paradigms to adopt a more transparent stance before society, even acknowledging the need of relying on differentiated programs based on taxpayers' morality. We shall pose the situation-problem, the role of strategic planning on process reviews, the solution adopted, preliminary results, the need to adjust to programs and the new outcomes.

To conclude, conclusions are presented to convey that taxpayer assistance, adopting a transparent stance and the respect for the principle of the taxpaying-capacity by the Tax Administration are factors that promote taxpayers' tax morality and increase voluntary compliance with tax obligations.

## **1. INTRODUCTION**

The notion of tax morality is of utmost importance for modern Tax Administrations, which shall define their actions increasingly centered on transparency and respect for their taxpayers. The latter, in turn, usually adopt a behavior that reflects the behavior of the tax authority, so, if treated with respect and honesty, they shall react accordingly.

In spite of the difficulties implied in the classification of taxpayers according to the tax morality criterion, it is vital to move forward in such direction to promote a healthier and more authentic tax administration-taxpayer relation. Likewise, the deeper knowledge of the taxpayer universe enables the creation of specific programs for each group, which entails a benefit in terms of resource allocation and results achieved.

In such respect, the Federal Revenue Secretariat of Brazil (RFB) recently started moving towards this new approach for the tax administration-taxpayer relation, breaking old paradigms and accepting the challenge of reviewing its procedure. And, in fact, this is the process addressed herein.

## **2. DEVELOPMENT**

The following paragraphs shall elaborate on the experience of the Federal Revenue Secretariat of Brazil (RFB) in the implementation of the program called “New taxpayer assistance model for individual income tax”, aimed at a specific group of taxpayers, which gave way to the reflection on the importance of classifying taxpayers according to the tax morality criterion.

### **2.1 Context for the Brazilian tax system.**

In Brazil, taxation is distributed according to three administrative levels: municipal, state and federal.

The Municipal Tax Administration applies central taxes, the Tax on Urban Property (IPTU) and the Services’ Tax (ISS). They are direct taxes, from the standpoint of the economic impact, collected by means of administrative assessments. In this assessment modality, the de facto taxpayer– which is mistaken for the de jure taxpayer – simply receives a payment plan, calculated by the tax office.

On the other hand, the State Tax Administration is responsible for the Tax on the circulation of goods and services (ICMS), whose de jure taxpayer is generally the business owner, who is in charge of calculating and collecting the tax, should not be mistaken for the consumer, who effectively bears the burden. It also enforces the Tax on the ownership of motor vehicles (IPVA), borne by the vehicle owner. In turn, the payment is made through the plan that is presented to the taxpayer.

On the other hand, the Federal Tax Administration is in charge of the RFB, the agency collecting the main direct tax, income tax. Such tax is collected by self-assessments, which entails completing statements and calculating the tax amount. Such functions, generally called, “ancillary obligations”, are conducted, in principle, by the taxpayer proper, except in the case of businesses, which rely on a specialized professional – the Accountant.

The multiplicity of taxes, in addition to the diverse forms of assessment and collection, leads to the creation of diverse taxpayers’ profiles, mainly if the classification criterion is the tax culture.

Therefore, we may observe certain taxpayers who are not even aware that they pay taxes, chiefly as regards excises and the taxes on the circulation of goods. The situation is even worse based on the fact that, in Brazil, in general, the tax burden is not detailed on invoices. On the other hand, when the tax is enforced directly, tax awareness improves, which triggers the discussion about the application of the collection proceeds.

## **2.2 Tax Administration Federal Context– RFB**

As it was specified on the foregoing sub-item, the Tax Administration in the federal sphere is a power of the Federal Revenue Secretariat of Brazil, hereinafter, the RFB. As mentioned before, it enforces, among other obligations, the income tax, which constitutes the central direct tax. Thus, taxpayers registered in this tax are aware of what they pay, as well as of the amount enforced upon them.

Additionally, the RFB adopted the self-assessment methodology for all the taxes and contributions enforced thereby. Such modality is provided for in the National Tax Code (CTN, Act N° 5.172 of 1966):

“Art. 150. The self-assessment, which applies in the case of taxes which payment the taxpayer shall anticipate without prior examination by the administrative authority, as mandated by law, is materialized with the act by which said authority becomes aware of the activity undertaken by the taxpayer and expressly validates it”.

Therefore, according to the validation modality that the RFB adopts, the taxpayer shall meet the ancillary obligations, which consist in drafting the tax statements on his own, which are sometimes complex and contain information and calculations of the amounts' payable. Subsequently, the taxpayer is required to duly file them with the Tax Administration, as well as make the applicable payments in due time. This assessment system originates a discussion on two aspects:

- the commitment that the Tax Administration shall assume of offering the taxpayer all the information and facilities required to meet the tax obligations, in addition to providing assistance, especially in the cases in which the taxpayer does not rely on the assistance of a specialized professional;
- the relative discretionary behavior of the taxpayer at the time of reporting the taxable events tempts him, by a licit or illicit means,

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to reduce the amount payable, mainly when the Tax Administration does not meet the taxpaying capacity principle.

### **2.3 Tax morality, voluntary compliance and the taxpaying-capacity principle.**

The issue presented in the foregoing sub-item calls for a reflection on the fact that in the context of federal taxes, enforced by the RFB, any analysis applicable with regards to taxpayers' tax morality necessarily relates to the answer to the following questions:

- is the RFB doing its share, by offering the conditions required for taxpayers' voluntary compliance with tax obligations?
- is the RFB applying the principle of the taxpaying capacity and, consequently, respecting the notion of "minimum vital income"?

If the answers to the two questions are affirmative, it becomes easier to understand taxpayers' behavior, especially in an attempt to clarify aspects relevant to tax morality. On the other hand, should answers be negative, it shall be very difficult to define whether noncompliance with tax obligations is due to behavior based on poor morality or simply the lack of information and guidance, or even defiance to an unfair tax system.

It is relevant to emphasize that the taxpaying-capacity principle is enshrined in the Federal Constitution of Brazil of 1988, which sets forth the following:

"Art. 145. The Union, the States, the Federal District and the Municipalities shall enforce the following taxes:

(...)

§ 1º - Whenever possible, taxes shall be personal and calculated on the basis of the taxpayer's economic capacity, vesting upon the tax administration the special power, in order to fulfill these objectives, of identifying the property, income and economic activities of the taxpayer in compliance with individual rights and the laws in effect.

Klaus Tipke, in the work he co-authored with Douglas Yamashita, calls the attention on the importance of the taxpaying-capacity principle, which shall regard the need to determine and respect the minimum vital income:

“The taxpaying-capacity principle is also realistic, since only those with a taxpaying capacity are required to pay. The opposite of the principle (“everyone pays taxes in the reverse proportion to their taxpaying- capacity”) would be unacceptable under the Social State. (...) The implementation of the taxpaying-capacity principle is a step forward in the face of arbitrary taxation, without principles, based on political opportunism, and limited pragmatism or taxation.

(...)

The taxpaying-capacity principle protects the minimum vital income. Unless income exceeds the minimum vital income, there is no taxpaying-capacity.” (Justiça Fiscal e Princípio da Capacidade Contributiva, São Paulo: Malheiros, 2002, pages 29/30 and 34).

On the basis of such notions, and considering millions of taxpayers, it is possible to envision the difficulty for the RFB in establishing the limit from which taxation would apply, in other words, the cutoff amount for the “minimum vital income” to determine the taxpaying capacity.

If the Tax Administration already faces difficulties in establishing the minimum amount from which the taxpaying capacity applies, it is practically impossible for it may to define its maximum amount accurately. In other words, the maximum amount for each taxpayer’s contribution. And, precisely, in the context of the “self-assessment” – given the small dose of discretionary behavior in determining the amount payable – the importance of the taxpayer’s tax morality is made evident. It becomes the determining factor for the taxpayer’s decisions, according to the analysis in the following sub-sections.

#### **2.4 Classification of taxpayers’ behaviors from the standpoint of tax morality.**

With respect to tax morality, two classification trends shall be defined for the taxpayers subject to the payment of the federal taxes and contributions enforced by the RFB:

- based on the taxpayer’s willingness to reveal the taxable events, in the context of the self-assessment;
- based on the taxpayer’s willingness to make the payment of the taxes and contributions already filed or calculated by the administration.

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### **2.4.1 Classification of taxpayers' behavior - tax morality and disclosure of the taxable event.**

Prior to discussing the classification itself, it is worth defining certain basic terms, owing to the multiplicity of meanings that theory has attached to them.

It is worth highlighting that in this paper, the definition of certain terms is not intended as absolute or conclusive, but is merely aimed at guaranteeing the internal consistency of the text. Additionally, the diversity of meanings attributed to certain legal-tax terms was already addressed by Ricardo Lobo Torres:

“Other important entities also bear relation with the taxable event: tax evasion, tax avoidance, misrepresentation and tax fraud. Semantic difficulties exist with respect to each one of these notions in Portuguese as well as the other languages, in addition to theoretical differences on their legality.” (Course on Financial and Tax Law, 15<sup>th</sup> edition, Rio de Janeiro: Renovar, 2008, pages 246/247).

Therefore, in this paper the moral typology of taxpayers, from the standpoint of the occurrence of the taxable event, is based on the following basic notions, taken from Wikipedia:

- Evasion – employing illicit means to avoid the payment of the applicable tax once the taxable event has occurred;
- Avoidance – employing legal means to avoid the occurrence of the taxable event and, consequently, avoid paying the tax.

#### **Type A – the “legal” tax evader**

This taxpayer is aware that the occurrence of the taxable event, and the mandatory nature of the respective tax payment, pursues within the Legislative Branch a special legal solution that favors its economic group. The solution pursued seeks to avoid the incidence of the tax, or simply modify the form of taxation in order to reduce the amount owed.

This type of taxpayer normally enjoys sufficient economic power and social prestige to hire highly specialized professionals who draft favorable opinions on the claim and submit the bill to Parliament. These are a group of procedures that seek to legitimate a type of behavior that is not provided for by the Tax Administration. Generally, the solutions set forth do not resist a more sophisticated ethical analysis, since they

are exclusively based on the intention of avoiding taxation, and not on any specific cause of need or impossibility.

A pertinent example is the case of intellectual services, of a very personal nature, mainly artistic and cultural. The tax administration has always deemed that the progressive individual table should apply, since this type of service shall not be rendered by a corporation.

In the light of this, and after countless proceedings, certain segment of society with great taxpaying capacity to face the maximum tax rate of the individual progressive table, obtained from Parliament the right to a special and more favorable taxation system applicable to corporations, from Act N° 11.196 of 2005:

“Art. 129. For tax and pension purposes, intellectual services, including scientific, artistic or cultural, whether rendered personally or otherwise, with or without designating an obligation for the partners or employees of the corporation delivering the services, when provided thereby, shall be only subject to the legislation applicable to corporations, without detriment to the provisions in Art. 50 of Act N° 10.406 of 10 January- 2002 – Civil Code of Law.”

### **Type B – Tax evader by fraud**

This taxpayer seeks to conceal the occurrence of the taxable event, or reduce the amount owed, by resorting to fraudulent means, such as false documentation, forged invoices, third-parties, etc.

### **Type C – Evader by simple omission**

This type of taxpayer simply seeks to conceal the occurrence of the taxable event from the tax administration, omitting the income or earning. This is the most common tax evasion practice. In such cases, doubts always exist with respect to the genuine taxpayer awareness on the act of omission.

### **Type D – Abusive planner (illegal avoidance)**

The abusive planner has broad knowledge of the tax legislation and, generally avails himself of a sequence of step-by-step transactions, which although individually legal, are illegal as a whole. These are related transactions, anchored by intent (animus) that does not exist in

reality, since it all serves the purpose of misrepresentation in order to conceal the occurrence of the taxable event.

For example, the apparent donation of an asset that upon completing the set of transactions, returns to the property of the donor via an offshore company, many times located in a tax haven; therefore, the intent of donating (*animus donandi*) is not confirmed. Likewise, corporate reorganizations that actually conceal a sale, diluting the intent of chartering a corporation (*animus societatis*).

### **Type E – Legitimate planner (legal avoidance)**

This is a taxpayer who also benefits from the deep knowledge of the tax norms to pay less tax, but does not incur in abusive behavior or misrepresentation. Although this type of taxpayer incurs in planning knowingly and with intent, he shall not be deemed immoral from the taxation standpoint.

For example, we may refer to the case of the inapplicability of the “Tax on Financial Transactions” in the case of transactions among joint accountholders. In fact, it was the case of the CPMF – Temporary Contribution on Financial Transactions, which always applied in any financial transactions with bank accounts (checks, deposits, etc.). At that time, many taxpayers who did not hold a joint account, but owing to their family situation, made deposits in their relatives’ accounts regularly, decided to convert such accounts into joint accounts, thus avoiding the incidence of the CPMF.

It is clear that, in such cases, it is impossible to avoid, or even show surprise when spouses, or siblings, or parents and sons, for example, conduct this procedure, since the financial “confusion” among family-members is common. Additionally, it is not reasonable to presume that individuals with no affinity would keep joint accounts, simply to avoid the incidence of the CPMF.

### **Type F – Simple compliant taxpayer**

The simple compliant taxpayer is the one who fulfills tax obligations exactly as determined by legislation. Although frequently lacking in great tax culture, he strives to meet his obligations as taxpayer and normally remains concerned upon receiving any type of communication from



the tax administration. This type of taxpayer is proud of his honesty and makes it a purpose to keep an unblemished name in the market.

### **Type G – Under-compliant taxpayer**

This is a taxpayer with poor tax culture, who keeps an intermittent relation with the tax administration. Therefore, he does not clearly understand his rights and duties. Normally, he is surprised and fearful upon receiving notifications or simply letters from the RFB. He feels incapable of solving the problems with the tax administration and generally requests assistance from third parties. The latter, in turn, are not specialists, but laymen who, in their effort to assist, many times tend to complicate the situation of the under-compliant taxpayer even more.

#### **2.4.2 Classification of taxpayers' behaviors - tax morality and compliance with key obligations (paying taxes).**

Tax morality not only implies matters relative to the occurrence of the taxable event, but also influences the collection phase of the outstanding tax. In the foregoing sub-section the different types were analyzed from the standpoint of admitting to the debt. Under this title, we shall present a classification according to the behavior adopted before the tax debt proper, whether the taxpayer admitted to it or by assessment in the auditing proceeding. **Type H – Illegitimate withholder**

This refers to taxes withheld from third-parties, normally deducted from the payroll (Source withholdings, Pension contributions, etc.). Thus, the taxpayer is entitled to deduct the tax at the time of making the payment to the third-party and, subsequently, make the respective payment to the tax administration. The illegitimate withholder, to the contrary, applies the tax deduction on the payment to the third-party (generally, his employee), but does not make the applicable payment to the administration, unduly withholding the deducted amount. Criminal legislation typifies this action as a crime.

### **Type I – “Legal” debtor**

This type of noncompliant taxpayer generally has no difficulties in meeting the payment of taxes, but ceases to do so under the certainty that in the future a law shall be passed that shall provide for the possibility of breaking down the debt into installments. Commonly, such

taxpayers are organized in groups representing economic sectors. Such groups seek, by proceedings in Parliament, the approval of norms that frequently exceed the simple breakdown into installments and even reduce the tax debt to infinitesimal levels.

A recent example of this practice resulted in the enactment of Act N° 11.946 of 2009, called “Refis da Crise”, which upon conclusion of the proceedings in the Legislature featured a much broader scope than that of the original bill.

### **Type J – Defiant debtor**

This taxpayer systematically ceases to pay tax debts or makes late payments. In general, they are taxpayers who, upon establishing the priority hierarchies, fail to include tax debts, whether by conviction or mere lack of organization.

### **Type K – Occasional debtor**

The occasional debtor is the one who is normally in good standing, but owing to a given circumstance becomes noncompliant. This situation occurs frequently in times of economic crises, as in 2009, which even leads to the application of installments under Act N ° 11.946 – Refis da Crise, mentioned above.

### **Type L – Compliant taxpayer**

This refers to the taxpayer who, no matter the circumstances, is concerned about meeting the debts with the tax administration.

### **2.4.3 Dynamics of the different types of taxpayers**

It is worth noting that the two classifications defined herein are not exclusive– the same taxpayer may be listed on both lists, by adopting a more transparent behavior at a certain time and a less transparent behavior at others, as typified.

Therefore, although the most honest and transparent taxpayers in terms of reporting the occurrence of the taxable event are generally the most compliant at the time of paying taxes, there are cases in which the features merge in a surprising manner: certain taxpayers who strictly meet their ancillary obligations, calculate the amount payable correctly (Simple compliant taxpayer), but do not make the payment

(defiant debtor); some also fail to report the occurrence of the taxable event (evader by simple omission), but when they are detected and receive the notification with the official assessment, make the payment without delay (compliant taxpayer).

Lastly, it is worth remembering that when classifying taxpayers, it is important to consider that any typology, no matter how well-grounded, shall not be deemed absolute, since behind the taxpayer is the human being, subject to the influence of many factors, even the capacity of reflecting and reviewing his behavior.

## **2.5 – Specific RFB program**

The way in which the Tax Administration classifies its taxpayers basically depends on the organizational culture, chiefly on beliefs, principles and values guiding their actions. In such respect, the experience presented in the following sub-sections shows that the RFB has gradually overcome old paradigms and adopted a more transparent stance before society, even acknowledging the need to rely on special programs based on taxpayers' morality.

### **2.5.1 Situation-problem**

In the course of the years, the RFB has classified its taxpayers according to the traditional criterion as micro, small, medium and large taxpayers without considering "tax morality" when defining the groups. Following this trend, a number of specific programs were implemented for each taxpayer category, as follows:

- Large Taxpayers' Program developed by a central Coordination office and with local and specialized Delegations.
- National Simple Program, a system of simplified calculations and payments for small and medium-sized entrepreneurs, based on unifying taxes from the three levels of government (federal, state and municipal);
- Individual Micro-entrepreneur Program aimed at formalizing economic activities not registered with the administration and lacking pension benefits.

With regards to this classification into groups and controlling compliance with ancillary and core obligations, the RFB had always applied a basic system, regardless of the group: the taxpayer meets the ancillary obligations (generally completing a statement) by which

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he admits to the occurrence of the taxable event and calculates the tax amount payable, and makes the payment.

Once the RFB receives the foregoing statement, it crosses the information provided by the taxpayer with the data in their databases, regardless of their being third-party data that the taxpayer obtains or whether they were gathered in a tax audit. If no mismatches are identified, the RFB implicitly validates the so-called “self-assessment”. If mismatches are detected, the RFB conducts the official examination and notifies the taxpayer of the new assessment, normally by adding 75% to the tax or contribution amount. Should the mismatch have been grounded on intentional behavior, as frequently occurring in the cases requiring the tax audit, the penalty shall amount to 150%.

Regarding taxpayers bearing the Individual Income Tax – totaling almost 5 million – the system described above was proving deficient, based on the following issues:

- most individuals do not rely on a specialized professional to complete the statement and conduct the tax assessment;
- when the statement processing is completed, the innumerable mismatches detected between the information filed by taxpayers and the one held in RFB databases caused millions of statements to be retained in the Tax Control mesh, popularly known as “Fine Mesh”;
- retaining such statements in the Tax Control mesh – many times for long time periods, over three years – exerted great pressure and significantly impaired the tax administration –taxpayer relation, since it would not make any distinction between the simple error and potential willful intent;
- in the period during which the statement remained under the Tax Control stage, the taxpayer was required to visit the Tax Administration offices on countless occasions, concerned and trying to solve his situation, but it was impossible to do so. We shall highlight that this regularization, in almost all cases, implied correcting simple errors or simply filing documents. The taxpayer was told to await the notification, which was generally accompanied with a fine from the administration, of at least 75% of the Income Tax amount;
- when the taxpayer finally received the notification, years after the occurrence of the taxable event, he was no longer able to gather the evidence required regarding the events; additionally, the fine

and charges (interest) increased the debt, terribly hurdling its reduction;

- thus, the taxpayer was required to respond to the assessment by the administration via a legal proceeding, many times with the exclusive purpose of delaying events.

### **2.5.2 – Strategic planning and processes’ review.**

Beginning in 2009, with the implementation of the strategic planning initiative in the RFB, relevant objectives and indicators were established, to make way for the review of the organizational processes. Regarding the Tax Administration-Taxpayer relation, such processes included promoting awareness in the sense that a good share of the institution’s scarce resources were being allocated to actions arising from the system described in the foregoing sub-section without looking into the degree of honesty and transparency of the relevant taxpayers. Thus, the practice was applied for individuals, as if all of them belonged in the poor tax morality group, even if they belonged to the “evader by simple omission” type (type C).

In this context, the attempt at measuring the degree of honesty and transparency of individuals brings forward the two questions presented in sub-section 2.3:

Is the RFB doing its share, by offering the conditions required for taxpayers’ voluntary compliance with tax obligations?

The number of discrepancies verified between the information presented by individuals and the one on the RFB databases suggested that maybe the problem of these taxpayers was not precisely the poor morality level, but the lack of information and guidance on how to manage their tax obligations. In such case, it became necessary to acknowledge that the RFB was effectively not doing its part.

### **2.5.3 Suggested solution: new taxpayer assistance model for Individual Income Tax.**

In the face of the situation-problem defined above, the New taxpayer assistance model for Individual Income Tax was implemented in 2009, which introduced the innovation of transparency in the treatment of the eventual mismatches on the statement drafted by the taxpayer. Said

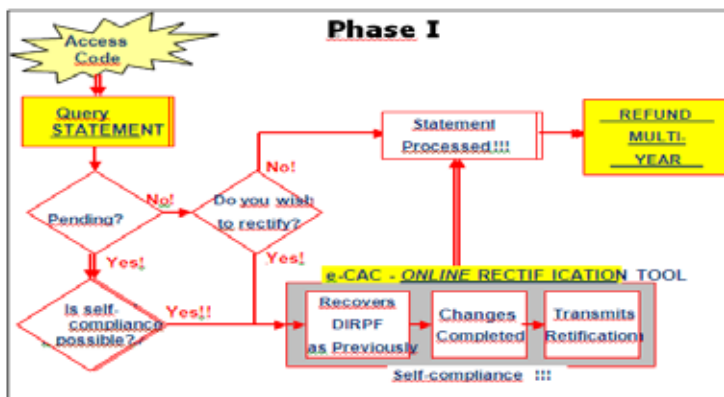
initiative implied an unprecedented change in paradigms in the RFB, as summarized hereinafter.

After submitting the Income Statement, the processing phase begins. Prior to the adoption of this new model, it was a “black box” for the individual taxpayer. As defined in the situation-problem, even if the citizen was aware that his statement had been retained in the Tax Control stage, he was not informed about the reason, and was unable to take the initiative and submit the evidence of the information delivered on the statement. The practice that the RFB had adopted required the taxpayer to wait for the assessment notification, frequently for over three years, since it included a fine from the administration amounting to 75% over the tax value and the late interest charges.

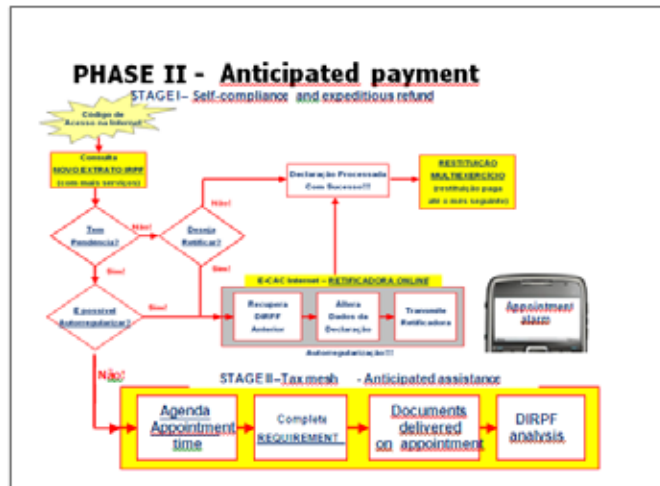
Thus, by breaking all paradigms, the RFB adopted an unprecedented transparency policy upon establishing two phases:

### 1<sup>st</sup> Phase – Self-compliance

The Statement report was posted on the Internet for taxpayers’ access with the code-access key or digital certificate. The report reveals all the mismatches that the administration detected, as well as the proceedings to regularize the situation. Additionally, the statement features functions to monitor payments and reimbursements. When the mismatch requires rectifying the statement, the taxpayer may do so on his own and automatically by the Online Rectification Statement. It is worth highlighting that the eventual rectification that renders a higher amount does not generate the 75% fine but simply a late charge never to exceed 20%.



These taxpayers feature mismatches on the statement, but are not eligible for self-compliance, since they do not intend to rectify the statement, but wish to verify the information filed. In this case, instead of having to wait for years for an RFB notification, the taxpayer may request an anticipated analysis of his statement and request an appointment to visit the Tax Office and submit the pertinent documentation.



### 2.5.4 Results from the program implementation.

The results were truly surprising:

- when the program was implemented, in fiscal year 2009, almost four million individual taxpayers registered on the RFB Website for the code-access key, to view the Statement Report and, if applicable, file for self-compliance, according to the system mentioned above. Thus, they were relieved from the Fine Mesh instantly and from the comfort of their home;
- out of the total statements retained in the Fine Mesh in fiscal year 2009, close to 63% were relieved via the self-compliance mechanism, that is to say, by simply correcting the errors made upon completing their information, without any willful intent;
- as regards the statements for fiscal year 2009 that had been retained on the Fine Mesh, over one hundred thousand taxpayers requested an anticipated analysis and called for an appointment.

The figures prove that a large number of mismatches verified on the individuals' statements were based on simple errors, from plain

ignorance of the rules applicable to complete the tax document. Thus, the final conclusion was that most of such taxpayers were Simple Compliant Taxpayers or Under-compliant Taxpayers, who, if properly informed and guided by the Tax Administration, would tend to voluntarily meet their tax obligations.

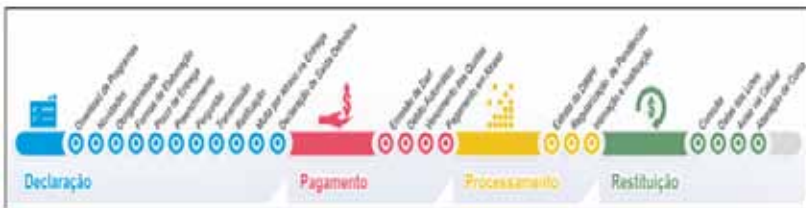
**2.5.5 Program adjustments - strengthening taxpayer assistance.**

Considering the foregoing conclusions, it became evident that, at least with regards to individuals, the RFB was not doing its share, that is to say, offering the conditions required for taxpayers’ voluntary compliance with tax obligations.

Thus, in 2010, adjustments to the New Taxpayer Assistance Model for the Individual Income Tax were required, aimed at strengthening information delivery, guidance and tools for perfect compliance with ancillary obligations.

This arm of the program consisted in drafting specific content on the RFB Website ([www.receita.fazenda.gov.br](http://www.receita.fazenda.gov.br)), which addresses all the information required in preparing the

Individual Income Tax statements for fiscal year 2010. Such information was organized according to a sequence that visually reminds the railway, guiding the taxpayer through the road to follow. Along such lines, the four central “stations” represent the main phases of the process, while the “sub-stations” represent the specific information in each phase:



1<sup>st</sup> “Station”: Statement

Sub-stations: Program downloads, News, Mandatory requirements, Drafting instructions, Delivery Date, Form-filing, Questions and Answers, Transmission, Rectification, Fine for Late Filing and Statement of Permanent Absence from the country;



2<sup>nd</sup> “Station”: Payment

Sub-stations: Issue of the Darf (payment guide), Automatic Debit, Installment maturity and late payment;

3<sup>rd</sup> “Station”: Processing

Sub-stations: Statement Extract, Settlement of mismatches, Demand for payment and Notification;

4<sup>th</sup> “Station”: Reimbursement

Sub-stations: Queries, Data on the Allocations, SMS notification, Account change.

### **2.5.6 Results obtained after the adjustments to the program.**

Transparency in the treatment of the mismatches detected on the statements from individual taxpayers, together with the availability of specific informative content, lead to the following results:

- In fiscal year 2010, 4.5 million codes-access keys were generated by individuals, amounting to a total of 8.5 million;
- the number of statements retained in the Tax Control stage in fiscal year 2010 dropped by 50% with respect to the previous year, since 40% of these taxpayers were released after they completed the self-compliance proceeding and close to 70 thousand called for an appointment.

Regardless of the specific results obtained in fiscal years 2009 and 2010, other advantages were also detected:

- Improvement of the RFB image, originated on the respect and transparency in taxpayer treatment, even with a positive image on the media;
- increased convenience and taxpayer satisfaction, upon replacing an obsolete and deficient system with a more expeditious and modern one;
- More taxpayers chose the self-compliance mechanism and, therefore, the anticipated tax credit calculation (increased collection);
- Taxpayer education with a multiplier effect, since the media communicated the cases of debts settled with the “railway line” system that the RFB posted on the Internet;
- Potential reduction of errors in subsequent fiscal years, since, once the eventual error is notified, the trend is that taxpayers will

- not repeat it;
- Expansion of the taxpayer assistance capacity, for taxpayers whose statements were retained in the Tax Control stage, by using the appointment tool;
- Fewer legal proceedings;
- Fewer taxpayers with statements retained in the Tax Control stage because of simple errors;
- Tax officials became relieved to take over the fraudulent cases involving poor tax morality groups.

### **3 CONCLUSIONS**

- the Tax System complexity, along with the diverse forms of assessment and collection, require classifying taxpayers according to different profiles, those with low tax culture, who are not even aware that they pay taxes, to those with high tax culture enabling sophisticated planning to reduce the tax amounts' due;
- Self-assessment, requires the Tax Administration to assume a greater commitment towards taxpayer assistance, and requires from citizens a certain dose of tax morality from the moment it determines the ceiling for their taxpaying capacity;
- when it comes to tax morality, the effort by the tax administration in improving taxpayer assistance and respecting the taxpaying-capacity principle facilitates the task of classifying taxpayer behavior, enabling to identify noncompliance based on poor tax morality, excluding noncompliance by mere ignorance of the law, or by the understandable defiance of an unfair system;
- It is important that Tax Administrations renew the traditional taxpayer classification criteria and apply the tax morality criterion and promote specific programs for each group within this new vision;
- once the classification based on the tax morality criterion is applied, the specific programs for each group become more effective with regards to the broad programs, since the former leads the taxpayer to perceive that the administration is aware of his reality, which increases risk perception.
- in the case of the RFB, the large number of mismatches between the information recorded on the Individual Income Tax Statements and the one in the administration's database posed a problem that was addressed on a general basis. In 2009, the implementation of the specific program for individuals, centered on transparency in the treatment of these divergences, proved they were in fact

simple errors, caused by the mere ignorance of the rules in place to fill the tax document. Thus, it was concluded that most of these taxpayers were Simple Noncompliant Taxpayers or Under-compliant taxpayers, who, upon relying on better assistance, made fewer mistakes in 2010.

- The more assistance the administration renders, the greater the transparency and respect for the taxpaying capacity, the more it succeeds in developing the taxpayer morality and, consequently, in improving voluntary compliance with tax obligations, whether ancillary or central.

## **TAXPAYER ATTITUDES VIS-À-VIS THE TAX ADMINISTRATION: DIFFERENTIATE AND CLASSIFY TAXPAYER BEHAVIORS**

**Steve Miller**

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*Contents: Summary – I. Introduction: Scope/Content – II. Discussion –  
1. What the data shows about the environment—the efficiency and  
effectiveness of third-party data – 2. Legislative and administrative  
actions taken – 3. IRS approaches to utilizing third parties and third-  
party data – III. Conclusion*

### **SUMMARY**

The area above the entrance to the IRS Headquarters in Washington DC carries the words of former U.S. Supreme Court Justice Oliver Wendell Holmes, Jr., “Taxes are what we pay for civilized society.” Throughout the centuries, people have written about the need for taxes and how problems come when there is a perception that the administration of the taxes is not fair. Voluntary compliance is the cornerstone of U.S. tax administration and the great majority of Americans pay their taxes willingly and on time. The Mission Statement of the IRS speaks directly to this great majority: “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.”

To maintain integrity and fairness in the tax system, the IRS must ensure that all taxpayers are afforded the opportunity to comply with their tax obligations. As we believe most people want to file and pay their taxes accurately and on time, the IRS focuses on assisting them in that task. However, the United States Internal Revenue Code is neither perfect nor simple and even those who seek to comply need our help. With respect to those taxpayers trying to comply, the IRS educates and creates systems that will both ease the path to compliance and utilize all available information to catch errors. In dealing with the noncompliant and to maintain equity in the tax system, the IRS also

focuses on enforcement. With respect to both the compliant and noncompliant, we are organized in our work by types of taxpayers. This includes not only specialized treatments intended for individuals versus business entities; it also takes account of how we deal with various levels of wealth.

As we look at categories of taxpayers and types of noncompliance we find two essential rules that guide much of our planning and approach. First, if payments to a taxpayer are reported to us by a trusted third party, that payment is very likely to show up on the taxpayer's return as income. Second, the more we deputize third parties into withholding the tax from the payments they report and remitting this amount to us, the better off we are in ensuring the tax gets paid. As a result of these rules, the IRS takes the position that while some taxpayers seek to comply and some do not, both types of taxpayers will respond in a positive manner to increased income reporting and better utilization of such reporting by the IRS. This paper outlines our work to pursue additional reporting of third-party data and in deputizing third parties to partner with us in our tax compliance mission. Of course, the IRS must balance the burden on the taxpayer and on those who must report as we consider or implement additional withholding and reporting.

Studies conducted by the IRS over the years do support the two rules outlined above and show that the more "visible" the income or the deduction amounts are to the taxpayer and to the IRS, the better the compliance. The discussion section of this paper includes summaries of some of these studies. Based on this evidence, the United States Congress has increased third-party reporting and the IRS is beginning the implementation of this series of new information reporting requirements.

In addition, the IRS is also taking steps to increase its work to leverage both third parties and third-party data, with initiatives such as our return preparer and whistleblower programs. The IRS is also increasing its technical capabilities to match data from various sources in order to better monitor compliance by taxpayers. This paper describes many of the IRS's current efforts.

## **I. INTRODUCTION: SCOPE/CONTENT**

The discussion section of this paper has three parts: What the Data Shows about the Environment; Legislative/Administrative Actions Taken; and IRS Approaches to Utilizing Third parties and Third-party Data.

## **What the Data Shows about the Environment**

This section summarizes studies done by the IRS which show that the greater the “visibility”, i.e., the extent of third-party information reporting, the greater the level of compliance.

## **Legislative/Administrative Actions Taken**

This describes recent legislation and IRS initiatives requiring new forms of third-party information reporting that are in various stages of implementation. This includes:

- Government Payments to Contractors;
- Merchant/Payment Card Reporting;
- Basis Reporting for Securities Dealers;
- Information Reporting for Payments to Individuals and Corporations;
- Information Reporting Related to Rental Real Estate;
- Foreign Account Tax Compliance Tax Act (FATCA); and
- Uncertain Tax Position Reporting.

## **IRS Approaches to Utilizing Third Parties and Third-party Data**

This describes a number of IRS initiatives aimed at how we classify taxpayers, and how we leverage the work of third parties and utilize third-party information. These include:

- Tax Return Preparer Initiative;
- Whistleblower Program; and
- Automated Underreporter Program.

## **II. DISCUSSION**

### **1. What the Data Shows about the Environment—the Efficiency and Effectiveness of Third-Party Data**

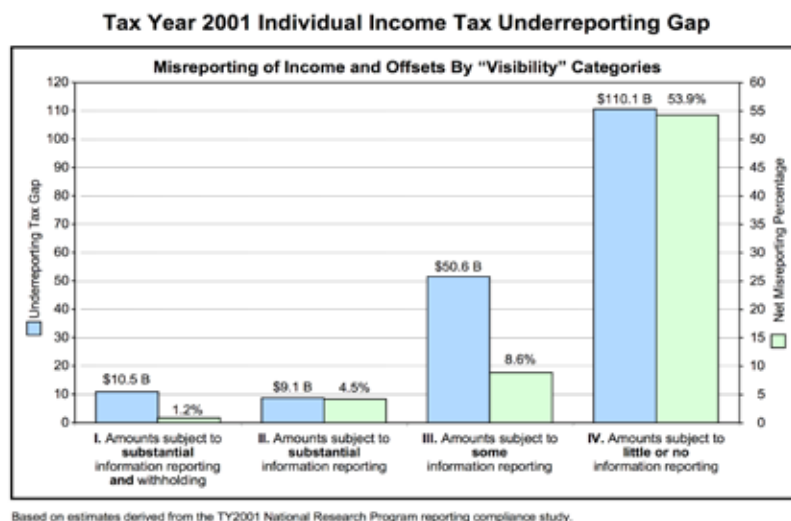
Historically, the IRS based estimates of federal tax compliance on special studies, including the Taxpayer Compliance Measurement Program (TCMP), covering income and self-employment taxes for particular groups of taxpayers and consisting of line-by-line audits of random samples of returns. These studies provided the IRS with information on compliance trends and allowed the IRS to update its audit selection formulas regularly. This method of data gathering, however, was extremely burdensome on the taxpayers whose returns

were selected. As a result of concerns raised by taxpayers, Congress, and other stakeholders, the last TCMP audits were done in 1988. The IRS conducted several much narrower compliance studies between 1988 and 2001, but these studies did not provide a comprehensive perspective on the overall tax gap.

The National Research Program (NRP), which the IRS has used to estimate the most recent compliance level updates, arose out of a desire to find a less intrusive means of measuring tax compliance. The IRS used a focused statistical selection process that resulted in the selection of approximately 46,000 individual income tax returns for Tax Year (TY) 2001 — somewhat fewer than previous compliance studies, even though the population of individual tax returns had grown over time. Like the compliance studies of the past, the NRP was designed to allow the IRS to meet certain objectives: to estimate the overall extent of reporting compliance among individual income tax filers and to update the audit-selection formulas. Data for analysis included amounts reported by taxpayers on their tax returns and the corrected amounts determined by examiners.

Figure 1 below, based on data from the NRP report on TY 2001 for individuals, shows the highest level of non-compliance in those areas where there is the least amount of “visibility”, i.e., the level of information reporting associated with the income. All types of individual business income are underreported, including farms, non-farm proprietorships, rents, royalties, and partnerships. Farm and non-farm sole proprietorships are the largest source of underreported income.

Figure 1. Underreporting of Income by “Visibility” Categories



This relatively high rate of underreporting of income among sole proprietors is largely due to the general absence of information reporting by third parties on their earnings. Prior research studies show that reporting compliance depends directly on the “visibility” of the relevant transactions, i.e., the degree to which a type of income is subject to information reporting determines the degree to which it is “visible” to the IRS. Quite simply, the more information reporting and withholding, the better the compliance.

Furthermore, Figure 1 shows that, even with substantial information reporting, compliance is improved with the addition of withholding of tax at the source. The misreporting percentage drops from 4.5 percent to 1.2 percent. Withholding serves the purpose of pre-paying one’s tax obligation as the income is earned; that lessens the possibility that the taxpayer will not have the money to pay the tax at the time of filing, which fosters better compliance.

## 2. Legislative and Administrative Actions Taken

### Organizational Structure of IRS

As we discuss how the IRS differentiates and classifies taxpayers, the IRS approach begins by focusing on specific taxpayer groups. As a result, a little more than 10 years ago, the IRS implemented a



major reorganization that called for the creation of Business Operating Divisions (BOD's) focused on specific groups of taxpayers. Over the years there were some shifts of responsibility for specific taxpayer groups from one BOD to another for a variety of reasons. Today, the IRS has the following structure:

- Wage and Investment (W&I) – Individuals with income from wages and investments;
- Small Business/Self-Employed (SBSE) – Businesses with assets of less than \$10 million including farms, trusts, estates and rental properties operating under a variety of organizational structures;
- Large Business and International (LB&I) – Businesses with assets of \$10 million or more, international taxpayers and the high wealth individuals; and
- Tax Exempt and Government Entities (TEGE) – Charitable and other tax exempt organizations; pension plans; state and local governments and Native American tribal governments.

Each BOD tailors its enforcement and outreach to meet the needs of the specific taxpayers it serves. Thus, each BOD approaches outreach and education slightly differently. LB&I's taxpayers, for example, work with the IRS through accounting or law firms or their own internal legal and accounting staffs and, as a result, do not need the kind of one-on-one service generally required for individual taxpayers. There are similar differences in the approach to enforcement.

The IRS has also taken steps to tailor its approach not only on the business form of the taxpayer, but on other demographics as well. For example, the IRS has developed a method of examining the very wealthy by forming the Global Wealth Industry Group. Tax agencies around the world, including those in Japan, Germany, the UK, Canada and Australia, have also formed high wealth groups.

The IRS launched its Global High Wealth Industry Group to centralize and focus IRS compliance expertise involving high wealth individuals and their related entities. High wealth individuals are quite different from a typical taxpayer with wages, dividends, interest and maybe a small business. Their tax picture is more complicated and nuanced. For a variety of reasons – including valid business reasons – many high wealth individuals make use of sophisticated financial, business, and investment arrangements with complicated legal structures and tax consequences. The IRS will initially focus the group's efforts on individuals with tens of millions of dollars of assets or income. By taking a unified look at the entire complex web of business entities controlled by a high wealth individual, the IRS believes it will be able to better

assess the overall tax compliance of such arrangements. Rather than continuing to approach each tax return in such enterprises as that of a single and separate entity, the goal is to better understand the entire economic picture of the enterprise.

### **Information Reporting Efforts**

The IRS is pursuing a wide range of initiatives, most based on legislation, around leveraging the efforts of third parties and third-party data in order to improve voluntary compliance with United States tax laws. Starting in 2005, Congress enacted a number of provisions to enhance tax-filing accuracy through increased third-party information reporting. The various provisions require new information reporting to the IRS for both individual and business taxpayers. This should not only improve the overall compliance rate, but will provide the IRS improved information that will make enforcement actions more effective and efficient.

### **Government Payments to Contractors**

The IRC Section 3402(t)(1), created by the Tax Increase Prevention and Reconciliation Act (TIPRA) of 2005, generally requires governmental entities to deduct and withhold a 3% tax from payments made to any person providing property or services, subject to certain exceptions. The governmental entities must provide the payee and the IRS with an annual information return concerning the payments and amounts withheld. TIPRA originally provided that it applied to payments made after December 31, 2010, but the American Recovery and Reinvestment Act of 2009 delayed the new withholding requirement for one year to payments made after December 31, 2011.

The following governmental entities will be subject to the new reporting and withholding requirements: the U.S. government, including all federal agencies, the executive branch, the legislative branch and the judicial branch; all states including the District of Columbia (but not including Indian tribal governments); and all political subdivisions of a state government or every instrumentality of such subdivisions unless it makes annual payments for property or services of less than \$100 million.

Generally, withholding will be required at the time of payment on all payments totaling \$10,000 or more to all persons providing property or services to the government, including individuals, trusts, estates, partnerships, associations, and corporations.

### **Merchant/Payment Card Reporting**

The Housing Assistance Tax Act of 2008 added Section 6050W to the Internal Revenue Code. This provision requires information reporting to the IRS on payment card transactions occurring after December 31, 2010. Under the provision, the bank or other organization with the contractual obligation to make payments to participating payees in settlement of a payment card transaction will issue to the payees a Form 1099-K, Merchant Card and Third-Party Payments. This statement will indicate the amount of gross proceeds paid to them for the transactions reduced by any fees, rebates, etc. A “payment card” generally means a credit card, debit card, transit card, governmentally-issued electronic benefit transaction (EBT) card, or any other card accepted as payment by a network of persons unrelated to the issuer of the card and to the other merchants who accept the card as payment. This new information reporting requirement is intended to help in ensuring that all income is reported. This information will also help the IRS in determining if non-credit card income is reported by comparing credit card data to other information.

### **Basis Reporting for Security Dealers**

The Energy Improvement and Extension Act of 2008 requires securities brokers to report a customer’s adjusted basis in sold securities and classify gain or loss as long-term or short-term. It also allowed taxpayers to compute the basis of certain stock (acquired through a dividend reinvestment plan) by averaging. The regulations affect brokers and custodians that make sales or transfer securities on behalf of customers, issuers of securities, and taxpayers that purchase or sell securities. The reporting requirements are effective beginning in 2011.

### **Information Reporting for Payments to Individuals and Corporations**

The Patient Protection and Affordable Care Act of 2010 added new reporting requirements as well. For many years, it has been required for businesses to report payments to individuals for certain property or services if the amount exceeded \$600 over the course of the tax year. After December 31, 2011, it also will be necessary for businesses to report to the IRS payments made to corporations for goods or services as part of their trade or business, if the amount exceeds \$600 over the course of the year. At the time this paper was submitted, the United

States Congress was in the process of considering repeal of this new requirement in light of the burden it places on businesses.

### **Information Reporting for Payments made in Connection with Rental Real Estate**

Section 2101 of the Small Business Jobs Act of 2010 modified information reporting in the case of rental income recipients to require that they be subject to the same information reporting requirements as other taxpayers engaged in a trade or business. This means that rental income recipients must file a Form 1099-MISC to the IRS and furnish a statement to a payee when they make payments of \$600 or more to the payee in any taxable year in connection with the rental activity. This reporting requirement applies to payments to non-corporate service providers made after December 31, 2010 (and will apply to payments for property, and payments to corporations, made after December 31, 2011).

Like the new information reporting requirement for payments made to individuals and corporations, Congress is also considering repeal of the new reporting requirements related to rental real estate.

### **Foreign Account Tax Compliance Act (FATCA)**

On March 18, 2010, the Hiring Incentives to Restore Employment (HIRE) Act of 2010, Pub. L. 111-147 (H.R. 2847) included FATCA, which makes a number of changes to the tax law affecting tax compliance with respect to foreign accounts and cross-border transactions.

The implementation of FATCA is one of the key projects the IRS is working on in the international area right now. The effective date is January 1, 2013.

FATCA will require participating foreign financial institutions to report on U.S. persons who hold accounts in foreign financial institutions or who own large interests in foreign entities that hold such accounts. If a foreign financial institution does not enter into an agreement to provide the IRS with such information on U.S. account holders, then FATCA imposes a withholding tax on U.S. source income and gross proceeds paid to the foreign financial institution.

The IRS has begun the substantial process of implementing FATCA. The IRS has sought and received well over 50 comment letters in response to Notice 2010-60 that it issued in August, and is in the process of carefully considering those comments as part of the regulatory rulemaking process. The IRS recognizes that it must partner with the private sector to effectively implement these rules and wants to devise a process that will meet the goals of the legislation, in an efficient manner that recognizes the operational considerations of the financial services industry and the sovereignty of U.S. trading partners.

### **Uncertain Tax Position (UTP) Reporting**

One of the most important steps the IRS has taken in improving the information it receives is UTP reporting. Guided by the fundamental principle that transparency to the tax administrator is essential to achieving an effective and efficient self-assessment tax system, the IRS took a major step forward with Announcement 2010-75, Reporting of Uncertain Tax Positions. With this Announcement, the IRS sought to leverage the work done in financial auditing and to bridge the gap between financial and tax reporting. Accordingly, certain corporate taxpayers, whether U.S.-based or foreign-based, using U.S.-Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS), now must report basic information about their uncertain tax positions when they file their tax returns. At least at a conceptual level, taxpayers and the IRS have shared goals:

- Certainty regarding tax obligations sooner, rather than later;
- Consistent treatment across all taxpayers; and
- Efficient use of resources – both government and taxpayer – by focusing on issues and taxpayers with the greatest risk of non-compliance.

Over the past year the IRS has worked in consultation with taxpayers to fine tune the UTP reporting process. As a result, UTP reporting will be phased in over a five-year period. With the phase-in approach (outline below), smaller companies will have additional time to comply with the new reporting requirement.

<u>Assets</u>	<u>Filings Begins With</u>
\$100 million or more	2010 tax years
\$50-99 million	2012 tax years
\$10-40 million	2014 tax years

An uncertain tax position shown in the financial statements of a company reflects a reserve established by the company. The reserve is essentially a hedge that offsets a tax benefit, where the tax benefit reflects a tax position taken on a tax and the hedge reflects the estimate that the benefit will not be sustained. The UTP form does not ask taxpayers to disclose the actual reserve. Instead it asks them to rank their UTPs from highest to lowest. Critical to the disclosure is the concise description that taxpayers must provide to sufficiently identify the issue and the relevant facts. The new form is intended to increase the ability of the IRS to select corporations for examination and also assist in the selection of issues once an examination is underway.

Finally, it is worth noting in this discussion that taxpayers have expressed concern that the reported UTP information would be automatically disclosed to foreign governments under treaties or tax information exchange agreements (TIEAs). The IRS has assured taxpayers that automatic disclosure will not occur.

### **3. IRS Approaches to Utilizing Third Parties and Third-party Data**

In addition to the direct reporting discussed in the prior section, there are a number of IRS initiatives to utilize third parties and third-party information.

#### **Tax Return Preparer Initiative**

A key example of utilizing third parties to improve compliance is our Tax Return Preparer Initiative. The IRS instituted this initiative to require registration, testing and continuing education for all individuals paid to prepare federal tax returns. The initiative is expected to increase the quality of tax returns prepared by paid tax returns preparers. Thus far, over 650,000 paid tax return preparers have registered for this filing season. The IRS will also test preparers for basic competence and will impose continuing education requirements.

The IRS has also begun a series of additional efforts related to paid tax return preparers, including contacting selected tax return preparers to improve the accuracy and quality of filed tax returns and to heighten awareness of preparer responsibilities. The IRS also sent letters to approximately 10,000 return preparers nationwide to outline current responsibilities, consequences of filing incorrect returns; and highlights of new tax return preparer requirements.

This year, IRS revenue agents are also conducting approximately 2,500 compliance visits with return preparers across the country. The purpose of these visits is to confirm that tax return preparers are complying with current return preparer requirements for maintaining records, signing and furnishing an identifying number on returns they prepare, and to provide information on new return preparer requirements effective for the 2011 filing season.

### **Whistleblowers**

The IRS and the United States Congress have also sought to utilize third parties by creating an initiative to bring in more third-party information from whistleblowers. The whistleblower program, which is legislatively mandated, presents a stream of improved information that will modify the way the IRS does business in the coming years. Since Congress changed the law in 2006 to mandate the amount of certain awards, there has been a sharp increase in the number of high dollar cases submitted and IRS has a wide variety of whistleblower claims in inventory. We have only recently proposed our first awards under the new rules.

Large corporate issues currently account for almost half of the open inventory of whistleblower cases. The issues raised in these cases cover a wide range, in areas ranging from transfer pricing, compensation, offshore activity, financial transactions and business restructurings.

The IRS has set up processes that coordinate the Whistleblower Office with the business operating divisions. In the future the whistleblower program will bring the IRS welcome data in a number of key strategic areas.

### **Automated Underreporter Process**

The IRS firmly believes that the amount and quality of information we are getting is key to improving the compliance rate of Americans under the United States tax system. While Congress has required that more data be provided, the IRS has the challenge of building the IT systems to make that data available for compliance purposes. Additionally, the IRS must create the business processes to utilize the data for ongoing enforcement.

The Automated Underreporter (AUR) Program combines the IT solution with a business process. The annual AUR process begins with an inventory list of potential underreporter cases by matching taxpayer return data against the data received by third parties. This works to identify taxpayers who appear to have received income which they did not report. Matches occur at multiple times during the year. The matches result in approximately 18 million potential underreporter cases.

The main purpose of the Automated Underreporter Program is to resolve income discrepancies between the information that taxpayers report to the IRS on tax returns and the related information employers and financial institutions provide the IRS on information returns. Once discrepancy cases are identified, the IRS decides how many cases it will investigate.

Once selected, AUR cases go to one of six IRS campuses where tax examiners manually review each case. After analyzing the tax returns, tax examiners are sometimes able to immediately resolve the discrepancies. For the remaining AUR cases, tax examiners may request additional information from taxpayers.

Because IRS resources cannot investigate every instance of noncompliance, including AUR discrepancies, the IRS is increasingly utilizing alternative approaches to resolve compliance issues outside its traditional processes. AUR has begun to issue what the IRS calls a "soft notice" to certain taxpayers with apparent underreported income. The notice informs the taxpayer that there appears to be a discrepancy with the income types listed but does not provide them with any type of tax calculations. Instead, the notice instructs the taxpayer to file an amended return to correct their return if the information shown on the notice is correct.

### **Use of Other Data**

In addition to AUR, and more generally, a key area of work for the IRS in the next couple of years will be to address what data it should acquire and how to use that data. There is no doubt that in coming years the IRS will have more and better data than it has today. This will be true all across the IRS.



The merchant/payment card and securities basis reporting data described above are key examples. Merchant/payment card reporting in particular will provide a window into the revenue flows of numerous business segments and should be most useful with smaller businesses. In fact, it will be the cornerstone of IRS attempts to address incorrect income reporting by small businesses.

Teams are working on the matching and analytic tools needed to successfully mine data for research, case selection and case audit purposes. These efforts will start with the new merchant/payment card data. Eventually, the IRS will apply these techniques to all areas.

### **III. CONCLUSION**

The IRS is fortunate in that the vast majority of U.S. taxpayers are compliant. What is less clear is whether this is the result of a national attitude or the result of a very successful set of withholding and reporting rules. Regardless of the answer to this largely philosophical question, the IRS and the United States Congress have worked to increase the type and amount of reporting that is required from the populace. In the coming years, the use of data will only increase as the new streams of data described above, along with the new processes that will utilize third parties to promote compliance, are implemented.

As stated, the IRS has found that the more visible a taxpayer's income, the greater the level of compliance. Third-party reporting assists the honest taxpayer in preparing a more accurate return and it lets the IRS more effectively focus on those returns that are not accurately reporting income. These efforts contribute not only to the perception but also to the reality that the IRS is making every effort to fulfill its mission statement by "...applying the tax law with integrity and fairness to all."

**“TAXPAYER ATTITUDES VIS-À-VIS THE TAX  
ADMINISTRATION: DIFFERENTIATE AND CLASSIFY  
TAXPAYER BEHAVIORS”**

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**SUMMARY**

The intrinsic motivation for individuals to pay taxes, or tax morale, is multifaceted and complex. Tax morale is related to many aspects of tax administration and government including: civic duty, trustworthiness of tax agencies, representativeness of the tax administration, government corruption, procedural justice, and the perceived value of public money’s use. Through this paper we describe a number of the activities that Inland Revenue (IR) are doing to maintain and enhance tax morale: specifically staff ethics, customer interactions and complaints resolutions, outreach programmes, and concluding with a discussion of tax morale in relation to the February 2011 Christchurch earthquake.

If corruption is widespread tax morale will be low and the shadow economy large. Corruption is one of the key reasons people cite for not paying tax and if the tax authority itself suffers from corruption

the effect on compliance will be significant. One thing that IR does to minimise the risk of corruption is have a strong recruitment and induction process that instills in employees the ethical and integrity standards of our organisation. Integrity is also a continual discussion between managers, team leaders, and staff to ensure ethical standards are upheld.

Irrespective of our ethical standards if IR is not ethical in our interactions with customers tax morale will be adversely affected. Tax morale is sensitive to beliefs and perceptions that the tax system is fair and transparent. Central to ethical interactions is procedural fairness - the perception that the revenue body adheres to procedures that are fair in dealing with taxpayers. This is particularly important when customers are dissatisfied or where there are disagreements or disputes. IR has a customer Charter which describes the working relationship we want to have with customers. We also have a Complaints Management Service and a Disputes Resolution Process to resolve issues quickly and provide a clear and transparent process to customers. Even if problems cannot be resolved there is the availability of external third parties, and finally the Courts, to review and decide on issues.

Surveys are also undertaken to get the views of customers and the population on our service delivery, perceptions in the community, and tax morale. Such surveys are an important part of monitoring tax morale over time.

In the maintenance and improvement of tax morale revenue authorities need to add to the traditional mechanisms of education, assistance, and enforcement – notably in the area of promoting positive norms. Within New Zealand there are some signs of lessening engagement with government and tax which could negatively impact tax morale. Two outreach examples that IR have undertaken to improve tax morale are working more closely with industries and developing a programme for citizenship and tax education in high schools.

Natural disasters will cause business continuity, staff welfare, and compliance issues. All have the potential to impact tax morale. Our response on these factors is discussed in relation to the February earthquake in Christchurch which caused catastrophic damage and the closure of the IR office for an extended period of time.

## 1 INTRODUCTION

Revenue agencies strive to increase voluntary compliance as an organisational goal. A core driver of voluntary compliance is tax morale which Alm and Torgler (2006) define as “the intrinsic motivation for individuals to pay taxes”. The development of tax morale is dependent on a complexity of behavioural, social, political and economic factors which interact to shape and maintain tax compliance across all tax entities.

There is currently considerable interest in tax morale, and some recent theories about tax compliance behaviour are framed around tax morale as their basis (see Torgler, 2007, for an overview). Many factors affect tax morale and tax compliance: civic duty (Braithwaite & Ahmed, 2005; Kirchler, 2007; Taylor, 2002), the trustworthiness of tax agencies (Makkai & Braithwaite, 1994; Cullis and Lewis, 1997; Cummings, Martinez-Vazquez, McKee, & Torgler, 2004; Torgler, 2004; Scholz & Lubell, 1998; Tyler and DeGoey, 1996) representativeness of the tax administration (Alm, Jackson & McKee, 1993; Taylor, 2002, in Braithwaite, 2002; Torgler & Schneider, 2007), known or suspected government corruption (Torgler, 2007), equity (Cummings et al., 2004; Levi, 1988; Wallschutsky, 1984), procedural justice (Kirchler, 2007; Taylor, 2002); and the perceived value of public money’s use (Bird, Martinez-Vazques, & Torgler, 2006; Braithwaite & Wenzel, 2008; Frey & Feld, 2002; Scholz and Pinney, 1995).

Tax morale is also closely linked to taxpayer ethics defined as “the norms of behaviour governing citizens as taxpayers in their relationship with the government” (Alm & Torgler, 2006).

In this paper we will look at tax morale in relation to Inland Revenue (IR) staff ethics, the ethical treatment of customers, and building tax morale. Firstly, we will explore the interplay between corruption, tax morale, and the shadow economy and what we have done to ensure IR is an ethical and trusted administrator. This includes a case study of an instance of corruption; secondly, the ethical interactions between IR and customers including our charter, complaints process, disputes resolution process, and concluding with our measurement of tax morale, customers satisfaction, and perceptions; thirdly improving tax morale through industry engagement and education in schools; and, lastly a case study of our response to the devastating February 22 Christchurch earthquake to ensure tax morale is maintained.

### 1.1 Ethics, Corruption, and Tax Morale

Corruption has a negative effect on citizens as it reduces their trust in governmental organisations and those in authority, and increases their willingness to act in the underground economy (Torgler, 2003; Schneider & Torgler, 2007). Schneider and Torgler specifically comment ‘if citizens feel cheated, if they believe that corruption is widespread, their tax burden is not spent well and that they are not well protected by the rules of law, the incentive for them to get involved in the informal [hidden] sector grows’. Aligned with corruption is the notion of public spending efficiency - when taxes are spent more efficiently tax morale is greater (Barone and Mocetti, 2009).

The shadow economy is clearly linked to tax morale. A variety of studies show a strong correlation of around -50 and -65 between tax morale and the size of the shadow economy (Torgler, Schaffner, & Macintyre, 2008). This indicates that as the size of the shadow economy increases tax morale declines. Similarly there is an equally strong link between corruption and the shadow economy – as displayed in Figure 1.

**Figure 1**

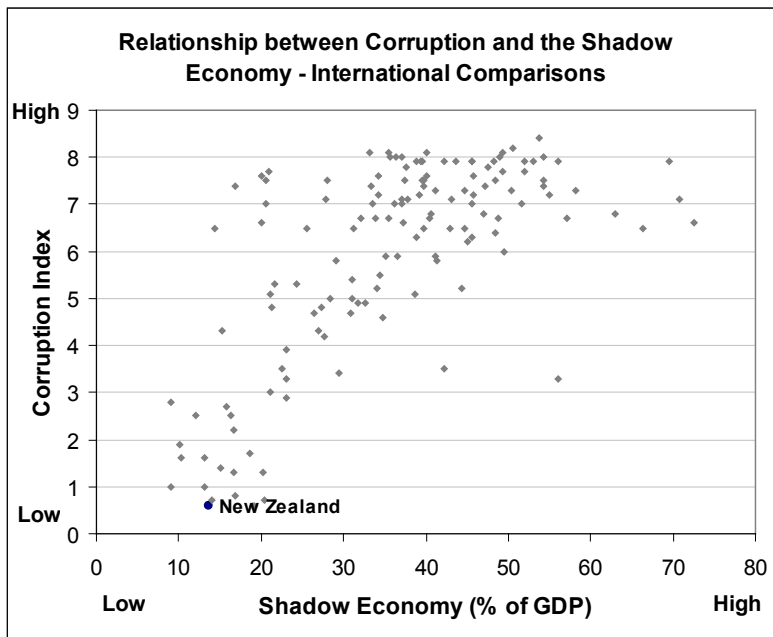


Figure 1. Plots 140 countries on The World Bank's measure of the Shadow Economy (Schneider, Buehn, & Montenegro, 2010<sup>1</sup>) and a separate measure of perceptions of corruption provided by Transparency International<sup>2</sup>. The data relates to 2007. The correlation between these two measures was .68 indicating a very strong relationship – the greater the shadow economy the greater the level of corruption. In Transparency International's assessment, New Zealand had the lowest level of perceived corruption of any measured country.

Torgler (2003) examined people's perceptions of reasons for not paying tax and found that corruption was one of the top three reasons along with the an individuals lack of honesty and because the taxes are too high. Where there are relatively low wages within government organisations there has also been found to be higher levels of corruption (Van Rijckeghem & Weber, 2001; Tanzi, 2000), which indicates that appointees may have a possibility of additional income; furthermore in some countries these jobs could be purchased (The World Bank, 1998). Corruption within a tax administration itself has an insidious and destructive effect on tax morale and compliance (Nawaz, 2010).

Governments and tax administrations need to create confidence in their credibility and deliver public goods for taxes (Torgler, 2003). The ethics and integrity of governments and tax administrations is paramount to tax morale. Blijswijk, Breukelen, Franklin, Raadschedlers, & Slump (2004, p. 718) note that to 'rebuild trust in government, employees must also act with integrity. Actions that are both ethical and carried out with integrity are necessary – neither is sufficient'. They describe how the Netherlands Tax and Customs Administration went through a organisational development process with two deliverable: firstly, standardised rules and codes of conduct; and, secondly recognising that rules alone cannot cover every situation, and therefore an integrity programme must implant basic values and integrity rules while at the same time promoting an individual's professional responsibility and occupational values.

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1 The shadow economy is difficult to measure directly. Schneider et al. (2010) used a number of indicators that best capture and reflect the characteristics of shadow economy activities, including: monetary indicators (eg. currency outside the banks and deposits); labour market indicators (eg. labour force participation rate and growth rate of the total labour force); and official economic measures (eg. GDP per capita converted to international dollars using purchasing power parity rates.

2 In the Corruption Perceptions Index (CPI) corruption was calculated using data from 14 sources from 12 independent institutions. All sources measure the overall extent of corruption (frequency and/or size of bribes) in public and political sectors. CPI sources include surveys; peer reviewed scores provided by experts; non resident and residents assessments; and resident business leaders evaluating their country. Further standardisation of data is undertaken and sources combined to determine an overall measure of corruption between 0 and 10.

Thus one way that tax administrations can reduce the risk of inappropriate staff actions like corruption is through careful staff selection and training, and on-going support and monitoring of ethics and integrity.

## **2 INLAND REVENUE'S STAFF ETHICS**

Similarly to the Netherlands Tax and Customs Administration IR have invested in a robust process to instill ethics and integrity in our staff.

### **2.1 Imbedding ethics and integrity**

Our programme on ethics and integrity is continual and covers recruitment, induction, and on-going training to ensure that staff act with utmost integrity and professionalism at all times.

#### Recruitment

- Vetting and Validation checks are completed before recruiting new staff members - including potential outstanding tax issues.

#### Induction

- Integrity discussions occur as part of the Orientation day including State Services Commission<sup>3</sup> videos on what it means to be part of IR and the public sector.
- Code of Conduct training given at Induction for new staff members.
- Staff are required to complete the online training through our intranet based learning and training facility in relation to the Code of Conduct.

#### On-going Support and Promotion

- IR have a dedicated Integrity Assurance team within our Corporate Risk and Assurance function that ensures we have a sustainable Integrity Policy and Framework in place, supports organisation wide education, investigates internal wrong doing and provides independent assurance to the Commissioner of IR regarding the health of the ethical environment.
- Regular Integrity discussions must be held with each team of employees and signed off every quarter by the team leader or manager.
- Integrity Assurance staff members are available for ad hoc training to business units when requested.
- There is a conflict of interest register where staff and managers note any conflicts of interest and steps are taken to minimise the risk of any such conflicts.

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<sup>3</sup> *The State Services Commission is the Government's lead advisor on New Zealand's public management system and works with government agencies to support the delivery of quality services to New Zealanders.*

- During each staff member's annual Performance Appraisal process core competencies in relation to Integrity are included and reviewed.
- The Corporate Risk and Assurance business unit undertakes continuous monitoring to provide assurance to the Commissioner of Inland Revenue that our systems are not being misused through:
  - Integrity Framework
  - Robust policy and procedures for reporting real and suspected instances of misconduct and wrongdoing
  - Leading practise Protected Disclosures policy and procedures
- The Tax Legislation underpins ethics and integrity including provisions regarding secrecy

Some of the key findings to come out of the State Services Integrity and Conduct Survey in 2010 were that all employees of Inland Revenue are aware of the Organisation's written standards of Integrity and Conduct.

Inland Revenue staff members have higher levels of awareness on where to report suspected wrongdoing or misconduct than other areas of the public sector. 96% of Inland Revenue staff members found the Integrity and conduct training useful and were able to apply the training when making decisions in their work environment.

## **2.2 Ethics Case Study on Corruption**

Irrespective of staff selection, induction, and training there will be occasions when an employee makes inappropriate or illegal decisions in the course of their work. In such cases tax morale can be impacted negatively by the discovery and publicity surrounding such breeches. In these circumstances it is vital that the matters are handled swiftly with integrity to ensure any internal or external consequences are minimised. In all cases investigations are instigated and where misdemeanours or offending is identified the full force of sanctions are applied, including criminal prosecutions.

On an audit of an immigrant couple with a business selling goods on an internet auction site a 32 year old Junior Investigator tried to extort money. He presented the couple with several options including leaving the country, facing a substantial tax shortfall, fine, and potential prosecution; or paying him and two colleagues a lesser amount so the case would be discontinued. Money was to be deposited in an overseas bank account.



Although the Investigator preyed on an immigrant couple who may not have been familiar with the cultural values of New Zealand, they recognised the seriousness of the extortion and went to the Police. Once Inland Revenue were alerted by Police, an internal investigation immediately commenced. He was suspended on pay. Concerned that this may not have been his only case of extortion, or that he may be working with others, the investigation extended to other IR files he had been working on to ensure that any accomplices were identified and his actions in relation to these other taxpayers were correct. The area in which the Investigator worked was also temporarily locked down from staff.

IR worked with Police, providing information required for the investigation. IR interrogated the Investigator's email, electronic files, swipe card access, phone records and internet access to ensure no other breaches had occurred. Extensive interviews were also carried out with work colleagues to identify issues or any potential co-conspirators. In fact these determined he was working alone.

The Police handed over IR information that they had confiscated from the Investigator's home. This showed he had breached tax legislation and IR began gathering evidence to prosecute him for this as well. An employment investigation was instigated and he was subsequently dismissed from IR.

The Investigator was charged with corruption and failing to maintain secrecy. He pled guilty. This plea, his demonstrable remorse, and the low likelihood of reoffending resulted in a sentence of three months community detention and 200 hours community work. He was also expelled from the New Zealand Institute of Chartered Accountants and order to pay the Institute a fine.

The Judge commented that the Investigator had damaged the integrity of IR and that bribery and corruption in high places strikes at the very heart of the public service. This case was widely reported as were the comments of the Commissioner who emphasized the integrity of IR and the rarity of this event. He commented that -

"This is a matter that we take extremely seriously" "When carrying out their duties, Inland Revenue employees must behave with the highest level of integrity in order to maintain the trust of the public," "The Investigator's actions were an exception." "We have more than six thousand employees, with a strong record of public service and integrity. A recent survey of ethics in the public sector gave Inland

Revenue employees high scores in all categories. I continue to have the greatest confidence in our employees.”

This case highlights that no authority is immune from corruption. With strong Tax Morale such instances will be identified by the public, and with swift action and collaboration with other enforcement agencies the damage to public confidence can be minimised or even enhanced.

### **3 ETHICAL INTERACTIONS BETWEEN IR AND CUSTOMERS**

Tax morale is sensitive to beliefs and perceptions that the tax system is fair and transparent. Central to ethical interactions is procedural fairness - the perception that the revenue body adheres to procedures that are fair in dealing with taxpayers.

Accordingly, revenue agencies must take care that their role in collecting taxes is separated from popular perceptions of distributive fairness by promoting an open focus on procedural fairness. This is a key consideration in framing thinking around tax morale. The OECD (2010) summarises research findings in this area including, Braithwaite (2003), Murphy (2004), and Tyler (2006) who report procedural fairness can directly influence acceptance of revenue agencies decisions and help build trust with taxpayers. Kirchler et al (2006) notes perceived supportiveness of advice by tax officers is associated with high self-reported compliance. Leventhal (1980) specifies several criteria that influence procedural fairness including - consistency, accuracy, representativeness, freedom from errors, correctability, and ethical applications. Tyler and Lind (1992) include respectful treatment by authorities, voice and neutrality as additional criteria.

Key to IR's ethical interactions and procedural fairness is a Charter which sets out the relationship we seek with customers. However, this relationship is not always achieved for a variety of reasons, and it is important that there are processes in place to manage these issues. When we find a customer that may not have been ethical or honest in their tax affairs this does not stop us from acting with integrity and ethically during an audit or when reassessments are raised. It is also important that we measure and manage customer perceptions of us and how we are delivering our service. This section will focus on IR's Charter, Complaints Management Process, Disputes Resolution Process, and our survey of customer satisfaction, perceptions, and tax morale.

### **3.1 Inland Revenue's Charter with Customers**

Through a set of principles IR's charter describes the type of working relationship we want to have with customers (see Appendix 1). The clearly written principles each contain the phrase "we will" indicating that these are a set of behaviours that IR staff will actively strive to achieve. The Charter applies to all staff regardless of whether they have direct customer contact. It is divided into 5 categories:

- How we will work with you
- Reliable advice and information
- Confidentiality
- Consistency and equity
- Your right to question us.

Each category contains a number of principles. Some are specific and definable, such as "We will treat all information about you as private and confidential". Others are slightly broader, such as "We will take your particular circumstances into account as far as the law allows."

IR also has a Charter Award to recognise those staff who give effect to the Charter.

IR's Charter with customers sets the organisational foundation for ethical treatment and procedural fairness.

### **3.2 Complaints Management Service**

Irrespective of the Charter, staff training, and quality of service delivery there will be occasions where customers disagree with the service provided. To maintain tax morale it is important that processes are in place to quickly handle issues as they arise and if these cannot be resolved the problem is directed to an independent external party. We have a Complaints Management Service (CMS) specifically to handle these types of issues.

The CMS provides an accessible and impartial resolution service for customers who have been unable to resolve issues satisfactorily through usual business processes. CMS aims to resolve issues efficiently, fairly and within a timely manner.

A complaint can be broadly defined as any expression of dissatisfaction with a service or product. "Service" can also refer to the quality and/or timeliness of work performed by IR which may lead to a perceived failure to meet the principles outlined in our Charter. All other statutory

avenues (such as disputes resolution which is discussed later) remain unchanged.

Customers can contact CMS directly by telephone, internet submission, fax or letter. The CMS aims to:

- Enable customers to resolve issues that have not been resolved satisfactorily through the usual business process.
- Ensure that customers and staff are aware of the avenues available to resolve complaints.
- Provide management information, which feeds into the design of processes and systems, and assists managers in improving customer service.
- Maintain the relationship between customers and delivery sites.
- Assist business improvements by identifying and reporting on complaint and feedback issues to Inland Revenue business areas, senior management and the Commissioner.

### **Case Management Officers**

Within CMS a Case Management Officer (CMO) manages the case through to resolution within agreed timeframes. Managing the case may require further input or information from staff who were involved in the original issue. Assistance may also be sought from other areas of IR. This information will be reviewed by the CMO, who makes contact with the customer. The intention is to resolve the matter as quickly and efficiently as possible.

### **Ombudsman**

At any time a customer has the option to go to the Office of the Ombudsmen to review decisions made by Inland Revenue, although the Ombudsmen will usually expect the customer to have first tried to resolve the issue with IR. Ombudsmen are independent and impartial Officers of Parliament who investigate complaints against Central and Local Government agencies. As Officers of Parliament, they are responsible to Parliament but are independent of the Government of the day. The Ombudsman investigations are free and are conducted in private.

Inland Revenue receives over 8,000 contacts each year where customers are unhappy or wish to comment about some aspect of their experience with IR. Some of these are genuine complaints; others are suggestions on processes that customers consider to be unfair or unnecessary. All of these contacts have a potential to inform IR about the way we do business and provide opportunities to improve our service and maintain and enhance tax morale.

### 3.3 Disputes Resolution Process

Disputes between IR and our customers regarding a tax position can be highly contentious. When there is disagreement about reassessments or tax positions taken, it is important that there is a clear and transparent process by which differences can be resolved in an ethical manner. If a customer disagrees with an assessment or adjustment made either by them or by IR, they may use the disputes resolution process to appeal the assessment. This process is designed to resolve disagreements quickly by early identification of all issues, full disclosure of the facts and evidence, and consultation with IR. IR have been working with the New Zealand Law Society and New Zealand Institute of Chartered Accountants to improve the disputes resolution process and tailor it more to the needs of our customers.

The disputes resolution process consists of a phased approach through a number of levels whereby issues are resolved or are escalated to the next step of the process. Even if a taxpayer has been dishonest or in disagreement about the correct tax position this process enables each side to discuss matters openly, and with integrity, and where aspects remain unresolved the issue can escalate through a conference, adjudication, Taxation Review Authority, or the High Court.

1. Where we have issued a reassessment and a customer disagrees, the customer submits a Notice of proposed adjustment outlining the reasons for disagreement with the assessment. If we do not accept;
2. We send the taxpayer a notice of response outlining why we reject their proposal. If the customer rejects this then;
3. A conference is held between us and the taxpayer where facts and issues are clarified and to allow any disputed facts to be resolved. If the conference still results in an impasse;
4. We send the taxpayer a disclosure notice which requires them to write a statement of position. The taxpayer sends in their statement of position. If the dispute goes to a hearing authority, they cannot introduce any evidence, facts, issues or arguments that weren't in their statement of position. This is called the evidence exclusion rule. We send the taxpayer our statement of position. Similarly the evidence exclusion rule says that we can't introduce any new material that wasn't in our statement of position unless agreed. Judicial discretion may allow previously undisclosed material to be admitted.
5. If no agreement is reached then in most instances, the case will go to our Adjudication Unit for consideration, regardless of the issue or amount of tax involved. The adjudicator is an independent expert

within IR who will take a fresh look at how the law applies to the facts of the case. The adjudicator will consider the facts, evidence, legal principles, and issues raised in each of the statements of position. If the adjudicator decides in the taxpayers favour, we will reassess their return in line with their figures, and the matter ends there. If the adjudicator decides in our favour, the assessment will stand. If the taxpayer is dissatisfied with this decision the process continues to the next stage.

6. The taxpayer files proceedings with the Taxation Review Authority or the High Court.

The Complaints Management Service and Disputes Resolution Process ensures that if customers do not feel they have received the best service or correct assessments they have access to clear and transparent processes, with escalations to independent parties. This enables ethical treatment of issues and minimises any potential harm to tax morale.

Customers who use this service and process have perceived grievances, but it tells us little about the general perceptions of the population or satisfaction of customers with IR's service delivery. To maintain and improve tax morale it is important that a revenue authority understands how it and tax is perceived by the community, as well as the satisfaction of customers who have direct dealings with us.

Many of the published research studies on tax morale have used the European Values Survey or World Values Survey<sup>4</sup> (Torgler, 2007; Frey & Torgler, 2007; Torgler, Schaffner, & Macintyre, 2008) as a measure of tax moral, based on the responses to one question:

"Please tell me for each of the following statements whether you think it can always be justified, it can never be justified, or it falls somewhere in between:

Cheating on tax payments if you get the chance".

(% "never justified" – code 1 from a 10-point scale, where 1 = never and 10=always)

A single question cannot provide a comprehensive measure of tax moral and does not reflect perceptions about the revenue agency of customer satisfaction with services. IR conducts regular surveys

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<sup>4</sup> *The World Values Survey (WVS) is a worldwide network of social scientists studying changing values and their impact on social and political life. The WVS provide a comprehensive measurement of all major areas of human concern, from religion to politics to economic and social life.*

which feed into quarterly reports on attitudes toward tax, perceptions of IR, and satisfaction with customer services. All are factors which directly relate to tax morale.

Questions also cover the Charter. The following section covers IR's on-going measurement of customer perception, satisfaction, and tax morale.

### 3.4 Surveying Customer Satisfaction, Perceptions, & Tax Morale

A survey was developed by drawing on findings from qualitative research, State Service Commission research, multivariate analysis of existing datasets, and similar surveys conducted by other tax administrations. The survey measures key themes including:

#### Community Perceptions

- Trust
- Fairness
- Operationally effective
- General perceptions of IR
- IR aspirations
- Attitudes about the role of tax in society.

#### Customer Satisfaction

- Overall satisfaction
- Expectations
- Accessibility
- Personable and knowledge staff
- Fair treatment
- Follow up
  
- Appropriate outcome

The survey is undertaken by an independent research organisation with two groups of subjects - community perceptions of a random sample of the general public who may or may not have had any contact with IR (approximately 375 surveyed per quarter); and customer satisfaction of those who have had recent contact with IR (around 1,000 surveyed per quarter).

Table1 presents the overall responses to the survey for the December 2010 quarter for respondents rating 3-5 on a 5 point Likert scale - ranging from 1 'strongly disagree' to 5 'strongly agree'. These represent those with positive views<sup>5</sup>. Data in the survey can be further broken down by a variety of demographic, tax type, and tax areas, as well as by type of customers (eg. business, individual, not for profit, tax agents). In addition, qualitative comments by survey respondents are analysed thematically. For example they are split into 20 categories such as 'quicker response time', 'better follow up', and 'more accurate

<sup>5</sup> Note: the question 'Do not resent paying tax' is a negatively worded question 'Resents paying tax' whereby a 3-5 rating is negative response. Therefore to keep consistency of scale this question was reversed scored in the table - with 56% rating 1-2.

and efficient systems and processes'. Survey reports and limited interactive analysis of survey results are available to all IR staff via the intranet.

In general the perceptions and satisfaction survey results from December 2010 show very good results and represent an underpinning of strong tax morale in New Zealand. We have a target of 85% of customers satisfied which was achieved in the quarter. The lowest perceptions were around Fairness (73%) and Makes it easy to get it right (70%). Attitudes toward tax are very strong all over 90% apart from the general resentment to paying tax with 43% of respondents resenting paying tax. This is an interesting juxtaposition whereby taxpayers accept the necessity and responsibility of paying tax but many also have a general resentment to paying.

**Table 1. December 2010 Perceptions and Satisfaction Survey Results**

Figures represent the percentage of survey participants positively responding

#### Community Perceptions

Attitude to Paying Tax	Quarter 2 December 2010 (n=375)
Accept responsibility for paying fair share of tax	96
Paying tax contributes to NZ	92
Paying tax right thing to do	95
Do not resent paying tax	56

Perception	Quarter 2 December 2010 (n=375)
Overall perception of service quality	81
Trust	84
Fairness	73
Operationally effective	80
Confidence in IR	87
Changing for better	79
Makes it easy to get right	70

#### Customer Satisfaction

Satisfaction attribute	Quarter 2 December 2010 (n=1003)
Overall satisfaction	86
Accessibility	81
Personable & knowledgeable staff	86
Fair treatment	85
Follow-up	81
Appropriate outcome	79
Meeting expectation	84



Undertaking surveys of this nature allows for the on-going and changing dynamics of tax morale to be ascertained. - tax morale, perceptions, and customer satisfaction can be monitored and where there is unexplained or unexpected change further research can be undertaken to determine causation. In this way any negative changes or trends in tax morale can be detected early and intervening actions taken.

#### **4 INLAND REVENUE'S OUTREACH FOR TAX MORALE**

Tax administrations have traditionally used standard mechanisms to maintain tax morale such as education, assistance, and enforcement. It is important that revenue authorities look beyond the traditional and what additional programmes can be run to further maintain and enhance tax morale. Within this section social norms and tax morale will firstly be discussed along with how we work with industry to improve norms; and secondly, the early warning signs of decreasing levels of citizenship in the population and lessening tax engagement and one initiative to enhance tax morale through citizenship and tax education in high schools.

Taxpayers are strongly influenced by what they perceive to be the compliance of other taxpayers (Frey & Torgler, 2007). If taxpayers believe that non-compliance is common then tax morale diminishes, while if others are perceived to be honest then tax morale increases.

These normative relationships appear to be a highly complex and bi-directional between personal norms, social norms, and tax compliance – for instance (Wenzel, 2006) found that greater compliance leads to more ethical beliefs and more ethical beliefs also leads to higher compliance.

Despite the complexity of social norms there is increasing focus on their application to compliance and tax morale. Several papers note that moral factors (presented as social norms) are used to explain the higher than predicted levels of actual compliance to that proposed by economic models promoting expected utility theory (Allingham and Sandmo, 1972, Yitzaki, 1974 ). For example, Halla (2010) comments “In recent years, the economic literature on the shadow economy and tax evasion emphasized the importance of moral considerations (or social norms) to explain compliance behaviour.” Likewise, research on public enforcement of law increasingly considers social norms because of their role to substitute or to complement formal laws, and because of the potential impact of laws on social norms (Polinsky and Shavell, 2000). This trend most likely results from the fact that neo-

classical models of compliance – in the spirit of the economics-of-crime approach – under-predict real-world compliance. Many scholars therefore conclude that the explanation for the tendency to comply must be that individuals are obeying a norm (Posner, 2000).

There is also a distinction between descriptive and injunctive social norms (Cialdini, Kallgren, & Reno, 1991). A descriptive norm refers to what reference others actually do, that is, what is perceived to be commonly done. An injunctive norm refers to what reference others feel one should do or is the right thing to do in any situation. The right thing to do may be different to what the tax laws state. In a similar manner religiosity also raises tax morale as it provides a moral constitution, an enforcement mechanism, and provides beliefs about the right behaviour (Torgler, 2006).

Social norms regarding tax are only internalised when people identify with the reference group to which the norms are attributed (Wenzel, 2005). Given that for strong tax morale there needs to be both a descriptive and injunctive norms for tax compliance it is therefore important to develop compliance with key reference groups – one such initiative was our Industry Partnership programme. Rather than trying to improve tax morale on an individual taxpayer basis this programme seeks to develop tax morale as a norm on an industry basis.

#### **4.1 Working with Industries**

In February 2002, IR established an Industry Partnership Team to address the cash economy – areas where compliance as well as tax morale are likely lower than the rest of the business community. Industry Partnership used a range of educational, assistance, and assurance techniques to encourage people to meet their tax responsibilities. The Industry Partnership approach was based on:

- Forming relationships with certain industry groups (usually through the national association).
- Learning about the industries and their tax issues.
- Building multifunctional field teams to help industry members with their taxes.
- Developing a range of plain-language communications products.
- Testing new methods designed to improve compliance.
- Tailoring our responses to industry needs.

There were three key work streams within the programme: Building Industry Relationships, Communications, and Field Delivery.

## **Building Industry Relationships**

Generally industry groups are keen to be seen as professional and promoting compliance. Industry Partnership worked actively building relationships across 14 industries including: automotive repair, bricklaying, hairdressing, plumbing, and taxis. These relationships took a number of forms from industry associations or bodies that directly represent industry members; sector bodies, or organisations, that are representative of, or connected to, members of an industry; and strategic partners - a relationship formed with any body that is a quasi-governmental agency or crown entity; that is representative of, regulates, or funds an industry or sector Industry Partnership is working with. In total there were over 30 relationships initiated.

## **Communications**

The Industry Partnership Communications team is responsible for designing and delivering communications products and advice to improve awareness of obligations and address specific issues identified for industries. The team's work substantiates the relationship-based approach to the partnership. The team has produced a range of materials and resources for the Industry Partnership field teams' use, and for insertion in partners' own publications.

Product topics are developed from feedback from field teams, where a "gap" is perceived in existing Inland Revenue products, or to bridge to more complex existing products. All aim to provide easy-to-understand and accessible information which answers industry partners' more commonly-asked tax questions. Research demonstrates that partners prefer material which is "tailored" for their industry.

Key communications products included:

- Tax Insights - presenting core information an industry partner needs about a tax topic – from their perspective.
- Industry Leaflets – a series of industry-specific A5 leaflets help field teams to promote Industry Partnership
- Posters/Display material - resources which field teams can use as mailers, posters, and for advertising in community newspapers, supported by supplied editorial about the relationship-based approach.
- Publications & Articles - regular easy-to-read articles on tax topics to 20+ industry partner publications.
- Other products such as the Electrician's Tale mailer which was sent to 30,000 electrical workers. The mailer took a new approach, by telling the story of "Dave", an electrician who has been doing

illicit cash jobs, but comes to recognise the effect of his actions on the industry and the community, so solicits Industry Partnership help to “come clean”.

### **Field Delivery**

A central component to trialling a relationship based approach was the development of regional Industry Partnership teams who would build relationships with local businesses and their employees to encourage compliance. The regional field teams were also set up to trial a multifunctional approach to customer service as a means of building effective relationships within the community. Previous research indicated that a system allowing customers to have all of their IR issues serviced by one person or one team would be preferential to having multiple contacts with various segments in the department. This would combine the case management and multifunctional team approach desired by customers.

With these two primary objectives in mind, trialling a relationship based approach and establishing multifunctional teams, the project established five field teams throughout the country. The teams were established within the control of each service centre where issues such as selecting personnel, securing resources, establishing performance standards (individual and team), using effective communication methods, were in most cases determined by local and functional management. To this extent, the Industry Partnership field teams were still very much “owned” by the regional Service Centres.

Initial observations from the field teams were that:

- A multifunctional team approach results in more timely resolution of individual cases.
- In order to have an efficient and effective multifunctional team, a broad level of expertise in tax and social policy, and in non-tax technical skills such as relationship building, must be included in the team.
- The challenge of operating an outcome focused multifunctional team when most organisational performance measures are output based.
- A multifunctional approach, either by team or industry, is the style preferred by staff who have worked in both the Industry Partnership and functional environments. Job satisfaction is considerably increased through –
  - Increase in technical knowledge gained by the case management environment
  - Ability to work in the field, i.e. not be desk bound

- Increase in general skills, e.g. presentations and seminars, communication
- Autonomy of the job
- Ability to undertake the complete job for the taxpayer / customer

With Industry Partnership we have demonstrated that tax administrations need to move beyond the traditional responses to non-compliance and the social norm component of tax morale can be enhanced.

## 4.2 Citizenship and Tax Engagement

Being a good citizen has many meanings and forms. Within these is an understanding of political and government processes as well as the reasons for tax and what tax is used for in society. The more a person understands government and the political process and sees the benefits of paying tax to the community, the greater their tax morale will likely be (Bird, et. al., 2006; Braithwaite & Wenzel, 2008; Frey & Feld, 2002; Scholz & Pinney, 1995). Civics education is not formally part of the New Zealand school curriculum, as it is in many other countries.

Recent trends in New Zealand point to decreasing levels of citizenship<sup>6</sup> and a potential lowering of understandings around tax. For example, between 1984 and 2008 voter turnout to the general elections dropped from 89% to 76%. Although by international standards New Zealand's voter turnout is still high and is ranked 10th out of 30 OECD countries. Similarly local body voter turnout dropped from 52% to 41% from 1989 to 2007. This decreasing engagement in the political process may adversely impact tax morale. Alm and Torgler (2006) note that strengthening direct democratic elements such as actively participating in the political process is likely to help increase tax morale.

Prior to 2000 working New Zealanders had to file an annual tax return with IR. In doing so they resolved tax owing or received refunds, as well as having at least an annual engagement with IR. However, from 2000 this annual relationship ended for 70% of all individuals in New Zealand who had no further tax or social policy obligation – primarily those that had tax deducted at source by their employer. For those with tax and social policy obligations there has also been a trend, and IR encouragement, to use e-channels and have less personal contact with IR. Consequently, there is a potential that people will become more disengaged with tax, positive social norms could decrease, as

<sup>6</sup> Source: Ministry of Social Development, <http://www.socialreport.msd.govt.nz/civil-political-rights/voter-turnout.html> - accessed 12 March 2011.

well as general lowering of tax morale.

While the community perceptions survey demonstrates that the majority of the public agree that by paying tax they are contributing to society there is still a general resentment to paying tax. IR's research has identified that the public do not see their individual actions of enabling cash jobs as contributing to tax evasion. Further, some businesses lack knowledge about their tax obligations and become non compliant through sheer ignorance - eg. Former wage and salary earners or young people who transition to self employment.

Therefore with potential decreasing citizenship activities within the population, less engagement with taxation, a reasonable level of resentment to paying tax, and a tolerance to enabling evasion, there is a need to look how this can be remedied and tax morale maintained and increased. One such initiative is an education programme within our high schools.

### **4.3 Citizenship, Tax Morale, and Tax Education in Schools**

As part of a broad strategy addressing norms that promote voluntary compliance as socially necessary behaviour, IR is developing a tax education and citizenship in schools programme.

The aim is to build the intrinsic motivation to pay taxes in the next generation of taxpayers before they enter the tax system. This project includes a 'Citizenship and Tax Education' in Schools resource for teachers to use as a tangible way in which IR can promote the core questions of why we pay tax and what we achieve by paying tax.

The New Zealand curriculum for schools provides a framework for schools but it does not dictate content. Schools decide what content and topics to teach. The curriculum describes "values, competencies, learning focus and future focus issue". The need for tax education is in the key value in the curriculum of 'community and participation', key competency 'managing self', learning area 'students' financial capability' and in the future focus issue of 'citizenship'. The curriculum was introduced in 2010 so it is timely to develop this resource.

It is intended that this unit will be used at Year 10 for students aged around 14. In Year 10 many students are starting to enter the workforce part-time, in some way, so there is some relevance/interest for them and the opportunity to give teachers something important, new, and different to tackle with students.

We are engaging an external educational provider to produce an

online Citizenship and Tax Education curriculum resource whose main target is Year 10 and as a minor target Year 6/7.

Teachers will access the resource through the Ministry of Education's resource website and it will have direct links to our website. It will reflect the social inquiry approach used in Social Studies, the variety inherent in New Zealand schools and include unit overviews, lesson plans and templates, pre and post assessment tools and associated resources relevant in guiding teachers to help students focus on the following:

- What is income and what are our tax obligations?
- Why must we as New Zealand citizens pay tax on our income?
- What do we get by paying tax?
- Who decides how much and what sort of tax we pay?
- What other types of revenue are collected by other local, central government agencies?
- How does society decide what tax is spent on and how is it assessed and paid?
- How they can control and manage their taxes on line?

The project to establish the course has been a collaboration across many areas of IR with external advice from the Ministries of Education and Youth Development. We are currently awarding the contract to produce this resource and intend it to be available on line on 1 July 2011.

A tax administration should not sit back at the early signs of decreasing citizenship and needs to look beyond the traditional with outreach programmes such as Education in schools and Industry Partnership. We also need to be prepared for times of business disruption such as natural disasters – which will strain any government, tax administration, and related tax morale.

## **5 CHRISTCHURCH EARTHQUAKE RESPONSE**

The Canterbury region of New Zealand experienced a 7.1  $M_w$  earthquake in September 2010 which caused widespread damage but no fatalities. Canterbury was again shook in February 2011 (6.3  $M_w$ ), centred close to New Zealand's second largest city Christchurch, which caused catastrophic damage and fatalities. Estimates of 1/3 of the central business district office buildings and 10,000 homes will need to be pulled down as well as 100,000 homes damaged. The impact on the people of Christchurch and New Zealand will continue to be large for many years.

Maintaining trust in the government and tax morale in times of natural disaster and the aftermath can be difficult. For example, some have described the efforts of US Government following Hurricane Katrina 2004 as a “failed response” (Sobel & Leeson, 2006). While there is the need for rapid response and additional financial support, controls around these are often less than during ordinary times. From revenue authorities there are large challenges including business continuity, responsible restraint in application of the tax laws, and staff welfare. The following case study covers the 12:51pm 22 February 2011 Christchurch earthquake: our immediate response, business recovery, staff welfare, and lastly compliance.

### **5.1 Immediate Response**

Immediately following the earthquake the Crisis Management team was activated and a 2:00pm meeting held chaired by the Commissioner of IR using the Crisis Management Plan as the base for the agenda. The Service Delivery Deputy Commissioner was appointed as Recovery Director to oversee our earthquake response and recovery. Immediate priorities were identified:

- Staff safety and communications to staff
- Taxpayer impacts and business continuity
- Internal policies – including temporarily closing the Christchurch office

The Christchurch office building is in the central business district and received minor damage during the earthquake and the internal furniture, fixtures, and equipment moderate damage. However, as the building is near many unstable buildings, and there are many issues within central business district, it could be months before the building can be used again.

### **5.2 Business Recovery**

The Crisis Management Team met daily in main Wellington office for updates on areas such as our people, communications, IT, impacts on the business, the state of the Christchurch building and cross-government cooperation.



While the initial focus is on the welfare of our people the Christchurch earthquake response soon moved its focus from rescue to recovery, our focus also shifted to business recovery. A Christchurch Recovery Team was created and temporary accommodation found. The members of this team have come out of their substantive roles to allow them to focus solely on the Christchurch recovery. The Recovery Team were quickly able to identify key work streams to focus on – people welfare, business continuity, communications, building recovery and inter-agency work.

By 10 March 2011 Temporary office accommodation was found that provides our Christchurch people with a safe working environment until our central business district building is available.

### **5.3 Staff Welfare**

For those not involved in the earthquake, or experienced anything similar it is hard to imagine the impact this could have on staff. There are 800 staff working from the Christchurch office, representing approximately 15% of all IR staff. The ethical treatment and support of staff in these situations as well as a flexible approach is vital to the moral of the organisation and the recovery to a fully functioning Christchurch office.

IR has a counselling service available through an external provider. Drop in centres were also organised for a number of days so staff could come together for mutual support.

A returning to work policy was established. Staff were continued to be paid their normal pay during this period. From mid March we have been gradually returning our people to work as we find meaningful work for them to do and where we can provide the facilities to work from.

Flexible work arrangements are also being applied such as working from home, other geographic locations, and allowing managerial discretion where a staff member may not be able to return to work due to other earthquake related reasons.

### **5.4 Compliance Post Earthquake**

At these times IR needs to be sensitive to the customers and businesses of Christchurch, and other impacted parties, who may have lost homes, tax records, physical business premises, or their normal levels of clients. Enforcement activities, such as audit and

complex debt, have been suspended. It would be very insensitive, unethical, and destructive of tax morale if we were to undertake enforcement activities on customers who have lost or damaged: homes, businesses, or clientele. These factors therefore provide the opportunity for customers to non-comply with less fear of enforcement action or penalty – which will be detrimental to tax morale. We are not the only agency or area with such concerns. This represents a difficult balancing act for government agencies for swift assistance with fewer controls, but with higher compliance sensitivities. We therefore need to take heed of overseas experiences.

Shortly after Hurricane Katrina a Fraud Task Force was created charged with deterring, detecting, and prosecuting unscrupulous individuals who take inappropriate advantage of the circumstances (US Attorney General, 2010). The joint task force members include representation from over 30 agencies. Particular focus of the Task Force included: fraudulent charities, benefit fraud, identity theft, contract and procurement fraud, and public corruption. The US Department of Justice (2010) identified three key factors to prevent and combat disaster related fraud:

- absence of fraud prevention controls and measures
- centralised process for intake and referral of disaster fraud reports
- close coordination among investigative agencies

Given the level of across government support and collaboration in the aftermath of the earthquake it also seems fitting that compliance and enforcement should be a collaboration as demonstrated with success with Hurricane Katrina. IR are looking to work with other government agencies in a joint and coordinated manner to ensure that appropriate compliance actions are undertaken in these circumstances.

Significant natural disasters will put a strain on any government and its agencies. We have displayed that good business continuity planning, staff welfare, and considerations of the sensitivities around enforcement at these times, are all factors that will have an impact of tax morale.

## **6 CONCLUSIONS**

The intrinsic motivation to pay taxes is a complex phenomenon and is impacted by a great many factors – much of which is not under the direct control of tax administrations. For instance, perceptions of trust in government and the distributive fairness of taxes are completely outside of tax administrators' control. However, there are many facets

of tax morale that are within our control and we must actively manage those in order to maintain and enhance integrity.

Within this paper we have discussed a number of activities that IR is undertaking to preserve and improve the motivation of customers to pay taxes. There is no one solution or process.

Our own organisational ethics and integrity are vitally important to tax morale, whether that is through conducting our work in an honest and principled manner, having clear and transparent processes with customers, or looking at the additional ways in which we can extend our outreach.

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## Appendix A: Inland Revenue's Charter

# How we will work with you

Inland Revenue collects money to pay for public services. We help people to meet their obligations and receive their entitlements. We work within the Inland Revenue Acts and other relevant laws, and our actions are consistent with the spirit of the Treaty of Waitangi.

 <h3>How we will work with you</h3> <ul style="list-style-type: none"><li>• We will be easy to deal with, prompt, courteous and professional.</li><li>• We will follow through on what we say we will do.</li><li>• We will be responsive to individual, cultural and special needs.</li><li>• The person you are dealing with will give you their name.</li><li>• We will value your feedback and use it to improve our services.</li></ul>	 <h3>Reliable advice and information</h3> <ul style="list-style-type: none"><li>• We will provide you with reliable and correct advice and information about your entitlements and obligations.</li><li>• We will assist you to get in touch with the right people for your needs.</li><li>• We will be well-trained and competent.</li><li>• We will keep looking for better ways to provide you with advice and information.</li></ul>	 <h3>Confidentiality</h3> <ul style="list-style-type: none"><li>• We will treat all information about you as private and confidential, and keep it secure. We will only use or disclose it in accordance with the law.</li></ul>
 <h3>Consistency and equity</h3> <ul style="list-style-type: none"><li>• We will apply the law consistently so everyone receives their entitlements and pays the right amount.</li><li>• We will take your particular circumstances into account as far as the law allows.</li></ul>	 <h3>Your right to question us</h3> <ul style="list-style-type: none"><li>• We will make it easy for you to question the information, advice and service we give you. We will inform you about options available if you disagree with us, and we will work with you to reach an outcome quickly and simply.</li></ul>	<p>For this charter to work effectively, we rely on each customer to provide all relevant information when dealing with Inland Revenue.</p>  <p><b>Robert Russell</b> Commissioner of Inland Revenue</p>

[www.ird.govt.nz](http://www.ird.govt.nz)



## **DESIGN AND IMPLEMENTATION OF CONTROL PLANS ACCORDING TO SPECIFIC BEHAVIORS**

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***Contents:** Introduction – 1. Compliance strategy – 2. Responsive enforcement: making choices – 2.1. Definition – 2.2. Segmentation – 3. Horizontal monitoring – 3.1. Introduction – 3.2. History – 3.3. What is horizontal monitoring? – 3.4 Key concepts and principles of horizontal monitoring – 4. Influencing behaviour in individual client treatment – 4.1. Introduction – 4.2. The role of the taxpayer's behavior – 4.3. Client profile – 4.4. Behaviour during the horizontal monitoring process – 4.5. Evaluation – 5. Influencing behaviour in the SME segment – 5.1. Introduction – 5.2. Cooperation between tax intermediaries and the NTCA – 5.3. Entrepreneur – 5.4 Covenants with sectoral organizations – 5.5. The role played by behavior – 6. Theme-based approach – 7. In conclusion*

### **INTRODUCTION**

How does the behaviour of taxpayers play a role in the design of a tax authority's compliance strategy? The Netherlands Tax and Customs Administration (NTCA) focuses on the promotion of compliance. To this end the Administration implements strategies designed to influence the behaviour of taxpayers. This contribution explains the general principles of the NTCA's monitoring and the practical implications of these principles for the monitoring of large and small enterprises.

#### **1. COMPLIANCE STRATEGY**

The duties of the NTCA are to:

- levy, audit and collect state taxes, health insurance contributions, national insurance contributions and employee insurance contributions;



- audit compliance with legislation governing the import, export and transit of goods and with legislation governing the economic, health, environmental and safety fields, economic planning and financial integrity;
- award and audit income-related benefits;
- carry out investigations in all the aforementioned fields.

The NTCA carries out these duties with due regard for legal certainty, uniformity of policy and equality of rights.

The NTCA's general policy objective is expressed as follows: individuals and enterprises are prepared to fulfil their statutory obligations to the Tax and Customs Administration (compliance). Individuals and enterprises fulfil their obligations when they:

1. (justifiably) register to pay tax;
2. file their returns (in time);
3. file correct and complete returns;
4. pay the tax stated in the return (in time).

The NTCA's monitoring strategy is intended to increase the effectiveness of its actions and, at the same time, reduce the administrative burden associated with monitoring. The NTCA's compliance strategy assumes that the majority of individuals and enterprises wish to fulfil their obligations, a wish that is also demonstrated by the results from scientific studies. The intention is to encourage good behaviour, prevent errors and to update as necessary. The NTCA's actions are based on trust: when taxpayers betray this trust then the NTCA responds by increasing the stringency of its monitoring and taking decisive action. Section 3 of this contribution explains the NTCA's strategy and Section 4 the concept of horizontal monitoring. Sections 5 and 6 review the detailing of this strategy for large and smaller enterprises. Section 7 explains the theme-based approach to income tax returns and the last section, Section 8, contains the concluding comments.

## **2. RESPONSIVE ENFORCEMENT: MAKING CHOICES**

### **2.1. Definition**

The NTCA has opted for the strategy of responsive enforcement, whereby the Administration tailors its enforcement in all segments to the motives (willingness) and ability of taxpayers to comply with the regulations. The approach to enforcement depends on the motives.

Pursuant to the responsive enforcement principle, the NTCA forms an insight into the causes of non-compliance with the tax legislation and regulations. Taxpayers who usually fulfil their tax obligations and make an unintentional mistake deserve a response different from the response to taxpayers who knowingly and wilfully seek the loopholes in the tax regulations or make misuse of the manner in which the NTCA is organised. Responsive enforcement entails NTCA enforcement actions (monitoring) that are not focused solely on the rectification of past errors but also, and above all, address the prevention of future errors. From the perspective of taxpayers' future compliance, consultations with them on the prevention of errors in the future can be more effective than punishment.

The NTCA makes carefully-considered choices in its monitoring activities, firstly in terms of the cases that will be examined (and the cases that will not be examined) and, secondly, in the deployment of monitoring instruments.

Examples of these instruments include:

- the provision of information
- the provision of services
- communication on enforcement
- the provision of impetuses for amendments of the legislation and implementation regulations
- horizontal monitoring (in the form of covenants or other agreements with third parties)
- desk audits
- visible monitoring by means of tax surveillance
- criminal investigations

This palette includes both proactive and repressive instruments. The NTCA gives preference to instruments that provide for horizontal monitoring (in cooperation with taxpayers and based on mutual trust, transparency and understanding).

The NTCA has adopted this strategy since a purely repressive approach focused solely on the correction of past errors frequently fails to result in permanent improvements in behaviour or required changes in behaviour. However this does not, self-evidently, imply that monitoring is always horizontal. In addition to horizontal forms of monitoring, the NTCA also continues to deploy repressive instruments. When taxpayers betray the trust placed in them then the NTCA responds by increasing the stringency of its monitoring and taking decisive action, for example by means of adjustments, administrative penalties

or criminal investigations. The Fiscal Intelligence and Investigation Service plays an important role in criminal investigations. Providing clarity and transparency about the repressive approach makes clear that non-compliance with the tax regulations is unacceptable.

## **2.2. Segmentation**

The NTCA makes a distinction between individual and group client treatment. Individual client treatment is standard in the Medium-Sized/Very Large Enterprises (MGO/ZGO) segment, a segment which encompasses about 13,000 enterprises. Individual client treatment is not feasible in the Small and Medium-sized Enterprise (SME) segment in view of the size of the segment (about 1.2 million enterprises). Within the SME segment the NTCA makes a further distinction between starters, self-employed persons without employees (ZZP) and SME sector enterprises with employees (MKB-P). The total segment encompasses about 1.2 million enterprises.

## **3. HORIZONTAL MONITORING**

### **3.1. Introduction**

The NTCA's objective is to influence behaviour, with the focus on permanent compliance. NTCA develops monitoring instruments designed to provide optimum support to the achievement of this objective. Instruments focused on cooperation with taxpayers, relatively new additions to the NTCA's range of instruments, are referred to as "horizontal instruments".

The development of increased horizontalisation in monitoring is explained below. It is important to establish that the focus of the overall monitoring activities is placed on acceptable returns, i.e. returns that comply with the legislation and regulations and are free of material errors. Horizontal monitoring places a greater emphasis on the responsibilities borne by all parties in the preparation of acceptable returns, whereby it is important that enterprises an appropriate attitude, behaviour *and* implement adequate internal controls (in the collective approach in the SME segment the quality assurance of the tax intermediary's processes is of importance).

### **3.2. History**

The Scientific Council for Government Policy (WRR) published its *De toekomst van de Nationale Rechtsstaat* ('The future of law-based society') report in 2002, which the Council submitted recommendations

on a more equivalent relationship between government and citizens in response to the changes in international and social relationships.

The government adopted the WRR's recommendations in its *Programma Andere Overheid* ('Modernising Government Programme', PAO). The NTCA began a pilot project at the beginning of 2005 which examined whether the monitoring of enterprises in the ZGO segment can be designed on the basis of the principles laid down in the PAO. In 2006, this pilot project was expanded to include the SME segment. The NTCA also gave an impetus to the enhancement of control with its *Toezicht dat ertoe doet* ('Monitoring that counts') programme. At the end of 2007, a pilot project was also started for the MGO/OCK (Medium-Sized Enterprises/Other Complex Clients) sub-segment.

Horizontal monitoring has become the spearhead of the individual client treatment enforcement policy. Horizontal monitoring is also the preferred method of working in the other segments.

### **3.3. What is horizontal monitoring?**

Cooperation is the key to achieving quality in our modern society. The production chains in production processes need to be harmonised to guarantee short leadtimes, low costs and high quality. This is also applicable to the tax process: the entire process from transaction to return and assessment is an administrative chain in which the entrepreneur, tax service provider *and* the NTCA play a role. The NTCA's horizontal monitoring assigns cooperation a much more pivotal role. This in turn implies consultations in advance, as necessary, rather than audits in retrospect. It also implies making use of the quality within the chain, reaching agreements on the quality and avoiding the duplication of work. Consequently, horizontal monitoring pivots on cooperation – by each party on the basis of their role, but focused on the appropriate implementation of the tax legislation in an efficient manner *and* in a manner which ensures that the taxpayers know where they stand.

### **3.4 Key concepts and principles of horizontal monitoring**

#### Key concepts

Horizontal monitoring is based on three key concepts: mutual trust, understanding and transparency.

Transparency refers to complete openness by the taxpayer and the NTCA. The taxpayer is transparent about the taxpayer's tax strategy and the relevant tax issues (no [material] standpoints are adopted

in filed returns that have not been discussed with the NTCA). The taxpayer gives open answers to all questions. The NTCA is open about the background to questions and the implementation of the Administration's monitoring. Constructive cooperation is possible only when both parties understand the position and (on occasion, conflicting) interests of the other party. Mutual, justified trust is necessary for the adoption of this method.

Trust between the enterprise, tax intermediary and NTCA is necessary since the parties' knowledge and/or information is unequal. If this inequality was not an issue then there would be no need for trust since there would be certainty. Consequently, trust is always accompanied by a form of uncertainty. The information that the NTCA does possess – the client profile – in combination with the enterprise's behaviour supports the decision to work with the enterprise on the basis of trust and justifies the acceptance of a degree of risk.

Pursuant to this method, the NTCA knows "less" about the facts and figures stated in the return, although this is justified since the Administration knows "more" about the manner in which the enterprise performs and manages its tax processes. It is important to realise that the NTCA observes behaviour and collects information during the horizontal monitoring programme that justifies the favourable expectations of the NTCA and the enterprise, and demonstrates that the trust given to the other party is justified. This enables the enterprise and the NTCA to establish that their trust in the other party is justified and that both parties are willing and able to assume their responsibility for compliance with the regulations.

### **Principles**

Pursuant to the aforementioned key concepts, the NTCA wishes to cooperate in the present with taxpayers (and the parties involved) in the maintenance and enhancement of compliance. This cooperation is given shape in the MGO and ZGO segments in the form of the conclusion of agreements (covenants) with individual taxpayers. The cooperation in the SME segment is based on collaboration with accounting firms, tax consultancies and sectoral organisations.

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## **4. INFLUENCING BEHAVIOUR IN INDIVIDUAL CLIENT TREATMENT**

### **4.1. Introduction**

Clients in the medium-sized and large enterprise sector are treated on an individual basis. The tax affairs of these taxpayers are dealt with by a team of experts in the various taxes and in accountancy. A “client profile” is compiled for each taxpayer, a description of the enterprise, supported by an automated system, which contains information about the enterprise’s facts, circumstances and behaviour. The treatment team uses the current client profile to determine the strategy for the treatment of the client as based on the enhancement and maintenance of compliance. The taxpayer’s behaviour plays an important role in the client profile: changes in the enterprise’s tax attitude, behaviour and internal control influence the client profile and the treatment strategy is continually modified accordingly. The client profile, treatment strategy and client treatment jointly form a cycle. As stated above, the NTCAs prefers to base this strategic treatment plan on horizontal monitoring.

### **4.2. The role of the taxpayer’s behavior**

Horizontal monitoring is based on the enterprise’s willingness to file acceptable returns. Within the context of monitoring an acceptable return is defined as a return that complies with the legislation and regulations and is free of material errors. Horizontal monitoring places a greater emphasis on the responsibilities borne by both parties in the preparation of acceptable returns, whereby it is important that enterprises exhibit an appropriate attitude, behaviour *and* implement adequate internal controls. This is manifested by the enterprise’s attention to and improvement of the internal control system, in particular the elements of the internal control system of relevance to tax issues, what is also referred to as the ‘Tax Control Framework’ (TCF).

The supervisory duties of the internal control departments and/or external experts are also of importance, since these duties contribute to the quality of the returns. In horizontal monitoring the relevant enterprise has expressed its intention to be transparent about observed (tax) points for attention, pursuant to which the enterprise agrees to actively seek preliminary consultations with the NTCA on these points for attention. In effect, these client contacts result in the continual development and enhancement of the trust between the enterprise, the relevant external experts and the NTCA.

The prior information received by the NTCA enables the Administration to adjust the form and intensity of the monitoring since the NTCA continually receives up-to-date information about the internal control processes and can observe that the enterprise actively shares points for attention.

The enterprise's approach to the preliminary consultations – together with the results from those consultations – jointly determines whether the entire return is acceptable.

### **4.3. Client profile**

The following elements can be of relevance to the specification of the client profile:

- What is the client's return and payment behaviour?
- Are any notices of objection being dealt with and are there any procedures or prior consultations in progress?
- Is there an insight into the enterprise's attitude to tax contacts (audits/prior consultations/objections)?
- Who are the tax consultant and independent auditor and what is their role in the tax contacts (audits/prior consultations/objections)?
- What is the concern structure? Do changes regularly take place?
- Does the enterprise employ sufficient financial and tax staff?
- Who are the members of the Executive Board and the Supervisory Board? How is the management effected?
- What are the enterprise's operations and known tax points for attention?
- What does the annual report contain (key figures, tax strategy)?
- Which type of auditor's opinion has been issued?
- Is there already an insight into the degree of the enterprise's tax control?
- For clients with international transactions within the concern: Can the transfer pricing documentation be used to improve the insight into the enterprise?
- Which other supervisory bodies are involved with the enterprise?

### **4.4. Behaviour during the horizontal monitoring process**

#### **1. Preparations: willing and able**

Following meetings with the enterprise and a study by the NTCA the Administration and enterprise decide whether they are willing and able to work in accordance with the principles of horizontal monitoring.

Any past unfavourable experiences with the client, where relevant, do not give reason to refrain from initiating horizontal monitoring: on the contrary, since these can actually offer opportunities for horizontal monitoring. Once the joint willingness and ability has been established the next important step is to settle any current issues for as far as is possible, such as current audits, current returns and notices of objection that are still being dealt with. The enterprise and the NTCA map these issues and reach agreements on their resolution, whereby mutual understanding and trust once again play an important role. Once the parties have agreed that cooperation on the basis of horizontal monitoring is feasible they conclude a covenant which specifies that the enterprise and the Netherlands Tax Customs Administration are going to cooperate and how they are going to cooperate.

## 2. Administrative organisation and internal control

Once the covenant has been concluded the enterprise and the NTCA cooperate on the administrative organisation and the internal control processes. The enterprise bears the primary responsibility for this work: the NTCA encourages and supports the enterprise, and gives feedback on the manner in which the tax processes, in particular, are controlled. The NTCA is then governed by the requirements imposed by the tax legislation and regulations. The degree to which the NTCA monitors the enterprise and the intensity of the monitoring depends on the degree to which the enterprise is in control.

The NTCA assesses the enterprise's degree of control, whereby the NTCA, in consultation with the enterprise, gives preference to statistical random sampling. One of the important elements of the degree to which the enterprise is in control is the NTCA's confidence in the enterprise's ability to identify tax risks in good time and to submit them to the NTCA. Any such risks are submitted before the return is filed so that they can be resolved as quickly as possible during the preliminary consultations or can be submitted to the court (agree to disagree).

## 3. Adjusted monitoring

Once these phases have been completed the NTCA has an insight into the enterprise's processes of tax relevance and the manner in which the enterprise controls these processes. The NTCA also has an insight into the work carried out by external parties (accountants, consultants, etc.). The NTCA tailors its monitoring to the degree and manner in which the client arranges for acceptable returns. This monitoring is detailed in the strategic treatment plan for the short and medium term



(five years), whereby the enterprise cooperating in the horizontal monitoring process receives information about the substance of the plan.

#### **4.5. Evaluation**

The enterprise and the NTCA need to maintain an insight into any changes in the circumstances of either party, since these can be of influence on the initial horizontal monitoring agreements. In addition, the enterprise *and* the NTCA need to discuss each other's experiences: this is compatible with the form of cooperation and is included in the agreements laid down in the covenant. The NTCA periodically determines whether the trust given to the enterprise remains justifiable.

##### **Changed circumstances**

The prevailing circumstances at the time of the horizontal monitoring meeting, exploration of compliance and the conclusion of the covenant can subsequently change.

Changes can occur at the NTCA such as:

- changes in policy;
- changes in the members of the treatment team.

These changed circumstances can be of importance to the enterprise and can have consequences for the mutual trust. For this reason it is beneficial to confirm this trust when any such changes occur.

Changes can occur at the enterprise such as:

- changes in the market conditions;
- changes in the strategy;
- management of shareholder changes;
- changes in the administrative organisation or legal organisation (the relocation of company divisions, mergers, takeovers and demergers);
- changes in the tax department or at the tax consultant;
- changes of auditor or other external experts.

These changes can have an influence on the enterprise's attitude, behaviour and/or tax control and, consequently, on the NTCA's client strategy.

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## Experiences

Favourable experiences confirm the trust in the other party and for this reason it is beneficial to state these experiences explicitly. When experiences give cause to doubts then it is important, from the perspective of repressive enforcement, to begin by sharing these doubts with the enterprise and jointly determine the factual situation.

In practice, enterprises will occasionally make mistakes and, consequently, fail to report a tax issue or file a return that is not acceptable. The NTCA can also make mistakes. However, a mistake does not automatically imply the total loss of trust. When the NTCA observes that an enterprise has made a mistake then the Administration needs to exhibit an adequate response (with understanding) by holding a meeting to discuss the causes of the mistake and the measures that have been implemented to prevent a repetition.

Mistakes can be made for many reasons: for example, the enterprise was not in control (and, consequently, was also unaware of the potential point of dispute, the enterprise assumed that the issue did not need to be discussed with the NTCA or, in an extreme situation, the enterprise deliberately decided not to be transparent. The NTCA will, depending on the outcome of the discussions, review the consequences for the client profile and the relationship of trust.

When the NTCA concludes that the enterprise's intention was and still is good then the relationship of trust can be restored by NTCA's exhibition of understanding and, as the occasion arises, the enterprise's implementation of appropriate measures.

When it transpired that the enterprise deliberately committed a breach of trust then the NTCA works through what is referred to as an 'intervention pyramid' or 'escalation ladder'. The intervention is responsive and is based on the intention, the circumstances, the severity and the frequency of the breach of trust. The intervention can be comprised, in ascending sequence, of the following:

- explaining or refining the agreements on attitude and behaviour (such as a renewed review of the principles of horizontal monitoring);
- temporary additional monitoring;
- corrective action (with a penalty, where relevant);
- terminating the agreement (the covenant).

Every intervention needs to be followed by an analysis to determine whether the behaviour has been improved and the client strategy can be adjusted favourably for the client.

## **5. INFLUENCING BEHAVIOUR IN THE SME SEGMENT**

### **5.1. Introduction**

Individual client treatment is not feasible in the Small and Medium-sized Enterprise (SME) segment in view of the size of the segment (about 1.2 million enterprises in the Netherlands). Nor shall a tax control framework in the form of that implemented by a large enterprise usually be in place.

The NTCA strives for a group treatment in this segment, pursuant to which the focus is no longer placed on the return of an individual taxpayer but on the returns of groups of entrepreneurs or the behaviour of sectors or other shared characteristics of groups of taxpayers. The NTCA adopts this approach by seeking cooperation with tax intermediaries. These service providers, such as accountants and tax consultants, play an important role in the design of the accounts, the internal control processes and returns of enterprises in this segment. The NTCA actively involves the tax intermediaries in its monitoring of the SME segment.

### **5.2. Cooperation between tax intermediaries and the NTCA**

Individual covenants are not concluded for the SME segment: instead, the NTCA reaches agreements with tax service providers. This cooperation, in analogy with the individual covenants, is based on mutual trust, understanding and transparency and is focused on the quality of tax returns. The NTCA and the tax intermediary conclude a covenant on the return process and harmonise their methods. During the preparations for the covenant the Netherlands Tax and Customs reviews the tax intermediary's internal quality assurance system.

Returns filed by the tax intermediary are referred to as 'covenant returns' and are acceptable to the NTCA. The NTCA settles covenant returns quickly: this increases the legal certainty. The cooperation with tax intermediaries limits the NTCA's need for monitoring to meta-monitoring: pursuant to meta-monitoring, the NTCA monitors random samples of covenant returns. Any inaccuracies in the design of the intermediary's processes are then, in a manner fitting to the horizontal relationship, discussed by the NTCA and tax intermediary in an open and transparent discussion.

All covenants include an agreement stipulating that the tax intermediaries submit relevant (tax) standpoints they have adopted or plan to adopt to their permanent contact person at the NTCA as soon as possible. This relates to issues that may be subject to a difference in opinion on the part of the NTCA, such as a difference in the interpretation of facts or the interpretation of legislation. The tax intermediaries enter into a commitment to actively provide the NTCA an insight into all facts and circumstances, their adopted standpoints and the (associated) legal consequences. The NTCA states the Administration's perception of the legal consequences as soon as possible after the receipt of a standpoint that has been or will be adopted, whenever possible in consultation with the relevant tax intermediary.

Each tax intermediary (or the association/federation to which they belong) and the NTCA meet at periodic intervals to discuss, in particular, the progress in the treatment of (new) tax issues. The tax intermediaries and the NTCA meet at least once a year to evaluate the performance of the covenant and update the covenant if so required. The tax intermediary and the NTCA hold regular meetings to discuss experiences. This approach (also) ensures that trust, understanding and transparency become material elements of the relationship between the tax intermediary and the Netherlands Tax and Customs. A third party is present in this relationship: the entrepreneur.

### **5.3. Entrepreneur**

The cooperation between the tax intermediaries and the NTCA offers the entrepreneurs affiliated with the covenant legal certainty on the quality of their tax returns. The entrepreneurs become affiliated with a covenant by submitting the requisite participation form to the tax intermediary. The entrepreneurs are required to conform that they shall submit their correct and complete financial accounts and other necessary information to the tax intermediary in good time and that they wish to maintain a relationship with the NTCA based on mutual trust, transparency and understanding.

In analogy with the horizontal approach to large enterprises, in essence the entrepreneur and tax intermediary jointly create a tax control framework that can give the NTCA confidence in the quality of the returns. This in turn results in legal certainty for entrepreneurs due to the rapid settlement of their returns.

#### **5.4 Covenants with sectoral organizations**

The NTCA has also concluded covenants with sectoral organisations active in the small and medium-sized enterprise sector. Two options are available for cooperation with the sectoral organisations. When a sector is governed by a specific form of monitoring then this can result in the conclusion of a horizontal monitoring covenant. When a specific form of monitoring has not been implemented for a sectoral organisation then it is still possible to reach sectoral agreements on tax affairs. The latter form of covenants do not extend to monitoring agreements but make arrangements for the formation of a consultative platform for advance harmonisation of tax issues. An example of the latter is the covenant concluded with the inland navigation sector.

#### **5.5. The role played by behavior**

When returns audited in meta-monitoring are not acceptable then the nature and reasons for the errors are reviewed in consultation with the tax intermediary. The results from this analysis determine the modifications that need to be made to the return that was audited and/or in the work processes of the tax intermediary and/or the entrepreneur. The NTCA can intervene, as necessary, in the event of actions in conflict with the covenant. The tax intermediary bears the responsibility for the modification of work processes that resulted in errors.

### **6. THEME-BASED APPROACH**

As is apparent from the above, the NTCA provides for the transparency of the Administration's monitoring approach. The NTCA always provides information about the monitoring approach adopted both for individual enforcement covenants and group agreements. In addition, the NTCA also strives to influence the behaviour of and promote compliance by the large group of taxpayers who file income tax returns.

A variety of instruments are deployed for this purpose:

- the provision of services
- the simplification of return processes
- pre-completed returns

Every year the NTCA devotes additional attention to a specific theme relating to the treatment of the income tax returns. This theme is announced in advance. With the 2010 return the NTCA increased the Administration's monitoring of the private use of company cars (in 2009, the NTCA devoted additional attention to the deduction for

expenses incurred in the support of children under the age of 30; in 2011, the NTCA will devote additional attention to the filing of returns in time)

## **7. IN CONCLUSION**

The NTCA is focused on the promotion of compliance and to this end deploys instruments designed to influence the behaviour of taxpayers. This compliance strategy is based on justified trust and focuses on the advance provision of as much support and information as possible. It has transpired that retrospective monitoring and adjustment often fails to have a permanent effect on taxpayer behaviour. For this reason the NTCA has opted for the development of new instruments that can be deployed alongside the existing instruments.

The NTCA investigates the motives for non-compliant behaviour: these in turn determine decisions relating to the monitoring approach, firstly in terms of the cases that will be examined (and the cases that will not be examined) and, secondly, in the deployment of monitoring instruments. Preference is then given to the horizontalisation of monitoring, since this results in speed, up-to-date information, the prevention of non-compliance, legal certainty and the avoidance of the duplication of work. This contribution explains the approach to horizontal monitoring on the basis of the methods used in two segments, namely the largest and smallest enterprises.



## **CREATING TAXPAYER AWARENESS: CORPORATE SOCIAL RESPONSIBILITY AND THE FORUMS FOR TAXPAYER- TAX ADMINISTRATION DIALOGUE**

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*Contents: Abstract – 1. The necessity and way to build tax morality among taxpayers - 2. The change in business models drives the new relationship – 3. Taking the EU VAT system as an example for an enhanced dialogue between tax administrations and taxpayers – 4. Breaking it all down: the main arguments*

### **ABSTRACT**

Tax compliance can be increased by improving the way how tax authorities interact with taxpayers. The idea of building better tax morality and promoting corporate responsibility is developing worldwide, also in the EU Member States. This is based on an enhanced dialogue between tax administrations and taxpayers, and builds on mutual respect and cooperation. Taking into account the development of business models, an enhanced dialogue between a single national tax administration and a businesses operating in an international environment has, however, its natural limits. Therefore, in 2010, the European Commission has decided to both launch a public consultation and to establish a communication channel for tax authorities and business operators at an EU-wide level. The preliminary outcomes of this comprehensive stakeholder consultation are to a large extent in line with the above-mentioned practices regarding the enhanced dialogue at national level. The key findings suggests that the establishment of trust between tax payers and tax authorities, fairness, legal certainty, transparency, responsiveness can result in an increased efficiency for both taxpayers and tax administrations.



## 1. THE NECESSITY AND WAY TO BUILD TAX MORALITY AMONG TAXPAYERS

Public administrations have responsibilities towards their citizens. The fulfilment of these responsibilities requires a significant amount of financing, and governments rely heavily -amongst others - on revenue generation through taxation. In the EU, VAT represents a major part of this tax revenue. Citizens as private individuals and business have to pay taxes; tax authorities have to collect them. The challenge is how to manage the tax system in a way to collect the revenue due in the most efficient way and with the least administrative costs. A key issue is taxpayers' compliance, but especially voluntary compliance is deemed to depend largely on intrinsic tax moral. The key question is, however, how to create this tax moral.

### **How to treat taxpayers in order to achieve an enhanced dialogue?**

Tax compliance can be increased by improving the interaction between tax authorities and taxpayers. Compliance theory suggests that taxpayers tend to respond in a systematic way to how the tax authority treats them. In particular the taxpayers' willingness to pay taxes and the overall tax moral is raised when the tax administration acts respectfully. Conversely, when the tax administration considers tax payers in principle as potentially non-compliant persons who need to be forced to pay taxes, taxpayers indeed tend to respond by actively trying to circumvent taxation and pursuing tax avoidance schemes<sup>1</sup>.

Theoretically, two diametrically opposite ways of treating taxpayers can be distinguished:

- a) An authoritarian treatment, undermining tax moral;
- b) A respectful treatment built on mutual trust, raising tax moral.

Tax authorities can define how they would like to balance the features of these two extremes and hence their very own approach in many different ways. In any case, these decisions will determine the relationship between taxpayers and tax administrations and consequently affect the level of tax moral.

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<sup>1</sup> Lars P. Feld & Bruno S. Frey *Deterrence and Tax Morale: How Tax Administrations and Taxpayers Interact* [www.oecd.org/dataoecd/9/51/2789923.pdf](http://www.oecd.org/dataoecd/9/51/2789923.pdf)

**a) The traditional “authoritarian” approach**

On the one hand, when following the “traditional” authoritarian approach, the tax administration manages taxes instead of people. Per definition, the strategy will be to effectively control rather than to fruitfully cooperate. Taxpayers are expected to file tax returns and statements disclosing an amount of factual information, declare the right amount of tax due and pay this tax on time. The tax administration will ensure taxpayers’ compliance by conducting ex-post audits and seeking more information about the tax return retrospectively.

Additionally, if necessary, the tax administration will also take enforcement measures to correct and collect the right amount of tax payable. Tax audits often have backblocks of 5 years and more. They usually result in a considerable number of queries regarding previous tax years, which is experienced by the taxpayer as an unfair fishing expedition. Due to the long lapse of time, the information requested by tax auditors is also many times difficult to obtain and therefore heavily interrupts the normal course of business. All this contributes to a culture of distrust between tax administrations and businesses. Generally, there is hardly any possibility for the taxpayer to get certainty in tax matters in advance. Due to the complexity of tax systems, taxpayers must in the absence of a constructive relationship with the tax administration often rely on external expertise, which further increases compliance costs.

Because of this “obligation based” nature of the relationship there is no incentive to disclose additional information to the tax authorities, particularly on areas of tax uncertainty or risk.

**b) The enhanced dialogue**

On the other hand, the idea of building better tax morality and promoting corporate responsibility is developing world-wide, and this development is also observed in EU Member States. It is based on an enhanced dialogue between tax administrations and taxpayers, and builds on mutual respect and cooperation. Key issues in these “new” compliance strategies are seeking to establish trust between tax payers and tax authorities, a fair balance between the rights and obligations, legal certainty, transparency and efficiency.

However the arrangement and implementation of these compliance strategies based on dialogue differ among countries, as they need to take into account the cultural environment, history and legislation. Existing relationships between tax authorities, taxpayers and tax

intermediaries differ widely and the changes required to move towards an improved relationship will have to be adapted to the circumstances. The following paragraphs of this section aim to give a short overview of the main features of these new compliance policies based on the experiences in a number of EU Member States.

### **i) Building trust**

Building a relation of trust will be a key issue driving cultural and behavioural change.

The majority of people, businesses and institutions can and wish to be socially responsible. However trust is not something any party can simply acquire or require, it has to be earned and established. This requires a number of changes in administrative practices and should not be regarded as a short-term process.

First, building trust requires an open exchange between the tax authorities, tax payers and their representatives, in particular involving the trade associations. In order to establish such an open and collaborative relationship, many tax administrations have set up client relationship managers or one-stop contacts. Although this approach was initially designed for large taxpayers, it is more and more extended to small and medium sized entities (SME).

Second, trust requires mutual understanding and commercial awareness, particularly by the revenue authorities. Taxpayers will be reluctant to voluntarily disclose information if they fear that the tax authorities will misunderstand the information and use it in their disadvantage.

Third, trust requires fairness and an impartial approach by the tax authorities. This is mainly a matter of cultural attitudes. Measures that can contribute to fairness are alternative dispute resolution techniques such as arbitration, public service quality commitments, and certification campaigns for regional tax and audit centres. But also acknowledging the taxpayers' right to make unintentional mistakes and granting the possibility to submit voluntary amending tax returns with no or lighter fines should be regarded as a vital component of the new compliance strategies.

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**ii) Increasing transparency and voluntary disclosure of information**

Both taxpayers and tax authorities are benefiting from more transparency and voluntary disclosure of information. The tax administration expects taxpayers to be fully transparent in their way of doing business and to disclose all significant risks in a timely manner.

Consequently, the taxpayer should disclose anything that he believes is of interest to the tax authority to undertake a fully informed risk assessment, or in other words, that accepts the responsibility to provide a self risk assessment. Internal control frameworks play an essential role in this context and some EU Member States even require, as a part of the enhanced dialogue, that the taxpayer develops a tax control framework, which forms then part of the internal control system. However, while the internal control system involves the control of all business processes, the tax control framework focuses on the internal control of tax processes.

Naturally, the taxpayer expects his openness and transparency to be reciprocated by the tax authorities, and particularly an ongoing and open dialogue. This can address, inter alia, questions on why particular behaviour or tax positions are seen to be risk or why the tax authority is seeking particular information. But also other measures may contribute to meeting this transparency goal, such as early explanations of new laws, the provisions of guidelines as well as an open and constructive stakeholder consultation on changes in tax policy and tax administration.

This voluntary disclosure of information may be laid down in formal “Partnerships” agreements, emphasising that supervision is a shared responsibility by taxpayers and tax authorities.

**iii) Legal certainty and responsiveness**

One of the main benefits that taxpayers can achieve through an enhanced dialogue is legal certainty. This requires tax administrations to be commercially aware, transparent and to disclose appropriate information. Moreover one of the best ways to satisfy the taxpayers’ need for legal certainty is to develop functioning and accessible advanced ruling procedures. As taxpayers need this certainty timely and quickly, these arrangements should be flanked with an obligation for the administration to respond within a specific length of time.

An enhanced level of trust, transparency and legal certainty will result in *an increased efficiency for both businesses and tax administrations*. On the one hand, the voluntary disclosure enables tax administrations to better, respectively more proportionately, allocate their resources and to pursue more efficient tax audit approaches, as audits could build on internal tax control systems previously implemented as a consequence of closer cooperation.

Moreover, the dialogue approach has the potential to avoid time-consuming and hence costly ex-post corrections and disputes. Consequently, it also entails an increased efficiency for the taxpayer, as it will reduce compliance costs and lead to simplified procedures. In the long-term, an enhanced dialogue has the potential to even contribute to an overall improved tax system with minimised administrative burdens for voluntary compliant taxpayers.

## **2. THE CHANGE IN BUSINESS MODELS DRIVES THE NEW RELATIONSHIP**

New compliance strategies based on the features outlined in the previous section require tax administrations to regard the cooperation with taxpayers as a possibility to also adapt their possibly outdated approaches to a fast changing business environment. Mutual understanding and openness is crucial as business models have changed dramatically in the last decades due to both political and economic developments.

Whereas the “old business model” had more a local focus - local sales, little cross border, local accounting – is the “new business model” driven by technological developments and globalization as both has led to new products and (remote) services. Global markets require global sourcing and a global supply chain. Staying globally competitive means increasing efficiency through economy of scale driven by outsourcing/centralizing production, focussing on core business, outsourcing of supporting services/functions and increasing the use of subcontractors and service providers. The higher level of mobility has led to changes in logistics and to new transport capabilities allowing for stocks to be owned centrally but located locally for just in time deliveries (cross-border consignment and call-off stock).

Under traditional business models, it was effective for business to produce locally and sell locally. Even if the production site was in another country, business would first sell to a local subsidiary and such local subsidiary would sell to the local customer. Logistics worked in more simple models (usually supplies to stocks of the customers,

inventory owned by customer). Cross-border services were even more uncommon.

Nowadays, businesses are operating in dynamic global markets and face global competition. Country borders are permeable, particularly for goods from low-cost countries. In fact, products which require a significant amount of human work-input will be produced in countries with the lowest working costs. Due to technological developments (particularly the internet), customers gain transparency and easy access to global markets. Particularly with regard to non-tangible services (e.g. download of software, music etc.), customers can virtually compare prices on a global level and can source such services from all over the world.

Also for SME the business model is changing, as they get more and more involved in cross-border transactions. For example, in the supply of goods and installation contracts (e.g. in the construction and heavy machinery industry) installation, repair and maintenance work is often subcontracted to both local and foreign SME.

### **3. TAKING THE EU VAT SYSTEM AS AN EXAMPLE FOR AN ENHANCED DIALOGUE BETWEEN TAX ADMINISTRATIONS AND TAXPAYERS**

Given the recent development and overall dynamic of business models, an increased cooperation between a single national tax administration and a multi-national business is, of course, of limited use. In the EU context, especially the relatively complex and harmonised VAT system offers considerable efficiency gains from a better cooperation of tax authorities with taxpayers. For cross-border tax issues involving more than one Member State, an EU level expert group was established in order to meet and facilitate the exchange of views on tax matters. This idea was firstly mentioned in the Commission's communication of 2008<sup>2</sup> and supported by many Member States in the 2009 Amsterdam conference on VAT fraud<sup>3</sup>. As a follow-up to the outcome of this conference, the Commission started the process to set up, a structured dialogue between tax administrations and business operators to discuss practical issues and possible means to improve the efficiency of the VAT system in view of reducing the administrative burden for business and tax administrations and combating VAT fraud in a more effective way.

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<sup>2</sup> COM (2008) 807 final of 1 December 2008

<sup>3</sup> Fiscalis seminar "VAT fraud: a common concern for business and tax administrations" Amsterdam (NL) 23 January 2009.

Up to now, the focus in cross-border non-compliance was on legislative measures seeking to enhance the tools for tax administrations to combat tax fraud more effectively and efficiently.

Often, these anti-fraud measures have led to increased administrative requirements for compliant taxpayers as well. However, it was pointed out at several occasions that in an international context, business and tax administrations share a common interest and that business is very often willing to assist tax administrations in order to lower the joint costs of compliance. In this context, the development of a voluntary compliance strategy by means of a real dialogue between business and tax administrations is considered a promising step forward as part of the EU's VAT policy.

Furthermore, such cooperation also contributes to a smoother functioning of the VAT system as such. When business and tax administrations can have an open dialogue on problems in applying the fiscal rules encountered in daily practice, a win-win situation can be achieved. On the one hand, it can remove anti-fraud obstacles of the current VAT system which are redundant for compliant taxpayers. On the other hand, an increased dialogue reduces the administrative burden for business and tax administrations and offers the latter the possibility to allocate more resources to the targeting of non-compliant behaviour.

In general, there are three main benefits which can be achieved through a stakeholder consultation. First, securing the support and co-operation of the stakeholders in gaining the leverage needed to influence compliance behaviour. Second, contributing by means of a dialogue to a greater potential for strategies or measures envisaged to become workable and innovative. Third, securing, as a result of a dialogue, the authority's credibility and trustworthiness.

As a first step, the Commission has therefore initiated such a dialogue with business representatives in the framework of a so called "Business Expert Group on the smooth functioning of the VAT system in the EU". Fully set-up in 2010, this group is composed of 20 representatives of small, medium sized and large businesses.

This stakeholder consultation focuses on ways in which the relationship between taxpayers and tax administrations could result in a smoother functioning of the present EU VAT system.

Day-to-day practical problems arising from managing the VAT system are discussed, as well as suggestions elaborated for possible solutions.

The focus of the group is on administrative and practical challenges and not on legal issues. Its main working areas are the following:

- a) The practical challenges of doing businesses in past and present times

As outlined in the previous section, businesses operate in a highly international and dynamic environment as globalization and new technological developments have increased the complexity of their business models. The Business Expert Group aims to explore, on an EU-wide basis, the practical challenges businesses and tax administrations face in today's world. In doing so, it takes into consideration both the business and tax administration perspective and tries to foster a common understanding of today's practical challenges that both sides face.

- b) Tax payer services, registration, transparency and disclosure of information

The first step a business has to do when carrying out activities outside their resident country is to work out whether these activities trigger a VAT registration or not. Since legitimate business is governed by its principle to be compliant and fulfill the different obligations in the respective country, there is a need for proper information regarding the respective rules and formalities in different EU Member States. The Business Expert Group aims to identify, share and support good practices of tax administrations for more transparency, fairness, legal certainty and simplification in the first step of the business cycle, namely registration. The aim is to eventually expand its working field to the whole business cycle.

The principal points of view expressed by the different stakeholders are to a large extent in line with the theoretical features of an enhanced dialogue mentioned in the first section of this paper.

- Both business and tax administrations need each other and have to cooperate in an open and trustful environment on both sides.
- Moreover it is considered as essential to gain mutual understanding and commercial awareness about the administrative and practical challenges which both businesses and tax administrations face in the current VAT landscape, with the aim to build a fruitful dialogue and cooperation between Commission, Member States and businesses.



- There is a need for a safe and fair VAT system to cope with today's complex business environment. The main factors to drive this are simplification, more consistent and standardized compliance practices across the EU, appropriate risk management processes and a fair and impartial approach.
- In order to facilitate compliance business need easy access to the relevant rules and administrative practices. When new legislation or a change in tax policy or in tax administration is introduced business need the appropriate lead time to implement the new legislation into business practice.
- Audit and control activities of tax administrations should be timely and risk management based. Internal control frameworks of taxpayers can play an essential role when it comes to this, as an enhanced dialogue can further reduce the duration of audits.
- Simplification and more consistent and standardized compliance practices across the EU are key instruments to increase efficiency and reduce costs. Modern technology can play an important role with respect to potential efficiency gains but it needs to be kept in mind that there might be no "push the button" approach and that this is hence only one factor required.

It is a future aim to widen this existing platform to tax administrations of the EU Member States, offering a possibility to share, discuss and – maybe - solve practical bottlenecks in the management of the VAT system. o This would help to smoothen the functioning of the system and generate benefits for both the tax administrations and the business.

The need for specific arrangements with stakeholders and their legal effects would also be considered in this context. For instance, consideration could be given on how to implement at EU level the idea of "Partnerships" (specific agreements between tax administrations and taxpayers). The possibility of ascertaining the tax treatment of certain transactions in advance is another topic that could be looked at in this context.

A first meeting of such a platform at EU-level is planned for 2011 and will focus on the challenges and opportunities for meaningfully changing the relationship between tax payers and tax administrations as well as possible ways forward to enhance tax compliance in international business.

#### **4. BREAKING IT ALL DOWN: THE MAIN ARGUMENTS**

Given the crucial role of business in the VAT system as unpaid VAT collector, the efficiency of their relationship with the tax authorities and the way the VAT system is managed will greatly affect the level of tax moral and influence the costs of administering the VAT system for both parties. This relationship has many aspects: it covers the information tax authorities obtain from the taxable persons via the reporting obligations imposed at EU or national level, the collection of the tax by the taxable person and its payment to the tax authorities, the way VAT is audited, but also the quality of information provided by tax authorities, the legal certainty they offer and the accessibility of the tax administration.

Regarding the relationship between tax authorities and taxable persons, new approaches have been developed. These are notably based on voluntary compliance, risk assessment and monitoring aspects with the aim of reducing the involvement of tax authorities and decreasing the administrative burden for business and tax authorities. This development has been accelerated in a number of EU Member States following a steady reduction of their human resources in tax administration.

The idea of voluntary compliance is already high on the agenda in some EU Member States and a regular dialogue with business representatives is crucial in this respect. In joint meetings, tax authorities and business representatives can discuss domestic tax issues at national level, ranging from proposals for new legislation to the implementation of adopted legislation and compliance issues, for instance regarding reporting obligations. Such a dialogue based on confidence and transparency increase tax moral and has proven to be fruitful and helpful in having legislation complied with in an efficient way.



## **CREATING TAXPAYER AWARENESS: CORPORATE SOCIAL RESPONSIBILITY AND THE FORUMS FOR TAXPAYER- TAX ADMINISTRATION DIALOGUE**

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**Contents:** *Executive Summary – CIAT Précis – 1. Introduction – 1.1 Purpose and scope of paper – 1.2 Corporate social responsibility (CSR) – 2. Canadian stakeholder perspectives – 2.1 Corporate taxpayers and tax intermediaries – 2.2 Individual taxpayers and other stakeholders – 3. CRA-supported fora addressing CSR – 4. CRA’s approach to large business compliance – 5. Next steps and conclusion – Appendix A: About the CRA – Appendix B: Taxpayer bill of rights and commitment to small business*

### **EXECUTIVE SUMMARY**

Canada’s tax administration, the Canada Revenue Agency (CRA) is committed to protecting the nation’s revenue base by ensuring compliance with tax laws. As a part of its efforts, the CRA actively pursues individuals and businesses, including participants in the underground economy and those avoiding taxes by hiding funds offshore, who are not paying the taxes that they owe to Canadians.

The CRA believes that in order to support excellence in tax administration and the sustainability of the Canadian tax system, the CRA must address the root causes of non-compliant behaviour in key high risk segments of the population. Large business compliance has captured the attention of the CRA and tax administrations worldwide.

Corporations’ access to aggressive and sophisticated tax planning strategies poses a risk that, left unchecked, could undermine the government’s ability to effectively deliver its programs. In fact, aggressive tax planning features prominently in the CRA’s inventory of risks to the sustainability of the tax system, and as such, has been the focus of increased resources, research, and compliance efforts.

One focus area for addressing potential aggressive corporate tax planning is the leveraging of the movement to view payment of taxes through the lens of Corporate Social Responsibility (CSR). The CRA would like to evolve our outreach, communication, and compliance efforts to encourage, and capitalize on, this development.

There are a number of stakeholders that affect the CSR behaviour of corporations, and the CRA is endeavouring to influence them through its policies, messaging, and through the fora in which the taxpayer – tax administration dialogue occurs. In part, these stakeholders inform the structure of this case paper.

The CRA also recognizes that some of the most important opportunities for the discussion and facilitation of responsible approaches to taxation occur during the regular meetings that the CRA holds with each corporate tax filer. Benefits accrue to both the corporation and the CRA when the corporation adopts a responsible approach to taxation.

While the CRA has such tools as the Canadian General Anti Avoidance Rule, the way of the future seems to be to encourage changes in corporate behaviour rather than to discourage specific actions or behaviours. Examples of this, such as CRA's new approach to large business compliance, are noted.

Even with CRA's new approach of encouraging an evolution of corporate behaviour, it must be recognized that the corporation faces pressures and incentives that may count against the widespread adoption of taxation as a CSR issue. However, the macro environment is ripe for incubating corporate interest in tax as CSR, and the CRA is positioning itself to leverage an environment where responsible taxation practices could become as much of an expected corporate behaviour as responsible labour practices, environmental sustainability, and workplace health and safety.

### **CIAT PRÉCIS**

“One of the mechanisms that proved more effective in enhancing the levels of tax morality at the corporate level are the business Fora in which the tax administration and taxpayers transparently and openly set forth the importance of the tax commitment and agree, in line with corporate social responsibility, the due compliance with the obligations pertaining to such companies.

On the other hand, the administration also recognizes the importance of attending, guiding and facilitating such compliance through the

development of effective support mechanisms that do not hurdle such compliance.

It is a kind of fiscal agreement between companies and the administration whose purpose is not the tax amounts due but rather to operate as a point of agreement between society and the government administration to attain the common good.

Such Fora shall be summarized in the case study, as well as their design and implementation process, the results obtained, the main hurdles in the process and their outlook.”

## **1. INTRODUCTION**

### **1.1 Purpose and Scope of Paper**

The purpose of this paper is to explore the taxpayer-tax administration dialog fora as it relates to Corporate Social Responsibility (CSR). This paper shares the Canada Revenue Agency’s (CRA) experience with tax as a CSR concern, and how that concept is incorporated into the CRA’s policies and ongoing dialogue with its partners and clients in Canada’s tax system.

After defining CSR itself, this discussion of the Canadian case approaches the subject from the perspectives of corporate taxpayers and their intermediaries, and individual taxpayers. These groups are important stakeholders of both corporations and the Canadian tax system. The realities of each are explored before discussing the CRA’s approach to large business compliance in greater detail.

### **1.2 Corporate Social Responsibility (CSR)**

#### **Defining CSR**

CSR is typically defined as a corporation’s commitment to a way of conducting business that takes into account the interests of all stakeholders.<sup>1</sup> These interests include economic, environmental and social concerns, often referred to as a corporation’s “triple bottom line.”<sup>2</sup>

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<sup>1</sup> *A number of views are surveyed, See Industry Canada, Diversity of Perspectives.*

<sup>2</sup> *KPMG. (2007). Tax and Corporate Social Responsibility.*

The term “stakeholder” refers to any individual or group that is impacted by the activities of a particular corporation and includes:

- Customers;
- Shareholders;
- Management and employees;
- Suppliers;
- Society at large; and
- Governments.

This wider responsibility is in contrast to the traditional view of the corporation’s role in society, which held no duty to any group but shareholders.<sup>3</sup> The extent to which other stakeholders were driving the corporation’s business activities was not significant. Recent corporate failures and social activism have led to a business environment where increased corporate integrity and accountability are expected.<sup>4</sup> However, the Canadian government has already been taking public policy actions in support of CSR for years, although they are frequently not explicitly labelled as CSR.<sup>5</sup>

Since the 1970’s, there has been a great mobilization of CSR as it relates to its environmental and social bottom lines. From environmental stewardship and sustainable production, to responsible labour practices, corporate stakeholders have come to expect that the organization will perform above that which the bare letter of the law requires of them in the countries where they do business. Some commentators have asserted that behaving responsibly is value-maximizing even if that responsibility is not advertised to customers.

However, that line of reasoning seems an incomplete rationale for engaging in the full range of possible CSR activities, which includes everything from intrinsically efficient efforts to use less paper, to the more expensive act of paying a fair share of taxes. Neither is pure altruism a sound nor complete explanation for the widespread emergence of CSR. A more robust explanation is that there is a reputational impact from CSR, or lack thereof, which affects sales and cost of capital, thus acting on corporate profits from two angles. The still ultimate fiduciary responsibility of corporate managers to maximize profit could explain why action on the less publicly visible applications of CSR has been slower to receive embrace by business.

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<sup>3</sup> Most famously asserted in [Friedman, M. \(1970\). \*The Social Responsibility of Business is to Increase its Profits.\* NY Times, Sept 17.](#)

<sup>4</sup> [Conference Board of Canada. \(2008\). \*The Trust Imperative: Taking Governance to the Next Level.\*](#)

<sup>5</sup> [Industry Canada’s website provides a good accounting of the GoC’s CSR activities and initiatives.](#)

Tax matters fit into this domain, and the corporate case in particular is the focus of this paper.

### **Taxation in the Context of CSR**

To date, the linkage between taxation and CSR often goes unrecognized by corporations. Taxes are typically viewed as an obligation to be minimized, and not as something that should be influenced by the corporation's moral or social stance. Nevertheless, corporations make some significant choices with large tax effects that could or should be viewed through a moral or social lens. Examples are where the corporation locates operations, where it registers assets or subsidiaries, and which tax credits it pursues.

A precise definition of socially responsible tax behaviour is difficult to frame because the issue is a nuanced ethical matter. A sense of ethical, moral and civic responsibility shapes a corporation's orientation on CSR and that stance, if genuine, should inform all of its business decisions, including the use of tax minimization arrangements.<sup>6</sup> Accordingly, that position should come to bear in its self-assessment of what its *fair* tax obligation is, technicalities notwithstanding. Ultimately, a strict rules-based approach to corporate tax responsibility is unlikely to add any additional value or clarity that cannot be imparted by legislation.

Promotion of CSR is better suited to guide conduct in situations that rules (i.e.; laws) fail to effectively address.

The determination of a fair tax liability, separate from a technical tax liability, is a subjective, values-based process. It may be guided by an interpretation of legislative intent, or by some other measure, such as an amount commensurate with the extent to which a given corporation uses public services and infrastructure, or the magnitude of its presence in Canadian society.<sup>7</sup> One moral case for tax responsibility is that society pays to educate workers, protect private property, and provide infrastructure and thereby supports an environment that allows corporations to pursue a profit. The CRA believes that part of the responsibility to fund the continuity of this environment falls on corporate citizens.

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<sup>6</sup> [\*KPMG. \(2007\). Tax and Corporate Social Responsibility.\*](#)

<sup>7</sup> Ibid.



## CSR as a Compliance Tool

The CRA's position is that aggressive tax planning undermines the integrity of tax laws and the tax base. It involves transactions, arrangements or events that are normally fully disclosed, but which are undertaken to achieve a tax result that is not supportable within the overall scheme of the *Income Tax Act*, *Excise Tax Act*, or Income Tax Conventions. When aggressive tax planning leads to such a result, the corporation is said to have engaged in abusive avoidance.

The principles-based *General Anti-Avoidance Rule* (GAAR) provision of the Canadian *Income Tax Act* was enacted in 1988 to address abusive avoidance and to counterbalance literal interpretation of specific sections, where those interpretations are contrary to a holistic, contextual understanding of the Act. However, pursuing GAAR in any specific case is burdensome on the tax administration and cannot be seen as a complete, broad-based solution. Traditional compliance efforts against corporate tax avoidance would be well-served by a supplement in the form of CSR promotion, support, and fora. Other reasons for expanding the toolkit are the relative expense of taxpayer audit to the tax administration (and the taxpayer), the difficulty of identifying compliance issues in complex multinationals, and the cost of prolonged litigation in an adversarial environment.

Because CSR encourages a degree of self-regulation, effective stakeholder engagement might pre-empt court challenges, in some cases, by seeing corporations more likely to accept the initial rulings of the CRA or by discouraging filers from arranging questionable schemes to begin with. Tax practices that could benefit most from such an approach generally include those that may be technically legal under some interpretations of legislation, but that are considered by the tax administration to be abusive. Consider the continuum view of tax minimization put forward by CSR think tank SustainAbility:<sup>8</sup>



On a practical level, there are a number of potential benefits for both the corporation and the CRA, including:

<sup>8</sup> [SustainAbility. \(2006\). Taxing Issues: Responsible Business and Tax.](#)

- Greater certainty for corporations with respect to how tax positions will be treated by the tax administration;
- Potential application of findings to past and future years;
- Improved identification of audit and legislative issues;
- Greater certainty and transparency in tax positions and their rationale from corporations;
- Less time and resources dedicated to pursuing litigation and to senior management dealing with tax compliance issues for the business;
- Greater audit currency and faster audit closure for the CRA; and
- Decreased interest expense for businesses while waiting for reassessment.

It is likely that corporations will also look for other value from the inclusion of tax in the CSR framework, as the reduced compliance burden described above is unlikely in itself to provide a sufficient business case, and altruistic motivations must compete against the reality of the bottom line.<sup>9</sup> In order to voluntarily accept higher effective tax rates, which is a likely consequence of adopting a responsible approach to taxation, support and pressure from a corporation's customers and investors is likely necessary: in the absence of moral concerns from shareholders, executives should be able to establish a business case. Investors and customers would form the foundation of the business case (with reduced tax compliance burden reduction being an additional incentive) because they supply sales and capital and, through their action, can cause corporations to reorient themselves on other CSR issues.<sup>10 11</sup>

## 2. CANADIAN STAKEHOLDER PERSPECTIVES

### 2.1 Corporate Taxpayers and Tax Intermediaries

Corporate taxpayers, particularly large ones, are central not only to the CSR conversation, but are generally important to tax revenue generation for the Canadian government. The large corporate filers, having more than \$250M in gross revenue or that are otherwise determined to be large based on the CRA's models of complexity, make

<sup>9</sup> *CSR is more likely to become an issue in the boardroom when there is a business case for it.* See [Strandberg, C. \(2005\). \*The Convergence of Corporate Governance and Corporate Social Responsibility\*](#).

<sup>10</sup> *For example, the Dow Jones now has a Sustainability Index for ethical funds. 44% of adults surveyed say that a high degree of CSR is important to them in their buying decisions.* See [IPSOS MORI. \(2003\). \*Corporate Brand and Corporate Responsibility\*](#).

<sup>11</sup> *In cases where the increase in the cost of capital caused by exclusionary socially responsible investing is higher than the cost of the tax payments at issue, previously non-complying, value-maximizing firms will comply.* See [Heinkel, R., Kraus, A. & Zechner, J. \(2001\). \*The Effect of Green Investment on Corporate Behavior\*](#).

up only about 0.5% of corporate filers by number, but generate close to 50% of corporate income taxes paid. Canadian corporations are also important in their roles as tax collectors. For a corporation operating in all provinces, for example, there are potentially 58 different taxes on them and another 28 that the corporation collects or withholds on behalf of the federal or partner provincial governments.<sup>12</sup>

Large corporate taxpayers are few in number relative to the magnitude of their tax contributions, but they possess a sophisticated ability to plan their tax liabilities in Canada. Mechanisms for avoidance that are less accessible to small corporations include transfer pricing, use of tax havens and offshore financial centers, treaty shopping, and abusive corporate tax shelters, although the latter is becoming more accessible to smaller taxpayers as tax shelters are now also marketed at the retail level. Both in house expertise and tax intermediaries are critical sources of expertise for corporations in determining which tax planning options are available to them, and in determining how aggressively to position themselves.

Although the CRA has continually increased its training and resources to combat these practices, the corporate development of coherent CSR policies which include tax management would help to address the root of the compliance challenge. CSR has encouraged self-regulation in other domains, as mentioned earlier in this report, such as sustainable development and workplace health and safety.

Fortunately, CSR policies are becoming more common in large organizations, with some 72% of Canadian business leaders stating that their companies have developed formalized policies for CSR activities.<sup>13</sup> Frameworks for CSR already exist within which taxation could be included as a component. Large corporations are much more likely than small corporations to have an existing CSR policy framework, which leads to the conclusion that they are the best target audience for dialogue on tax as CSR.<sup>14</sup> Furthermore, they can afford to sacrifice proportionally more profit to pursue social ends than can smaller firms, while still remaining competitive.<sup>15</sup>

It is within this environment that the CRA encourages taxation as a CSR concern. Much of the research on the tax non-compliance behaviour of large corporations is focused on individual cases rather than broader trends, and research on corporate compliance as a result of tax as

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<sup>12</sup> *PriceWaterhouseCoopers. (2008). Total Tax Contribution 2008.*

<sup>13</sup> *Ipsos Reid. (2006). Corporate Social Responsibility in Canada.*

<sup>14</sup> *BusinessRespect. (2009). Large Firms more likely to have CSR Policies.*

<sup>15</sup> *Adams, M & Hardwick, P. (1998). An Analysis of Corporate Donations: United Kingdom Evidence.*

CSR is basically nonexistent. However, taken at face value, the idea of tax as a CSR issue appears to be incubating in corporate Canada. The recognition that tax payments are an important contribution to society, and the showcasing of amounts paid in Canada, are elements of CSR reports for a number of large corporations including:

- Sun Life Financial;
- Royal Bank of Canada;
- Bank of Montreal; and
- EnBridge Gas Distribution.

In the annual CSR reports of Sun Life Financial, Royal Bank of Canada, and Bank of Montreal, for example, taxes paid are listed by type and by province. The reports preface this disclosure with statements indicating recognition that their tax contributions strengthen the economy. Bank of Montreal stands out in that it draws the connection that the taxes it pays help to fund programs and services across the country. Deeper transparency, along with metrics and the development of key performance indicators and other standards for Tax as CSR would lend comparability to the reports, demonstrate their substance, and facilitate stakeholder action.

This is all an indication that the link between taxes and CSR has currency with industry and that advocacy for the concept has potential. Although still largely unformed, the fact that interest is developing means that the CRA has an opportunity to play a role in shaping the attitudes and discourse surrounding the issue.

## **2.2 Individual Taxpayers and Other Stakeholders**

Corporate actions do not exist in isolation from the individual perspectives of corporate stakeholders. Directors are both individual taxpayers and influencers of corporate tax stances, as are customers and investors. Often in a small- or medium-sized enterprise, the individual attitude and the corporate attitude are one and the same. If there is a sufficient level of transparency in corporate affairs and a willingness, on the part of individuals, to use their investment, and purchasing power, then we would not expect a great deal of divergence between the social responsibility beliefs of individuals and the social responsibility actions of corporations.

Indeed, individuals are the foundation of society, businesses and the tax system. They have the freedom accorded them by their rights, but they also have legal, social and moral obligations to uphold the law and act in a socially responsible manner. The CRA engages Canadians in

each of the numerous roles that they play in the system: taxpayers, business owners, corporate investors, customers, and employees.

The CRA has a number of outreach initiatives that specifically target responsible citizenship. They include educational programs, information seminars for youth and newcomers to Canada, and underground economy outreach activities. During these outreach events, messaging highlights how taxes and meeting one's tax obligations contribute to the quality of life and services for all Canadians. The fora include:

- Responsible Citizenship and Canada Tax System – School Learning Unit;
- Teaching Taxes Program;
- Learning About Taxes;
- Presentations in Trades Schools;
- Information seminars for newcomers to Canada / Welcome to Canada Seminar;
- Homeowner Initiative;
- Community Visits;
- Speaking Engagements;
- Information session for non-residents;
- “Get it in writing” Campaign; and
- Underground Economy YouTube Contest.

More generally, all of the CRA outreach activities promote and inform citizens and businesses of obligations and entitlement in the context of taxes. This consists of explaining responsibilities for filing, remitting, reporting and keeping books and records. At a very basic level, this can be considered as a component of advocating responsible citizenship. In 2009/10, over 6,900 information sessions were delivered to some 125,000 participants.

CSR engagement with small corporations is more similar to engagement with individuals than it is to large corporations. Small business responsibility messaging focuses on the underground economy, and those businesses where opportunities for non-compliance are more readily available, and where such non-compliance may impact the consumer, such as the trades (e.g. construction). It emphasizes the importance and benefits of behaving responsibly as a business owner and of demanding that the businesses with which you contract also behave responsibly. For example, the CRA's “Get it in writing” campaign highlights the importance of consumers insisting that businesses give them receipts and written contracts. The goal is protection and recourse for the consumer, and more comprehensive

information being reported to the CRA that will allow the Agency to ensure the correct taxes are paid.

The CRA is still considering fora and messaging directed towards individuals to encourage them to use their consumption and investment power to encourage large businesses to behave responsibly with respect to tax. A greater awareness of the impact of corporate tax avoidance and how it negatively affects social programs and government services in Canada would strengthen the business case for corporations to treat tax as a CSR issue if it effects buying and investing behaviour. There is evidence that socially responsible investing at the retail level has an effect on environmental responsibility, and many say that a high degree of CSR is important to them in their buying decisions. To date, the full extent to which socially responsible consumption and investment is actually occurring is unclear. Moreover, the ultimate contribution of CSR behaviour by corporations towards environmental, social, and economic sustainability is unclear.

### **3. CRA-SUPPORTED FORA ADDRESSING CSR**

The Canada Revenue Agency (CRA) administers income tax, goods and services tax/harmonized sales tax (GST/HST), and other taxes. It is the principal revenue collector in the country, while Canada's Department of Finance is the source of tax policy. The CRA also distributes billions of dollars in tax and non-tax benefit payments to millions of Canadians.

Canada's tax system is based on voluntary compliance and self-assessment, which is both cost effective and minimally intrusive on the privacy and operations of individual Canadians and businesses. In practical terms, this means that taxpayers are expected to register as required under the law, report complete and accurate information to determine their tax liability, file their tax returns on time, and pay any amounts due. However, the different interests of the tax administration and the taxpayer can lead to disagreement in those areas where there is room for interpretation.

Especially relevant to the present topic, in recent years, compliance has captured the attention of the CRA and tax administrations worldwide. The increased availability of aggressive and sophisticated tax planning strategies poses a risk that, left unchecked, could undermine the government's ability to effectively deliver its programs. In fact, aggressive tax planning features prominently in the CRA's inventory of risks to the sustainability of the tax system and, as such, has been the focus of increased resources, research, and compliance efforts.

The CRA believes that in order to continue to achieve excellence in tax administration it must address the root causes of non-compliant behaviour in key high risk segments of the population. This was part of the rationale for the CRA's initial exploration of tax as it relates to CSR, namely, the extent to which Tax as CSR had been adopted as a practice in corporate Canada, and how the concept might be applied to reduce the use of irresponsible tax strategies. The CRA is, like most tax administrations, still in the early stages of explicitly incorporating CSR in its toolkit. Corporations in Canada are at a similarly early point in embracing Tax as CSR, and the effect of the concept on compliance outcomes is, as yet, untested. Nonetheless, we believe it is worthwhile to pursue further the notion that responsible tax practices could contribute to corporate reputations in the same way that CSR issues such as environmental stewardship, sustainable production, and responsible labour practices have in recent years.

Presently, Tax as CSR considerations are a supporting factor in the CRA's holistic approach to corporate compliance. The CRA does not explicitly refer to the term CSR in its contacts and communications with corporate taxpayers, but those channels incorporate the principles of CSR and encourage its application. For example, corporations with a history of open and co-operative relationships with the CRA and who work to address tax management issues in a speedy and professional manner, all other things equal, will be rated more favourably by the administration's corporate risk-rating models. This is consistent with treating CSR as a corporation's way of doing business in all spheres including tax, rather than just as a label to market specific activities or philanthropy. Viewed another way, programs are designed such that corporations who exhibit the substance of Tax as CSR are recognized, whether or not they have themselves packaged and branded that behaviour as CSR.

The subsections that follow describe some of the ways that the CRA incorporates CSR dialogue fora into its relationship with corporate taxpayers outside of the routine contact that it has with them during the regular compliance and audit processes.

### **Ministerial and Senior Management Speeches**

Canada's Minister of National Revenue is the principal spokesperson for the CRA, while the Commissioner leads and is responsible for the overall management of communications, as well as its integration with other key functions at the CRA, particularly policy and program development and management.

Whether as a dedicated topic for discussion, or as a point that rounds out the discussion of other taxation issues, senior CRA officials frequently use their speaking engagements as a platform to raise awareness that corporations have more than just a legal responsibility to pay a fair share of taxes. For example, consider this excerpt from Former Minister of Revenue Gordon O'Connor to the Tax Executives Institute, which Tax Business magazine refers to as the most influential group of taxpayers in the world:

“If you’re doing business in Canada today, whether you know it or not, you depend on government services. To be profitable in business, you rely on the services that governments provide: good infrastructure to move product to market, a sound education system to draw on for a trained workforce, and health care to ensure that your employees are physically able to do their jobs. Without those basics, we don’t have a well functioning state. So it is with the best interests of our country at heart, that we must all contribute our share.”

### **High Level Dialogue Fora with Business Leaders**

As referred to above, the CRA maintains a two-way dialogue with a number of organizations that have the capacity to influence behavior in the Tax as CSR domain. These fora stand apart from the regular dialogue that the CRA engages in with corporate taxpayers during the course of normal service and compliance throughout the year. These groups are important channels that the CRA uses to engage the corporate community collectively and include:

- Tax Executives Institute;
- Canadian Institute of Chartered Accountants;
- Canadian Banker’s Association;
- Canadian Taxpayers Federation; and
- Canadian Federation of Independent Business.

### **Voluntary Disclosures Program**

The CRA’s successful Voluntary Disclosures Program (VDP) allows taxpayers to come forward and correct inaccurate or incomplete information or to disclose information they have not reported during previous dealings with the CRA, without penalty or prosecution. Disclosures may be made for income tax, sales taxes, as well as export and other charges.



As it relates to CSR, the program allows businesses to come back into a full compliance relationship with the CRA, an obvious first step to any conversation about tax responsibility, but also a chance for them to reconsider their tax management practices. Intake has grown significantly in recent years, particularly with regard to the use of offshore transactions. Filers have become aware of efforts by the CRA and its international partners to address offshore and other unreported income and assets, partly as a result of domestic media attention on EBay powersellers and the whistleblowing at some financial institutions.

### **Advocating Responsible Citizenship**

With the overall long term objective of improving voluntary compliance through an enhanced understanding of responsible citizenship, the CRA began a multi-phase initiative in 2008 to take stock of its existing responsible citizenship activities, explore what other tax administrations do, and identify partnership opportunities to engage additional government departments. Although the responsible citizenship concept is focussed on individuals, the CRA believes that individual citizenship and corporate citizenship are two sides of the same coin, and as a result, there is an overlap in work being performed in support of these two concepts. In fact, the opportunity to better calibrate this messaging and outreach to achieve maximum effect is expected to be a fruitful area for future work.

## **4. CRA'S APPROACH TO LARGE BUSINESS COMPLIANCE**

Perhaps the most important opportunities for the discussion and facilitation of responsible approaches to taxation occur during the regular meetings that the CRA holds with each corporate tax filer.

The CRA negotiates audit protocol agreements in an effort to introduce greater co-operation, openness, and flexibility into the audit of corporations. Although not a legal document, a protocol, developed jointly between a corporation and the CRA, represented a mutually agreeable framework that established the guidelines for the audit process and the taxpayer-tax administration relationship. The idea is based on a set of principles that were developed out of a consultation process with the corporate community.

However, in recent years the CRA felt the need to further advance this approach in order to more effectively address avoidance transactions that may play out over a number of years. Such issues

include transfer pricing, reorganization, financing arrangements, and use of derivatives and hybrid instruments. The objective is to achieve openness and reciprocity in the relationship between the taxpayer and tax administration.

The CRA is now in the process of adopting a new approach to large business compliance, to be phased in over several years. It will strengthen the International and Large Business Directorate's risk assessment process, enhance its interaction with large business taxpayers and tax intermediaries, and improve the use of resources directed at large business compliance. One of the main objectives is to optimize the use of compliance resources, but there are a number of derivative benefits, including a lower compliance burden for corporations who behave transparently and demonstrate a history of responsibly managing their tax affairs. Lessons learned from the CRA's experience with negotiated audit protocols helped to inform the new approach to large business compliance, which is the basis for the CRA's regular compliance contact with corporations, and is a key forum for the mutual transmission of expectations. The demonstration of responsible corporate policies and behaviour is emphasized as an important precursor to a healthy working relationship.

On the basis of a wide variety of measures, which include historical information and past relationships along with more recognizable metrics, the population of corporations will be segmented using three categories of risk: low, medium, and high. Risk assessments will be done annually, and reclassification to a lower level of risk will require the corporation to change risk issues and behaviours, thereby demonstrating openness, cooperation and trustworthiness to the CRA. Developing a full evaluation of all members of the population, though, will be a multi-year process. In relation to CSR and taxation, the benefits, too, will perhaps be most evident when surveyed from the long view.

As CSR is a way of doing business, rather than a checklist of activities, the risk-rating formula that the CRA employs not only takes into account the *existence* of certain types of transactions, business partners, and sector-specific risks, it also takes into account more qualitative attributes that give insight as to the ability and positioning of a corporation to manage those risks responsibly. The CRA will assess a range of corporate governance principles related to tax decision-making and will discuss them with the taxpayer to ensure that all tax risks are properly identified and addressed on a timely basis. For example:

- Is there a sound framework to manage tax risks and comply with tax obligations?
- Is there a strong in-house tax capability?
- Are tax positions determined inside or outside the business?
- Are significant tax risks elevated to decision makers such as the Chief Financial Officer, Chief Executive Officer, the Board or its Audit Committee?
- Are there appropriate review and sign off procedures for material transactions?
- Is there an effective tax risk mitigation capability including the corporation's relationship with the applicable tax jurisdictions?
- Is there capacity to regularly evaluate the effectiveness of tax governance systems?

Face-to face meetings are an important opportunity for dialogue between the CRA and corporate taxpayers, and are held regardless of taxpayer risk categorization. As mentioned earlier, the existence of particular risks and the taxpayer's tax management are discussed, and that discussion is a vehicle for the transmission of CRA concerns. The opportunity is also provided for feedback to be given to the CRA. As each meeting concludes, the corporation should have a clear understanding of the CRA's approach to large business compliance, and the CRA should have a clear understanding of how the taxpayer's business operates. In particular, the CRA should understand how tax issues are handled, who is responsible for handling them, whether a formal risk committee exists, and so on. Among the important objectives of the meeting are to:

- Inform the taxpayer of the correlation between the risk issues identified and the planned compliance approach;
- Heighten the CRA's awareness of any issues that may impact on current or future risk assessments; and
- Heighten the CRA's awareness of any items expected to impede compliance from either a legislative standpoint or a responsible tax management standpoint.

Each corporation will be assigned a Large File Case Manager who will play a liaison role between the corporate taxpayer and the section managers and tax specialists of the International and Large Business Directorate at the CRA. This role is important because it gives the corporation a single point of contact with whom to discuss concerns and to whom additional information can be given if it is expected to have an impact on risk classification in subsequent years. This relationship is valuable because it provides continuity for both the corporation and the CRA, and facilitates long term cooperation. The Large File Case

Manager can also receive input from the corporation as to legislation and other changes that could be beneficial, where there are issues impacting on the corporation's ability to comply.

As mentioned previously, CRA literature, including planned material laying out the CRA approach to large business compliance does not mention CSR as such. Yet, CSR in the tax realm is clearly supported by these policies, because responsible tax management and a co-operative stance towards the tax administration are synonymous with businesses treating taxation as a CSR priority.

## **5. NEXT STEPS AND CONCLUSION**

At this time, the CRA's policies are well placed to benefit from interest in CSR as it relates to taxation. Whether or not taxation as a CSR issue attains widespread and substantive adoption depends largely on the willingness of all corporate stakeholders to lever their influence. Although the CRA believes that tax as a CSR concern has viability, the significant costs and time horizons inherent to altering social responsibility norms mean that the CRA's policies will not be the primary driver behind its adoption.

Of particular note in this case study is the emphasis the CRA has placed on encouraging changes in behaviour. This can be seen in its interactions with corporate stakeholders and its new approach to large business compliance. It is therefore the CRA's assertion that measures rewarding change have merit for use alongside of, or arguably in preference to, those employing sanctions when encouraging changes in corporate taxpayer behaviour.

As global cooperation has come to put considerable pressure on tax havens and aggressive tax planning, similar cooperation could be brought to bear on the responsible tax front. Eventually, as the concept gathers more momentum, standards like the International Accounting Standards Board or the voluntary Global Reporting Initiative could incorporate responsible tax metrics among their standards and key performance indicators. Ultimately, perhaps the most prudent path that a tax administration might take at this time is to have strategies and approaches that reward responsible tax planning and embed messaging about tax responsibility in existing channels of outreach and communication, rather than divert significant scarce resources to engineer public attitudes on the matter.

## **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/km<sup>2</sup>, it is one of the least densely inhabited, yet one of the most highly developed 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 2009-2010, the CRA collected more than \$358 billion in taxes and other revenues, and issued over \$17 billion in benefit payments to millions of families and individuals.

Revenues come from three key sources: 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 approximately 44,000 employees across Canada, including 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 38 Tax Services Offices (TSOs), six Tax Centres (TCs), one 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.

## **CREATING TAXPAYER AWARENESS: CORPORATE SOCIAL RESPONSIBILITY AND THE FORUMS FOR TAXPAYER- TAX ADMINISTRATION DIALOGUE**

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***Contents:** Introduction – 1. Corporate social responsibility and corporate governance – 1.1 Question: % completely and mostly agree – 1.2 Statement: % Very and somewhat important – 1.3 Factor: % Great deal or somewhat – 2. Crossroads: Is there room for mutual interests and common ground? – 3. Forums for taxpayer - tax administrator dialogue – 4. Conclusion*

### **INTRODUCTION**

The challenge of tax administration of global companies has increased significantly over the recent years. Opportunities for change are increasingly abundant. Responsibilities and expectations of the tax authorities are heightened.

For companies operating in a global environment, the challenges of managing tax risk and controversy are tremendous. The rules and relationships are complex; the stakes are high.

There are several key factors that are driving change in the global tax controversy and risk management landscape: the accelerating pace of globalization, the shifting economy, the rapid succession of legislative and regulatory changes, and the changing model of tax administration.

Around the world, companies have been striving to achieve success in an increasingly competitive global marketplace, even as they address the challenges or economic turmoil.

Shifting flows of capital have re-balanced economic influence from west to east, giving rise to a new global economics. Companies around the world have had to re-frame their decision-making processes and look to emerging markets in their efforts to grow and become more efficient.



For each change that businesses have had to make, governments have had to consider how to react. They have adapted their tax policies and adjusted their administrative approach to more effectively compete for international business and investment while collecting the revenue they need to address growing deficits and increased spending needs. Tax administrators today face significant challenges in understanding the complexities of new business structures and transactions, as well as the dynamics created by an expanding global footprint for people and businesses. Governments are looking to their tax administrators to rise to these challenges and deliver fair tax administration to very complex global businesses in a time of significant change. In doing so, they are attempting to create more efficient dispute resolution tools; refining their risk assessment models; sharing and collaborating more; and focusing on enforcement as a way to make sure they collect the amount of taxes they consider are due.

The result: complexity, uncertainty and, increasingly, controversy. This is the reality that businesses and tax administrators face. The financial and reputational risks of ignoring new global realities have never been greater for corporations. The opportunities for tax authorities to approach tax administration of large global businesses, efficiently and effectively are abundant. Many tax administrations are adopting more business-like and cost-effective approaches to improve compliance through both service and enforcement. Though countries around the world are at differing stages in their development of new policies, procedures and tools, one thing is clear. They are communicating more and seeking ways to leverage one another's experience in the global tax community to improve tax administration in their own country.

The topic for discussion raised for this forum relate to this issue of corporate social responsibility and the forums for taxpayer-tax administration dialogue. The concept of corporate responsibility and governance and the importance of a dialogue between the tax administrator and its stakeholders to achieve compliance and mutual interests will be discussed.

## **1. CORPORATE SOCIAL RESPONSIBILITY AND CORPORATE GOVERNANCE**

“Corporate social responsibility” is a concept of “corporate self regulation incorporated into business model.” It is also sometimes called, “corporate conscience, corporate citizenship, social performance, and sustainable responsible business.” There has been some debate over whether it is the corporation who has the conscience or its leadership

who help set the tone and its culture. Typically, the term “corporate social responsibility” is spoken in relation to the environment, its ethical operations, the community, to its employees and to its stakeholders. Whether or not there it is specifically stated that corporations should “pay their fair share” of taxes in its statement of corporate social responsibility, there is an indirect link.

It is noteworthy that in the United States, a tax system that is reliant on voluntary compliance, the compliance levels of individuals is the highest of other segments. While it is certain that the information reporting and withholding has a significant impact on the level of compliance, the attitude of taxpayers has an impact on their willingness to comply.

The IRS Oversight Board, in its 2010 Taxpayer Attitude Survey showed the following results.

When asked, “How much, if any, do you think is an acceptable amount to cheat on your income taxes?” The responses were:

A little here and there	8%
As much as possible	4%
Not at all	87%
DK/NA/NR	2%

For the following statements, respondents were asked about their level of agreement or disagreement, with the following five choices:

- Completely agree
- Mostly agree
- Mostly disagree
- Completely disagree
- DK/NA/NR

**1.1. Question: % completely and mostly agree**

It is every American’s civic duty to pay their fair share of taxes	69 + 28 = 97
Everyone who cheats on their taxes should be held accountable	69 + 27 = 96
It is everyone’s personal responsibility to report anyone who cheats on their taxes	30 + 32 = 62
Taxpayers should just have to pay what they feel is a fair amount	10 + 17 = 27
The more information and guidance the IRS provides, the more likely people are to correctly file their returns	45 + 40 = 85

For the following statements, respondents were asked how important it is “that the IRS does each of the following to ensure that all taxpayers honestly pay what they owe?” with the following five choices:

- Very important
- Somewhat important
- Not very important
- Not at all important
- DK/NA/NR

**1.2. Statement: % Very and somewhat important**

Ensures low-income taxpayers are reporting and paying their taxes honestly	69 + 24 = 93
Ensures small businesses are reporting and paying their taxes honestly	73 + 22 = 95
Ensures high-income taxpayers are reporting and paying their taxes honestly	78 + 17 = 95
Ensures corporations are reporting and paying their taxes honestly	85 + 13 = 98

When asked “How much influence does each of the following factors have on whether you report and pay your taxes honestly?” with the following five choices:

- Great deal of influence
- Somewhat of an influence
- Very little influence
- Not at all an influence
- DK/NA/NR

**1.3. Factor: % Great deal or somewhat**

Fear of an audit	35 + 29 = 64
Belief that your neighbors are reporting and paying honestly	21 + 23 = 44
Third parties reporting your income to the IRS	39 + 27 = 66
Your personal integrity	80 + 12 = 92

One might draw some conclusions from the following statements that:

- Individuals feel that it is their civic duty to pay their fair share of taxes
- Those who cheat on their taxes should be held accountable

- Tax administrators should be ensuring that corporations are reporting and paying their taxes honestly
- Integrity is a key factor in compliance with tax laws

What would be the public perception of a corporation that did not pay their “fair share”? Corporations are paying increased attention to issues that might have an impact on financial and reputational risk. Tax controversy poses one of those risks. Beyond the costs associated with tax controversies, the corresponding financial impact can be significant. A sizeable adjustment stemming from an audit could lead to millions of dollars in additional taxes. Add in potential fines and a single tax controversy can cause financial restatements, reduce future dividends or even cause the sale of an asset to pay the additional assessment.

Along with these financial risks come considerable reputational risks. Over the past several years, the press has taken a much keener interest in tax issues, with an emphasis on real or perceived corporate abuses. Media attention is often magnified by industry watchdogs and other stakeholder groups, which can expand a single event into ongoing scrutiny that can affect shareholder confidence and, ultimately, share price. Thus, the importance of risk management strategies and achieving certainty with the tax authorities to minimize or avoid controversy becomes increasingly important to a company and its leadership as a part of its overall responsibility.

Corporate governance, both from external sources as well as internal sources are focusing on tax risk management as a part of overall enterprise risk management that is addressed by company leadership, boards of directors, internal and external auditors and regulatory agencies. In the United States, the recent years have brought an increased focus on financial and tax risk. With the financial accounting scandals of the recent past, came the Sarbanes Oxley Act, followed by FIN 48 for the accounting for uncertain tax positions and the increased transparency and disclosure. The recent US requirement to disclose uncertain tax positions is yet another risk management tool for the tax administrator to bring a focus on areas of uncertainty. Recognizing that “uncertainty” related to tax positions can be driven by several factors, including the lack of clear guidance, complexity of the law or where there is a range of acceptable answers, it need for processes to resolve or avoid disputes with the tax authorities becomes increasingly important.

Tax authorities around the world have made significant efforts to elevate tax risk as a corporate governance issue. The goal of many is

to put tax planning on the boardroom agenda as a social responsibility issue, thereby encouraging a more cautious and prudent approach. Several heads of tax administrations, including in the UK, Australia, the Netherlands and the United States have commented on the need for increased accountability by the board and the “C-suite” on issues related to tax risk, whether to ensure an appropriate framework for tax risk management, or to review specific transactions that might present risk to the company. The OECD Forum on Tax Administration released an information note in July, 2009 entitled, “General Administrative Principles: Corporate governance and tax risk management,” to reinforce the belief that tax administrations have a vital role to play in ensuring that corporate boards understand that they are ultimately responsible for the business’s tax strategies and outcomes. The note looks at the experiences of three countries, Australia, Canada and Chile, in encouraging good corporate governance and enhancing relationships with large business.

## **2. CROSSROADS: IS THERE ROOM FOR MUTUAL INTERESTS AND COMMON GROUND?**

As the tax administrators have the responsibility to administer the tax laws of their countries, they must do it in a way that is efficient and effective. Collecting the proper amount of tax due and dealing with the tax gap requires a multifaceted approach. For large global companies, the tax laws and cross border implications present additional complexities that lend themselves to increased uncertainty and risk, for the taxpayer as well as the tax administrator. If tax administrators are to be efficient and effective, they must be able to use scarce resources appropriately, making distinctions between taxpayers who want to comply and those who make conscious decisions not to comply. Many of the processes afforded to taxpayers to resolve disputes or achieve certainty require a relationship of collaboration and increased transparency and disclosure.

Tax administrations in different countries have evolving models for compliance assurance of large enterprises. Some are dealing with issues of integrity and internal controls and the basic infrastructure and needs to approach this segment of taxpayers. Others are more mature in their model to address service and enforcement approaches for global companies.

Companies with expanding global footprints make business decisions that consider but are not necessarily driven by the tax administration processes in those countries. However, they do have increasing expectations and interests that the tax administrator provide an

opportunity for a fair and objective hearing of tax disputes and that there will be opportunities to resolve those disputes administratively, or even before a return is filed.

Regardless of the challenges faced by taxpayers and tax authorities, with the constant change that is required to keep pace with the changing business models, behaviors and compliance treatments for large corporations, creating forums for taxpayer-tax administrator dialogue has significant benefits and if done with proper protocols, little risk.

### **3. FORUMS FOR TAXPAYER – TAX ADMINISTRATOR DIALOGUE**

The United States Internal Revenue Service has embraced the concept of stakeholder relationship management for years. Following the restructuring of the IRS along taxpayer segments, the focus on “understanding the customer” strengthened. Various groups and approaches were used to seek the perspective of the public to be served as new processes, initiatives and approaches to compliance were formulated. Four overall goals of the Stakeholder Relationship Management (SRM) strategy:

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

The dialogue to improve tax administration through the balance of service and enforcement can take many forms. The protocols to ensure appropriate access and influence are in place through public law and internal procedures.

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

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

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

With regards to large corporations, the IRS has an advisory council (IRSAC) with a subgroup focusing on issues related to that segment, advising the Large Business and International division commissioner. There is also an Information Reporting Program Advisory Committee (IRPAC) and an Electronic Tax Administration Advisory Committee (ETACC) which are covered in this category. The IRS Commissioner and his leadership team are actively engaged with these groups and personally committed to ensure that their purpose is achieved.

There are other key stakeholder groups of large corporate taxpayers and their service providers whose input is actively sought to improve tax administration through an enhanced understanding such things as of the implications of new processes, need for guidance, ways to improve compliance with reduced burden, the practical implementation of strategic initiatives and leadership direction and the changing business models and transactions that have tax implications. Engaging in a dialogue with these taxpayer and their intermediaries can also provide the leaders of the tax administration to hear directly from taxpayers as well as send key messages that are important for the segment to hear. Examples of key stakeholder groups include the Tax Executives Institute (TEI), American Bar Association (ABA), American Institute of Certified Public Accountants (AICPA), Organization for Foreign Investment (OFII), and industry groups. Tax authorities can learn about specific taxpayer problems and concerns from these groups that can provide a "taxpayer's point of view". Such an approach is very much in keeping with a guiding principle of "understanding and solving problems from the taxpayer's perspective" and "walking in their shoes".

The OECD Tax Intermediaries addressed the role of the relationship among tax authority, taxpayer and the intermediary. "The key issue was the recognition of the mutual benefits to all parties from revenue bodies using modern risk-management concepts. In turn, to underpin the risk management approach, two further essential elements were noted: (a) an enhanced relationship between revenue bodies, taxpayers and tax intermediaries, and (b) the use of effective operational tools and techniques." The message in the study was that mutual interests can be met if taxpayers are transparent and collaborative, with timely disclosures.

Taxpayers wanted to have tax matters resolved quickly, quietly, fairly and with finality. The five things that the study team's consultation has suggested revenue bodies need to demonstrate in order to give taxpayers the incentive to engage in the enhanced relationship are:

- Commercial awareness
- An impartial approach
- Proportionality
- Disclosure and transparency
- Responsiveness

The concept of seeking a business perspective is embraced, not only for tax authorities and taxpayers, but in its own operations as a global forum for tax policy and administration by recognizing the Business and Industry Advisory Committee to the OECD (BIAC). The BIAC is an independent international business association devoted to advising government policymakers at the OECD and related fora on the many diversified issues of globalization and the world economy. Officially recognized in 1962 as being representative of the OECD business community, BIAC promotes the interests of business by engaging, understanding and advising policy makers on a broad range of issues with the overarching objectives of:

- Positively influencing the direction of OECD policy initiatives;
- Ensuring business and industry needs are adequately addressed in OECD policy decision instruments, which influence national legislation;
- Providing members with timely information on OECD policies and their implications for business and industry.

This group also serves to provide input to the OECD on specific issues and have working groups to focus on those collaboratively.

#### **4. CONCLUSION**

In times of unprecedented change for business and tax authorities, the dialogue between taxpayer and tax authority becomes even more essential. As corporate governance and regulatory requirements over large businesses are strengthened, the desire for proactive tax risk management becomes a business imperative. More companies are seeking to build collaborative relationships with the tax authorities to resolve disputes but also to be a positive influence on effective and efficient tax administration.



The public can best be served when they know that they have a voice. The tax administration is the owner of the tax administration processes and has the clear authority and responsibility to embrace or disregard the input of the stakeholder. Establishing a forum for the dialogue, seeking and valuing input, can reap significant benefits in establishing and improving practices for efficiency and effectiveness. Creating a culture that values the external stakeholder input and manages it appropriately assist with today's challenges and prepare for the future.

**TOPIC 3**

**TAX MORALE AS A TOOL FOR PROMOTING  
VOLUNTARY COMPLIANCE. SUCCESS STORIES IN  
THE TAX ADMINISTRATIONS**



## THE DEVELOPMENT AND STRENGTHENING OF THE TAX CITIZENSHIP CONCEPT: THE TAX EDUCATION PROGRAMS

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*Contents: Summary – 1. General framework – 2. Background – 3. Current management – 3.1 Recommendations carried out – 3.2 Establishment of a strategy for training teachers in order to reinforce their knowledge in this field – 3.3 Recommendations pending compliance – 4. National tax education program – 5. Structure of the national tax education program – 6. Dissemination of the activities – 7. Recommendations – 8. Conclusion*

### SUMMARY

In the past eight years, the General Directorate of Taxation (DGT) of Costa Rica has undertaken to develop the Tax Education concept as an innovative process, in order to create awareness among citizens of the social function of taxes. Little by little, one has found out and learned why it is more important to convince rather than apply coercive actions. A convinced citizen is a citizen involved in the payment of taxes and in taking care of public properties. UNESCO (1996) defines culture as “the way of living together, which moulds our thoughts, our images and our values”. Citizen culture is thus, if not the sole factor, one of the most important ones in the development of a country.

Fiscal civics is a broad concept that involves not only the passive attitude of complying with the right to vote, with the payment of taxes, but rather goes beyond in the sense that each citizen must be responsible for the public property that has been assigned to him, or of which he makes use in his social environment; that they be watchful so as to ensure that public revenues be invested in the items for which they were established. If one manages to achieve a fiscally committed citizen, the Government will have to invest ever less in those expenditures that are currently originated as a result of serious

problems in citizen behavior and may do more by way of infrastructure, education and health.

The DGT initiated its actions in the field of Tax Education in 2001 when a multimedia game called “Tribuchicos” was developed. Nevertheless, this first attempt failed, since it was developed without the coordination of the Ministry of Education (MEP), and the latter considered that the game involved problems with the historical background and gender. Later on, in 2003, other attempts were made which likewise turned out to be fruitless, inasmuch as in spite of the good intentions, they lacked a structured program to support them and to somehow achieve the MEP’s trust in order to be able to start working jointly. All of these tasks were carried out by the former Deputy Directorate of Taxpayer Service.

Along this same line, an important initial step was taken in 2009. A working group was established, exclusively devoted to Tax Education activities, while technical and financial support is requested from EUROsociALFiscalidad. Such fundamental support allowed for providing the working group the necessary resources for what would become later on the National Tax Education Program. The National Plan for Preventing and Fighting Against Tax Fraud was approved that same year with one of its components, Tax Education and Culture, becoming, through time, one of the fundamental mechanisms for preventing tax evasion and fraud. The plan allows for setting up a series of fundamental pillars that will lay the groundworks for the establishment of structured Tax Education in our country. The objective pursued was to strengthen the citizens’ tax awareness, to which end it was not only necessary to undertake Tax Education programs, but in addition another of its components; namely taxpayer service was established in order to count on institutional communication measures to favor voluntary compliance and taxpayer service to dissuade fraud behaviors.

Thus on the one side education is provided and, on the other, voluntary compliance is facilitated.

In 2010, following a reform of the General Directorate of Taxation’s structure, the former Deputy Directorate of Taxpayer Service became a directorate, thus counting on four deputy directorates and as part thereof, the Deputy Directorate of Tax Education was created, thus taking a first step that support Tax Education in Costa Rica, since there is already a duly structured working group, exclusively devoted to follow up actions in the field. In June of that same year, the National Tax Education Program was approved, within the framework of the

conclusion of the Project carried out withEUROsociAL, which closed with the inauguration of a tax games room at the Children's Museum.

## 1. GENERAL FRAMEWORK

In developing this paper, consideration has been given to historical aspects that have supported public education in our country, as well as to all those elements which originated initial actions in Tax Education and those which subsequently contributed to currently making this a reality, within a duly structured framework. All the information on education programs established by the Ministry of Education which cover most of the issues dealing with civics, and the programs developed by the Ministry of Finance in the field of Tax Education, outside and within our institution have been taken into account.

## 2. BACKGROUND

On December 1<sup>st</sup>, 1948, Costa Rica decided to abolish the army and up to this date, our country is proudly identified at the international level, as the country with the army of teachers. Through a constitutional reform approved in 1997, it was determined that the national education budget could not be less than 6% of the GDP<sup>1</sup>. At present, according to figure provided by the Ministry of Finance, the goal constitutionally established has been achieved and exceeded, since the education budget represents 7% of GDP. The fact, in turn, of not having to invest in a military army, further facilitates the investment made in the field of education. According to the State of the Nation, in 2009 Costa Rica had a total of 4, 509,290 inhabitants, of which 67,933 were teachers and 1.220,378 students, among preschool, elementary and high school. With the previous data and based on such important concepts as that which states that culture is developed, the ground in our country is fertile for considering that the establishment of a strong tax culture may lead to committed tax citizenship; something which can be hoped for and the reason why all the work undertaken firmly makes sense.

The General Directorate of Taxation undertook its first actions in the field of Tax Education in 2001 when a multimedia game called "Tribuchicos" was developed. Nevertheless, this first attempt failed, since it was developed without the coordination of the Ministry of Education (MEP), and the latter considered that the game involved problems with the historical background and gender. It was in early 2003, when the first activities framed within the field of Tax Education were undertaken and work began in schools and colleges; there was

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<sup>1</sup> IDB and Banco Mundial. Costa Rica, report on public expenditure "Toward greater efficiency in expenditure", page 38, 2009

an ever greater rapprochement of the DGT with the communities of the country, in order that the citizens may understand what we do and why, always within a framework that may allow us to establish that it is a fundamental issue for maintaining our society. All of these activities were established in accordance with the taxpayer service functions in the operational areas, while at the normative level, the guidelines originated from the Deputy Directorate of Taxpayer Service.

The work involved the development of educational material together with the National Didactics Center, a dependency of the Ministry of Education. This constituted the first rapprochement with the education governing entity; however, it did not go any further. Later on, this material would serve to support the activities to be undertaken and the initial steps were some processes for training teachers. Since there was no knowledge and the necessary tools for making that activity something interesting that would pervade throughout the minds of students and teachers, it was quite difficult to achieve the objective, since we were approaching them as tax experts and not with concepts that could be clearly understood by them. Little by little we came to realize that we could not undertake such an important task without counting on strategic allies and one of them, perhaps the most important being, the Ministry of Education. Thus several attempts were made at working jointly with said institution, but in the same way and in spite of the same interest, our proposals did not turn out to be very interesting either, perhaps because we did not yet count on a specific program that would guarantee that our proposal would be sustained through time.

In early 2009, a working group on Tax Education was established and technical and financial support was requested from EUROsociAL Fiscalidad. Such support constituted an essential contribution, given that the establishment of the Tax Education area not only involved the appointment of a group of officials for said function. Since the subject was new and innovative, the preparation and knowledge of the staff in charge were essential elements.

This was achieved through the exchange of experiences with countries like Argentina which was ten years ahead of us in the field and which had based its training in Tax Education on such fundamental concepts as values and citizenship, which could be easily understood by our groups of interest, and El Salvador which had recently carried out a project similar to ours with EUROsociAL and had begun its Tax Education Program. This allowed our officials to expand their view and to know that there were already innovative proposals that, to a great extent, facilitated the work. With the support of EUROsociAL,

didactical materials were prepared, specifically a didactical guide for elementary school as well as the development of two multimedia games, whereby children may learn about public properties and what is a tax return. A web page on Tax Education was developed, which includes the didactical guide, interactive games, as well as all that information of interest, such as dates on which lectures will be conducted and activities carried out, etc. An internal training program for the ministry of Finance's staff was also developed. Its purpose is to establish a sense of belonging to the institution and to create greater awareness of the importance of the work carried out by the institution to which they belong. A games room was built in the Children's Museum, whereby the kids may learn in a simple and amusing manner the purpose of taxes. Also pedagogic partners were established; formed by a MEP teacher and an official from the Ministry of Finance, duly trained by Argentine experts, which have assisted in the subsequent training of teachers. Also, closer relationships are being established with the Ministry of Education.

In February of last year, the National Plan for Preventing and Fighting against Tax Fraud was approved. One of its components was Tax Education and Culture. To that end, an inter-institutional working group was established for the purpose of determining a Tax Education strategy. This resulted in a series of recommendations that originated the National Tax Education Program, as described below:

Issuance of an executive decree that may integrate the State's institutions and public and private organizations, which by the nature of their competencies are related to Tax Education, in a national plan for strengthening the values that reinforce the tax culture. Also proposed is the issuance of a decree providing for the establishment of policies for the integration with the Ministry of Finance, of institutions in the educational as well as other sectors, in addition to public and private organizations.

Preparation of a National Tax Education Program that may count on the human resources required for such purpose.

Include the Tax Education issue within the organizational structures of the departments of the Ministry of Finance.

Establish a strategy for the training of teachers, in such a way as to reinforce their knowledge in this field.

Establish agreements with public and private universities to include this subject gradually in the university curriculum, in addition to a



cooperation plan between the Ministry of Finance and the universities to facilitate the necessary agreements for including greater training in tax culture as part of the professional profile..

An important step was taken at the institutional level in 2010, since by means of a reform to the structure of the General Directorate of Taxation through Executive Decree N° 35688-H, the Directorate of Taxpayer Service was created, with the Deputy Directorate of Tax Education as part of it.

### **3. CURRENT MANAGEMENT**

All of the elements described in the background information currently allow us to count on a well structured program in Tax Education. However, before referring to the program as such, it is important to go over the recommendations originating from the Plan for Preventing and Fighting against Tax Fraud, to determine which ones have been complied with up till now and which are pending compliance.

#### **3.1 Recommendations carried out:**

Include the Tax Education issue in the organizational structures of the departments of the Ministry of Finance.

In this respect it may be said that to date, the establishment of the Deputy Directorate of Tax Education of the General Directorate of Taxation, through Executive Decree N° 35688-H, is a necessary and important step which has allowed for developing and sustaining a Tax Education Program. The following were determined as functions of this deputy directorate in article 25 of the aforementioned decree:

Develop and implement a National Tax Education Plan, which may promote citizen awareness capable of voluntarily complying with the tax obligations.

- Establish the necessary coordination processes with the different education entities for the development of a national Tax Education strategy.
- Promote and disseminate within and outside the Tax Administration, the Tax Education program and actions required for executing it.
- Design and modify the documents for disseminating the Tax Education program.
- Undertake actions for conducting induction courses for teachers, taxpayers and citizens in general, that may allow the follow up of the

institutional objectives as regards Tax Education, in coordination with the Finance Research and Training Center.

- Carry out the necessary coordination processes with the Ministry of Public Education, for the review and treatment of the curricular contents of Tax Education.

Gradually, the rest of the dependencies of the Ministry of Finance have been involving themselves; among which we may mention the General Directorate of Customs, which has actively participated in Tax Education in schools and colleges. However, since this directorate and the DGT are separated, Customs does not yet have a structured program. With respect to the other entities, the DGT has established several coordination processes for the purpose of obtaining information that may improve the Tax Education concepts and little by little their officials have been involved in the Fathers and Mothers of the Finance Ministry go to school Program.

### **3.2 Establishment of a strategy for training teachers in order to reinforce their knowledge in this field.**

The school year in our country consists of 200 days, for which there is currently a plan called “200 Plan”, whereby teachers are trained in different fields and as part of the cooperation process between our institution and MEP the Tax Education concepts have been taught to the educators. Such training has been possible as a result of the establishment of the didactical partners and the training of officials of the Deputy Directorate of Tax Education, since they are the ones carrying out this task. The change in concepts previously used in the teachers’ training process, has allowed a 360 degree shift in this experience, The apathy and lack of interest on the subject by teachers in the past, since they only heard about taxes, has turned into great enthusiasm on their part, on being able to replicate in their classrooms what they have learned, to teach their students the concepts that in the future will help them become citizens aware of the social sense of taxes and public expenditure and the welfare this implies for our country. Although at present, only 90 teachers have been trained, it is clear that those whom we have trained are totally convince that the issue is of great personal and national interest and thus we understand that it is preferable to sacrifice quantity for quality. In this regard, we intend to train groups of teachers by region. Since our country has a total of 27 regional educational directorates, we have only been able to reach one region.

Likewise, another aspect of interest is that the Tax Education courses be recognized by the Civil Service (entity responsible for human resources management in Public Administration), in such a way as to create greater interest among teachers in taking said courses..

### **3.3 Recommendations pending compliance:**

Although there has been significant progress, the following recommendations are still pending compliance:

Issuance of an executive decree integrating the State institutions and public and private organizations which because of the nature of their competencies are related to Tax Education, in a national plan for strengthening the values that reinforce the tax culture. This is necessary, inasmuch as Tax Education should become a policy of the State, since the latter is responsible for ensuring the people's welfare and it does, so based on the constitutional mandate that all Costa Ricans should contribute to public expenditures. In this context, Tax Education understood as a State policy should endeavor to ensure that citizens participate and be aware of their rights and obligations. This policy corresponds to a teaching-learning process based on the three axes that comprise Tax Education:

- Development of Values
- Structuring of Citizenship
- Tax Culture

Although draft decrees pursuing this objective have been prepared, the issuance of the decree as such has not been materialized. In order to fulfill this desire, political sectors of the country and especially the government must necessarily be convinced, since only thus the sphere of action of Tax Education may go beyond what has been achieved up till now.

Issuance of a decree providing for the establishment of integration policies of the institutions in the educational as well as other sectors, as well as public and private organizations with the Ministry of Finance. This recommendation will be fulfilled when there is consensus on the part of all the entities involved and to that end, Tax Education should have been established as a State policy, so as to ensure the commitment of all sectors involved.

Establish agreements with public and private universities for gradually incorporating this subject within the university curriculum, as well as a cooperation plan between the Ministry of Finance and the Universities

that may facilitate the necessary agreements for ensuring greater training in tax culture, as part of the professional's profile and to promote this subject in all careers. As may be seen further on, this recommendation and the previous one are included within the actions determined in the National Tax Education Program. In order to comply with them, it is initially necessary to fulfill a series of objectives proposed at the level of the program with schools and colleges, to subsequently focus efforts in these fields.

#### 4. NATIONAL TAX EDUCATION PROGRAM

The elaboration of this program has, in turn, facilitated the inclusion of "The development of tax education and culture" within the strategic objectives of the General Directorate of Taxation's Strategic Plan. Thus, the Taxpayer Service Directorate has described a series of duly determined and scheduled activities within its Tactical and Operational Plan. Since the Deputy Directorate of Tax Education is an area under the functional structure of our institution, the general guidelines to be followed in this field by the different regional directorates and, accordingly, by the different tax administrations are issued here. Therefore, the actions should be carried out at the national level. This program covers the training of teachers, officials of the Ministry of Finance, the holding of a tax fair at the national level, the follow up and control of guided tours in the Children's Museum; all of these as operational tasks that may be carried out at the central or regional level and which involve another type of tactical activities, such as the development of a didactical guide for high schools and activities carried out with state universities, as well as other entities such as professional associations, chambers, etc.

The National Tax Education Program is defined by means of two strategies; namely:

**Formal education:** This is understood to be the educational system of each country; that is, the series of teachings that lead to obtaining an official degree, according to the regulations in force. For example, the development of the subject matter relative to tax education in elementary, high school education, etc., of a country, whose grade is averaged with other subjects such as "Mathematics", "Geography", etc., for obtaining the corresponding degree and considered within such subjects as social studies and civics.

To establish a structured education program in the field of formal education, it is necessary to carry out a series of fundamental processes

in order that this may be carried out according to different working strategies. These strategies should involve the following aspects:

- Preparation of didactical material for teachers and students at all levels.
- Continuation of the training plan for teachers of the Ministry of Public Education as well as of the private educational centers.
- Optimize the inclusion and development of tax education within the school curriculum.

**Nonformal education:** Is defined as every information received in an almost nonspecific manner, in nonteaching spheres, which is not graded and has no official implication. For example: many tax education programs consist of advertising campaigns for the youth, stands in fairs, exhibitions, museums; or else in plays, television series, in publications for youth, games and spots in leisure sites or malls, etc. For these strategies to be sound, they must complement the actions of a formal nature. They are very useful and interesting since they encourage freedom and creativity, and contribute to develop on occasions, recreational centers for boys and girls attending, in general with their relatives, friends or varied groups.

The components to be implemented in nonformal education are:

- Promote workshops and guided tours to the Tax Education Room “I pay taxes to my country” of the Children’s Museum.
- Build game areas in the tax administrations of the country.
- Develop a program called “Finances under the Son” which endeavor to carry out playful and physical activities in order to reach children when they are not in school, either during vacation or in different fairs held in the country..
- Promote tax education through the theater and other similar activities.
- Hold contests that promote tax education.
- Production of educational videos on tax education.
- Dissemination of tax issues through advertising campaigns for creating awareness.

“Based on the fact that there are two sides in tax education, “as in every educational process: informative and formative, if citizens are informed about the tax framework and which are the formal obligations of taxpayers, they must also be informed about the sense of such norm and why it is important to correctly comply with those obligations. Said otherwise: along with the “How” of taxes, one must explain the “What for of taxes”. The “What for” of taxes is the essential formative side

of tax education. The key here is in the public budget. One collects to spend and one spends to comply with the common objectives of economic development and social progress that may allow for integrally improving the quality of living conditions of individuals. Otherwise, all the legal and management system would make no sense to the citizens. One only respects what one understands”<sup>2</sup>.

“One should not disregard the fact that even though tax education is especially aimed at the younger citizens, it affects a large proportion of adult citizens. The messages transmitted do not only reach the students, but also all those involved in the education process: professors, parents, educational authorities, etc. Thus, beyond the reluctance which the tax issue may arise (the “How” of taxes), all of them must consider their current situation and future perspectives as regards expenditures of the Public Budget for fulfilling the goals of the National Development Plan. In this way, a significant multiplying effect is achieved.

Thus conceived, tax education is not a mere tactic for greater and better collection. It is rather a strategy for structuring a better society with everyone’s effort.

The State must look after the people’s welfare and does so on the basis of the constitutional mandate that all Costa Ricans must contribute to public expenditures”<sup>3</sup>.

## 5. STRUCTURE OF THE NATIONAL TAX EDUCATION PROGRAM

The program consists of 5 modules, as described below:

**Module 1:** For elementary school. Intended for children in preschool and elementary school (6 to 12 years). Actions that have been carried out up till now are precisely framed within this module, since most of the material developed supports the actions of Tax Education at the elementary school level. These are the didactical guide, multimedia games, the material in the Web Page and the training of teachers, of which a total of 90 have already been trained.

The purpose is to prepare them so that, in turn, they may replicate to their students what they have learned; also the construction of the games room at the Children’s Museum, wherein the children may informally experience the concepts of Tax Education, through a series

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<sup>2</sup> Interview to Maria Luisa Delgado, in charge of the Tax Sociology Area of the Institute of Fiscal Studies of Spain.

<sup>3</sup> Tax Education Project, EUROsociAL- Costa Rica.

of slides that teach them which professions or activities are subject to taxes, how taxes are paid, how they are distributed in a budget, how is the budget invested and, with respect to customs, which items should or should not enter the country. Although the room is open to any child wishing to visit it with his parents, one of the main objectives is the guided visits, whereby the teachers, after having studied the concepts in class, take the students to the museum for reviewing so that they may strengthen the concepts by playing.

In the processes of coordination with MEP it has been determined that the subject matter of Tax Education is considered within the study programs of a subject called Social Studies; which subject is given by every elementary school teacher. Therefore, the focus is on preparing all of these teachers for discussing these topics in their classes from the perspective of Tax Education.

The progress achieved with this first group facilitates, to a great extent, the rapprochement between the DGT and the Ministry of Education. However, since there is not cooperation agreement between both institutions, there is no clear commitment in the actions carried out in this field.

**Module 2:** This one is intended for high school adolescents (13 to 17 years), for considering in greater depth, the topics dealt with in elementary school. Nevertheless, up till now, the DGT has not yet developed the activities of this module, because there is no high school didactical guide and the teachers at this level have not been trained. Within the process of coordination undertaken with MEP officials, it has been determined that the subject matter is widely developed in Civics. With respect to this subject, at present, there is an innovative project called “Ethics, Aesthetics and Citizenship Project” The purpose of the Project is “for youth to develop sensitivity, the necessary skills and abilities to know how to live and coexist with others, facing the various dilemmas arising in daily life. The purpose of this project is to achieve its objective by promoting spaces and activities that may result in greater sensitivity and appropriation of values to know how to select with criterion and freedom, what is considered good, correct or ethically valuable, what they consider beautiful or aesthetically valuable, not as absolute or static categories, but as categories and criteria that are structured at the individual as well as social level, in the very process of development of the identity of youth. These are basic criteria for promoting citizen coexistence centered on the recognition and respect for the other. They are in addition concepts that deal with recovery and the articulation of educational activities linked to enjoyment, at expression, inclusion, tolerance and respect for diversity, sound

competition in sports practices, individual and collective identity, the promotion of democratic leaderships, appropriation and appreciation for participation spaces”<sup>4</sup>. Although it is true that the development of the didactical guide for high school teachers is necessary in order to train them, the project in process by MEP is quite ambitious. Knowing, in turn, that it began with a process for training teachers in this field, it has only been considered necessary that teachers change their approach to the subject and the weight attributed to it within the school curriculum. This is one of the aspects that should be improved and is part of the work being carried out at present. Likewise, the development of the didactical guide is part of the tactical-operational plan of the Deputy Directorate of Tax Education for 2011. It is extremely advantageous that there is a subject in high school that deals with the subject matter and that there are trained teachers in the field.

However, as in the previous item, since there is no cooperation agreement, our action must be limited to coordination meetings, that may allow us to go further with the subject.

An aspect considered important to reach this type of students, is the signing of agreements with universities in such a way that, in order to more effectively reach the youth, it is necessary to develop plays, videos so as to more attractively convey the message and it is at this stage where information education acquires greater relevance.

**Module 3:** Intended for the university sphere. This sphere has likewise not been yet considered. To this end, it will be necessary to enter into agreements with the universities, in order to include as an obligatory graduation requisite, a tax education course that may create awareness among future professionals of the importance of contributing to the country, as well as to involve the youth about to graduate, to participate in tax education by working in the community. Why has this group been considered as the one that should be approached in the third module? Because according to Amartya Sen, *“the ethical values of businessmen and professionals (two key groups in society) are part of the productive assets of said society.*

If businessmen and professionals are in favor of investing in the country, of genuine technological progress, of paying taxes, of share growth, that will be highly positive. If instead, they are in favor of maximizing immediate profit, of taking advantage of every opportunity to corrupt every corruptible public official, of extracting everything possible from the country to send it to a tax haven that is something else. The

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<sup>4</sup> Summary of the Ethics, Aesthetics and Citizenship Project <http://www.mep.go.cr/downloads/RESUMEN%20EEC%20abril%202009.pdf>



situation will be totally different. Therefore, such values are part of the “productive assets” or of the “productive liabilities” of a society”<sup>5</sup>.

As long as this group is not approached and levels of commitment on the part of the university sectors are established, it will be impossible to reduce the levels of evasion that currently exist in the professional and business sectors in our country.

**Module 4:** Intended for public servants as part of a process of developing awareness and commitment to the program and making them feel as being part of a state system that fulfills a series of needs of Costa Rican citizens, although to a great extent, what is pursued is to instill in them a system of values. This group is indeed one of greater interest, since public servants are one of the main assets of the State and therefore, the conduct and ethical behavior which they show are extremely important, inasmuch as they will serve as parameter to society for measuring the state system. The first step taken in this field is the awareness program developed within the Ministry of Finance: “Fathers and Mothers of the Finance Ministry go to school”. Initially, this program endeavors to establish a series of values and within them, the institutional ones and then a sense of belonging to the institution. Until now, a total of 181 officials from the Ministry of Finance have been trained and in addition, we believe there is compliance with what has been established in this module, through the involvement of the different public institutions in the tax culture fairs, where by means of interaction processes, the concept has been expanded with the public officials that have accompanied us in these activities. However, the idea is to expand our sphere of action, to which end it will be necessary to sign agreements with different public entities, which aspect, like module 3, has been considered within our 2011 tactical plan, although it is not a secret that it will take many years.

With respect to the guided actions, in this sense, the staff of our institution has shown great interest in the Fathers and Mothers of the Finance Ministry go to school program, especially in the visits to schools and colleges of our relatives where they talk about the work carried out by the Ministry of Finance. Nevertheless, it has been necessary to emphasize the concept, since one of the main ideas are the ethical value and principles and the social function fulfilled by our institution toward society and they have come to equivocally think that the programs only consist of learning the games to go to the schools.

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<sup>5</sup> SenAmartya and Kliksbeg Bernardo. *Primero la gente*. Ediciones DEUSTO, Barcelona 2007. Page 266

**Module 5:** Society in general, which involves all of the other entities of the country, as well as citizens not considered within the previous modules. This does not cease to be one of the groups of greater interest and again I quote AmartyaSen, who says that “*the predominant ethical values in a society are decisive in what may happen to said society*”. Thus, the behavior and involvement of all actors of our society is essential for its development. Activities for approaching citizens by way of cultural festivals have allowed us to reach the communities which have gradually become aware of our work, inasmuch as a concept that is very common among our citizens is we are merely tax collectors. From there follows the importance of creating awareness among citizens that we must all be responsible and vigilant of the collection of taxes and their investment, and that the problems which our country may currently face, is everyone’s problem and not only that of the State. Only by reaffirming this concept among our citizens, be it the common or political citizen, will it be possible for our country to move forward. For this type of activities, there is a budget that allows the use of every type of material requirements for carrying them out at the national level, and at present, the officials of the Taxpayer Service areas are the ones devoted to their organization. With respect to this activity, although there has been significant progress, we have not yet reached the expected levels, since the purpose is to involve all actors of society, such as taxpayers, professional associations, chambers, unions, etc. To some extent, in the lectures given to these groups as part of the taxpayer service, we have included tax education to begin working in these sectors. Nevertheless, it will be necessary to sign agreements with all these organizations, because otherwise it will be impossible to expand our action framework, since the material and human resources available are not sufficient for reaching all sectors of society.

## **6. DISSEMINATION OF THE ACTIVITIES**

As part of the program’s dissemination activities, every three months a newsletter is issued within the Ministry of Finance for disseminating the activities carried out in all spheres, whether in the training of teachers, of officials of the Ministry of Finance, fairs, meetings, new information in the Web page.

## **7. RECOMMENDATIONS**

The establishment of Tax Education as a State policy must be done as soon as possible, if one wishes this subject to be accepted within the different spheres of our society.

Likewise, one must ensure the commitment of all the sectors involved, such as universities, Ministry of Education, municipalities, public institutions, etc. Only by establishing a commitment will it be possible to achieve the development of Tax Education. Involvement of the universities is urgent, since it is necessary that our future professionals graduate with a different concept as to the importance of contributing to the State. To this end, it will be necessary to begin with students in the education areas because in this way, one will ensure the preparation of future committed teachers, to gradually convey the concept to the other faculties and thus achieve a Tax Education multiplying effect.

It is necessary for Tax Education to be considered in the school curriculum in a more structured manner. If this is achieved, it will be necessary to increase the number of officials currently working in Tax Education activities within the Ministry of Finance, in the functional as well as operational sphere, it being required in this last sphere to exclusively appoint officials for this type of activities, in order to bring to their regions, the activities undertaken in this field.

It is necessary that training courses for teachers be considered within the training system of the Civil Service Directorate, in order that courses given may count on a weighted score that may render them more attractive to the teachers.

It is necessary to initiate an interaction process with the editorial companies that prepare the books currently used in schools and colleges, in order that all the concepts dealing with Tax Education may be expanded and reinforced with tax values, citizenship and culture.

## **8. CONCLUSION**

Although it is true that there have been great achievements in this field up till now; given that at some time it was thought that it would be very difficult to reach the point where we currently are, the path to be followed is very broad, since there is still a long way to go before Tax Education may be considered as one of the main mechanisms for preventing and fighting against tax fraud. Perhaps one of the main reasons is that its effects cannot be seen within short term, but rather, the generations that are currently creating awareness and the different actors involved therein, such as parents, teachers, etc., are the ones that will begin to show a different citizen behavior.

Even though control actions are necessary for evaders to comply with their tax obligations, the idea that culture plays a preponderant role in the development of nations becomes ever more important. Therefore,

there should be greater awareness that Tax Education is a fundamental factor in a country and Costa Rica has sufficient resources, when we look at the sphere of education, to ensure that citizens may be aware and more committed to the needs of the State. Of course, we cannot disregard the economic factor, since it is precisely here, where we create the culture among citizens and make them aware that not everything must be solved by the State. And much like in the case of our families, we must contribute to the great Costa Rican family in order to pay for increasing expenditures, since internal and regional problems force the State to invest resources in ever greater situations that affect our society.

Only by investing in a strong citizen culture may we be able to refrain, in time, from investing in expenditures that are mainly the result of an unconscious citizen culture and to invest more in infrastructure, education, health, etc.. Only thus will our country be able to count on committed citizens, aware of the importance of citizen participation in all spheres, and not merely by voting every four years. In this way, the citizen that fulfills a public function, as well as the one who works in private business, children and youth, will be responsible for the role they play in our society. Only thus will the State be able to breathe freely and recover from so many commitments currently faced, because its citizens have learned that they must also contribute to sustain the society wherein they live. If we consider the good things about our democratic system, the health, education and recreational services, etc., we must all struggle together for the welfare of our country.



**THE DEVELOPMENT AND STRENGTHENING OF THE TAX  
CITIZENSHIP  
CONCEPT: THE TAX EDUCATION PROGRAMS**

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***Contents:** 1. Tax education or tax culture programs in Latin America and their contribution to the tax citizenry focus – a. The agents of change – b. The contents – c. Tax citizenry – d. The future challenge – 2. The evolution of the Tax Culture Program in Peru and our concept of tax citizenry – a. Recent evolution – b. Achievements – c. Building the concept of Citizenship with a tax focus – 3. Peru: the exploratory study of tax awareness supplies a theoretical and methodological model as a starting point and baseline – a. One Step Beyond Educational and Values Approaches – b. The study of tax awareness confirms that the problem transcends the framework of the education system – c. Real Citizenry: Personal values in the discourse and harmful practices in tax compliance – d. Significance and contribution of the indicators that define tax awareness: The peruvian model – e. Where are the differences in tax compliance levels regionally – f. Tax awareness is multidimensional – 4. Conclusions – 5. Recommendations – a. Tax citizenry public policy to redistribute voluntary tax compliance responsibility – b. Integrate tax culture or tax citizenry into the business and central functions of the Tax Administration – c. New findings and challenges – 6. Annexes*

**1. TAX EDUCATION OR TAX CULTURE PROGRAMS IN LATIN AMERICA AND THEIR CONTRIBUTION TO THE TAX CITIZENRY FOCUS**

Tax education is the strategy par excellence for the creation of a tax culture based on the concept of tax citizenry that involves taking the fulfillment of tax obligations as a necessary counterpart to the legitimate exercise of civic rights

In the last two decades Tax Administrations have expanded their collection and supervisory mission, towards a new role to society, aimed at the promotion of voluntary compliance through the adoption of tax education actions which aim to motivate citizens to adopt attitudes that are favorable for voluntary tax compliance and contrary to fraudulent or evasion behaviors.

**a. The agents of change**

Like most of the countries of the region, the Tax Culture Program of Peru covers three segments in which the educational strategy is self-evident: school children and higher education students.

All countries have identified that, in this effort, their main target audience are children and young people, especially those which are already incorporated into the school system because it is estimated that the education system would facilitate the application of teaching methods and is a life stage conducive to work and reflection on citizens' values, rights and obligations.

To reach them, countries that have developed tax education activities within the educational system, have found important allies: on the one hand, the governmental institutions responsible for education, which have played an essential role in the normalization of these efforts. And as a complement, regular basic education teachers because they are who guarantee the appropriate development of the tax culture subject, not only because they are the ones who develop the classes in the classroom, but especially for the decisive role they assume at the annual and daily programming phase.

Likewise, work has been carried out with higher education students, because it is a relevant group to the extent that they will soon become economically active citizens. In this regard, Mexico has set the pattern to follow, by including tax content courses in the curricula of some universities. University gatherings and knowledge competitions are being developed in Peru, and we have achieved the first incorporation of the subject in the curriculum mesh of the School of Education of a major private University.

As the third complementary component, constant work is developed in several countries of America with tax administrations officials to ensure that they act as educators prosecutors.

The AFIP of Argentina started with the "Dads and Moms go to school" Program through which tax administration workers go to their children's

schools to explain in a pleasant way, what their work is about and the importance of the same for the well-being of the country. In this regard, it is convenient to mention that Chile, El Salvador, Costa Rica and the Dominican Republic have launched similar programs and we hope they will be incorporated by other countries in the region. Peru has delivered to each worker the Tax Culture consultation Book that puts together topics, definitions and examples that tax administrators do not necessarily see on a daily basis but that are important when they play the role of tax educators.

### **b. The contents**

The contents of the tax education/culture programs were initially focused on the primary role of taxes as a source of fiscal revenues to finance the activities of the State and on how compliance with tax obligations is closely linked to the foundation of citizenship.

However, issues related to the budget cycle and the knowledge of the work of the institutions responsible for ensuring the proper management of public resources were progressively addressed. In this way, it has become essential to teach the children and young people that guaranteeing a proper management of public expenditure is as important as collecting sufficient public revenue to finance sustained development.

And following the political reforms, tax education now includes the teaching of existing tools for citizen participation and the creation of the channels to monitor, report and prevent the misuse of resources and corruption and to improve the quality of expenditure.

### **c. Tax citizenry**

In the last international tax education seminars, it has been disclosed that, even though the Tax Administrations are leaders in this field and have the education sector as an essential partner, the work to train citizens - particularly on issues such as tax compliance - requires harmony between the main agents of the society and the economy. Thus, agreements and collaboration are currently being sought with other institutions of the State, of the sub-national Governments, of the private sector and, in general, of the civil society as a whole.

The common axis that raises the interest of all the institutions is to ensure participatory and responsible citizens who, furthering our objective, be aware of their tax rights and responsibilities. This is the reason why the term "tax citizenry" is being coined, whose scope has



the ability to include the concept of social cohesion and reflects the desire of a high degree of consensus by the members of a community around a common national project that goes beyond the strictly tax topic and collections.

#### **d. The future challenge**

Despite the diversification of efforts and the increasing extension of tax education or tax culture programs and even when these programs receive a significant allocation of budgetary resources – as it is the case of Peru-, the work of developing the tax culture and citizenship through education still has not received the attention or the importance that this task requires and usually develops in isolation, running along paths parallel to the core business of the Tax Administrations. It is so the case that in the majority of countries in the region the number of officials assigned exclusively to this subject is insufficient. Also, the activities and goals of these programs compete at a disadvantage with the collection goals and even with the taxpayer services areas, which instead should be an important part of this educational endeavor.

However the achievements of our tax culture programs are very rich in content and educational materials, quite technical on the pedagogical aspect, enjoy great convening power among the units of other institutions dedicated to similar themes and in the educational communities, recreational spaces and even very valuable artistic pieces have been developed.

And most importantly, now the recognition of the importance of the tax citizenry subject that calls to this Assembly, imposes upon us a challenge which covers several aspects: planning, research, integration into the core business and goals as well as the adequacy of our organizations to give them the necessary resources fulfill a regulatory rather than operational work, which requires a positioning enabling the tax administration to incorporate a tax citizenry focus that is cross-cuts the Organization, its functions and goals.

## **2. THE EVOLUTION OF THE TAX CULTURE PROGRAM IN PERU AND OUR CONCEPT OF TAX CITIZENRY**

### **a. Recent evolution**

Shortly after the beginning of Tax reform in Peru in, a cross-functional team was established, which developed a series of programs and activities with the purpose of contributing to the transformation of

cultural perceptions and assessments of the Peruvian society with respect to tax compliance.

An agreement was signed in this stage, for the first time, with the Ministry of Education of Peru. Professors were trained in tax contents, they carried out of payment receipts school contests, itinerant exhibitions in major cities where theater shows and tax guidance were provided and plenty of informative and educational material were delivered.

However, it is only as of 2005 when the Tax Culture Program is included as an integral part of the Institutional Operating Plan and, in 2007, SUNAT establishes the “generation of tax awareness on the basis of strengthening citizen values” as a strategic institutional objective. It is in this context that the Tax Culture Program gained power by providing it with resources and including it with some tasks within the operational plans of the national level. It is also at this time that a process of program modeling or configuration is carried out, which involved a diagnosis, conceptualization, and a new design, goals and explicit forms of intervention; the same ones that set the course of the work of the next few years.

#### **b. Achievements**

The Tax Administration of Peru considers that, in order to achieve its first goal, aimed at setting the bases for creating tax awareness in children and school-age adolescents in the education system, it must and has made important efforts that have allowed us to make a noteworthy progress in what respects to the incorporation of the topic in personal, social, citizen and civic training areas at all educational levels and modalities.

This has caused a great impact on the Peruvian society because it guarantees its compulsory teaching to over 7 million school children, which is almost 100% of our children and adolescents ages 3 to 19. Now we have the challenge of supporting teachers in this task, developing materials and strategies that ensure the quality of the contents transmitted for to the students, for which we already are a part of the National Teacher Training Plan of the Ministry of Education.

This experience has allowed us the satisfaction of exchanging valuable experiences with Paraguay, on the one hand, lending them technical assistance to reform their school curricula and, from them, we have received their visit where they have shown us their alternative educational work and, especially, with the topic of payment receipts school competitions.

The organization of tax knowledge competitions where universities and institutes compete have allowed for a more active participation of future professionals from different departments in the country, at the activities carried out for them by the program. We have recently expanded the geographical coverage of these university events, which has allowed us to reach places where young people do not always have the opportunity of attending seminars with the participation of speakers coming from the national government or from universities located in the capital. The next objective in this line is the inclusion of the tax culture topic in the study plans of higher education centers and, in that regard, we can now inform that tax contents are already a part of the curricular mesh of the school of education in one of the universities with the largest student population in the city of Lima.

Concurrently, we have multiplied the dissemination of the message in non-formal environments, such as parks, fairs, libraries and public auditoriums, using different alternative communications tools such as theater shows and with an itinerant learning space created to be installed in those public places adequate for cultural consumption by children.

It must be mentioned that SUNAT personnel from all offices at the national level has participated in most of these actions. Likewise, in order to achieve the goals, the different officials have had to become involved, carrying out constant coordination with education authorities, carrying out exhibits, attending events, holding dissemination meetings with the media outlets and even participating in program improvement and feedback. All this, although it has implied strong efforts, has caused officials to take up the message as their own, going from supporting in the execution of the task to a renewed conviction that working in tax education is what the country needs.

### **c. Building the concept of Citizenship with a tax focus**

Peru has been working, since 1994, on a theoretical framework that has been reformulated and full of experiences and studies of its own and from other Tax Administrations in the Region. This has allowed us to build, in addition to educational materials and teaching strategies, concepts and definitions, as well as to formulate citizen competencies and attitudes that we consider optimal to be used as points of reference for the educational strategies.

Our concepts and definitions of tax citizenry have evolved as we gain experience. Thus, during the first years we chose to emphasize on the Modern State and State of Law concepts, on the role performed

by taxation and on the responsibility of the citizens in supporting the State; but we observed that this was not sufficient for the acceptance of the obligation to pay taxes, especially among teachers, which led us to include topics referred to the National Budget, the distribution of income and sources of financing.

Given its own historical, social and economic diversity, Peru has important social and anthropological studies about the citizen and pre-citizen practices of Peruvians. In order to respect our diversity, the conceptual framework of citizenship that we have adopted supposes minimum elements that define it.

First, in other realities subjects tend to be analyzed as a group of individuals, who generally do not have significant personal dependency relations with anybody or have broken with them and therefore are relatively autonomous as is the prevalence in Latin American, there are still obsolete modern pre-citizen practices such as personnel subjection, lack of autonomy in decision-making, deficient use and respect to individual and political freedoms.

It must be emphasized that citizenry can only be developed in a society of individuals (in the liberal tradition) and even sets of individuals (in the communist tradition enrooted in our societies) with no subjection, that is, autonomous to make their own decisions and do not need to be represented by any corporation to exercise their individual rights.

Second, a citizen is defined as an individual or a community of individuals entitled to act freely without any impediments that block or detour action; to decide and participate in public affairs; and, participate in the wealth and wellbeing produced by society.

Third, the existence of a citizen with rights entails a peculiar relation of society and individuals with the modern State, which acknowledges the clear predominance of rights over responsibilities and offers a series of constitutional, organizational and institutional guarantees and, likewise, resources to apply them, unlike the traditional relation, which emphasized responsibilities with the State over the rights of individuals.

Fourth, citizenship also implies a sense of belonging to a specific political community among whose members interdependence, responsibility, solidarity and loyalty relations are established. In general, these political communities have appeared when elites have been capable of integrating popular classes to the economic, social and political life of a specific country.

The last assumption is the existence of many types of citizenships in our country that arise from our own traditions and experiences with the State. Just like throughout Latin America, in Peru there are real or effective citizenships and citizenships for discourse and statistics.

Concretely, minimal citizenship and State definitions are linked in our educational activities with taxation, through what we call “The Virtuous Circle of Taxation” where citizens deliver their contribution to the State through the Tax Administration to receive, in Exchange, social benefits and public services as well as the efficient operation of government offices with the purpose of guaranteeing the true exercise of their citizen rights.

Our main strategy is to establish two learning moments: initially we start from the establishment of the ideal definitions and then cover the concepts based on examples designed according to the geographic, social, economic contexts and the circumstantial problems affecting or benefiting the public. Una vez incorporadas estas nociones resulta de fácil comprensión y sobretodo aceptación que estos bienes y servicios necesarios u obtenidos, deban ser financiados con el aporte de todos los ciudadanos.

The other concept refers to the *complete citizen* as the one who actively participates in complying with its duties, in decision-making and in overseeing public expenditure.

Finally, it is timely to mention that for this task we have important bibliographical references that are at the reach of everybody. On the one hand, the Political Constitution of Peru, which states citizenry definitions, State, common and general wellbeing, utilities, public assets, private assets, taxation, among others. And as a complement, we have developed a set of reading materials and in this item it is important to highlight the Consultation and Reference Manual<sup>1</sup>, the same that is used by trainers and teachers as well as by tax administrators, due to its relative contents to our society, the State, citizenry, taxation and our country’s history.

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<sup>1</sup> SUNAT. *Tax Culture, a reference book, published by the Institution. Lima, July 2010.* .

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### 3. PERU: THE EXPLORATORY STUDY OF TAX AWARENESS SUPPLIES A THEORETICAL AND METHODOLOGICAL MODEL AS A STARTING POINT AND BASELINE

*“... in most studies fiscal morale is treated as a black box without discussing or even considering how it arises or how it is maintained. It is generally perceived as part of the meta-preferences of the taxpayers and it is used as a residue in the analysis that captures unknown influences on tax evasion. The most interesting question is what facts from the rise and maintenance of fiscal moral”*

Feld and Frey (2002 a, 88-89)

For SUNAT, the issue of low compliance and tax evasion are not issues that the tax administration must solve on its own. On the contrary, it should start from a new conception involving not only the entire state apparatus but society-at-large, since we are all responsible of tolerating, promoting or being accomplices of said behaviors.

This conception is largely supported by the Tax Awareness Exploratory Study we developed in 2009 through surveys to individuals, which has provided us with the evidence of how tax compliance relates to tax awareness, as well as a model that represents the complexity of the variables that intervene in the creation of tax awareness among Peruvians.

We will present the main characteristics and virtues of the aforementioned study below.

#### **a. One Step Beyond Educational and Values Approaches**

The Tax Awareness Exploratory Study contributed important evidence regarding the manner Peruvians relate to the tax topic.

On the one hand we can affirm that paradoxically Peruvians are people that mostly consider that “top pay taxes is good because it is the right thing to do and show citizen responsibility” but at the same time say that they would stop paying taxes if they had the opportunity of not being discovered. Similarly, most citizens believe that they do not have much information on taxes, although half of them know what taxes are about and ascribe to the same a fiscal and social function.

As expected, more than a third of those polled are opposed to paying taxes and state a set of reasons, which we chose to call *conditional cooperation* such as “I do not want to give money for nothing,” “ others

do not pay,” “others do and its not necessary for me to do it”, “no one forces me to do so.”<sup>2</sup>

With these and other evidence properly tabulated, a definition for tax awareness or tax moral was designed, which is expressed by a multivariate probit<sup>3</sup>. type index. In this regard, the use of multiple variables has also been useful to establish profiles of complying and non-complying individuals at the national level and for each region, which in turn will facilitate the design of new strategies to improve the management and results in particular in the field of interventions related to education in civic and tax culture.

Reference shall be made in the following sub-paragraph to the key outcomes of the study with the intention of sharing new reflections and new decisions relating to tax citizenry and the co-responsibility shared by the State and society which would bridge the gap between political citizenship and the citizenry tax between the exercise of the rights and responsibilities, or rather, how can we move from practical passive citizens to active and participatory citizen practices.

**b. The study of Tax Awareness confirms that the problem transcends the framework of the education system**

Learning to become a member of society begins as soon a person is born, that is, the primary socialization allowing it to understand the notion of others and submersed in the assume reality of what he/she is, taken by the hand of the father, mother and/or caregiver. At this stage an individual is not autonomous and, therefore, cannot choose what will be worthy of trust to learn and that will allows it to interpret the world and handle things and people in order to obtain results with the minimum of effort and avoiding undesirable consequences.

Later when the individual is ready to attend school<sup>4</sup>, another parallel process called secondary socialization begins. In this second phase, the affective relationships provided parents or caregivers during stage one and which was the condition without which socialization could have not happened, begin to become inconsequential for social learning.

At this time, they begin to be replaced by created pedagogical (intentionally or unintentionally) so that individuals learn to internalize

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<sup>2</sup> *Exploratory study of Tax Awareness and Baseline 2009.*

<sup>3</sup> *The univariate probit model relates an unobserved variable with an observed counterpart; the multivariate probit model is an expansion of the univariate one and allows work with an observed variables series.*

<sup>4</sup> *The individual also relates with other institutions, legal or legitimately accepted by their social environment, for example, church, folk customs, clubs and even gangs.*

specific sub-worlds. At this stage individual begin to process their autonomy and will increasingly be better able to choose to take or leave the new instructions offered in school or by others.

Social awareness as well as tax awareness has two dimensions because it is process and contents at the same time. This approach permits identifying two fundamental problems: one relating to the generation of tax awareness and the other with the contents of tax awareness.

With the purpose of facilitating communications between tax specialists it has been agreed to call each dimension tax awareness y tax culture, respectively.

The building of tax awareness is a process that intertwines structured and non-structured teaching events. These events are produced by formal and non formal institutions of society and the learning that takes place in the individual have a regulatory weight on their behavior and model their attitudes when an individual performs roles as a service user, consumer, customer or citizen.

However, as learning it is not an event exclusively produced in the field of the education system and as the tax awareness process development is a learning process within a social context; its approach should not be limited to educational programs or to Tax Education as it is called in many tax administrations. Moreover if we are now aware that the people that are mainly responsible for their education are not educators and tax administrators but all the all individuals in society and in particular those directly linked to the tax issues.

Thus the change that we are pursuing in the tax awareness of citizens, the narrowing of the gap between the discourse in favor of taxation and voluntary tax compliance behavior, should be elevated to the category of issue with public value for the scope that gives its social nature and the connotations that it has in the well-being of the countries.

### **c. Real Citizenry: Personal values in the discourse and harmful practices in tax compliance**

The traditional response on what determines tax compliance is given by deterrence theory based generating fear regarding the possibility of detecting and punishing fraud<sup>5</sup>. This theory was born with the cold war and was also used to prosecute crime, proposes that the compliance decision is primarily based on cost-effectiveness analysis, by which

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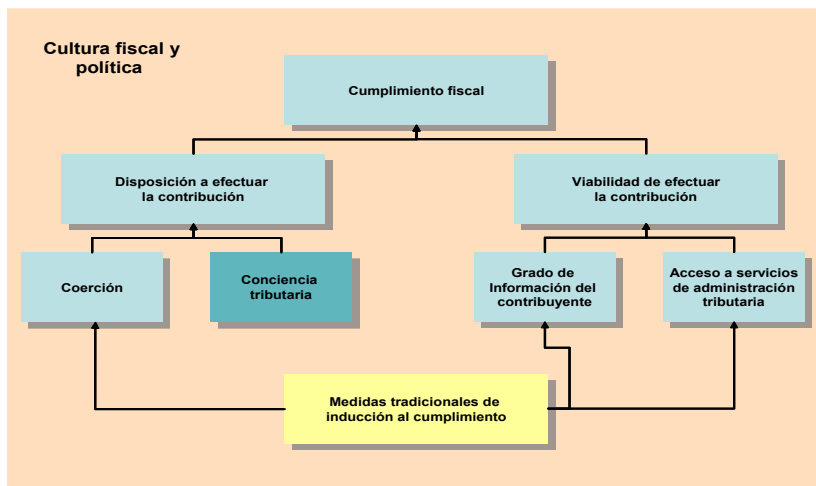
<sup>5</sup> Alligham, M., A. Sandmo (1972)



people weigh the economic rationality the benefits of non-compliance against the risks of detection and penalty costs.

However, subsequent studies have shown that this theory has limited explanatory power and traditional methods of auditing through coercion and sanction only generate a fraction of the observable voluntary tax compliance. This has led to explore the importance of elements not associated with economic rationality in the prediction of voluntary tax compliance. So, recently, theorists and researchers attribute significant importance to what has been called tax awareness or “intrinsic motivation pay taxes”, in which the building of the political culture has a role to play with respect to its adoption by the public.

**Graph 1: Tax Compliance Elements**



Source: Tax Awareness Survey and Baseline Study 2009 - Peru

Thus, from a perspective that we consider wider, it can be said that tax compliance is a consequence of two conditions: (i) the disposition to make a contribution (“actors want to pay”) and (ii) the feasibility of making the contribution (“agents know and can pay”). The first condition is determined, on the one hand, by the effectiveness of the rules of coercion, the calculation made by agents through economic rationality, their degree of aversion to the penalty of fraud. On the other hand, the willingness to contribute is determined by the tax awareness of the agent, which determine its willingness to pay<sup>6</sup> and which is often

<sup>6</sup> *Voluntariness is understood as compliance with obligations without the intervention of the responsible agent of the tax administration. The literature is vast and is associated with a wider field that investigates why people comply with the laws. Ellickson, R. (1991); Tyler, T. (1990)*

represented by a single indicator called fiscal morale or tolerance to fraud as a result of the legitimization, socialization and internalization processes of tax obligations (see Graph 1).

Accordingly in Peruvian society, tolerance to fraud was expected to be greater among those who do not comply with their tax obligations and vice versa between those who comply with their tax obligations.

**Table I: Tolerance to Fraud and Tax Compliance (Peru 2009)**

Toelcerance to fraud	Percentage Distribution	% of the population that does not pay income tax	% of the population that buys contraband products	% of the population that makes purchases without a receipt
Does not tolerate	25%	29.8%	21.3%	23.0%
Low tolerance	21%	35.1%	32.8%	26.5%
Very tolerant	54%	37.1%	29.5%	29.1%
Total	100.0%	34.5%	28.1%	27.4%
Memo:				
Chi-cuadrado (6 g.l.)		100 859	260 610	100 763
Kendell-Taub		0.041	0.021	0.040

Source: 2009 Tax Awareness Survey and Baseline Study - Peru

According to the results of the survey (see Table I), 54% of the working population subject to the payment of income tax would classify itself as very tolerant, and is a group that shows the largest percentages of population that are in breach of the payment of said tax (37%)<sup>7</sup>. Furthermore, 30% of the population would classify as not tolerant at all to tax fraud and, of these, 29% does not comply with the payment Income Tax. (37%).

This result reveals, as expected, the existence of a positive association between the degree of social permissiveness to fraudulent behaviors and the level of tax compliance, although according to the Chi-square and Kendell-Taub statistical tests, there would be a weak association between two variables.

<sup>7</sup> The classification was carried out on the basis of the answer to question 66th of the survey, where they were asked "If you had the opportunity, would you pay less taxes than the ones you have to pay? On a scale of 1 (Completely disagree) to al 5 (Completely agree), those that answered 4 or 5 were classified as very tolerant. In turn, those who selected alternative 3 were classified as slightly tolerant, while those who are not tolerant at all correspond to those that answered 1 or 2.

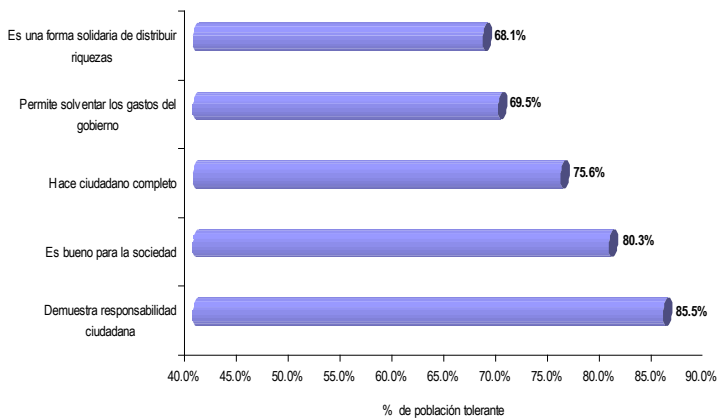
The latter reinforces the hypothesis that the tax compliance problem has a multidimensional nature.

Regarding the relationship between the degree of tolerance to fraud and the propensity of people to buy products without payment receipts or smuggled products, the results are similar to is found in the case of payment of tax income from a tax policy perspective.

In this regard, it is important to take into consideration the following aspects that would characterize the population with high social permissiveness for fraudulent behavior or tolerance to fraud:

- Notwithstanding being a group prone to defaulting in their tax obligations, the social value they assign to paying taxes is high. Said in other words, their importance and the benefits they generate for society is acknowledged, because they allow individuals to show their civic responsibility (85%), allow to cover Government expenses (70%) or because it is a solidarity mechanism for distributing wealth among the population (68%).

### Graph 2: Beliefs regarding the function of paying taxes



Source: 2009 Tax Awareness Survey and Baseline Study – Peru

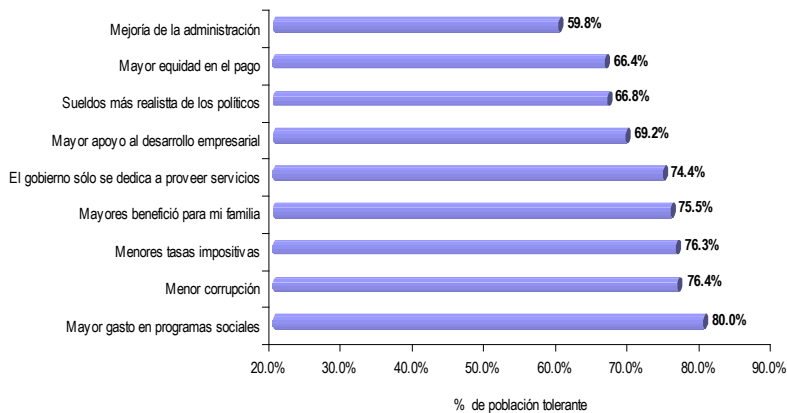
- The reasons why these individuals would justify tax evasion are linked to factors relating to State corruption (56%), lack of income (55%), high taxable bases (52%), poor use of resources by the Government (52%), the perception that there are no benefits from the State's expenditure or investment (46%), among others. This indicates issues beyond economic factors, which regulate the

behavior of the citizen as a taxpayer and which are somehow associated with the individual's perception regarding the way in which the State appropriates public funds. (See Graph 2).

- These results suggest a certain Citizen-State responsibility in the determination of the tax compliance level: it does not suffice with the citizen fulfilling his or her duty as a taxpayer but the State must also show that these resources are used adequately and that they generate a social return to guarantee the continuity in the payment of taxes (taxpayer loyalty creation).

This is consistent with what is reported by the population classified as tolerant to fraud with respect to the main actions under the responsibility of the State that would contribute to raise their willingness to pay taxes, among which we may identify: a greater orientation of resources towards social programs (80%), reduction of corruption levels (76%), concentration of State actions in the provision of services (74%), improvements in the tax policy equity conditions (66%), improvements in public administration management (60%), among other factors.

**Graph 3: Factors that would promote a greater disposition to pay taxes among the population tolerant to tax fraud**



Source: 2009 Tax Awareness Survey and Baseline Study - Peru

**d. Significance and contribution of the indicators that define tax awareness: The Peruvian Model**

Ever since deterrence theory, the tax administration is responsible for creating an increasing risk to discourage potential evaders and avoiders and, at the same time, develop various forms of access to information and facilitation of the return and payment procedures. From

this perspective, in recent years, countries have made a great effort in simplifying formalities, create virtual tools and open service centers for taxpayers. Also, lately, emphasis is being made on control centers and the participation in public service centers that concentrate more than one institution. Under this predominant focus, tax administrations are placed in the center of the stage, as solely responsible for tax compliance.

However, the results obtained through the exploratory study carried out by the SUNAT, although they do not claim that the tools employed are incorrect, they do confirm that such an approach is at least incomplete. Therefore, in order to assess the importance of each of the analyzed determining factors on tax compliance, a statistical model was developed referred to independent individuals<sup>8</sup> that allowed to estimate the probability that an individual working on his/her own evades paying income tax given: (a) the level of risk of being detected and penalized by SUNAT, (b) sensitivity to the cost of penalty, (c) the level of the moral cost (tolerance to fraud), (d) the degree of access to the Tax Administration services and (e) the level of knowledge about the tax system<sup>9</sup>. The relative importance of each of these variables on the level of tax compliance was determined from the measurement of marginal variations in the likelihood of evading the payment of taxes arising from changes in the levels of fiscal compliance determinants.

**Table II: Perceptions regarding the Tax Administration and tax compliance**

Percepción sobre la Administración Tributaria y cumplimiento fiscal				
	% de población que no paga impuesto a la renta			
	Según percepción sobre la efectividad de la SUNAT para promover pago voluntario		Según percepción sobre la efectividad de la SUNAT para facilitar trámites de pago	
	Global	Independientes	Global	Independientes
No contactó a la SUNAT	43.9%	46.2%	43.9%	46.2%
Si contactó a la SUNAT	20.7%	22.3%	20.7%	22.3%
No es efectivo	27.1%	31.1%	38.6%	36.9%
Parcialmente efectivo	22.5%	21.3%	17.8%	18.0%
Efectivo	15.1%	17.7%	15.9%	20.7%
Total	34.5%	38.3%	34.5%	38.3%
<b>Memo:</b>				
Chi-cuadrado (4 g.l)	132 234	431 749	234 199	89 304
Kendell-Taub	0.089	0.240	0.132	0.112

Source: 2009 Tax Awareness Survey and Baseline Study - Peru

<sup>8</sup> It refers to individuals that practice a profession or occupation independently.

<sup>9</sup> This referential model did not include the socioeconomic characteristics of the individual as an independent variable due to his high correlation with the set of selected variables, mainly with the moral cost, which would have biased the measurement of the marginal contributions of each one of the variables on tax compliance.

The main results that deserve to be emphasized were the following:

- i. All the variables included in the model are important to explain the behavior of tax compliance levels in the country.
- ii. The negative signs to the “access to services” and “level of knowledge about the tax system” variables are indicating that the probability that a self-employed worker evades the payment of the tax decreases, the greater the use or availability of the services offered by SUNAT and the greater the level of information on tax matters. This result suggests that policies aimed at reducing the knowledge gap and facilitating the act of providing the service are effective in raising voluntary compliance with tax obligations of this labor segment.
- iii. The positive sign of the “moral cost” variable is indicating that the more tolerant the worker independent is to fraud, the greater will be the likelihood that it fails to comply with its tax obligations. This highlights the importance of carrying out policies aimed at improving tax awareness to raise the willingness to voluntarily pay taxes.

On the other hand, the results displayed in Table III, suggest that in the short term, interventions aimed at increasing access to and use of the services of the SUNAT and improve the levels of tax information in the population would have a greater relative effect on tax collection levels than actions aimed at raising tax awareness. In the first two cases, the probability of evasion could be reduced from 25% to 50%, while in the case of interventions to improve tax morale would help reduce the likelihood of evasion by 10%.

**Table III: Marginal Changes in the Probability of Tax Evasion**

Áreas de intervención	Probabilidad de evasión		Cambio marginal
	Sin intervención	Con intervención	
Conciencia tributaria	34.3%	31.0%	-10%
Conocimiento tributario	39.4%	30.0%	-23%
Acceso a servicio SUNAT	36.3%	17.9%	-50%
<b>Efecto conjunto</b>	<b>49.6%</b>	<b>18%</b>	<b>-65%</b>

Source: 2009 Tax Awareness Survey and Baseline Study - Peru

These results are reflecting the fact that the activities associated with the generation of tax awareness require lengthy maturation processes to change the attitudes of the population with regard to the payment of taxes and therefore its effects become evident in the long-term. In this regard, we would expect that marginal changes as a result of the implementation of such policy are higher in dynamic or temporary models.

**e. Where are the differences in tax compliance levels regionally.**

Modern citizen practices, as well as pre-modern citizen practices, are not homogeneous across the country. Likewise, experiences with the democratic political system and its tax subsystem are not homogeneous either. In Peru, tax compliance and tax awareness levels vary from one province to another. The same happens with their reasons and arguments. Therefore, first of all, the variables involved in the tax compliance had to be explored, namely: coercion, fraud tolerance, degree of information and access to services, and select those which were significant.

On the basis of the levels of compliance in income tax payment found by the survey, the regions of Peru were classified into three groups. The first one clusters the regions with compliance levels below 25% (low compliance level), the second one includes those regions compliance percentages between 25 and 45% (moderate compliance level); while the third one groups the regions with a tax compliance level over 45%. Using this segmentation, an exploratory analysis of the characteristics of these groups of regions was carried out, in terms of tax compliance determinants, in order to identify a factor or factors that could explain the differences in the levels of tax compliance.

The results clearly show two discriminatory factors: perceptions of the risk of detection and criminalization by evaders and the degree of tolerance to fraud. Thus, the majority of the regions belonging to the group with highest level of tax compliance have a perception that the risks of detection by SUNAT, in case of committing evasion, are high; while distinct risks can be seen within the group with a lower level of tax compliance.

With regard to the degree of tolerance to fraud, the population of the regions belonging to the group with higher tax compliance is characterized for being tolerant, in contrast to the group of regions with lower tax compliance whose population is characterized by being very tolerant of tax fraud (see table IV).

**Table IV: Classification of the regions according to tax compliance level determining factors.**

**Tabla XXXV: Clasificación de las regiones según determinantes del nivel de cumplimiento fiscal**

Tasa de cumplimiento	Región	Probabilidad de ser descubierto	Sensibilidad al costo de la penalidad	Tolerancia al fraude	Grado de conocimiento	Uso de servicios SUNAT
Menor de 25%	Junin	Alto	No sensible	Muy tolerante	Medio	Bajo
	Tumbes	Alto	Sensible	Muy tolerante	Medio	Bajo
	Loreto	Alto	Sensible	Poco Tolerante	Medio	Bajo
	La libertad	Alto	Poco sensible	Muy tolerante	Bajo	Bajo
	Ayacucho	Medio	Poco sensible	Muy tolerante	Bajo	Bajo
	Huancavelica	Alto	No sensible	Tolerante	Medio	Bajo
	Piura	Alto	Poco sensible	Tolerante	Medio	Bajo
	Puno	Medio	Poco sensible	Tolerante	Medio	Bajo
Entre 25% y 45%	Ica	Alto	Poco sensible	Muy tolerante	Medio	Bajo
	Apurimac	Medio	No sensible	Muy tolerante	Medio	Bajo
	Moquegua	Alto	No sensible	Tolerante	Bajo	Bajo
	Arequipa	Alto	Poco sensible	Muy tolerante	Medio	Bajo
	Amazonas	Alto	Sensible	Tolerante	Medio	Medio
	Tacna	Alto	Poco sensible	Muy tolerante	Medio	Medio
	Ancash	Medio	Sensible	Muy tolerante	Medio	Bajo
	Callao	Alto	Sensible	Muy tolerante	Bajo	Medio
	San martin	Alto	Poco sensible	Tolerante	Medio	Bajo
	Ucayali	Medio	Poco sensible	Muy tolerante	Bajo	Bajo
Mayor de 45%	Cajamarca	Alto	Poco sensible	Muy tolerante	Medio	Bajo
	M. de Dios	Alto	No sensible	Tolerante	Bajo	Bajo
	Pasco	Medio	Poco sensible	Tolerante	Medio	Bajo
	Lima	Alto	Poco sensible	Tolerante	Medio	Bajo
	Huanuco	Alto	Sensible	Tolerante	Medio	Bajo
	Cusco	Alto	Poco sensible	Tolerante	Medio	Medio
Lambayeque	Alto	Sensible	Muy tolerante	Medio	Bajo	

Source: 2009 Tax Awareness Survey and Baseline Study - Peru

These results highlight the importance of implementing policies aimed at improving tax awareness in the population to increase voluntary compliance in the payment of taxes.

To that end, however, it was vital to understand the fundamentals that explain the tax moral in the country to select the most relevant type of tax policies for the Peruvian reality.

#### **f. Tax awareness is multidimensional**

Tolerance to fraud is an indicator commonly used as an approximation to tax awareness in studies on the subject. However, it has some limitations that may skew tax awareness behavior analysis and monitoring in a certain zone or country. It must be mentioned that these limitations (a) do not portray the multidimensional nature of this variable, (b) do not allow to determine its intensity or magnitude, it only reflects the incidence of tax awareness, (c) do not possess some properties required in order to properly monitor the evolution of tax



awareness to be able to draw comparisons between countries<sup>10</sup>.

To correct the above limitations, we selected fifteen variables shown in the following table.

**Table V: Tax awareness dimensions, variables and indicators.**

SOCIAL PROCESSES AND STANDARDS			
Procedural justice	Distributive justice	Reciprocity	Political factors
<ul style="list-style-type: none"> <li>◆ Institutional trust</li> <li>◆ Institutional honesty</li> <li>◆ Justice of standards</li> <li>◆ Participative processes</li> </ul>	<ul style="list-style-type: none"> <li>◆ Fairness of tax burden</li> <li>◆ Fairness in tax information exchange</li> <li>◆ Compliance with the social contract</li> </ul>	<ul style="list-style-type: none"> <li>◆ Perception of the degree of tax evasion</li> <li>◆ Trust in the members in the environment</li> </ul>	<ul style="list-style-type: none"> <li>◆ Perception of the degree of democracy</li> <li>◆ Satisfaction with democracy</li> </ul>

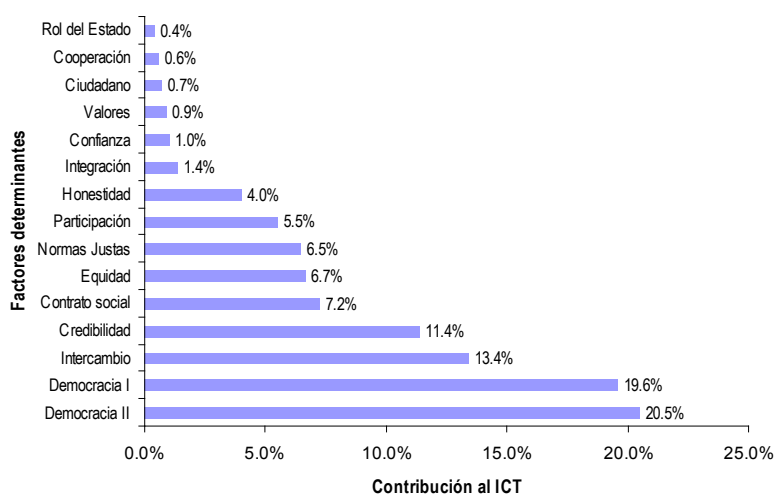
VISION OF THE WORLD		
Role of the State	Citizenry	Integration
<ul style="list-style-type: none"> <li>◆ Perception of the role of the State</li> </ul>	<ul style="list-style-type: none"> <li>◆ Typology of the citizen according to their relation with the State</li> </ul>	<ul style="list-style-type: none"> <li>◆ Perception of the degree of social integration</li> </ul>

VALUES
<b>Personal values</b>
<ul style="list-style-type: none"> <li>◆ Dimension of the predominant value</li> </ul>

Statistical exploration confirmed that the selected set of variables and their scales are reliable and consistent to adequately represent tax awareness, apart from being statistically significant.

<sup>10</sup> In this respect, review chapter IV of the "Conceptual and methodological framework for the formulation of the tax awareness baseline" (2009).

**Graph 4: Contribution to tax awareness according to determining indicators**



Source: 2009 Tax Awareness Survey and Baseline Study – Peru

- ▲ The determinant factors related to the social processes and standards dimension are helping to explain 97% of the population tax awareness level, while personal values and factors associated with a vision of the world have a scarce contribution.
- ▲ This result is reflecting that the interaction of these elements for the generation of tax awareness, perceptions of the performance of the system and tax practices of the population are predominating over the evaluative aspects and the vision of the world of Peruvians.
- ▲ Given that the values and vision of the world are interacting in antagonistic way regarding perceptions related to processes and social standards (the system), the predominance of this last dimension is generating displacement towards less cooperative attitudes in a population as the Peruvian, which favors values of transcendence and shares a common collectivist vision of wellbeing.

In terms of determinant factors, those linked to the political aspects (democracy) are having a crucial importance in the generation of tax awareness of Peruvians, explaining 40% of its total level. In turn, the factors associated with distributive justice (fairness, social contract and exchange of tax information) and procedural (credibility, justice of standards and participation), each have a relative weight of 27%.

Finally, the results confirm the absence of reciprocity, since the associated variables have a scarce contribution in the determination

of the level of tax awareness (1.6%). This result is attributed to (a) the influence of past behavior in persons who do not usually pay and (b) the conflict with the personal values that attenuates the intensity of the reciprocal behavior of the population.

In short, the determinant factors that are linked to macro aspects and with high social vulnerability, such as democratic order, generally have greater relative importance in the generation of tax awareness. In second place we find the determinant factors related to political or institutional aspects, while determinant factors associated with individual aspects have the lowest contribution.

Taking into account the results of the study, the functional scope of the Tax Administration in relation to the tax awareness and in the actions that can be deployed to positively modify their level, is not designed so that it can intervene on all the political or institutional aspects that model it. This why education and/or tax culture programs are limited to what the Tax Administration obtains jointly with the Ministry of Education and other public agencies, which is insufficient because it would not affect the set of the root of the... (Spanish text incomplete) That is why the results of studies such as the one developed by Peru must not only aim at measuring how we are, but mainly to substantially change the map of distribution of responsibilities regarding tax awareness, as a dynamic element of the tax citizenry.

#### **4. CONCLUSIONS**

The study carried out by the SUNAT highlights the technical progress in this matter. Its importance lies in the contribution of previously unknown details that serve to adjust the strategies specifically to our heterogeneous social, economic and civic reality.

But it essentially reveals that accountability in the voluntary tax compliance and in tax awareness generation is not a matter that is exclusive to the Tax Administration. To this end it provides statistics, testing, data to objectively support the above:

- a. In Peru, the zones areas with greater non-compliance and lower-level of tax awareness are mostly those with perceptions of a very low performance of the democratic political system and the economic and social achievements obtained by the citizen. Secondly, there are the areas that attribute less credibility and confidence to decisions made by public institutions and, thirdly, the zones in which it is mostly considered that there is no fairness in the exchange of tax information.
- b. Being these processes dynamic, they depend on the variations

in the indicators that make them up that largely depend on the decisions and political directions taken by political power.

- c. The effect produced by the variables that weight more on the tax awareness: political factors (perceptions about the performance of the democratic system and benefits that this provides), fairness in the exchange of tax information and credibility and trust in public institutions, is lower in tax compliance when said variables increase favorably than when they deteriorate which is when they grow to a large scale causing a very negative effect on tax awareness among the population and affecting tax compliance.

Tax compliance and its driving force, tax awareness, are primarily determined by the performance of the political system, justice in the distribution of the tax burden and credibility attributed by the citizen to public institutions. Consequently, voluntary compliance and tax awareness as its driving force will not be efficiently or effectively impacted by tax education programs based on personal information and values managed exclusively by Tax Administrations and some of their allies.

## **5. RECOMMENDATIONS**

### **a. Tax citizenry public policy to redistribute voluntary tax compliance responsibility**

For Peru, the results obtained in the exploratory study carried out by the SUNAT makes clear that the tax administration should move from being the sole actor in this stage to play a new role which seeks to obtain a legal and social mandate, as well as support political actors and stakeholders, to convert tax citizenry into a public policy that influences tax awareness and voluntary tax compliance.

### **b. Integrate Tax Culture or Tax Citizenry into the business and central functions of the Tax Administration**

- Consider the functional and organic standardization of education/tax culture programs, whose main purpose is to regulate and establish guidelines in a holistic manner to ensure the incorporation of the tax citizenry approach in the planning and business management processes.
- Incorporate the function at all operating levels involving the enforcement and taxpayer services functions.
- Integrate tax culture processes and products in the institutional goals, for which the proposal is to design work, monitoring and evaluation protocols, as well as process and product indicators,

minimally standardized at the regional level.

- Include the professional profiles of educators, social scientists and communicators in the organization and functions manuals, as well as in the career line of the tax administrations.

### **c. New findings and challenges**

The statistical tests applied to establish the significance and contribution of the indicators showed that they are reliable and consistent to adequately represent tax awareness.

Likewise, they suggest that the variables as a whole are relevant to explain tax awareness behavior in the country. However, reflecting, it might be excluding variables linked to cognitive processes that influence tax awareness levels. For this reason, we put the following challenges to the consideration of the Assembly:

- Open more spaces for the dissemination of progress made research models on fiscal awareness/tax moral.
- Recommend the allocation of resources and personnel to venture into quantitative and qualitative social research of taxation.
- Convert research on non-economic issues related to compliance and tax awareness into a functional activity of the Tax Administrations, which require different professional profiles, of resources and organizational.
- Link the results of the research on tax awareness with the tax culture or tax citizenry programs to provide them with technical authority in this aspect.

## 6. ANNEXES

## ANNEX I

## Tax Awareness Dimensions, Subdimensions and Indicators

VALORES (DISTAL) ¿Cuál prioritarías sea los valores que sirven a intereses colectivos o sociales?
<p>En esta dimensión se analiza la estructura de valores personales de la población peruana, según la clasificación propuesta por Schwartz (1992), y se evalúa que tipo de valores predominantes en los individuos están contribuyendo hacia actitudes más cooperativas con el sistema tributario. El indicador utilizado para el análisis es la dimensión de valor (trascendencia, conservación, apertura del cambio y autorrealización) predominante o priorizada por el individuo.</p>
Valores personales
<ul style="list-style-type: none"> <li>• Dimensión de valor predominante</li> </ul>

VISION DEL MUNDO (DISTAL): ¿Cuál integrado está el mundo de la vida con el sistema?		
<p>En esta dimensión se analiza diferencias en la moral fiscal de la población en función a la práctica social de sus derechos ciudadanos, a través de indicadores que mida las formas de percibir la legitimidad de la apropiación de los bienes públicos, la primacía de los intereses de la comunidad o de los individuos, las relaciones con los beneficios del mercado, entre otros.</p>		
Rol del Estado	Ciudadanía	Integración social
<p>Esta categoría de análisis incluye indicadores que midan la relación de primacía de los intereses de la comunidad y el rol del Estado para atenderlos.</p>	<p>Referido a indicadores que miden cuantitativamente los grados de ejercicio de los derechos de ciudadanía en una sociedad específica.</p>	<p>Referido a indicadores que miden las percepciones en los agentes sociales sobre los fenómenos de desintegración social que pudieran afectar la moral fiscal de la población</p>
<ul style="list-style-type: none"> <li>• Percepción del rol del Estado</li> </ul>	<ul style="list-style-type: none"> <li>• Tipología del ciudadano según su relación con el Estado</li> </ul>	<ul style="list-style-type: none"> <li>• Percepción del grado de integración social</li> </ul>

## Dimensiones, subdimensiones e indicadores del Índice de Conciencia Tributaria

<b>PROCESOS Y NORMAS SOCIALES (PROXIMAL)</b>			
<b>¿Cuánto dispuestos están los individuos a contribuir voluntariamente?</b>			
Esta dimensión trata de evaluar de manera indirecta cuán internalizado tienen los individuos la norma de cumplir con las obligaciones tributaria atribuida a sus creencias y percepciones sobre la justicia procedimental y distributiva del sistema tributario, del grado de evasión en la sociedad, así como a su satisfacción (o insatisfacción) con el régimen democrático peruano.			
<b>Justicia procedimental</b>	<b>Justicia distributiva</b>	<b>Reciprocidad</b>	<b>Factores políticos</b>
Esta categoría de análisis está referida a la percepción de la población respecto de la justicia de las reglas o procedimientos que intervienen en el proceso de toma de decisiones de la política tributaria.	Referido a indicadores de percepción de la población respecto de la equidad en la distribución de la carga fiscal y la equidad en el intercambio fiscal.	Referido a indicadores de percepción sobre el grado de evasión en el país o de confianza en su entorno. Permite evaluar si las actitudes individuales hacia el pago de los impuestos está influida por la conducta tributaria de la sociedad	Se incluye indicadores de percepción del individuo sobre el sistema político y de valoración sobre el grado de democracia existente u otros que afecten la moral fiscal
<ul style="list-style-type: none"> <li>• Confianza institucional</li> </ul>	<ul style="list-style-type: none"> <li>• Equidad de la carga fiscal</li> </ul>	<ul style="list-style-type: none"> <li>• Percepción del grado de evasión tributaria</li> </ul>	<ul style="list-style-type: none"> <li>• Percepción del grado de democracia</li> </ul>
<ul style="list-style-type: none"> <li>• Honestidad institucional</li> </ul>	<ul style="list-style-type: none"> <li>• Equidad en el intercambio fiscal</li> </ul>	<ul style="list-style-type: none"> <li>• Confianza en los miembros del entorno</li> </ul>	<ul style="list-style-type: none"> <li>• Satisfacción con la democracia</li> </ul>
<ul style="list-style-type: none"> <li>• Justicia de las normas</li> </ul>	<ul style="list-style-type: none"> <li>• Cumplimiento del contrato social</li> </ul>		
<ul style="list-style-type: none"> <li>• Procesos participativo</li> </ul>			

## ANNEX II

### Survey Fact Sheet used for the 2009 Peru Exploratory Tax Awareness and Baseline Study

<b>INFORME TÉCNICO</b>	
<b>Objetivo</b>	El objetivo del estudio recopilar información de fuentes primarias en las zonas urbanas de las 25 regiones del Perú para desarrollar y asistir en la generación de indicadores que permitan comparar, a través del tiempo, los avances del Proyecto de Cultura Tributaria implementado por la SUNAT.
<b>Contenido</b>	Los temas de estudio considerados fueron los siguientes: <ul style="list-style-type: none"> <li>• Demográficos:               <ul style="list-style-type: none"> <li>- Datos de la vivienda.</li> <li>- Tenencia de bienes.</li> </ul> </li> <li>• Datos socioeconómicos de los miembros del hogar.</li> <li>• Contenido del cuestionario:               <ul style="list-style-type: none"> <li>- Grado de información sobre tributación.</li> <li>- Datos de comportamiento tributario y conciencia tributaria.</li> </ul> </li> </ul>
<b>Población</b>	Público en general, hombres y mujeres, de 15 a 70 años de edad, pertenecientes a todos los niveles socioeconómicos, residentes en zonas urbanas.
<b>Técnica</b>	Investigación cuantitativa, de tipo concluyente. Se utilizó la técnica de entrevista directa y personal, en el hogar.
<b>Instrumenta</b>	Cuestionario estructurado y pre-codificado, proporcionado por la SUNAT.
<b>Metodología</b>	Estudio probabilístico y polifásico (ver metodología anexa).
<b>Cobertura</b>	Estudio a nivel nacional, considerando las zonas urbanas de seis zonas geográficas de Lima-Callao y 24 regiones del interior del país (ver cuadro de distribución de la muestra estadística).
<b>Muestra</b>	Se realizó un total de 8,148 encuestas efectivas (ver número de encuestas realizadas).
<b>Error global</b>	+/- 1.1%, en la hipótesis más desfavorable, para un nivel de confianza de 95%.
<b>Actividades</b>	Las actividades realizadas fueron las siguientes: <ul style="list-style-type: none"> <li>• Elaboración de la versión final de los instrumentos a utilizar.</li> <li>• Prueba piloto bajo las mismas características en las que se desarrollará la encuesta final.</li> <li>• Selección y capacitación de encuestadores y supervisores.</li> <li>• Trabajo de campo, revisión de la calidad de las encuestas y supervisión del trabajo de campo.</li> <li>• Control de calidad previo al procesamiento de la información.</li> <li>• Procesamiento y validación de los resultados.</li> </ul>
<b>Prueba piloto</b>	Se desarrolló una prueba piloto previa al inicio del trabajo de campo, la misma que nos permitió conocer la operatividad del cuestionario, estimar tiempos de aplicación del mismo y proponer mejoras al instrumento por aplicar (ver informe de la prueba piloto).
<b>Fecha de campo</b>	El trabajo de campo se desarrolló en las siguientes fechas: <ul style="list-style-type: none"> <li>• En Lima : 19 de junio al 05 de setiembre de 2009.</li> <li>• En provincia : 30 de junio al 05 de setiembre de 2009.</li> </ul>

Servicio de Aplicación en Campo de Instrumentos de Recreación de Datos para Evaluar el Estado de la Cultura Tributaria





## **THE DESIGN AND IMPLEMENTATION OF TAXPAYER ASSISTANCE PROGRAMS IN KEEPING WITH HIS BEHAVIOR**

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(Chile)

***Contents:** Summary – 1. Introduction – 2. General Background – 3. Taxpayer treatment strategies in accordance with his tax behavior – a. Income tax differentiated treatment – b. Focused preventive plans – c. Differentiated Treatment for electronic invoice issuers – d. Remote examination and assistance – 4. Case study: risk analysis of taxpayer behavior – a. Factors used for the design of the program – b. Case description – c. Examination results – d. Case conclusions – 5. General conclusions*

### **SUMMARY**

For many years, the Internal Revenue Service of Chile has been concerned about affording its taxpayers a differentiated treatment. This process began with the creation of the Large Taxpayers Directorate and subsequently continued with the implementation of Taxpayer Segmentation in each of the operational units. In addition, in recent years, it has been gradually including the level of tax compliance of taxpayers in the different assistance and examination plans. To this end, different examination as well as assistance treatment strategies have been determined, based on a series of factors for classifying the taxpayer. Some of these factors are: taxpayer size, economic sector to which it belongs, type of corporation, taxation system, violations of tax regulations, etc.

One of the factors for classifying the taxpayer is tax behavior, which has allowed for differentiating the application of some strategies. Thus, in this paper we will discuss different treatments applied in relation to Income Tax, targeted prevention plans (brief field examinations), requirements for using Electronic Invoicing and Remote Examination and Assistance.

Finally, consideration will be given to a case designed with the tax behavior of taxpayers as main discriminating factor. Such behavior is related to tax noncompliance, specifically, “the noncompliance risk”, and accordingly, related to the application of examination actions. This is based on the premise that risk measurement may ensure tax compliance within long term, and optimize the use of institutional resources by focusing them on areas of greater risk.

## **1. INTRODUCTION**

Globalization and technological development have brought about significant economic and social changes. These, in turn, have generated requirements and challenges for the Tax Administrations (TA) as regards the exercise of their examination powers, which must be applied with due respect for taxpayers’ rights, as provided in the laws of the countries, which constitute a legal framework that guarantees the appropriate balance in the relationships between the TAs and the taxpayers. Thus, in the case of Chile, the Tax Code provides, among other things, for the right to be treated courteously, with due respect and consideration; to be informed and assisted by the Tax Administration in relation to his rights and compliance with his obligations; to be informed, at the beginning of every examination, about the nature and aspects to be examined; and to be aware at any time, in an expeditious manner, of his tax situation and the status of the procedure; to be informed about the identity and position of the Service’s officials responsible for the processes in which he might be interested; and that the actions be carried out without unnecessary delays, requirements or waiting time, and that the official in charge certify the receipt of all background information requested.

The measures listed above allow taxpayers and TA officials to feel confident with the tax system, in such a way that the actions of both parties be carried out within the normative framework in force, thus guaranteeing that their rights and powers be exercised according to the regulations in force.

In terms of the TA officials’ actions, it must be borne in mind that they are the ones that determine the corporate image in the community. If positive, it will result in prestige, respect and credibility, which attributes will facilitate the work of the TA; and if not, foreseeable negative effects will follow.

Thus, the SII has been concerned for many years about adjusting its actions according to the following guidelines: strengthening control of taxpayer compliance, minimizing noncompliance and facilitating and

simplifying procedures before the TA. It has also been concerned about giving its taxpayers differentiated treatment, by implementing Taxpayer Segmentation in each of its operational units and gradually incorporating in the different assistance and examination plans, the taxpayers' level of tax compliance.

## **2. GENERAL BACKGROUND**

In 2001, the Internal Revenue Service created the Large Taxpayer Division (DGC) in order to provide differentiated assistance and examination to these taxpayers, especially because of their importance in collection at the country level. Subsequently, starting in 2008, taxpayer segmentation was implemented in all of the countries' operational units.

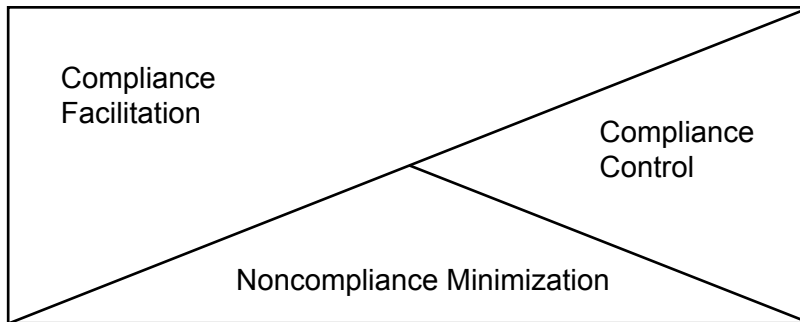
One of the objectives pursued with segmentation was to apply different treatment strategies given the taxpayers' compliance attitudes, so as to:

- Facilitate voluntary compliance to those taxpayers who were willing to do things properly.
- Assist those taxpayers who tried to comply but were not always successful.
- Dissuade from noncompliance those taxpayers who did not wish to comply when there is some problem with a tax obligation.
- Finally, strict application of the law to those taxpayers who had decided not to comply.

It was determined that initially it was necessary to move from a model based on processes (Income Operation, VAT Operation, Selective Auditing, Preventive Auditing) to one based on attention, assistance and control of taxpayers with similar characteristics. Thus, five segments were identified:

- Four segments for businesses, corresponding to Large, Medium, Small and Micro taxpayers; which were primarily classified in accordance with their sales figures, acquisition figures and amount of capital held.
- One segment for Individuals, whose requisite was not to be subject to tax on capital gains and not to be an independent businessman.

Each segment has had to devise mechanisms to deal with the strategic guidelines defined for taxpayer examination and assistance, as shown in the following figure:



In 2010, the control strategy applied, based on the Taxpayer Segmentation model, consisted primarily of selective audits of taxpayers from the for the Medium and Large Business segments, and massive and preventive processes for Individuals, Micro and Small Business segments.

In the sphere of Compliance Facilitation, worth noting is the consolidation of the Segmentation Model in the Regional Directorates, both in the platform and in the control areas, which has significantly improved the quality of taxpayer assistance, thus saving them time in complying with their obligations. Also important in that sphere were the different functions developed in the MIPYME (Full Accounting System and other improvements) Portal, as well as other services available in Internet, such as the application for requesting refund of Exporters VAT.

Significant in the sphere of Noncompliance Minimization is the generation of proposals for income rectification for 25% of objected taxpayers; the proposal of the F29 return for taxpayers of the MIPYME portal, users of the simplified accounting system; and the 1.4 million proposed AT2010 income tax returns used, among other initiatives.

In determining the control, facilitation and noncompliance minimization strategies, one of the basic activities has been the **classification of taxpayers in each segment**. Such classification has been made on the basis of a series of such factors as:

- Taxpayer size
- Economic sector to which the taxpayer belongs (industrial, commercial, financial, others)
- Type of corporation (limited, limited liability, individual, others)
- Relative taxpayer importance in terms of the business the taxpayer is involved in

- Type and scope of operations (national and/or international)
- Taxation system (general, special, simplified, others)
- Exemptions used by the taxpayer and use of tax benefits or exception regimes
- Tax behavior (is there a record or not of violation of tax rules)
- Impact on collection
- Examination modalities to be applied (massive, focused, others)
- Review costs for the TA
- Review costs for the taxpayer

### **3. TAXPAYER TREATMENT STRATEGIES IN ACCORDANCE WITH HIS TAX BEHAVIOR**

As mentioned earlier, the Tax Administration has developed different strategies for treating taxpayers, depending on their characteristics, and one of these being **tax behavior**.

Shown below are some of the treatment strategies that take into consideration the taxpayer's behavior. Thanks to the technological means available in the Administration, it is possible to carry out checks and verifications for determining the type of treatment to be applied. The latter may range from revisions performed by the operational units, those that the taxpayer may solve directly through the SII website as well as others whereby inconsistencies may be corrected without the taxpayer having to visit the TA offices.

#### **a. Income tax differentiated treatment**

The annual Income Operation process in Chile is applied to the Large, Medium and Small Businesses and Individual taxpayer segments. Determination of the action to be applied depends on the type of inconsistency detected and the taxpayer's classification, in order to ensure that it may be an objective and equitable process, considering due protection of taxpayer rights, as well as its tax behavior, as well as the effectiveness and efficiency of the examination process. To this end, in 2010, 209 observations were performed to verify the accuracy and consistency of reported data, thereby identifying 248,511 taxpayers whose returns were objected and which represents 11% of all taxpayers who filed income tax returns. Those who did not have inconsistencies or which because of the amounts involved their examination was not economically convenient for the TA or the taxpayer should not have undergone additional actions, but were nevertheless reviewed.

In this process, ever more mechanisms have been implemented for facilitating taxpayer compliance and thus the SII has provided:

- Proposed income tax returns, having received in 2010, 1,412,257 returns based on the proposals made by the Service to the taxpayers, which represented 59.7% of the total returns received.
- Proposals for corrections to income tax returns, having received in 2010, 16,069 corrections based on the proposals made by the Service, which represented 15.1% of the total corrections received.

Some complementary statistics are shown below:

Income Tax Returns	2009		2010	
	Number	%	Number	%
Taxpayer returns	2,346,900	100%	2,362,430	100%
Taxpayers who filed using the SII proposal	1,401,869	59.7%	1,412,257	59.8%
Taxpayers who filed by Internet, without proposal	904,685	38.5%	912,425	38.6%
Taxpayers who filed using a cellular phone	89	0.0%	71	0.0%
Taxpayers who filed using a paper return form	40,257	1.7%	37,677	1.6

#### b. Focused Preventive Plans

The Focused Preventive Plans correspond to in-person examination activities that are focused on certain types of risk, mainly taxpayers from the Micro Business segment. Since the businesses in this segment are very small, the costs of interaction with the Administration along with the cost of location are high. Therefore, they are preferably visited in the field to verify “in situ” if they are complying with their tax obligations.

The overall objective of this type of actions is to develop an examination presence that may be based on precise and updated information. To this end, some specific figures are established that may account for the behavior in order that the SII may focus the Service’s action, since it is presumed that there is a greater level of noncompliance.

Some of the figures incorporated are: nonfilers of tax forms, corporations with partners having problems, new invoice issuers, taxpayers with negative annotations in force, etc.

In each of these situations, the SII tries to educate the taxpayer, indicating the reason for the visit and accordingly, the noncompliance identified, while encouraging him to change his behavior in the future.

In general, taxpayer visits are made once a year; however, those taxpayers with a very risky tax behavior may be visited more than once.

Shown below, are some statistics.

Period	2009	%	2010	%
Taxpayers visited 1 time	169,150	75.2	145,134	70.6
Taxpayers visited 2 times	36,434	16.2	41,611	20.2
Taxpayers visited 3 times	11,568	5.1	11,774	5.7
Taxpayers visited more than 3 times	7,639	3.4	7,142	3.5
<b>Total</b>	224,791	100.0	145,134	100.0

### c. Differentiated Treatment for Electronic Invoice Issuers

The electronic invoicing system is also used within the range of measures for facilitating voluntary compliance by Internet. This system's primary objective is to provide businesses a basic function for working with electronic tax documents, thereby affording them an opportunity to learn about and benefit from the reduction in costs of printing and storing of tax documents. Electronic invoicing also helps keep orderly record of transactions and earnings, to take advantage of the efficiency that results from introducing information technologies to the world of production, in this case via tax compliance.

However, there are some taxpayers who cannot make use of this system, depending on the type of noncompliance or the level of risk. Some such situations are:

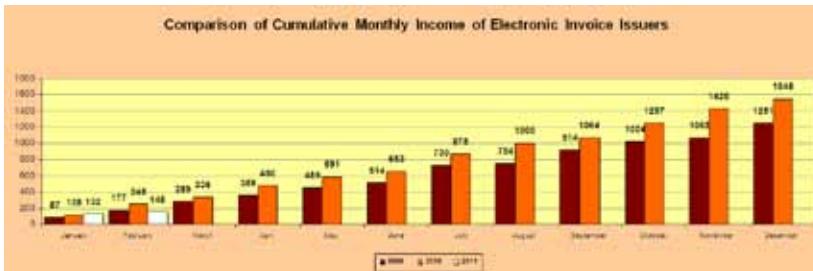
- Taxpayers who have certain annotations of lower risk are blocked from accessing the system, but they may solve these situations either by Internet or by visiting an SII office.
- Taxpayers who are being investigated for some type of tax violation, either in process, accused, sued or else sanctioned.
- Taxpayers who have not been located in their declared domiciles or who are in the process of terminating a business activity.



## TOPIC 3.2 (Chile)

It is important to note that as of February 2011, the number of electronic invoice issuers was almost 30,000.

The chart below shows a monthly evolution of the entry of new electronic invoicing issuers from 2009 to date, with external solutions (system acquisitions) that primarily correspond to large and medium-sized taxpayers.



Note: The X axis represents the months of the year. The Y axis represents the number of taxpayers

Another facility developed by the Service is the Mipyme (Micro, Small and Medium Business) Portal where the micro and small business taxpayer may find all the information and free applications that the SII has at their disposal. Some of these are:

- Mipyme electronic invoicing system
- Simplified taxation system (14 Ter)
- Mipyme complete accounting system (CCM)
- Modification of company data

The chart below shows the evolution of revenues of electronic invoice issuers that have joined the Mipyme Portal, with a solution provided by the SII, from 2009 to date.



Note: The X axis represents the months of the year. The Y axis represents the number of taxpayers

#### **d. Remote Examination and Assistance**

One of the recent innovations developed by the Tax Administration was the creation of the Remote Examination and Assistance Area that began operating in March of 2011, and whose objective is to contact specific groups of taxpayers, either to provide them with information or guidance as to specific tax obligations, as well as to promote the solution of tax issues that can be easily solved. For this purpose, this area counts on 15 experienced examiners who must analyze the tax situation of the taxpayer, analyze the way it should be solved, contact the taxpayer and encourage him to solve it.

These plans are carried out at a distance, are focused on assisting those taxpayers who intend to comply but are not successful; or else, are not clear about their tax obligations. Therefore, they should be provided guidance so that with the necessary assistance, they may solve or clarify their tax situation through the SII's website.

The preferred mode of contact in this area is by phone, where it is noted that the taxpayer does not need to visit the SII offices and it is stressed solution of the situation is "At a Distance".

There are two types of contacts:

- **Control:** The taxpayer is informed of the noncompliance situation and is directed to resolve the issue through the SII website.
- **Preventive:** The taxpayer is informed that some action he has fulfilled involves errors that may subsequently have tax implications, either for him or third parties about whom the taxpayer is obliged to provide information. This information can also be rectified through Internet.

The area follows up the matter until the taxpayer solves his situation. Otherwise, greater control actions are undertaken such as, for example, summoning the taxpayer to the SII office.

#### **4. CASE STUDY: RISK ANALYSIS OF TAXPAYER BEHAVIOR**

The case study presented below corresponds to a program implemented by the Tax Administration and whose design took into consideration the taxpayers' behavior. This behavior is related to tax noncompliance, specifically the "risk of noncompliance" and, accordingly, related to the application of examination (control) actions.

Risk measurement allows for ensuring, within long term, tax compliance, as well as optimizing institutional resources by focusing them on greater risk areas.

The models that measure risk in a operation where the taxpayer and the Administration interact, allow for measuring a situational risk and identifying corrective operational measures.

These models are based on the definition of an objective vector that may be used to establish specific compliance behavior to be modeled and a vector of attributes that allows for predicting future taxpayer behavior in terms of the objective variable determined.

### **a. Factors used for the Design of the Program**

In order to explore and learn about Risk Modeling, the Administration designed a pilot project oriented at detecting taxpayers that unduly increase their VAT credits so as to reduce their tax burden.

- **Evasion method**

The term 'evasion' is understood as any action produced when a taxpayer ceases to comply with filing his return and paying a tax, as provided by the law. This action could be involuntary (due to ignorance, error, or some alternative interpretation of the law done in good faith) or guilty (preconceived intention of violating the legal standard, by using any means forbidden and sanctioned by law.

In terms of VAT, the main tax of the Chilean tax system, all the mechanisms used to evade its payment generally involves underreporting of debits, or else, overrepresentation of credits. In the latter case, evaders recur to such schemes as using false transaction invoices, personal acquisitions registered in the company's name, acquisitions from fictitious taxpayers, and over-reporting in the accounting records and tax returns.

The objective of the study is the use of **false invoices** that are defined as those that "misstate the truth or reality of the data therein contained. Its falsity may be of a material nature, such as indicating a nonexistent name, domicile, RUT (tax ID number) or economic activity, or registering a nonexistent operation, among others."

- **Data Mining**

Data mining involves the exploration and analysis, by automated or semi-automated means, of large volumes of data in order to discover meaningful patterns and trends. The objective is to use this information to detect existing fraud, noncompliance, and to prevent their recurrence in the future.

- **Knowledge Data Discovery**

The KDD (Knowledge Data Discovery) process guides and allows for understanding how to discover and generate knowledge intrinsically found in a data set originating from a common phenomenon among them.

It is basically a matter of interpreting large amounts of data and finding relationships or patterns. To achieve the objective, use is made of several statistical techniques, of supervised and non-supervised learning, among others. Some of the objectives of KDD are the induction of rules, classification issues, the creation of segments or clustering, recognition of patterns, predictive modeling, detection of dependencies, among others.

- **Technological Tools**

There are tools that permit the structuring of models, adjusting them to the KDD process.

That is, the modeler may use its modules for the selection, pre-processing, transformation and data mining, in addition to the interpretation and evaluation of results.

- b. Case Description**

The VAT Fiscal Credit that fails to comply with the current legal norms is an ever present issue faced by the country's different operating units since, in this way, a small number of taxpayers unduly increase these credits, in addition to the costs and/or expenses in the income assessment process, thereby leading to reduced collection of taxes.

The Tax Administration, in its constant search for new tools to identify taxpayers that endeavor to unduly reduce their tax burden, has created a risk indicator for the filing of Form F29 "Monthly Filing and Simultaneous

Payment of Taxes,” which uses information that characterizes every return and tax behavior in terms of the aforementioned tax, following the KDD methodology in data mining.

This indicator considers the information included in the returns filed by the taxpayer and compares it with information in previous returns filed by the same taxpayer, as well as with returns filed by taxpayers in the same segment and field of activity. From said comparisons, a selection was made of taxpayers with the largest number of returns that show a significant negative deviation, as compared to their previous returns and those filed by their peers.

This tool allows for estimating when the return would probably include information about the VAT Fiscal Credit that does not comply with article 23 of the Sales and Services Tax Law, thereby permitting that the examination be focused on said periods.

- **Objective Vector**

The objective vector is a database that contains cases from the past in which occurrence of the event to be modeled is certainly known. In this case, we are dealing with monthly tax returns that were examined and wherein the objective was to determine whether the VAT Fiscal Credit complied with the provisions of the current legal norms.

The total number of declarations was 105,536, filed by 3,914 taxpayers. Of the total number, 13,860 did not contain VAT Fiscal Credit supported by false invoices, and in the remaining 91,676, occurrence of the event was detected.

- **Attributes Vector**

The attributes vector corresponds to the information dealing with characteristics or behaviors that will be used for modeling the event being discussed.

In the case being analyzed, 76 codes of the Monthly Filing and Payment Form were used and 50 attributes were developed, taking into account batches of returns, ratios, variations, etc., such as “Average Sales Receipts,” “Calculated VAT divided by the average of ‘n’ preceding months,” “VAT Fiscal Debit divided by average VAT Fiscal Debit of comparable segment- sector.”

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- **Information Volume**

The volume of information can be measured by looking at the amount of data that was explored in searching for valuable information. One measurement that allows for estimating the magnitude is the number of returns (files) multiplied by the number of attributes considered – the result being some 13 million data.

- **Model**

It was determined that the technique to be used would be based on the successive application of decision trees, weighed on the basis of error found in the immediately preceding decision tree.

Through this technique it was determined that only 7 out of 112 attributes initially suggested are necessary to model the event in question. These are:

- $(\text{VAT Fiscal Debit}) \div (\text{VAT Fiscal Credit})$
- Total Sales Liabe to Tax
- $(\text{VAT Paid}) \div (\text{Total Purchases})$
- VAT Fiscal Credit on Invoices Received
- $((\text{VAT Paid}) \div (\text{Total Sales})) \div \text{Average of } ((\text{VAT Paid}) \div (\text{Total Sales})) \text{ of the 3 preceding months}$
- $(\text{VAT Fiscal Credit on Invoices Received}) \div \text{Average of (VAT Fiscal Credit on Invoices Received) of the 3 preceding months}$
- Average Purchases Receipt

- **Taxpayer Selection**

The resulting model was applied to 2,871,283 tax returns filed between January 2008 and December 2009 and corresponding to 190,879 taxpayers of the Micro and Small Business segment.

A selection was made of 27,219 taxpayers who filed the largest number of returns with high probability of registering false invoices in their purchase records.

Nevertheless, in order that the measurement would result in a more precise and reliable evaluation of the experience, the experiment design technique was used. The 27,219 taxpayers selected were divided into two similar groups: the first, called “the Treatment Group,” which was immediately subjected to examination actions. The second was the “Control Group”, whose taxpayers were not subjected to any examination, at least until the evaluation period was concluded.

**c. Examination Results**

**• Direct Results: Yield from Examination**

The Treatment Group, consisting of 13,608 taxpayers, was notified of the upcoming examination and of these, 8,700 taxpayers (63.93% of the total) responded to the notification.

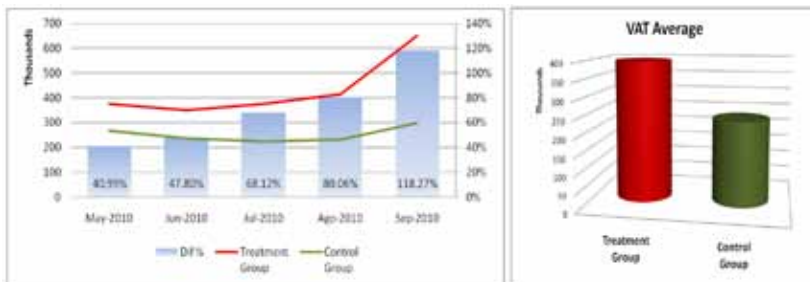
Of the total notified taxpayers, differences were found in 10.15% of the cases, which represented a total of CLP 636,502,491 as a direct result of examination of previous tax periods. The yield per taxpayer with inconsistencies amounted to CLP 460,900.

At the same time, outside the framework of the case study, the SII selected another group of taxpayers called: “Other Observations,” who were also notified of the upcoming examination. These were selected by using other criteria, based on actual differences calculated by comparing the information included in the returns filed by third parties and Form 29 filed by the taxpayers under examination. A total of 13,120 taxpayers were notified. The rate of responses in this group was 29.12% and the rate of yield reached 7.86%, for a total of CLP 809,716,658 – with an average yield per taxpayer with differences of CLP 785,370.

**• Indirect Results: Change of Behavior**

In a longer term analysis, that is, by monitoring the taxpayer over a period of 5 months following the examination notification, as regards the level of VAT payment, the following was determined:

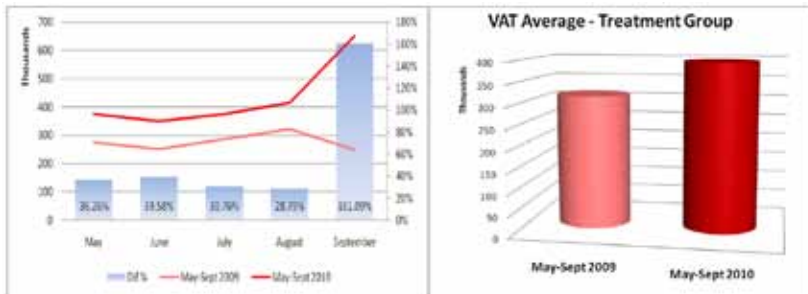
**i. Average VAT: Treatment Group vs. Control Group**



Note: In this section, a comparison is made of average VAT payment made by the taxpayers of the Treatment Group in the months following the examination and it is contrasted with the average VAT payment made by the taxpayers in the Control Group over the same period of time.

The increase in VAT assessed by the taxpayers in the months following the date of notification is much greater in the treatment group than in the control group, and in average, in said months the contribution from the first group was 67.43% higher.

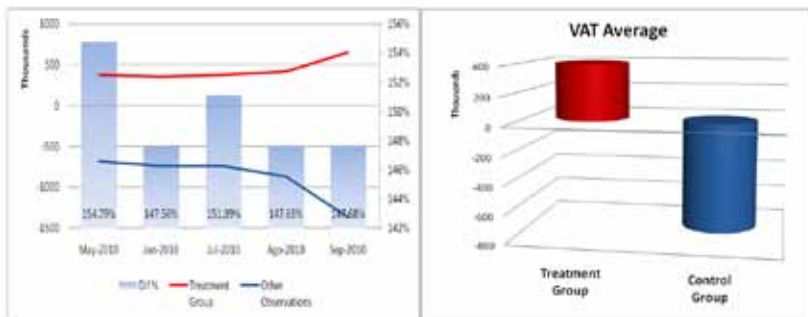
**ii. Average VAT: Treatment Group, Period Before and After the Application of the Plan**



Note: In this section, a comparison is made of average VAT payment made by the taxpayers of the Treatment Group in the months following the examination and it is contrasted with the Average VAT Payment made by the same group, but in a similar period in the previous year.

The increase in VAT assessed by the taxpayers in the treatment group, in the months following the date of notification was much greater than in the similar period the year before, and in average, in said months, the contribution in the period following the date of notification was 25.73% more.

**iii. VAT Average: Treatment Group vs. Other Observations**



Note: In this section, a comparison is made of average VAT payment made by the taxpayers of the Treatment Group in the months following examination, and it is contrasted with the average VAT payment made by the taxpayers of the Other Observations group.



The increase in the VAT assessed by the taxpayer in the months following the date of the notification is much higher in the group selected in this study, than those selected by other methods (Other Observations Group), which is even negative.

#### **d. Case Conclusions**

- The history of examinations stored in the SII database allows for the use of data mining to find taxpayer behavior patterns.
- In spite of dealing with estimations made using statistical tools, it is possible to detect taxpayers who are in the described undesirable situation.
- The immediate yields obtained compete with those generated by other means for selecting taxpayers to be examined. Therefore, it is possible to use the taxpayer risk criterion as complement for taxpayer selection.
- Selected taxpayers respond, within medium term, to the examination strategy applied by the operating units of the SII by increasing their tax payments.

### **5. GENERAL CONCLUSIONS**

As has been shown throughout this document, the SII is devoting ever more efforts to applying varied treatment strategies, given the tax behavior of taxpayers, so as to facilitate compliance to those wishing to do so and minimize or examine with greater periodicity those showing greater tax noncompliance.

In-depth consideration has also been given to the fact that, although it is the taxpayer's duty to comply with his tax obligations, the SII has a very important educational and assistance task, since in many cases taxpayer fail to comply for lack of information or facilities for accessing the system.

In order to distinguish between those who wish to comply but cannot do so, from those who do not want to comply, it is necessary to continue to classify taxpayers, so as to count on more reliable databases and thus be more assertive in determining the tax behavior of taxpayers and accordingly, the most convenient treatment strategy to be applied.

The recent incorporation of the concept of risk, as well as remote examination and assistance are deemed to be appropriate for a better taxpayer classification and in sum, for continuing to design and implement taxpayer assistance programs in keeping with their tax behavior.

## **GENERATING TAXPAYER TRUST: ACCOUNTABILITY AND INTERNAL CONTROL SYSTEMS**

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***Contents:** Executive summary – 1. The tax system and the generation of trust – 1.1 Strategic context – 1.2 Strategic objectives 2. MUISCA management model – 2.1 Elements of the model – 2.2 Vision components – 2.3 Quality management and internal control system – 3. Conclusions and recommendations*

### **EXECUTIVE SUMMARY**

The design of the tax system is the cornerstone on which the trust of citizens is built, when contributing at all levels through taxes. In this regard the Government of Colombia is promoting in the Congress of the Republic a comprehensive reform in substantive and procedural matters, which will result in a more just and equitable system, progressive in nature, which will rescue the design of taxation as an engine of economic prosperity.

It is a proposal for competitiveness, employment, formality and banking. This is a simple user-friendly system for anyone wishing to be entrepreneurial or starting a productive project, or for those who were not blessed with sufficient conditions to tackle large or complex projects.

This means that we are going to simplify the tax status for the simple and make it more solid for the complexes. The purpose is to always propose a simpler language and form when drafting the current standards. On the side of Customs national security and competitiveness of the national production apparatus are highlighted as priorities over collection objectives.

The combination of the precedence of these priorities without neglecting the control of value statements is one of the challenges we face.

Therefore the tax and customs administration is in charge of realizing this purpose – making it happen -, by providing modern tools to facilitate the compliance of obligations by citizens who voluntarily come to it, through agile, simplified and understandable processes, by having a technically modern organization, with competent officials who evidence vocation of service and commitment.

On the other hand the society calls for a strong Tax Administration capable of: complying with and enforcing tax law through the effective control of tax fraud and non-compliance - evasion, avoidance, smuggling, foreign exchange violations - and unfair practices, - inefficiency and corruption - and on the other hand the firm recognition of complying citizens.

The tax administration's management must then have tools that facilitate efficiency and organizational efficiency, in such sense it is not enough to design and implement an internal control system, but it is necessary to assign a specific weight to it in the work of the organization, in the operation and continuous improvement of the organization. The same must be characterized by the ability of anticipation that this must provide to management, to address institutional risks at all levels and demonstrate the response capacity of the administration to feedback its processes.

In this regard we adopt best practices from successful learning experiences around the world, to improve the administrative and managerial procedural aspects from a technical perspective, drawing on the advantages and the added value that others have already experienced and tested.

**For example:**

One of the substantial discussions is how to reach legal stability to shield taxpayers from unexpected changes in the rules of the game, as well as strengthening both internal and external investment. This is accompanied by an institutional design capable of protecting the administration at the same time in which reliability and stability is given to the economic interpretation of the rules to the taxpayer. In this vein greater insight of the tax administration and public finance around the interests, the checks and balances of these two institutions may be virtuous.

In other words, the creation of a high rank office, remuneration and level within the Ministry of Finance and Public Credit to ensure stability and relevance in the application and interpretation of standards; the professional and transparent relationship between the tax administration and the taxpayer; as well as the research and documentation of complaints by putting due process and the defense of the public above any short term fiscal objective can be better than the institutional designs in which the tax administration can end in the natural conflicts of being judge and jury.

Finally, we evidence the need to strengthen accountability through which the administration returns to the citizen the testimony that it gave in the social contract established in the Constitution and the laws.

In the conclusion the role that must be complied with to achieve a transparent tax administration with all actors involved in the same is evident.

“Trust means that the citizen ‘has faith’ in its tax administration”

## **1. THE TAX SYSTEM AND THE GENERATION OF TRUST**

The design of the tax system is the cornerstone on which the trust of citizens is built, when contributing at all levels through taxes. In this regard the Government of Colombia is promoting in the Congress of the Republic a comprehensive reform in substantive and procedural matters, which will result in a more just and equitable system, progressive in nature, which will rescue the structure and the management of tax affairs as an engine of economic prosperity.

It is a proposal for competitiveness, employment, formality and banking. This means that we are going to simplify the tax status and make simpler current rules; it is not intended to increase rates.

This is about creating simple rules, for simple companies and complex for complex companies. Furthermore, tax reforms should have very clear standards, which are written in simple language and are permanent in time.

In this regard the existing tax benefits should be revised, to avoid unnecessary tax privileges which erode collections by way of refunds and compensation in the same manner the benefits given to tax compliant employers must be reviewed. “There are some who are very compliant, but what happens when they sustain losses? We must

discuss whether they are entitled or not to exemptions when they have a credit balance because of a loss.”

Similarly the purpose of to reduce the tax procedure to make it more flexible and consistent with the times tending towards effectiveness in tax control.

The citizen must receive a simple and fair tax system mediated by a clear and easy to understand regulation which is refereed by an effective tax administration, objective, compassionate and able to guarantee the rights of citizens. Notwithstanding the above the taxpayer must understand how onerous is the failure to comply with its obligations and the social repudiation generated by the non-compliance with these obligations.

In sum, citizen trust in the tax administration starts with the design and implementation of a fair and equitable tax system that involves clear and understandable rules of game on which the social contract is made to achieve healthy state funding by way of taxes within the framework of the Social State based on the rule of the Law.

This abstract challenge must be framed in the story of an institutional framework and a tax organization, which does not start from perfect rules unanimously accepted. The challenge is to conquer the natural areas of tax administration surrounded by legitimacy and respect. Even if the starting point are rules and organizations with defects and multiple opportunities for improvement. The prevailing is continuous work to improve the administrative and regulatory processes to make them fairer, transparent, stable, so that they are instruments on the way to the legality and formalization of the production system and not an obstacle.

The tax and customs administration must ensure the principle of neutrality; therefore, it should strive to collect at the lowest transaction cost for citizens, through a facilitation service for the fulfillment of obligations.

Trust consists of approaching the citizenship to the administration - locate a meeting place - this exercise must be two-way facilitating social and fiscal control from the citizen relieving its rights and enhancing its duties from the effective collaboration with the administration either through the fulfillment of all obligations, provision of information and strengthening the payment culture.

In such a way that each person can feel part of the Government and its policies through mechanisms among others to provide inputs for the formulation of policies and the generation of the plans and programs of the entity through citizen participation. Public expenditure, its effectiveness and relevance are determinants of the credibility of a tax system and the levels of voluntary compliance; corruption and administrative expense, its greatest enemies.

To realize these objectives, the strategy of the DIAN is the provision of services to the taxpaying citizen, through multiple technological means and attention centers, to facilitate compliance with its obligations at the lowest possible cost.

On the subject of evasion and smuggling control, fiscal intelligence is being strengthened, that is the great challenge. In the future, MUISCA will be enhanced with statisticians, engineers, and people able to infer from the data the reality of the sectors.

The financial difficulties of the country highlighted by the end of the century international payments crisis made cash flow a priority in public policies and multilateral entities. Therefore, DIAN's emphasis in the past 13 years has been on collection. To have the cash to facilitate the payments to be made by the State in spite of living with major liquidity restrictions.

Consequently the pressure of getting cash is contrary to in depth examination and subsequent litigation and favors the search for the voluntary correction of taxpayers of increasing their payable tax or reducing their refunds requests. The institution is accordingly weakened in its ability to perform research at depth where it has a total diagnose of the possible evasions and avoidances of the different economic sectors.

More favorable economic conditions give us "The advantage of being able to see in the long-term, planning collection over time, pursuit evasion in depth. People will understand that when you go in depth, if there is evasion they will have to shoulder very high loads for breaching their tax obligations." The risk of evading should be internalized by the population at large.

"This will generate a consciousness in Colombia of what they call subjective risk, which is that people will know that to evade or being opportunistic will be exemplary sanctioned. When you are aware of

this risk, you adjust your behavior, many believe that they will never be found, therefore, they must have very clear that we will penalize them.”

Accordingly, from the strength displayed by the tax and customs administration to facilitate an agile and safe public service, and the effectiveness of the systematic and transparent exercise of control, a strong educational message is sent to present society and future generations: to be honest is to pay and opportunism is punishable and rejected. This should lead to greater trust towards the tax administration and the State in general provided that the quality of public expenditure is planned.

Herein are some of the instruments available to the tax and customs administration to strengthen internal control, risk management and accountability.

### **1.1 Strategic Context**

The National Tax and Customs Directorate of Colombia in the development of the organization's strategy are working systematically to:

Achieve international quality standards to enable the tax and customs administration to become more competitive in its purpose of contributing to the sustainability of public finances.

Adopt best practices from successful learning experiences around the world, to improve the administrative and managerial procedural aspects from a technical perspective, drawing on the advantages and the added value that others have already experienced and tested. Discussions as the opportunity to force the payment of the VAT depending on what was incurred or accrued versus paid or perceived are substantial.

Strengthen the fiscal Intelligence for real evasion and smuggling control as a guarantee of the principle of neutrality, from the intensive use of the information available and the use of relevant tools for data analysis, strengthening organizational capacity to anticipate as a basis for institutional risk management.

Joint work is being carried out on the drafting of legislative proposals that would enable an adjustment of the substantial and procedural aspects of the tax law. A simple system for emerging enterprises or enterprises with constraints to their development and growth; with the purpose of not encouraging fiscal dwarfism but rather stimulate the accumulation and growth of the productive apparatus. Give priority

to formalization particularly in terms of social security and making individual's tax returns an ownership participation mechanism through tax credits. Adjust sanctions, so that while sobering they are not to the point of being incredible as the current sanctions.

Increase tax and customs collections by three percentage points as a proportion of the Gross Domestic Product, by fighting evasion and smuggling.

The provision of a flexible and relevant public service to facilitate foreign trade operations and compliance by citizens and taxpayers, customs and foreign exchanges.

In this regard the vision, mission and strategic objectives were restated.<sup>1</sup>

## 1.2 Strategic Objectives

- To increase voluntary compliance with tax, customs and foreign exchange obligations
- Support the sustainability of the public finances of the country
- Foster the competitiveness of the national production apparatus.

## 2. MUISCA MANAGEMENT MODEL

DIAN has been over the last few years building a management model that fits the reality of the tax and customs administration. This model seeks to respond to the complexity of its purpose and to integrate the elements necessary to achieve organizational effectiveness. In MUISCA strategic skills and elements of the mission and vision were merged on the basis of the Quality Management and Internal Control System.

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### 1 Vision

*“By 2010, the National Tax and Customs Directorate of Colombia will accomplish a high level of voluntary compliance of tax, customs and foreign exchange duties, will support the country's financial sustainability and will foster the competitiveness in the national economy, managing quality and applying the best international practices in its institutional actions.”*

### Mission

*“At the National Tax and Customs Directorate we are responsible for managing the compliance with tax, customs and foreign exchange duties with quality, through service, auditing and control; facilitating foreign trade operations and providing reliable and timely information with a view to assuring the Colombian State's fiscal sustainability”:*





## 2.1 Elements of the Model

The model adopted by the entity adds mission and vision elements and is framed on the principle of comprehensiveness, which involves coordinated and balanced management of the administrative, organizational and human aspects of the entity which facilitates citizen participation and social control.

It contains principles and tools of different organizational theories especially in the approach to management processes for which it has defined a DIAN corporate standard technique.

DIAN as any modern organization develops in an environment of progress, social economic and industrial changes that impact the manner in which challenges are addressed, the future is faced and ensuring sustainable development.

The principle of unity of the model leads the DIAN to management focused on processes, clearly identified and interrelated, giving rise to management conditions based on technical criteria that are conducive to the efficiency and quality of its products and services.



## 2.2 Vision Components

### Processes

The basis of the organizational model is the processes map that defines the strategic, mission character, support and control thereof, as seen in the graph herein:



Strategic processes are intended to provide guidance to the entity to enable it to fulfill its mission, vision, policy and objectives and meet the

needs of stakeholders (organization, person or group) who have an interest in the entity.

The mission has to do with the *raison d'être* and responsibilities of the DIAN as an institution of the State, which includes helping ensure the fiscal security of the Colombian State and the protection of national economic public order through the administration and control due compliance with tax, customs and foreign exchange obligations, and the facilitation of foreign trade operations in conditions of equity, transparency and legality.

Support processes provide support to the mission, strategic and measurement, analysis and improvement processes.

Finally monitoring and evaluation processes enable measuring exercises, feedback and adjustment, so that the entity can achieve the proposed results. These also include measuring, monitoring and internal audit processes, corrective and preventive actions, and are a comprehensive part of strategic, support and the mission processes.

### **Organization**

The primary purpose of the DIAN is the administration of taxes generated by national domestic economic activities and international business operations, these functions are framed within the State's purposes and the administrative role stipulated in articles 2 and 209 of the Constitution of Colombia.

The organizational structure of the entity, responds to a processes based approach which allows managing the requirements and needs of its clients and stakeholders, organized administratively into 3 levels: Central, Local, and Delegate.

The entity has an operational Claims, Complaints and Suggestions System in place.

The Taxpayer and Customs User Advocate is a special body of the National Customs and Tax Directorate.

### **Resources**

DIAN has an own assets, and receives inputs from the National Budget needed for the operation and investment of the entity, it also has own income.

## **Human Talent**

To develop their processes DIAN has a team made up of public employees, approximately 8,500 staff which must abide by the profiles defined by institutional, managerial and technical competencies.

Similarly, it carries out the institutional PIC training Plan, as well as the Social Security and Labour Welfare Programme, aimed at ensuring compliance with the requirements set out in its products and services, in order to meet the needs of its customers.

## **Information**

Information is the concentric axis of the actions of the DIAN, - effective collection is carried out through the banking network and is transferred directly to the Directorate General of the Treasury -. It becomes input process and result of the tax administration, there are primary sources which produce the same entity and the secondary information from the other actors of the Tax and Customs System such as Exogenous Information which supports the Examination process.

## **Mission Components**

Service and control collection elements are responsible for the registration, assessment, discussion, charge, collection and foreign trade stages are the competence of DIAN.

### **2.3 Quality Management and Internal Control System**

The Quality Management and Internal Control System of the DIAN is formed in the concentric axis of the organizational actions, and connect of the MUISCA Culture management model is based on that the DIAN is an entity organized by processes in pursuit of organizational effectiveness and the satisfaction of all parties concerned.

It relies on qualified technical work tools and methodologies under ISO Standards which are in harmony with higher-order public policies geared towards the development of a modern and competitive government system.

Its fundamental purpose is to provide security for the fulfillment of the goals and commitments that have been allocated to ensure organizational effectiveness, provide reliability to the institutional information within the framework of the laws, regulations and institutional policies.

The Quality Management and Internal Control System is the result of the institutional effort to harmonize higher-order public policies (Quality Management System of the Public Sector, Internal Control Standard Model, Rationalization of Procedures Policy, Government Online, and Single Procedures Information System – SUIT – in Spanish, among others) and the organizational elements of their organizational actions.

The SGCCI of DIAN relies on self-regulation principles, self-control and self-assessment where each manager is responsible for their actions and outcomes, the Office of Internal Control is responsible of evaluating the systems and for this purpose it uses the relevant audit, analysis and evaluation tools, from which the institutional improvement plans are derived from.

The system has different feedback mechanisms such as the petitions, Complaints, Claims and Suggestions System, assessment reports of fiscal control bodies, service perception surveys and Taxpayer and Customs Users Advocate reports, among others.

In the same manner the entity is increasingly incorporating in the procedures streamlining, simplification and automation policy that guides citizen and employer relationships for the exercise of their rights or compliance with the customs and foreign exchange tax obligations, within the procedures and services information and disclosure principles through the Single Procedures Information System - SUIT-. In turn is geared towards the strengthening of citizen attention improvement mechanisms as provided for in the National Program for Citizen Services – PNSC, in Spanish - through the use of the information technology and communications – ICT - under the regulation of the online Government strategy – GEL, in Spanish – of the Connectivity and Transparency Agenda Programme by Colombia that promotes the existence of a system of petitions, complaints, claims and suggestions – PQRS, in Spanish - ensuring service and information to citizens.

The Risk Management System and the promotion of self-assessment, independent evaluation and the implementation of improvement plans are also part of the Management and Results Planning and Control System of the entity.

This policy seeks to improve the quality in the supply of products and/or services with the sole objective of increasing confidence and credibility in citizens aligned within the institutional commitment of service, control and collection:

During the week from November 29 to December 3, 2010, Bureau Veritas Certification, conducted the audit verification of the status of compliance of the Integrated Management System of the entity for certification under the NTCGP 1000: 2009 and ISO 9001:2008 Standards on all the processes of the DIAN at the Central level and randomly in of the Customs Directorates of Barranquilla, Bogotá and Cali, Taxes and Customs of Ibagué, Tunja and Santa Marta and Taxes of Bogotá and Large Taxpayers.

The certification audit found an Integrated Management System that was documented and implemented, and one which complies with the majority of the requirements of the NTCGP 1000: 2009 and ISO 9001: 2008 Standards. Several strengths are evident in the commitment of all staff audited and focus on clients.

### **Fiscal Control**

In Colombia the Fiscal control is exercised by the Office of the Comptroller General of the Republic an agency in charge of the external evaluation of the Internal Control System, which gives rise to the respective improvement plans.

Information and communication in the control system, and the provision of the service in the quality system guide the Anti-procedures policy with the support of information technologies to improve services and information offered to the citizens, to increase the efficiency and effectiveness of public management and substantially increase the transparency of the public sector and citizen participation.

### **Social Control**

The Colombian constitutional regime identifies various citizen participation mechanisms that allow bringing the State closer to citizens as a means to protect constitutional rights, popular actions, and along these lines the national Government has regulated accountability and citizen participation in the social control of the State.

### **Online Government Strategy**

In an international context, Colombia has undertaken regional and global commitments to include national strategies, the promotion of modern administrations, more efficient, effective and transparent, by offering online information to citizens, management control mechanisms, participation, services, procedures and procurement.

At this level the country is recognized as the E-Government leader in Latin America and the Caribbean according to the electronic Government world report of the United Nations (UN): moving up 21 seats in the last two years. (See table herein).

**Table No. 2 – UN E-Government Statistics**

Country	E-Government 2010	Rank 2010	Rank 2008	Change in Rank
Colombia	0.6125	31	52	+21
Chile	0.6014	34	40	+6
Uruguay	0.5848	36	48	+12
Argentina	0.5467	48	39	-9
Brazil	0.5006	61	45	-16
Peru	0.4923	63	55	-8
Venezuela	0.4774	70	62	-8
Ecuador	0.4322	95	74	-21
Bolivia	0.4280	98	72	-26
Paraguay	0.4243	101	88	-13

Source: United Nations E-Government Development Knowledge Base<sup>4</sup>

<sup>2</sup> Colombia's position in E-Government

DIAN has been carrying out technological developments to manage an open and participatory online Government, which combines the following aspects:

- Government - Citizen,
- Government -Company and
- Government - Government:

Similarly, it participates in important procedures chains for the country's competitiveness such as the One-Stop Window for Business, which in association with the Chambers of Commerce throughout the country:

Transacts the registration in the Tax Identification Number - TIN - is managed based on information from the Business Register, and the One-Stop Window for Foreign Trade – VUCE, in Spanish – managed by the Ministry of Commerce, Industry and Tourism, and through which all the entities responsible for issuing and authorizing approvals for imports or exports and carry out the corresponding procedures

<sup>2</sup> Source: Conpes, Online Government 3650, 2010.

interact in providing online information on the TIN for the effects of authenticating applicants, such as the request for the confirmation of the approvals issued and made available as support documents on shipment authorization requests.

Similarly, there is online interaction with citizens through:

- The processing and virtual filing of tax, customs or foreign exchange returns,
- Consultation of inconsistencies,
- Process management
- The departure of goods or import cargo and
- Payment transactions through electronic channels;

The purpose is to make management more transparent and encourage citizen participation for voluntary compliance with tax obligations, customs and exchange, generating trust in taxpayers in their interaction with the administration.

Likewise, the DIAN generated in the Web page of the entity a “Forum”, as a mechanism to ensure the participation of citizens; in turn it enabled the use of social networks **Facebook** and **Twitter** and currently has 1708 and 116 followers respectively generating online interaction and participation.

To promote citizen participation in DIAN's 2011-2020 Strategic Planning, in September there were 8 internal forums with 117 users and 389 comments, 2 forums with management personnel with 118 users and 535 comments an external forum with 54 expert users at national and international levels in tax, customs and exchange rate issues and 16 comments. In October the open forum “Citizenship Participation in DIAN's Strategic Planning,” took place with 22 users, 33 comments and 11 opinions.

### **Accountability**

Accountability is the ability that the Tax Administration has to deliver citizens a public response to the requirements made by the same, for the management of resources, decisions and the management carried out in exercise of the power that has been assigned thereto, the DIAN, following the guidelines set out in the law and in the same, economic and social policy documents and the Public Hearings Guide for



accountability to the citizenship of the civil service, and making use of information and communication technologies, the information provided in the Web page of the entity, proceeded to carry out the following activities with a view to provide accountability of its management to citizens:

In this regard an Organizational Management Directorate group was created, to find and organize information on accountability minimums as well as information on requests, claims, complaints and suggestions received. During this stage the communication strategy was designed to ensure a two-way dialogue with citizens and also develop the plan of action with activities, resources and persons responsible for said process.

To improve the interaction with citizens an inventory of the complaints and claims submitted virtually and in person by citizens on the development of the management of the DIAN was carried out, and civil society, universities, unions and experts on specific topics through the Forum of the entity were consulted.

Also a virtual accountability public hearing was organized, where a call to the public was made, citizens' proposals were registered, the publication of a document explaining the accountability process and the realization of a virtual forum making use of the progress achieved through online Government with the Forum mechanism.

A final report of the public hearing to sum up the above, the comments and questions received from citizens was finally prepared. Verification implied compliance with the objectives of the process and the evaluation of the activities undertaken to achieve institutional transparency to facilitate communication and information with citizens.

Finally, feedback is carried out so that the actions to improve institutional management are adopted.

The entity by organizing the activities mentioned, met the democracy criteria of the online phase of the 2010 Government manual – a call for online participation by electronic means, online participation, qualification of spaces for participation by making use of social networks, publication of public participation results for the construction of policies, plans and comments to draft bills, call for online democracy and tracking e-democracy online.

The fifth version of the National Transparency Index (NTI, in Spanish), presented in July 2009, assessed 138 national public entities and 20

entities of special nature and regime, doing a review of the measuring of factors, indicators and variables relating to the Finance Sector during the year 2009 had an transparency index of 86.6% and in the DIAN sector occupied seventh place in the year 2009 with a of 81.2 rating.

### **3. CONCLUSIONS AND RECOMMENDATIONS**

In conclusion, we believe it necessary to move from formulation to action in terms of consolidating institutional development in function of achieving the goals on the subject of collection service and control, requires the country to move forward on the path of sustainable economic development. At the same time that Society strengthens trust in the tax and customs administration and improves the citizens' perception of the public service,

The tax system must be fair, equitable and progressive, inclusive, with temporary, manageable fiscal incentives measurable and relevant, which contribute to the generation of national wealth, jobs and development.

Similarly, a procedure for harmonizing legal time with administrative procedures to incorporate fair income in a short time and in this manner prevent individuals and bodies corporate from being disqualified from paying their debts to the tax administration.

In this regard a broad consensus for fiscal transparency is required from all the individuals that form part of the tax and customs administration.

In the development of the principle of neutrality which seeks to obtain the proposed targets at a lower cost transaction for citizens. The tax administration must then, generate a perception of strength in the citizenship with their exemplary, systematic and forceful actions especially in the sanction of evasion, which should generate subjective and objective risk from the intensive use of the information on the basis of fiscal intelligence understood as the capacity of the administration to be accurate and fast in detecting the omission, inaccuracy, failure and fraud, from the information available, using optimally the resources of the administration.

Whilst offering a modern technological and computer platform, accessible to all citizens to ensure their compliance with their obligations and the input of information on the economic activity of persons and companies, for the in-depth control that must be carried out by the administration.

The website must be enhanced to a maximum so that this is the environment where the citizen meets with the tax administration, so it should be complete, up-to-date and easy to understand to be more user friendly in order for citizens to comply with their obligations from any place in the national territory and the world.

The tax culture is reached when citizens perceive the strength of the tax administration and the proper use of public resources through public expenditure.

The usefulness and applicability of higher-order public policies issued by the national Government must be analyzed as well as the definition of institutional development policies public - quality, internal control, human development, performance evaluation, rationalization of procedures ... - and fight against corruption, therefore tax administrations must ask themselves if they need a special regulatory treatment for them and for the strengthening of an administrative career and promote its own disciplinary regime.

The tax administration must then strengthen and provide sustainability to internal control systems, empowering management for the effective operation of a risk management system, and management sustainability, attention to complaints, claims to the suggestions and requests in the short medium and long term. And the Office of Internal Audit to perform structural and systemic evaluations that contribute to the institutional improvement and which would improve the effectiveness of tax administration.

Regarding the public servants of the tax administration more beyond their code of ethics, requires the strengthening of an administrative career of special nature for the tax administration to have a competent team, which merges qualifications, experience and ethics of civil servants and the generational replacement, which adds modern performance evaluation tools and results-based competitive strategic compensation.

Same as an agile disciplinary regime that allows the Administration to have qualified and transparent staff in real time and waive those which are not.

Taxpaying responsible citizens, and other taxpayers should meet their obligations, rights and duties with the tax administration, therefore they must among others comply with their registration in the Mater Taxpayer Registry, submit and pay their returns, issue invoices,

denounce evasion, and in this sense the special body of the Taxpayer and Customs User Advocate is justified.

Unions, associations, cooperatives, users must strengthen their role in the generation of the contribution culture between its members and report to the tax administration, unfair practices that they see, also promote the formalization of employment, the use of banking services and other legally accepted practices.

Considering the intermediation of the citizens with the tax administration the role of accountants and fiscal reviewers and other professionals must be evaluated, by applying exemplary sanctions to those whose behavior is not pursuant to the law. Likewise requires breaking possible alliances with administration officials.

The sanction to accountants and fiscal reviewers as it is appropriate should be effective, it is necessary to separate the unfair practices of processes inherent to the tax administration

Tax control bodies must specify structural improvement measures to eradicate root constraints, which should not wear out entities audited or tax control bodies.

Police and judicial authorities should provide permanent collaboration to respond reactively in identifying misconduct by public officials and intermediaries and the prevention of the same so that they are not repeated.

In this manner the Tax Administration can reach the objectives that have been entrusted thereto and society can head towards tax morale by consensus.



## **FINAL CONSIDERATIONS**



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### Dr. Everardo Maciel



*Dr. Everardo Maciel*

May my first statements be of gratitude to the CIAT Executive Council and its Executive Secretary, my dear friend, Mr. Márcio Verdi, whose outstanding management of this organization fills his fellow countrymen with pride—, for having distinguished me with the invitation to present the Final Considerations of this 45<sup>th</sup> Assembly, and which mission I am proudly fulfilling for the second time; this being also an opportunity for returning to this institution, where I had the privilege of being a delegate, as well as Executive Council member and president.

Ladies and Gentlemen:

These final considerations do not summarize the lectures presented, or considerations expressed, nor are they intended to become an independent presentation. Their purpose is to merely identify convergences and general guidelines, arouse debate and add some personal reflections.

I praise CIAT's daring on choosing Tax Morale as theme for this meeting, inasmuch as it is a controversial and complex subject, capable of arousing a wide diversity of perspectives and judgments. Precisely for this reason, discussions were bountiful in contributions for structuring doctrinal bases and paths for action.

Since the "Kantian turn" (*kantische Wende*), to use an expression established by the German thinker, Otfried Höffe, the re-reading of Kant's work promoted, in the early seventies, an intensification at the doctrinal level, of the relationships between ethics and law, in contrast to positivism which prevailed then and which postulated a segregation between those two schools.



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In the light of this new trend of thought, compliance with the law does not exempt the individual from the observance of ethics, understood as a series of standards and provisions for a virtuous conduct.

As well noted by the Brazilian jurist, Ricardo Lobo Torres (in “Tratado de Derecho Constitucional, Financiero y Tributario”, [Constitutional, Financial and Tax Law Treaty], vol. II), the “Kantian turn” offers, among other innovations, the juridical positivism of the abstract ethical norm and the projection of tax ethics toward the international, national and local dimensions.

Tax ethics, herein understood as a synonym of tax morale, recently acquired doctrinal relevance, particularly with the Works of Klaus Tipke – in particular, “Die Steuerrechtsordnung” and the “Tax Morale of the State and the Taxpayers”, as well as of other distinguished German tax experts as Paul Kirchhof and Klaus Vogel.

Tax morale represents a complex system that expresses, in the tax sphere, justice, freedom and fundamental rights; and which is projected from the administration, including its agents up to the taxpayer. For that same reason, it cannot be solely limited to one of them, since its legitimacy is based on bonds of trust and reciprocity between the State and those that are subjected to its jurisdiction. The rupture of those bonds eliminates the possibility of structuring a fiscal democratic state.

As principle, tax morale requires that it be specified at the normative and procedural levels, which results in tax morality as a concept derived therefrom, and which involves the behavior of the State and the taxpayer.

Tax morality is conditioned to cultural factors, political acceptance and the availability of means, given that its real expression can be greatly differentiated among the countries, but always enlightened by tax morale as universal value.

We learned here that the tax administrations, as well as academic institutions and private entities, by their own initiative or at the request of third parties, have endeavored to find out by means of surveys or laboratory experiences, how taxpayers perceive the tax administrations and how they react vis-à-vis the fundamental duty to pay taxes.

These initiatives are meritorious, since fortunately we were able to gain awareness of the difficulties of generalizing the respective conclusions, by reason of the diversity of tax cultures, not to mention the very dynamics of the taxpayers’ expectations and the circumstances wherein they are

inserted, which ultimately calls for carrying out permanent research as guiding source of the strategies of the Tax Administration.

Having considered the taxpayer's attitudes in the light of tax morality, K. Tipke, at that time, proposed a suggestive typology:

1. homo oeconomicus: the one who decides, according to economic convenience, taking into account the advantages and risks of not paying taxes, waiving any behavioral moral duty;
2. compensator: the one who believes that taxes are paid only if one receives public services as benefits, in the presumption that the tax is the price;
3. bad-tempered: the one who does not accept to pay taxes, because he disagrees with the political line followed by the State;
4. liberal: the one who perceives the tax as a limitation of his freedom;
5. legalist: the one who seeks to identify the fiscal gaps and fragilities of the law to avoid, reduce, or postpone the payment of taxes;
6. inexperienced: the one who is incapable of understanding tax legislation without the help of an adviser;
7. sensitive to justice: the one who protests against the unequal application of tax laws and the granting of fiscal favors.

The research work undertaken with a view to identifying the attitudes of taxpayers vis-a-vis tax morality are quite close to Tipke's typology, which to a good extent appears to confer it universal nature.

The most common offense of fiscal morality by the taxpayer is concealment, which additionally constitutes a violation of the law. During the course of this Assembly we were able to evidence the evolution of the taxpayer selection models, based on risk analysis and segmentation according to types of fiscal interest, which results in greater operational efficiency in examination procedures. Their dissemination will certainly be for the benefit of a better grading of those procedures.

Although it is a relatively modern phenomenon, harmful tax planning, carried out through the exploration of legal gaps, may also be included within the sphere of violations against the principle of tax morality on deviating from the possible limits of reasonableness of the law, although many times it may not be considered as a violation of the tax legislation.

To prevent eventual formal allegations, it is convenient to provide in the legislation for specific situations that may constitute harmful tax planning or, more generically, link it to classical statutes of civil law, such as lack of purpose of the business, or abuse of form, or abuse of the law or fraud in law (*fraus legis*).

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The combat against the underground economy calls for a more careful treatment in order that fiscal repression will not be focused on the poor people that are led to such condition by unfair labor or migratory legislations. They constitute real human shields to conceal the de facto beneficiaries of such illegal behaviors.

Tax intelligence actions must investigate the suppliers' network, in order that examination may put an end to the sources that feed the informal economy.

The segmentation of taxpayers following the risk analyses, called for a review of the operational structures of the tax administrations, previously organized exclusively according to space criteria, to now allow for new organizational methods focused on the size of the taxpayers.

It is equally reasonable to explore new possibilities for establishing specialized units by sector (similar to financial institutions or economically determining sectors in a national economy) or by themes (such as transfer pricing or harmful tax planning).

Without considering intrinsic restrictions in each country's constitutional order the treasury must expand to a maximum the information to be used for detecting indicative elements in taxpayer selection.

In addition to what is extracted from the very taxpayer returns, to be included is information on the financial activity, transactions involving real estate and vehicles, transactions with credit cards, insurance and exchange contracts, commercial leasing activities, stock exchanges businesses, etc.

The crosscheck of such information calls for establishing data models and an adequate technological platform, if possible, by resorting to artificial intelligence aimed at the appropriate selection of taxpayers eligible for the examination program.

However, such crosschecks will not be viable without a reliable taxpayer cadastral base. An appropriate way for the maintenance of the cadaster is the inclusion of filters in registration that may prevent errors, whether intentional or not, as well as the filing requirement for all the economically active population and for all businesses, regardless of their size, their eventual exemption condition or actual exercise of their businesses. That is a good way of eliminating the nonfiling hypothesis.

Obviously, for exempt taxpayers as well as inactive businesses, extremely simple return models should be conceived, exclusively

aimed at maintaining the file. Brazil is a good example of such a solution. Accordingly, the tax registration number, because of its quality and respectability, came to be used as the business identification of individuals, even for banking transactions.

In addition, new resources that result in cost reduction for taxpayers and greater efficiency in the examination action are being fully developed and implemented. I am referring in particular to electronic invoicing and the digital accounting systems.

For achieving these objectives, besides the normative support that may allow access to the information, permanent investment in technological infrastructure is essential.

Nevertheless, in said context, special attention should be given to the selection, treatment and protection of the information, at the risk of taking away the moral legitimacy of said function from the Tax Administration.

There is no reason for compiling information of little or no use for examination, such as the nature of the expenses of individuals, because in said hypothesis, the taxpayer's fundamental right should prevail over public interest, which is understood to be included in said activity.

Procedural loyalty, inherent in administrative morality, imposes on the Treasury the duty to clarify the taxpayers that such information is compiled systematically. The secrecy of investigations should only be reserved for those incidental procedures dealing with taxpayers or group of taxpayers under suspicion of fraud.

All the information compiled should be subjected to strict secrecy rules, based on a legal structure that provides for administrative sanctions, civil responsibility for moral and material harm and penal typification for whoever violates secrecy.

The very access of the tax agent to the information, as stated herein, should be motivated and strictly linked to examination, likewise observing the relative equivalence between violations of secrecy and unmotivated access.

Data banks must be protected by means of technical procedures that are currently well developed and which may guarantee the security of information, from access by unauthorized persons to the detection of irregular accesses by authorized agents.

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The globalization of financial and commercial businesses constitutes a definitive fact, with inevitable consequences, in terms of economic productivity, technological evolution, structuring businesses into networks with outsourcing and even some other form of delegating the performance of the activities, corporate reorganizations, etc.

Unfortunately, in that same context, the economic crises are disseminated at great speed and vast expanse, in the same way there is an increase, with a growing level of sophistication, of such criminal activities as concealment, money laundering, piracy, terrorism, drug trafficking, smuggling, trafficking of persons and organs, etc.

There is no way for effectively facing those criminal practices without international cooperation. Oddly enough, such cooperation is frequently requested for combating terrorism, piracy and drug trafficking, without it being extended, for example, to concealment and money laundering. On the contrary, one commonly finds protective attitudes in favor of harmful tax competition, centered on tax havens, or bank secrecy, linked to secret accounts, fiscal investigations of other countries.

Undoubtedly, the transfer of information must involve mechanisms for protecting secrecy and should be authorized through cooperation agreements. Nevertheless, the unwillingness to carry out such information exchange without any acceptable justification, discloses an attitude that is not in keeping with tax morality.

The obligingness to harmful tax competition is a true State violation, because everyone is aware that resources channeled toward tax havens are always linked to concealment, money laundering, and corruption in the State's system, harmful tax planning and other not as virtuous practices.

If it is true that fiscal action takes advantage of a good perception of fiscal justice by taxpayers, it is also essential that it may have real consequences, in terms of fiscal credit liquidity. Fiscal impunity is the opposite of tax morality.

This issue holds back decisions regarding lawsuits and revenue collection, in the administrative as well as judicial sphere. It would seem interesting to explore ideas about specialized justice in the field of taxation, as well as greater integration between the administrative and judicial process, from the use of evidence up to greater functional autonomy in the administrative judgment processes within the sphere of the tax administrations.

However, one could do without actions marked by their spectacular nature, of a merely media effect which, not rarely, have undue repercussions on human dignity. The State's tax morality cannot deviate from the rules dealing with abuse of authority, collection that is excessive or applied through offensive means and the State's civil responsibility.

Jean Dubergé, in "Dédramatiser l'Impôt", is against the absurdity of fiscal collection that attributes an offensive nature to the sanction (penibilité). The great Italian tax expert, Victor Uckmar, noted that the taxpayer's abuse could not justify the tax administration's abuse.

In the same way, the use of extra fiscal coercive actions, such as restricting taxpayers who are in arrears with the treasury from carrying out their economic activity is but a symptom of fragility of tax collection, in addition to being classified in the doctrine as undue political sanction. It would be more appropriate to inquire into the causes of such fragility and find solutions to overcome the deficiency.

Taxpayer awareness as regards tax morality cannot disregard the use of tax education programs, mainly focused on school age youth. In this regard, we heard successful stories from several countries, although we know it is barely an element in the structure of social norms which should be combined with other civic and political education strategies.

The best form of tax education, I believe, is transparency with respect to public expenditures.

That is the most effective form of tax citizenship. The taxpayer has the right to be precisely informed about what has been done with the taxes collected and what is allowed by way of tax exemption, in order to evaluate whether there is consistency between his electoral option and the application of public policies.

At the level of citizen awareness, it is necessary to highlight that the State's obligation, especially in poorer countries or those with significant social inequalities, cannot be limited to conventional public policies, such as provision of educational and health services, infrastructure, defense, public security, etc. To all this one must add social inclusion and poverty reduction programs, as a demand resulting from the principle of social solidarity, by virtue of which there will inevitably be asymmetry between the taxpayers and the beneficiaries of public expenditure.

As for those who resort to precariousness of public services or governmental corruption as illegitimate argument for not paying taxes,

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it is worth recalling that there is no evidence that such behavior at no time or place may have resulted in improvement of public services or may have overcome corruption.

Since tax morality is a two-way street between the State and the taxpayer, it is essential that the Tax Administration's morality be perceived by all. It begins with the behavior of its agents, for whom ethics is an essential attribute.

Any suspicion of corruption must be strictly investigated by the judicial bodies, which should have the necessary functional Independence for investigating without any type of restriction.

After guaranteeing the right of defense and observance of the due legal process, sanctions should be strict and made public.

Nevertheless, the investigation does not exempt the authorities from applying other measures such as the continuous monitoring of the public servers' net worth evolution, permanent exercise of practices dealing with ethics and, finally, as observed in this Assembly, the previous examination of the moral, professional and tax background of the applicant wishing to become a tax official.

Although it might seem obvious, it does no harm to highlight the fact that the Tax Administration should be an organization of a strictly professional nature, whose commitments should respond to the public interest and not to private net worth pretensions or to temporary governmental decisions. This is, in addition a mandate dictated by tax morality.

The State's tax morality should reject acts that weaken the taxpayers' perception of justice, such as, for example: amnesties, remissions and everything else that may result in tax debit losses; unjustified withholding of undue taxes, which corresponds to the State's illegal enrichment; unjustified concession of tax benefits, etc.

Another aspect of the State's tax morality is transparency of the Administration, given that it obliges itself to account to society for its activities; that is, through the intensive use of the communication media, to make known what it does or fails to do, and subject itself to public evaluation of its performance by means of independent audits.

Coinciding with the recognition of the State's tax morality, as complement to the adoption of sanctions for the noncompliant taxpayer is the granting of benefits for those who do comply. I consider interesting the

measures adopted in Brazil which provide special customs processing systems for companies with an appropriate fiscal reputation, not to mention the fiscal compliance bonus, not yet regulated, which allows a tax reduction to compliant taxpayers.

It could possibly be that in the near future companies may be recognized for their fiscal responsibility; much in the same way it is currently being done with social responsibility and environmental responsibility, as an element of their image before the public and their stockholders.

In my opinion, the two most important doctrinal contributions of this Assembly were the linking of tax simplification and taxpayer services to the State's tax morality concept.

Klaus Tipke, in his work: "Tax Morale of the State and the Taxpayer", on referring to the deficiencies of the State's tax morale at the legislative level, highlighted the fact that in all Western parliamentary democracies tax chaos is denounced, while tax simplification is being demanded. And to this I add the comment by the Institute for Fiscal Studies, of London: the demand for tax simplification has become universal.

In late 2010, at a symposium held in São Paulo, Vito Tanzi, quoting Leonardo da Vinci, stated that: "simplicity is the last degree of sophistication".

Do not hesitate, tax administrators, in proposing solutions for simplifying tax legislation, of a presumptive nature, offered optionally to individuals, as well as to micro, small and medium-sized businesses. Do not fear to give up obedience to the ancient manuals of tax dogma that affect simplicity, diversity and creativity. May you know that, ultimately, public revenues and the taxpayers will thank you for it.

In the nineties, the tax administrations ceased their strict examiners position and maintaining the persons under their jurisdiction at a distance and began to consider the taxpayer as a customer.

I now perceive that another quality leap has been taken. Some tax administrations have achieved a new taxpayer service practice, which I call tax friendship in contrast to tax ill will.

In this context, inquiries have been evolving, by adding to the written and face-to-face communication, the telephone and Internet options, with preference for remote assistance which renders possible the standardization of responses. It also allows for greater clarity, given that,



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in a parody of Ortega and Gasset, clarity is the minimum expression of sensitivity of the tax administration toward the taxpayers.

Tax friendship is an innovation on opening the possibility for dialogue in a respectful manner, as well as for the establishment of debate forums between the tax administration and the taxpayers, as a tribute to the principles of protection of trust and good faith. It thus maintains a certain analogy with practices dealing with what is known, in the theory of international relations, as "Soft Power".

Forums endeavor to deal with complex and specialized issues in times of overall reorganization of the business models, thus raising consultation to a higher quality level.

It is thus concluded that tax morality is a multifaceted phenomenon and path with no return and, because it is new, it constitutes an open space for creativity, always for the benefit of structuring a prosperous society of free men, where there may be opportunities for everyone. All of this calls for coherence and continuity.

My last words, as those with which I began my presentation are likewise of gratitude.

First of all, I would like to thank the speakers, commentators and panelists, whose teachings were the most valuable contribution for the preparation of this report, of a tone disproportionate to the high quality of the presentations. Therefore, I found inspiration in the words of the French thinker, Raymond Aron, who noted two essential intellectual virtues: first, respect for facts; second, respect for others.

Lastly, I would also like to thank Economist Carlos Marx Carrasco, new president of the CIAT Executive Council, and all the staff members of the Internal Revenue Service of Ecuador, for their hospitality and generosity and the opportunity they gave us to learn about an operational and ever more efficient tax administration and likewise, to visit a country which captivates us for its culture, natural beauties and the warmth of its People.

I kindly ask those present to join me in thanking them with a round of applause.

Thank you.

## **TECHNICAL PROGRAM**



**CIAT GENERAL ASSEMBLY**  
**Quito, Ecuador**  
**April 4 to 7, 2011**

**DAILY SCHEDULE OF ACTIVITIES**

**MAIN THEME: “TAX MORALE AS DETERMINING FACTOR IN IMPROVING THE EFFECTIVENESS OF THE TAX ADMINISTRATION”**

Monday, April 4

**Morning**

09:00 - 10:20 Inaugural Ceremony, Statement by the President of the Republic of Ecuador

10:20 - 10:40 Coffee break

10:40 - 11:40 Keynote Speech

**Speaker:** Benno Torgler, Professor, School of Economics and Finance at Queensland University of Technology, Australia (60’)

**TOPIC 1: DEFINITION, SCOPE AND OBJECTIVES OF THE TAX MORALE CONCEPT**

**Moderator:** Pablo Ferreri, General Director of Revenue, General Directorate of Taxation, Uruguay

11:40 -12:10 **Speaker:** Carlos Marx Carrasco, General Director, Internal Revenue Service, Ecuador (30’)

12:10 -12:20 **Commentator:** Márcio F. Verdi, CIAT Executive Secretary (10)

12:20 - 12:45 Discussion (25’)

12:45 - 14:00 Lunch

**Afternoon**

**Topic 1.1. The strategic plans and tax morale**

**Moderator:** Margaret Sivers, Permanent Secretary, Ministry of Finance and Economic Affairs, Barbados

14:00 - 14:20 **Speaker:** Rudy Villeda, Superintendent, Superintendency of Tax Administration, Guatemala (20')

14:20 - 14:40 **Speaker:** Anders Stridh, Compliance Strategist, Swedish Tax Agency (20')

14:40 - 15:00 Discussion (20')

**Topic 1.2. Methodologies for measuring tax morale within the tax administrations.**

**Moderator:** Gustavo Manzano, Head of Anti-Corruption and Internal Affairs, General Directorate of International Taxes, El Salvador

15:00 - 15:20 **Speaker:** Rosario Massino, Head of the International Cooperation Office, Finance Guard, Italy (20')

15:20 - 15:40 **Speaker:** Alvaro Romano, Deputy General Director, Directorate of Taxation, Uruguay (20')

15:40 - 16:00 Discussion (20')

16:00 - 16:20 Coffee break

**Topic 1.3. Methodologies for measuring the tax morale of taxpayers and the results achieved.**

**Moderator:** Robert Joseph, General Director, General Directorate of Taxes, Haiti.

16:20 - 16:40 **Speaker:** Jean Noël Briday, Delegate of the General Director, General Directorate of Public Finances, France (20')

- 16:40 - 17:00 **Speaker:** Byron Vásconez, Economic Consultant, Internal Revenue Services, Ecuador (20')
- 17:00 - 17:20 Discussion (20')

Tuesday, April 5

**Morning**

**TOPIC 2: TAX MORALE AND THE TAXPAYER'S BEHAVIOR**

**Moderator:** Germania Montás, Acting Director, General Director of Internal Taxes, Dominican Republic

- 09:00 - 09:30 **Speaker:** Juan Manuel López Carbajo, General Director, State Agency of Tax Administration, Spain (30')
- 09:30 - 09:40 **Commentator:** Jeffrey Owens, Director of the Centre of Tax Policy and Administration, OCDE (10')
- 09:40 - 10:00 Discussion (20')
- 10:00 - 10:30 Coffee break

**Topic 2.1. Taxpayer attitudes vis-a-vis the tax administration: differentiate and classify behaviors.**

**Moderator:** Trinidad & Tobago

- 10:30 - 10:50 **Speaker:** Maria Helena Cardozo, General Coordinator of Tax Assistance and Education, Secretariat of Federal Revenues of Brazil (20')
- 10:50 - 11:10 **Speaker:** Steve Miller, Deputy Commissioner for Services and Enforcement, USA (20')
- 11:10 - 11:30 **Speaker:** Vanessa Johnson Group Manager, Corporate Risk and Assurance Corporate Services Inland Revenue, New Zealand (20')

11:30 - 11:50 Discussion (20')

**Topic 2.2. Design and implementation of control plans according to specific behaviors.**

**Moderator:** Jamila Isenia, Director Inspectorate of Taxes, Inspectorate of Taxes, Curacao

11:50- 12:10 **Speaker:** Marian Bette, Senior Policy Advisor, Tax and Customs Administration, The Netherlands (20')

12:10- 12:30 Discussion (20')

**Topic 2.3. Creating taxpayer awareness: Corporate social responsibility and the forums for taxpayer – tax administration dialogue.**

**Moderator:** Viralee Lattibeaudiere, Director General, Tax Administration, Revenue Service, Jamaica

12:30 - 12:50 **Speaker:** Frank Van Driessche, Tax Administration and Fight Against Fiscal Fraud, Directorate General for Taxation and the Customs Union, European Commission (20')

12:50 - 13:10 **Speaker:** Catherine Bennett, Assistant Commissioner, Canada Revenue Agency (20')

13:10 - 13:30 **Speaker:** Deborah Nolan, Private Consultant (20')

13:30 - 14:00 Discussion (30')

14:00 - 15:00 Lunch

**Afternoon**

Administrative Session

Wednesday, April 6

**Morning**

**TOPIC 3: TAX MORALE AS DETERMINING FACTOR  
IN PROMOTING TAX COMPLIANCE**

**Moderator:** Miguel Acosta Andino, National of the Fiscal Studies Center, Internal Revenue Service, Ecuador

09:00 - 09:30 **Speaker:** Fredrik Aksnes, International Director, General Directorate of Taxes, Norway (30')

09:30 - 09:40 **Commentator:** Celia de Pablos Salgado, Director of the School of Public Finance, IEF (10')

09:40 - 10:10 Discussion (30')

10:10 - 10:40 Coffee break

**Topic 3.1. The development and strengthening of the tax citizenship concept: the tax education programs.**

**Moderator:** Yamilé Pérez, National Tax Administration Office, Cuba

10:40 - 11:00 **Speaker:** Billie Brenes, Director, General Directorate of Taxation, Costa Rica (20')

11:00 - 11:20 **Speaker:** Nahil Hirsh, National Tax Superintendent, National Superintendency of Tax Administration, Peru (20')

11:20 - 11:50 Discussion (30')

**Topic 3.2. The design and implementation of taxpayer assistance programs in keeping with his behavior**

**Moderator:** Vladimir Teran, General Manager, National Tax Service, Bolivia



11:50 - 12:10 **Speaker:** Julio Pereira, Director Internal Revenue Service, Chile (20')

12:10 - 12:30 **Speaker:** Juan Toro, Division Chief, Fiscal Affairs Department, IMF (20')

12:30 - 13:10 Discussion (40')

13:10 - 14: 10 Lunch

## **Afternoon**

### **Topic 3.3. Generating taxpayer trust: accountability and internal control systems.**

**Moderator:** Alberto Barreix, Regional Economist, Inter-American Development Bank, IDB

14:10 - 14:30 **Speaker:** Rubén Toninelli, General Director, Federal Administration of Public Revenues, Argentina (20')

14:30 - 14:50 **Speaker:** Juan Ricardo Ortega López, General Director, Directorate of National Taxes and Customs, Colombia (20')

14:50 - 15:20 Discussion (30')

15:20 -15:40 Coffee

**Moderator:** CIAT

15:40 - 18:00 **Panel 1:** The Negotiation of Double Taxation and Information Exchange Agreements: The role of the Tax Administrations, other Government entities and private sector specialists.

**Participants:** Argentina, Brazil, European Commission, Mexico, OECD, USA

Thursday, April 7

**Moderator:** CIAT

08:40-09:00 Kunio Mikuriya, Secretary General, World Customs Organizations, WCO (20')

09:00 - 11:00 **Panel 2:** Tax agreements, the morale of the tax administration and corporate social responsibility: their role and scope in developing tax citizenship.

**Participants:** ECLAC, Ecuador, IMF, GIZ, Kenya, Portugal, Private Sector Specialist

11:00 – 11:20 Coffee

11:20 – 11:40 Evaluation of the event

**Closing Session**

11:40 - 12:10 Final considerations by Dr. Everardo Maciel

12:10 - 13:00 Closing Ceremony (Continuation)

13:00 - 13:30 Transportation to integration activity

13:30 -14:30 Lunch

14:30 - 18:00 Integration Activity



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Montevideo, Uruguay

April 12 to 15, 2010

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