

# 51th. CIAT General Assembly



## ADVANCES OF THE TAX ADMINISTRATIONS TOWARDS GREATER TAXPAYER EQUITY BY IMPROVING EFFECTIVENESS AND EFFICIENCY

Asuncion, Paraguay  
April 25 – 27, 2017



## **INTER-AMERICAN CENTER OF TAX ADMINISTRATION - CIAT**



**“ADVANCES OF THE TAX ADMINISTRATIONS TOWARD GREATER  
TAXPAYER EQUITY BY IMPROVING EFFECTIVENESS AND EFFICIENCY”**

**Asuncion, Paraguay  
April 25- 28, 2017**

## About CIAT

CIAT is a public, nonprofit international organization established in 1967, with the mission of providing an integral service for the modernization, strengthening and technical development of the Tax Administrations of its member countries. Its membership currently consists of 39 member and associate member countries from four continents: 31 countries from the Americas, five from Europe, and two from African countries and one Asian country. Angola and India are associate members.

The Web site: [www.ciat.org](http://www.ciat.org) includes information of a technical and institutional nature, as well as on the various activities carried out such as international meetings, tax studies, publications, training, technical assistance and information technology.

## Member Countries



Angola	Curacao	Mexico
Argentina	Dominican Republic	Netherlands
Aruba	Ecuador	Nicaragua
Barbados	El Salvador	Panama
Bermuda	France	Paraguay
Bolivarian Republic of Venezuela	Guatemala	Peru
Bolivia	Guyana	Portugal
Brazil	Haiti	Sint Maarten
Canada	Honduras	Spain
Chile	India	Suriname
Colombia	Italy	Trinidad & Tobago
Costa Rica	Jamaica	Uruguay
Cuba	Kenya	United States of America

## EXECUTIVE COUNCIL 2016- 2017

### Councilors:

Alberto Abad	Argentina
Luenne Gomez Pieters	Aruba
Santiago Rojas Arroyo	Colombia
Miriam Guzmán	Honduras
Oswaldo A. Santín Quiroz	Mexico
Marta González Ayala	Paraguay
Víctor Shiguiyama	Peru
Santiago Menéndez Menéndez	Spain
Kirsten Wielobob	United States of America

## EXECUTIVE SECRETARIAT

Executive Secretary  
Planning and Institutional Development Director  
Operations and Institutional Management Director  
Technical Assistance and Information and  
Communication Technology Director  
Training and Human Talent Development Director  
Tax Studies and Research Director  
International Cooperation and Taxation Director  
Accounting and Finance Manager  
Internal Administration and Human Resources Manager  
International Cooperation Manager  
Information Technology Manager

Márcio F. Verdi  
Socorro Velázquez  
Francisco J. Beiner

Raúl Zambrano V.  
Alejandro Juárez  
Santiago Díaz de Sarralde  
Isaac Gonzalo Arias  
Xiomara Tejada  
Rita L. Solis  
Mónica Alonso  
Tomás Torres

## REPRESENTATIVES AND CORRESPONDENTS OF CIAT

Country	Representative	Correspondent
Angola	Silvio Franco Burity	Luis Gomes Sambo
Argentina	Alberto Abad	Angel Pacheco / Horacio Castagnola
Aruba	Luenne Gomez Pieters	Angeline Geerman-Giel
Barbados	Margaret Sivers	Margaret Sivers
Bermuda	Lucia M. Peniston	Mary Inocencio
Bolivarian Republic of Venezuela	José David Cabello Rondón	Erick Romero
Bolivia	Veimar Cazón M.	Juana Patricia Jiménez
Brazil	Jorge Antonio D. Rachid	Flávio Antonio Araujo
Canada	Michael Snaauw	Javier Nacarino
Chile	Fernando Barraza L.	María Bernardita Moraga
Colombia	Santiago Rojas Arroyo	Sandra Virguez
Costa Rica	Carlos Vargas Durán	Maribel Zúñiga C.
Cuba	Yamilé Pérez	Alberto Fernández Reyes
Curazao	Jamila Isenia	Yut-Ha Natalie Sint Hil
Dominican Republic	Magín J. Díaz	Nieves Vargas Collado
Ecuador	Leonardo O. Arteaga.	Paola Hidalgo V.
El Salvador	Sergio De Jesús Gómez	Ramón Pérez Gómez
France	Bruno Parent	
Guatemala	Juan F. Solórzano F.	Oty Aixa Farfán A.
Guyana	Godfrey Statia	Janet Abbensetts
Haiti	Miradin Morlan	
Honduras	Miriam Guzmán	Gabriel Perdomo
India	Rajat Bansal	Sinha Vinay
Italy	Giorgio Toschi	Stefano Gesuelli
Jamaica	Ainsley Powell	Meris Haughton
Kenya	John Karimi Njiraini	Maureen Njongo
Mexico	Oswaldo A. Santín Q.	Enrique Lavín V.



Netherlands	Uijlenbroek Jaap	Jaco Tempel
Nicaragua	Martin Rivas Ruiz	José Francisco Reyes
Panama	Publio Ricardo Cortés	Yessika Araúz
Paraguay	Marta González Ayala	Augusto Delvalle
Peru	Víctor Shiguiyama K.	Dioselina Urbina
Portugal	Helena María Borges	
Sint Maarten	María Bass	Sherry Hazel
Spain	Santiago Menéndez Menéndez	Ignacio del Río Angulo
Surinam	Winston W. Wirht	Aruna Rampersad
Trinidad & Tobago	Allison Raphael	Ravi Taklalsingh
United States of America	Kirsten Wielobob	Virginia Tarris
Uruguay	Joaquín Serra	Margarita Faral

## PERMANENT TECHNICAL ASSISTANCE MISSIONS

### France

Head of Mission:

### Spain

Head of Mission: Juan Francisco Redondo

### Italy

Head of Mission: Stefano Gesuelli

### GIZ – German Cooperation

Head of Mission: Joerg Wisner



## DAILY SCHEDULE OF ACTIVITIES

**Topics and subtopics based on the initial proposals of the member countries and which were approved by the General Assembly**

### TUESDAY, APRIL 25

FROM	UNTIL	DURATION	TOPIC	
09:00	09:30	0:30	<b>Opening Ceremony</b>	
			National Anthem – Symphony Orchestra of the Municipal Council, Paraguay	
			Statement by the Executive Council President, Mrs. Marta González and CIAT Executive Secretary, Mr. Márcio F. Verdi.	
09:30	10:15	0:45	<b>Keynote Address:</b> <b>“Progress of the Tax Administrations toward greater tax equity”</b>	
		0:05	Moderator:	Marta González Ayala, Vice-minister of Taxation State Undersecretariat of Taxation, Paraguay
		0:20	Speaker 1:	Michael Keen, Deputy Director of the IMF's Fiscal Affairs Department, IMF
		0:20	Speaker 2:	Ministry of Finance, Mr. Santiago Peña Palacios, Paraguay
10:15	10:35	0:20	Coffee and Integration	
<b>10:35</b>	<b>12:00</b>	<b>1:25</b>	<b>TOPIC 1 “Tools for improving the implementation of Tax Policies”.</b>	
10:35	10:45	0:10	Moderator:	Carlos Vargas, Director General of Taxation, General Directorate of Taxation, Costa Rica
10:45	11:05	0:20	Speaker 1:	<i>“Modern trends in Tax Policy (what to tax, whom to tax, which should be the objectives of the tax system)”</i> . Santiago Díaz de Sarralde, Tax Studies and Research Director, CIAT Executive Secretariat
11:05	11:25	0:20	Speaker 2:	<i>“Experience with the implementation of new trends”</i> . Alberto Barreix, Senior Tax Economist, IADB
11:25	11:40	0:15	Commentator	Miguel Silva Pinto, Executive Secretary, IOTA
11:40	12:00	0:20	Debate	
12:00	12:20	0:20	Official photograph	
12:20	14:00	1:40	Lunch	

## Continuation

FROM	UNTIL	DURATION	TOPIC	
14:00	15:10	1:10	<b>Subtopic 1.1 “Current main challenges of the Tax Administrations (globalization and digitalization of the economy, financial capacity, recruitment, education and training).”</b>	
14:00	14:10	0:10	Moderator:	Bruce Snider, Manager, International Relations, Canada Revenue Agency and Regional Director of CATA
14:10	14:30	0:20	Speaker 1:	<i>“Experience of Country Tax Administration”</i> . Michale Snaauw, Assistant Commissioner, Canada Revenue Agency
14:30	14:50	0:20	Speaker 2:	<i>“Experience of Country Tax Administration”</i> . Virginia Tarris, Tax Law Specialist, Internal Revenue Service, United States
14:50	15:10	0:20	Debate	
15:10	15:30	0:20	Coffee and integration	
15:30	17:00	1:30	<b>Subtopic 1.2 “Normative anti-avoidance and anti-evasion framework”.</b>	
15:30	15:35	0:05	Moderator:	Vinay Sinha, Director, Foreign Tax Division, Department of Revenue, Ministry of Finance, India
15:35	15:55	0:20	Speaker 1:	<i>Development of plans to address tax evasion and avoidance” (focus on smuggling and multinational entities; address formulation of status and regulations formulation)</i> Stefano Gesuelli, Head of the Permanent Italian Mission al CIAT, Finance Guard, Italy
15:55	16:15	0:20	Speaker 2:	<i>“Information exchange between the Tax Administrations, experience of Country Tax Administration”</i> . Paulo Mendes, General Coordinator of Programming and Studies, Federal Revenue, Brazil

Continuation

FROM	UNTIL	DURATION	TOPIC	
16:15	16:35	0:20	Speker 3:	<i>"Proposal Law which Updates the Tax System for improving voluntary compliacen and preventing tax fraud"</i> Lilian Román, Directorate of Planning and Tax Techniques, State Undersecretariat of Taxation, Paraguay
16:35	16:50	0:15	Commentator	Osvaldo Santín, Head of the Tax Administration Service, General Directorate of Taxation, México
16:50	17:00	0:10	Debate	



WEDNESDAY, APRIL 26				
FROM	UNTIL	DURATION	TOPIC	
09:00	10:20	1:20	<b>TOPIC 2 “Focusing on assistance, services and transparency in management”.</b>	
09:00	09:10	0:10	Moderator:	Socorro Velazquez, Director, Planning and Institutional Development, CIAT
09:10	09:30	0:20	Speaker 1:	<i>“Use of technological advances for improving taxpayer assistance”.</i> Cecilia Rico Torres, Director, Revenue Management Directorate, Colombia
09:30	09:50	0:20	Speaker 2:	<i>Taxpayer benefits resulting from technological innovation</i> Roberto Castillo, Taxpayer Assistance and Fiscal Credit Directo, State Undersecretariat of Taxation, Paraguay
10:50	10:00	0:10	Commentator	Jorge Luis Silva Mendez, Public Sector Specialist, World Bank
10:00	10:20	0:20	Debate	
10:20	10:40	0:20	Cafee and integrationtion	
10:40	12:10	1:30	<b>Subtopic 2.1 “The TA’s relationship with the citizens and taxpayers”.</b>	
10:40	10:50	0:10	Moderator:	Yamilé Pérez, Head of the National Tax Administration Office, Cuba
10:50	11:10	0:20	Speaker 1:	<i>“Experience of Country Tax Administration”.</i> Victor Shiguiyama, National Tax Superintendent, Customs and Tax Administration National Superintendency, Peru
11:10	11:30	0:20	Speaker 2:	<i>“Context – Specific Interaction of the European and Caribbean Netherlands Tax Authorities”.</i> Nichalin Martina, Managing Director, The Tax and Customs Administration, Caribbean Netherlands

## Continuation

FROM	UNTIL	DURATION	TOPIC	
11:30	11:50	0:20	Speaker 3:	<i>"Methodologies for measuring improved assistance. Methods, Cost – Benefit".</i> Fredrik Aksnes, Programme Manager, Norway
11:50	12:10	0:20	Debate	
12:10	13:50	1:40	Lunch	
<b>13:50</b>	<b>15:20</b>	<b>1:30</b>	<b>TOPIC 3. "New paradigms in the use of risk models".</b>	
13:50	14:00	0:10	Moderator	Miriam Guzmán, Executive Director, Income Administration Service, Honduras
14:00	14:20	0:20	Speaker 1:	<i>"Expenses of Country Tax Administration"</i> Ignacio Del Río Angulo, Head of the International Relation Coordination Unit, State Agency of Tax Administration, Spain
14:20	14:40	0:20	Speaker 2:	<i>"Expenses of Country Tax Administration"</i> Theodoro Setzer, Assistant Deputy Commissioner, International, Internal Revenue Service, USA
14:40	15:00	0:20	Speaker 3:	<i>New paradigms in the use of risk models: Best practices to strengthen tax intelligence. The case of Chile's, SII</i> Fernando Barraza, Director, Internal Revenue Service, Chile
15:00	15:20	0:20	Debate	
15:20	15:40	0:20	Coffee and integration	
<b>15:40</b>	<b>17:25</b>	<b>1:45</b>	<b>Subtopic 3.1: "The strengthening of tax control processes"</b>	
15:40	15:50	0:10	Moderator	Ramón Pérez, Deputy General Director, General Directorate of Internal Taxes, El Salvador



Continuation

FROM	UNTIL	DURATION	TOPIC	
15:50	16:10	0:20	Speaker 1:	<i>“Experiences with high impact evasion methods detected by the Tax Administrations”</i> Marcelo Pablo Costa, Deputy General Director of Examination, Federal Administration of Public Revenues, Argentina
16:10	16:30	0:20	Speaker 2:	<i>“Interrelationship of compliance control programs with the different modalities or organized crime”</i> Riccardo Rapanotti, Finance Guard, Italy
16:30	16:50	0:20	Speaker 3:	<i>“Strengthening of the tax control processes through BEPS Initiatives”</i> Grace Pérez-Navarro, Deputy Director, OECD
16:50	17:05	0:15	Commentator	Rui Canha, Director of International Relations, Tax Customs Authority, Portugal
17:05	17:25	0:20	Debate	

PARAGUAY - 2017

THURSDAY, APRIL 27				
FROM	UNTIL	DURATION	TOPIC	
09:00	10:15	1:15	<b>Subtopic 3.2 “Examination techniques and E-commerce control”.</b>	
09:00	09:10	0:10	Moderator:	Publio Cortés, General Director, Directorate of Revenues, Panama
09:10	09:30	0:20	Speaker 1:	<i>“Experience of Country Tax Administration”.</i> Raúl Zambrano, Technical Assistance and Information Technology and Communication Director, CIAT
09:30	09:50	0:20	Speaker 2:	<i>“The control of goods and services invoicing with emphasis on Electronic Invoicing”.</i> Fernando Martínez, Central Administrator of Services and Procedures Management through electronic means, Tax Administration Service, Mexico
09:50	10:05	0:10	Commentator	Júlio Londa, Director of Tax Services, Tax General Administration, Angola
10:05	10:15	0:10	Debate	
10:15	10:35	0:20	Coffee and integration	
10:35	12:00	1:25	<b>Subtopic 3.3 “Programs and best practices for carrying out massive plan”.</b>	
10:35	10:45	0:10	Moderator:	Anthony Gittens, Senior Manager, Barbados Revenue Authority
10:45	11:05	0:20	Speaker 1:	<i>“Experience of Country Tax Administration”.</i> Miguel Palumbo, Director, Collection and Related Controls Division, General Directorate of Taxation, Uruguay
11:05	11:25	0:20	Speaker 2:	<i>“Analysis of behavioral change resulting from massive plans”.</i> Michael Snaauw, Assistant Commissioner, Canada Revenue Agency
11:25	11:40	0:15	Commentator	Katherine Baer, Division Chief, International Monetary Fund
11:40	12:00	0:20	Debate	
12:00	13:30	1:30	Lunch	



## Continuation

FROM	UNTIL	DURATION	TOPIC	
13:30	15:30	2:00	<b>Round Table and Closing Ceremony</b>	
			Topic:	<i>"Progress of the Tax Administrations toward greater tax equity"</i>
			Moderator:	Márcio F. Verdi, Executive Secretary, CIAT
			Participants:	Ecuador, Honduras, India, Kenya, Paraguay, Trinidad & Tobago
15:30	15:50	0:20	Coffee and integration	
15:50	17:05	1:15	<b>CLOSING</b>	
15:30	16:20	0:30	Relator:	Pablo Ferreira, Deputy Minister of Economy and Finance, Uruguay,
16:20	16:35	0:15	Invitation to the 2017 Technical Conference in Costa Rica	
16:35	16:50	0:15	Invitation to the 2018 General Assembly in Canadá	
16:50	17:05	0:15	<b>Closing Ceremony:</b> by Executive Council President	

26/04/2017

## **MODERN TRENDS IN TAX POLICY: WHAT TO TAX, WHOM TO TAX, WHICH SHOULD BE THE OBJECTIVES OF THE TAX SYSTEM**

**Santiago Díaz de Sarralde**  
Tax Studies and Research Director  
(CIAT)

**Contents:** Summary. 1. A brief overview of taxation in Latin America and the Caribbean (LAC). 2. What, Whom and What for: 2.1. The Economy and Public Expenditure. 2.2. The tax bases and their relationships. 2.3. The “other” tax systems and the practical control of tax obligations. 3. How: 3.1. The global structure of the tax system. 3.2. The configuration of international taxation. 3.3. Taxation alternatives according to income sources and uses. 3.4. Subnational financing. 4. Documentary references

### **SUMMARY**

This presentation endeavors to provide a framework for reflection, rather than an inflexible response to the transcendental questions posed in its title. We thus begin with a synthetic panorama of taxation in Latin America and the Caribbean within the world environment, its level, structure, effects, deficiencies and heterogeneity.

These characteristics are framed below within the scheme of relationships existing in each society, of its “tax model”: the definitive and changing characteristics of the Economy; the decisions with respect to Public Expenditure; the internal and international interdependencies with other tax jurisdictions; the practical configuration of its rules, its control and acceptance; and, in greater detail, the relationships between the different manifestations of the economic capacity (capital and labor income; consumption and savings; accumulation and transfer of wealth; intermediation of corporations and juridical persons) and the tax figures that encumber them.

To conclude, the most recent options for facing the challenges faced by the tax systems will be reviewed: the latest theoretical contributions for defining the global structure of the tax system (Mirrlees Report and background; the “standard” model; the role of tax rules); the configuration of international taxation (BEPS; DBCFT; Single Base of the Corporate Tax in the EU; electronic commerce and collaborative economy; tax amnesty; exit-tax); the taxation alternatives according to income sources and uses (VAT personalization; green taxation; taxes on “junk food”; taxation of “robots”; encumbrance of wealth; integration of the income and net worth encumbrance); and challenges and options in the area of subnational financing.

The presentation concludes with the references used and the links to the basic documents to continue, and not close this discussion.

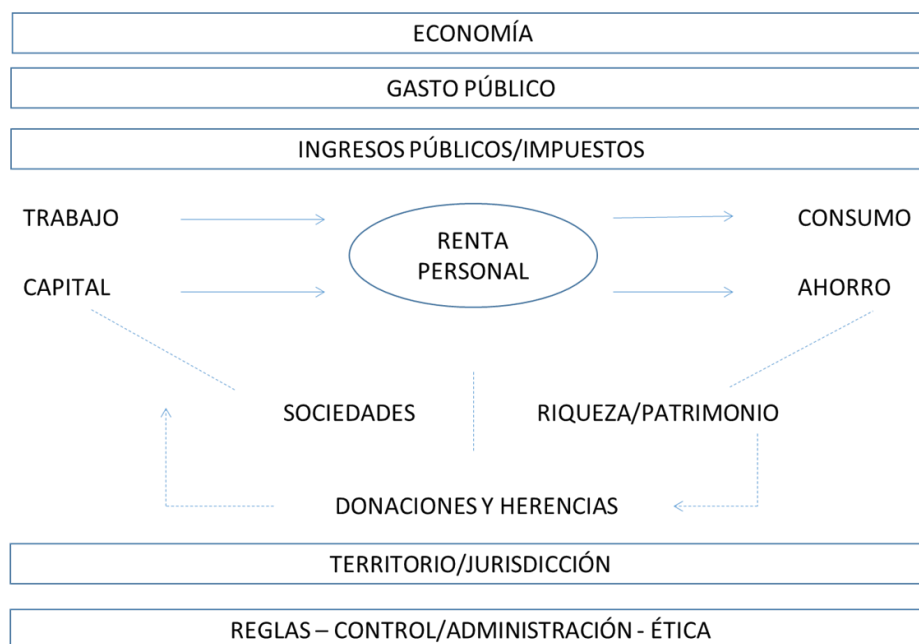
## **1. A BRIEF OVERVIEW OF TAXATION IN LATIN AMERICA AND THE CARIBBEAN (LAC)**

- I. Relatively low tax pressure: 22.8% of GDP, eleven and a half points less than the OECD -2015-. It should be noted that it is the shortest distance registered and that there are large differences between countries.
- II. Greater dependency on indirect taxation (fifty per cent of total, vis-a-vis one third of the mean in the OECD; however, this distance has been shortened) and taxation of corporate income (18.8% of total, 8.7% in the OECD).
- III. Low participation of personal income taxation (8.8% of total, 24% in the OECD).
- IV. High inequality in the distribution of revenues and scarce redistributive capacity of tax policy (in the OECD inequality -0.47 Gini Index- is reduced 36%; in ALC, 6% -beginning with a Gini Index of 0.5-).
- V. High Informality (41% vis-a-vis 17% of the OECD).
- VI. High evasion, especially in corporate income tax. High impact of the erosion of the tax bases and the shifting of benefits to avoid taxation.
- VII. High tax expenses (around 30% of potential collection).
- VIII. Diversity of national experiences: in taxation levels (ranging between 12.4% in Guatemala and 13.7% in the Dominican Republic up to 32.0% in Brazil, 32.1% in Argentina and 38.6% in Cuba); dependency on revenues originating from natural resources (recent negative impact due to prices of raw materials); financing and social security contribution systems; tax decentralization tax decentralization of subnational governments.

## **2. WHAT, WHO, WHAT FOR**

These questions lead us to consider which is or should be the «tax model ». This is a complex question inasmuch as this model is, at the same time, a reflection of the collective objectives as regards the configuration of an economy and a consequence of the latter's structure, with causality flows in both senses. And, from this standpoint, when we talk about «an economy» it must necessarily be understood in a broad sense, with some connotations that would bring us closer to the concept of a corporation than to the simple representation of the production and consumption relationships between «economic agents ». What is the role of collective action organized through the State? ¿What is the desired configuration and level of public expenditure and which are its consequences on private activity? What should be the structure of the tax system for financing those policies and which are its effects on the economy? How should its space configuration be, bearing in mind the different competencies in this matter within and outside the country and which are the limitations introduced by this factor? How are the different income sources and uses taxed?

**Figure 1. What to tax, whom to tax and what for**



**Source:** prepared by author

## 2.1. The economy and public expenditure

As for the structure and characteristics of the LAC economies, together they represent around 8% of the world GDP (in parity of acquisition power), a percentage which is similar to its participation in the total population, having decreased 4 points since 1980, although one must take into account that in this period the G7 countries have gone from 50 to 30%, decreases in relative terms that are explained, fundamentally, by the growth during this period of the emerging Asian and developing countries, that have gone from 10% to 30%. In terms of average income (per capita GDP) the region is around fifteen thousand dollars, with a distance that has been expanded with respect to the more developed countries (three times less than the mean of the G7 in 2015; in 1980 2.5 times less), although most of its economies are framed within the category of “average income countries”. In commercial terms, the region represents 3.8% of the exports of goods and 4% of imports, with a decreasing role since the middle of the past century.

As for the destination, 75% of exports are distributed almost equally between North America, Asia and the region itself, while Europe represents 19%, with emphasis on the low percentage of interregional trade, much lower than the European, North American,

and even African. According to products, the most distinctive feature is the great weight of agricultural products with 31%, and fuels and minerals with 40%, vis-a-vis the low participation of manufactures, of 26% (the world mean is 10, 20 and 66%, respectively). To these characteristics one must add the already commented high inequality, not corrected by the fiscal policy, the high informality and, as usual, the wide heterogeneity between the countries of the region. In 2015 and 2016, the entire region experienced a recession, due to problems in the main South American economies, the restraint in trade and world growth and the evolution of the international prices of its main exports, which recession is expected to be overcome in 2017.

Although this is an incomplete summary, it is useful to highlight the potential impact of the structural factors of the economy of the region when it comes to conditioning the level, structure and evolution of its tax revenues.

At the same time, as part of a globalized economy we must bear in mind the main international trends and their impact on the tax system: the role of multinational enterprises and their possible deviation from the taxable benefits; the technological innovations and their effects on the labor market; the very transformation of the labor market with respect to the stability of jobs, decrease of the weight of salaries in national income and conversion of part of the labor income into mixed or corporate income, promoted by the different treatment of some or other juridical figures in the tax systems; the recent protectionist trends and, in particular, the possible orientations of the U.S. policy in this sense; the challenges of the digital economy, electronic commerce and the so-called “collaborative economy”; aging, in particular, in the most developed countries; etc.

On the other hand, the tax system has a subordinate role and, to a certain extent, a passive one with respect to the democratic decisions as regards the level and structure of public expenditure. Should public services be universal or focused on the citizens most in need? Is it better to provide such services in kind -sanitation, education- or through monetary transfers? Should we resort to public “production” of services or is it better to use public “provision” and reserve the final service to the market? How can we organize and finance pensions, sanitation, education or unemployment insurance? Does it make sense to consider a universal basic income? Should redistribution be fundamentally instrumented on the expenditure side or should the progressiveness of the tax system contribute? The answer we may give to these questions will be reflected in the tax system, as well as in the opposite sense, their design and strength condition the capacity for instrumenting said policies.

## **2.2. The tax bases and their relationships**

After considering the general economic framework and the desired configuration in relation to public expenditure, the analysis and design of public revenues also involves consideration of the relationships between multiple elements: the income sources (capital and/or labor); its uses (consumption, savings); the accumulation of income and

its transfer (wealth, inheritance, donations); and the different formal mechanisms for organizing the economic activity (corporations, autonomous work, dependent work).

Within this scheme, **direct taxation and, in particular, that applied to personal income** plays a main role in the design of the tax systems, to the extent that said income is traditionally the most complete indicator of the payment capacity of individuals<sup>1</sup>. The latter is essential in terms of equity and also because it is one of the main determining factors in the most relevant decisions of an economic nature: employment offer, savings, consumption and investment.

For this reason, the individual income tax design is at the core of reflection regarding optimum taxation and the so-called “Fundamental Tax Reform”, as nominative grouping of several theories that advocate a radical transformation of the tax systems, that may allow for correcting the multiple failures observed as a result of their configuration in a difficult balance between the theoretical guides provided by the taxation principles and the practical demands of the economic reality. This has thus given way to the existence of multiple tax figures, the duplicity of encumbrances on the different manifestations of payment capacity and the complexity of the tax system.

In a very simplified manner, we could identify two main lines of reform. On the one hand, the “extensive encumbrance” or “Comprehensive Taxation”, which is focused on the elimination of exceptions to the generalized encumbrance of the income sources and the tax incentives that erode the bases, distort the economic activity, introduce inequities and complicate the encumbrance, which would allow for reducing the types of encumbrances without losing collection.

On the other hand, there is the “encumbrance on personal expenditure” or “Expenditure Taxation” which, together with the previous one, poses a radical change in the encumbrance base of personal taxation, by transferring it to –personal- expenditure, while exempting savings and income derived therefrom, thereby prompting investment. Given that income, consumption, labor offer and savings decisions vary throughout life, by adapting themselves to the needs and capabilities of each age, the optimum design of the taxes and the analysis of their effects must take this fact into account, if it endeavors to be efficient and fair from the standpoint of the individuals’ complete life and not merely in isolated moments, thus adopting a vital cycle perspective. Considering its value throughout the entire vital cycle, the sole difference between an individual’s income and his consumption would be donations and inheritance, with consumption being, in addition, more stable throughout life than income. Thus, the only role of savings would be to accumulate resources to soften the consumption patterns throughout the cycle, thereby saving the logic alterations at the income level and for which reason, one should avoid distorting through the encumbrance, the individual’s

---

<sup>1</sup> As compared with consumption or wealth, which would provide complementary, indirect and incomplete indicators thereof, without this implying that they cannot play a relevant role when undertaking the global design of the system. As we shall see, this viewpoint has been disputed from a theoretical standpoint with the proposal for encumbering personal expenditure.

decisions regarding present and future consumption. Such reasoning would result in the theoretical superiority of consumption as basis of the individual tax, with the complementary taxation of wealth transfers and constitutes the basis of the different proposals for taxing personal expenditure.

As transversal element to the different formalization of the previous proposals, there are proposals for establishing a single encumbrance ("Flat Tax") for simplifying the tax and reducing costs in terms of the efficiency that may be introduced through formal progressiveness.

Although it may not be said that such theoretical reform models may have been applied in a pure and integral manner in the actual tax reforms, they have in fact conditions their general characteristics and, above all, their motivations. On the one hand, one may observe a trend toward the decrease of the maximum marginal types, in the corporate income tax as well as the individual income tax, accompanied in the latter case by a flattening of the rates through the reduction of the number of sections and arriving in extreme cases, at single type models. On the other hand, income from capital – interest, dividends, capital gains – are the ones that have received a clearly more favorable tax treatment (reduced rates; exemptions; "dual" or "semidual" models) in relation to labor income. With respect to this latter aspect, its special treatment would be justified – in addition to the objective of not distorting the savings and investment decisions – due to the greater elasticity of its offer and thanks to the mobility in its location, with a view to minimizing the so-called "excessive encumbrance", which objective constitutes the basis of the "Optimum Taxation Theory"<sup>2</sup>.

In spite of all of the above, the encumbrance of income from capital is essential from the standpoint of equity, efficiency<sup>3</sup>, the minimization of the means for tax avoidance and, what is perhaps most important, the social perception of the tax system as a fair structure in the distribution of the burdens, without which the sustainability of a democratic state would be more difficult. In addition, one cannot disregard the fact that it is the source of income which to a greater extent is focused on the taxpayers with high

---

<sup>2</sup> From a technical perspective, its encumbrance is also complex, to the extent it requires to take into account the inflationary components of the outputs, adequately assess the values, count on adequate administrative registers, correct the excessive progressiveness in case its period of generation would exceed a year and the rates to which they are subjected are progressive and take into account losses as well as profits, correct double taxation if it originates from previously encumbered economic activities, etc.

On the other hand, the tax legislation should also avoid that income be treated differently, depending on whether it is manifested periodically or in cycles above that of the encumbrance, which is generally annual. This affects, in particular, the treatment of outputs from capital with respect to net worth variations, given that these, even though they constitute income from capital equivalent to dividends or interest, are not taxed as they are generated, except solely when they are realized, thus resulting in lower effective taxation, arbitrarily favoring some means of investment over others and promoting the lock-in of the investment.

<sup>3</sup> In spite of the theoretical arguments, the capital's elasticity is not absolute and encumbrance of labor also includes efficiency costs. In addition, one would have to consider its efficient use for controlling the explosive dynamics associated to the creation of stock exchange, real estate and financial bubbles in general.

income levels and, generally, with greater political influence capacity in the determination of the tax policy.

**The taxation of business income**, when it takes place under the corporate juridical form, could perform a secondary role and in a superfluous extreme, in a developed tax system that would allow for integrally taxing all the sources of individual income, to the extent they are the ultimate receivers of the payment capacity generated in the enterprises.

However, the practical reality is very different. On the one hand, encumbrance of the capital income of individuals is limited, as we have seen, due to different factors (The privileged tax treatments, the difficulty in assessing outputs that are not paid through a transfer of income to the owners, the administrative difficulty for controlling individual income – which are more numerous and disaggregated than the corporate ones-, the geographical situation of the owners in other foreign tax jurisdictions, etc.). On the other hand, in practice, the design of the tax systems has been aimed at using corporate taxation for regulatory purposes, by introducing incentives<sup>4</sup> and disincentives for different activities, according to the general planning of the economic activity.

In sum, corporate income taxes have ended having a very relevant role as means of withholding the capital income from individuals<sup>5</sup>, mechanism contributing to the redistributive capacity of the tax system<sup>6</sup> and regulatory instrument<sup>7</sup>.

With these premises, the main difficulties in the optimum theoretical design of corporate taxation is focused on the adequate calculation of the taxable benefit for not distorting the economic activity. In general, the starting point is the accounting benefit on which the necessary tax adjustments are made to avoid the latter from being manipulated for reducing the tax payment<sup>8</sup>. However, certain elements are difficult to quantify and in particular, the cost of the capital itself is usually not considered deductible, whereby it is considered that it introduces an undesired bias in favor of another's financing<sup>9</sup>.

---

<sup>4</sup> In particular the attraction of investments.

<sup>5</sup> In general, with some method for correcting double taxation, in case it may occur.

<sup>6</sup> Although its final incidence is a controversial issue.

<sup>7</sup> Additionally the corporate encumbrance is justified because of the particular advantage conferred by the limited liability juridical regime.

<sup>8</sup> Accounting is an exercise with a broad maneuvering margin, even without considering its fiscal consequences, between the application of the “faithful image” and the “valuing precaution”. This affects multiple entries such as provisions, amortizations, the distribution of dividends, the assessment of inventories, etc.

<sup>9</sup> Given the deductible nature of interest. Vis-a-vis this problem there are various theoretical solutions which, nevertheless, have not been generally implemented given their technical difficulties and collection risk (an exclusive encumbrance of cash-flow; the accelerated amortization of investments, without interest discount; the introduction of a deduction for another's financing; etc., see, for example, the Mirrlees Report (2012) and the alternative known as Destination Based Cash Flow Taxation).



In addition, one must take into account the manipulation risks associated to transactions between related entities, at the international as well as national sphere. To this end, specific rules for the assessment of transfer prices and preventive undercapitalization<sup>10</sup> rules are introduced. In this respect, the European case deserves special attention for the with respect to the managing projects for the creation of a consolidated tax base regime for the corporate groups, with its advantages -in terms of market unit and limitation of the problems associated to transfer pricing – and its application difficulties – because of the homogenization of the criteria for determining the bases as well, above all, the rules for distributing the bases among jurisdictions (assets, sales, staff costs etc.).

Likewise, the existence of special regimes renders difficult the design and analysis of the tax, in particular because it affects the small dimensoón entrepreneurial activities and the concession of specific fiscal benefits according to industry or location. In this respect, it would be preferable to focus the incentives according to activity and not the dimension of the business, thus giving up the use of reduced types and simplifying to a máximum the tax for reducing indirect costs, which are especially cumbersome for small businesses.

In addition, one must bear in mind that the practical difficulties for the calculation and control of the taxable benefit has promoted the creation of “heterodox” encumbrance figures through approximation to the benefits and introduction of “minimum” encumbrance based on the sales figures or the volumen of assets. An encumbrance which in the case of the gross revenues of the businesses is also used as financing source by the local governments, even though the theoretical considerations with respect to its efficiency and ease of administration would dissuade its use.

At this point, although briefly, reference must be made to the **social security contributions**, which are located in a limbo that is difficult to manage, as regards their consideration or not as tax revenues in spite of their inclusion –and relevant weight – in the tax pressure concept. On the one hand, their administration and budgetary allocation –which are usually done separately from the rest of the taxes – and their connection –more or less direct – with the services they finance, distinguishes them from. However, from an economic standpoint it is difficult to separate their effects, since they coercively fall back on labor income and the business costs linked to them.

Therefore, the reflections regarding their reform should be included within the proposed framework. In addition, **public income derived from the exploitation of natural resources or infrastructures** complicate the analysis of public revenues and even though, again, their budgetary classification does not include them in the chapter on taxes, in response to the organizational options of each State, their joint consideration

---

<sup>10</sup> As we shall see further on, the OECD’s BEPS initiative has promoted the application of these anti-abuse procedures.

improves the analysis of support, efficiency and equity of the mechanisms for financing public policies<sup>11</sup>.

**Neutrality and coordination between the various direct taxation figures.** An essential aspect which not always is sufficiently cared for, would be to preserve the tax neutrality in the selection of the different juridical options –wage earner; autonomous; business- for the performance of the activity and the collection of outputs. Therefore, the applicable types should be modulated, so that there may be homogeneity in the encumbrance of the income from wage earners, autonomous workers and businesses.

Such modulation should satisfy the following identity:  $(1 - \text{Type of Capital}) \times (1 - \text{Type of Corporation}) = (1 - \text{Type of Job})$ . That way the tax structure would not alter the decision between receiving income as corporate income, working as an independent or receiving a salary, given that the net income from tax would be the same in all cases.

This would be the result sought by the flat tax system where the types of encumbrance of personal income and corporations would be aligned, with total correction of doubleé taxation, although at the cost of reducing the progressiveness of income tax and its collection and redistributive capacity. The dual models, on excluding the income from capital from the base which pays taxes at the progressive rate and subjecting it to inferior tax rates that are closer to the corporate tax, would also endeavor to reduce this problem, through a lower cost than that of the previously commented linear taxation structure by preserving progressiveness for the rest of the income. However, this structure is unfair from the standpoint of equal treatment of the sources of income and promotes avoidance through the formal conversion of labor income into capital income.

An alternative solution as recommended by the Mirrlees Report could be to establish a single rate for labor, capital and economic activities, in the case of individual income tax and to modulate the rates applicable to capital income, to the extent they may have been previously encumbered with Corporate Tax, thus eliminating double taxation.

**Taxation of wealth and property** is perhpas one of the most discusse spheres within direct taxation, with varied positions according to the tax figure in question and, in some cases, the technical and ideological considerations

Taxation of transfers of wealth -donations and successions- has a greater theoretical and practical support and is present in most of the tax systems, although with a reduce collection significance. Its defense is based on its role as closing element of the system, without which the “unrealized” capital gains would not be taxed at any time, and as factor in the promotion of equal opportunities within a reality with increasing

---

<sup>11</sup> For all these reasons, the statistical efforts of CIAT and the IDB were combined to build a new tax revenue statistics base under a new methodology which, in addition to the regular tax revenues includes the obligatory contributions to the private health and pensions systems and the revenues from natural resources (royalties and other special encumbrances applied to companies extracting publicly owned resources) under the concept of Equivalent Tax Pressure.

concentration in the distribution of wealth<sup>12</sup>. However, the technical, economic and social difficulties for the application of this tax may be very relevant in such cases as the transfer of an active business (whose encumbrance could put its feasibility at risk) or of some savings that would actually have borne the encumbrance on the income, with which its taxation could be considered unfair and inefficient. Generally, all this results in material and personal exemptions that end up changing its initial purpose.

On their part, net worth taxes are the most ill-treated, for technical (the difficulty of homogeneous assessment of the assets) as well as economic reasons (on being considered an additional tax on saved income, with negative consequences on investment, competitiveness and growth).

However, its defenders use as basis their role in tax control, the redistribution of income and the encumbrance of capital gains which escape taxation of personal income. Currently, the encumbrance structure of personal income excludes, in general the capital income and gains channelled through various financial instruments, until the time of their settlement, which circumstance is on many occasions indefinitely postponed. IN this way, the declared income would not truly reflect the economic capacity of the individuals, because of the privileged treatment of income and capital gains as well as the existence of special systems for estimating some economic activities, with consequence not only in the payment of taxes, but also in the access to services requiring verification of income through IIT (scholarships, nurseries, co-payments, housing, etc.). In these circumstances, the net worth would be a fundamental indicator of the payment capacity which, if not observed and taken into account otherwise, could be taxed separately with a specific tax or integrating it with individual income taxation<sup>13</sup>.

Lastly, taxes on ownership of specific goods (above all real estate and vehicles) are usually defended because of their role as indirect indexes of the payment capacity (something which could actually not be really defended if the encumbrance of personal income and /or net worth would be applied correctly) and, especially in the case of real estate, as appropriate base –given its immobility – for the encumbrance of local entities.

---

<sup>12</sup> In theory, this encumbrance should be global –and if possible, throughout the life – of all the wealth transfers (donations and inheritance) received by the taxpayers, although the administrative complexity of this measure is recognized.

<sup>13</sup> This is the model existing in The Netherlands, where part of the individual income tax base is determined by attributing an income-yielding capacity of 4% to the annual average value of the net capital belonging to the individual, which is taxed at a fixed rate of 30%, and is equivalent to an encumbrance of 1.2% of the value of the net capital. Only the capital susceptible to savings and investment is considered, therefore, housing and personal business are not part of said estimated base (their yields are taxed in other areas apart from IIT). It would include, for example, deposits, second and other houses, stock, etc. Some exemptions are: personal means of transportation, some investments with incentives (environment, art if it is not investment, investments in start-ups with limits, etc). In addition, there is a minimum general exemption of 21.139 Euros, increased for those above 65 and taxpayers with children.

In all this scheme, **consumption taxes and essentially, value added taxes** present, as compared with the other pillars available for achieving sufficient collection, known advantages in terms of neutrality, efficiency and management and certain inconveniences, above all, with respect to equity and compliance costs. These inconveniences, whose usual solutions (differentiation of types and exemptions; simplified regimes for small businessmen) are in addition counterproductive and of doubtful effectiveness. The justification for taxing consumption basically deals with collection and, obviously, implies double taxation of the income sources which previously might have been subject to income taxation. Nevertheless, its success is indisputable and since the idea of value added taxation arose in the first half of the twentieth century, it extended progressively throughout the world: France in 1954, almost ten countries in the late sixties, forty eight in the late eighties... and more than 160 countries at present, with almost the sole notable exception of the United States.

The **application of excise taxes** has differentiated characteristics. It has served as substitute of tariffs within the framework of the negotiation of international trade agreements, served to discourage the consumption of goods that are potentially harmful to health (tobacco, alcohol and more recently, “junk” food or sweet drinks) and corrector of negative external effects (fuel; pollution). In this latter role, the analysis is linked to the known **green taxation** and its potential “double dividend” by contributing to reduce pollution and replace, at least partly, the income obtained through the most distorting tax figures.

### **2.3. The “other” tax systems and the practical control of tax obligations**

Lastly, and without going into too much detail, there are two other dimensions that are essential for determining the best way to design the tax system: the coexistence of a central national tax system with the existence of other subnational and international tax competencies; and the specific structuring of the tax system into rules, the administrative capacity for managing and applying, and its social acceptance.

**Internal decentralization of the tax policy**, by giving competencies to the local, regional, provincial or state governments – within a federation- is within the framework of the fiscal federalism theories, whose first recommendation in this sphere is that competencies dealing with revenues follow and correspond with those granted in the field of expenditure, in such a way that the proximity in the rendering of services to the citizen with a margin of autonomy, may be linked to the responsibility in its financing and may be democratically evaluated by the voters.

**Figure 2. Guides and options of tax decentralization**

GUÍAS PARA LA DESCENTRALIZACIÓN FISCAL	OPCIONES DE DESCENTRALIZACIÓN FISCAL
<ol style="list-style-type: none"> <li>1. Responsabilidad tributaria paralela a la del gasto</li> <li>2. Principio del “Beneficio” (no “exportación” de cargas)</li> <li>3. Utilizar bases equilibradamente distribuidas</li> <li>4. Utilizar bases inmóviles</li> <li>5. Fomentar la visibilidad de las decisiones tributarias</li> <li>6. Elegir tributos de sencillo control y administración</li> <li>7. Otorgar capacidad fiscal “en el margen”</li> <li>8. Estabilidad, predictibilidad, sostenibilidad</li> <li>9. Enfoque Integral: tributos/transferencias/deuda</li> <li>10. Restricción presupuestaria dura</li> </ol>	<p>CANDIDATOS TRADICIONALES:</p> <ul style="list-style-type: none"> <li>• Tributos ligados a servicios: tasas, contribuciones especiales, precios públicos, licencias, ...</li> <li>• Impuestos sobre la propiedad (tenencia / transmisión / incrementos de valor)</li> <li>• Impuestos sobre los automóviles</li> </ul> <p>OTRAS OPCIONES DE BASE AMPLIA:</p> <ul style="list-style-type: none"> <li>• Consumo</li> <li>• Gravamen de la actividad empresarial</li> <li>• Gravamen renta personal</li> </ul>

**Source:** prepared by the author

In spite of its conceptual clarity, the achievement of this ambitious principle of organization of the public activity is faced with numerous practical difficulties which one should try to overcome by using the guides for tax decentralization and the catalogue of options available in the international experience.

As for the challenges posed by **international taxation** in the configuration of the tax system, there is no need to insist much on its relevance, especially given the data available with respect to its potential effect on tax evasion and the current uncertainty regarding the evolution of commercial policies.

To conclude this section, we must briefly refer to the ultimate structure for sustaining a tax system: **legal transcription of the tax provisions, the administration and control of the tax obligations and their connection to public ethics in this respect.**

These issues, which are more related to the tax administration, require a much wider space of their own, than that allowed by this paper, and will be discussed by specialists with better qualification throughout the Assembly. However, one cannot but highlight its importance within global framework of design of the tax policy which we have been presenting.

Some complex rules, with frequent changes, lack of certainty or fiscal security, complexity and high compliance costs may ruin any theoretical design, no matter how perfect it may appear on paper. The tax administrations have improved –especially in respect to massive control methods – but there still continue to be difficulties in international fraud and more sophisticated areas. There are such factors as the special treatment of capital vis-a-vis labor –although they may be justified for reasons of “efficiency”-, tax amnesties or regularizations –even though they may subsequently be income-producing and consistent-, reductions and deficiencies in public services –in spite of being supported by the need for budgetary stability -, whose inefficiency and corruption deteriorate tax ethics and citizen support to the system.

The tax administration must continue to improve its performance by exercising its role according to the laws in force, but also being prepared to apply the laws which one might want to approve in the future. A future referred to in the last quotation of this paper.

### **3. HOW**

All that has been previously stated, the relationships between the economy, society and the fiscal system impose challenges to the sustainability of the fiscal revenues which will need to be considered when deciding what, whom to tax and what for. However, what are our options for making these decisions? This latter section gathers the latest options available, with a summarized overview thereof and a reference catalogue to analyze their contents in greater depth.

#### **3.1. The global structure of the tax system**

Among the latest theoretical contributions for determining the global structure of the tax system, the **Mirrlees Report** (2011) plays an essential role. Following the tradition of previous reports –such as the Meade Report (1978) on direct taxation – the United Kingdom Institute for Fiscal Studies (IFS) put to work over sixty of the more reputable economists on the subject of preparation of an ideal, but feasible model to be put into practice for the overall reform of the tax system. After four years of work and directed by the Nobel Prize winner in Economics, James Mirrlees, the results were published and these currently constitute a reference in this subject matter.

The Report’s approach is clear: an overview of the taxes as a system, not in isolation, seeking coordinated and stable solutions for financing public expenditure; complying with the redistributive objectives while minimizing the conflicts with efficiency; and seeking neutrality as reference, in general, for evaluating the system. In other words: equity, efficiency and overall view, considering the level of expenditure and the scope of redistribution as externally determined objectives according to citizen preferences.

**Figure 3. The Mirrlees Report**

TRABAJO	CAPITAL	PEQUEÑA EMPRESA
Gravamen homogéneo de todas las fuentes de renta, con deducción de gastos asociados a la generación de ingresos. Base de la progresividad y capacidad redistributiva del sistema fiscal. Excepciones puntuales.		
Base amplia. Un mínimo exento y estructura sencilla de tipos marginales (2 o 3). Racionalización de tipos marginales efectivos y limitación-eliminación de las deducciones decrecientes con el nivel de renta.		
Consideración de la unidad familiar: imposibilidad objetivos simultáneos de progresividad y neutralidad. Lo más adecuado es tributación individual de las rentas y consideración conjunta de las mismas para el acceso a prestaciones sociales. En todo caso, peligro desincentivos.		
Considerar y atenuar desincentivos sobre contribuyentes con mayor elasticidad en la oferta de trabajo: salarios en los extremos de la distribución; mujeres con hijos pequeños; mayores de 55 años.	Neutralidad decisiones consumo-ahorro y entre diferentes activos Exención de la “rentabilidad normal” del ahorro (aproximada por la deuda pública a medio plazo), mediante una reducción en la base (RRA) combinada con la exención de activos sin riesgo (depósitos, ISAs) Resto de las rentas del ahorro gravadas en la tarifa general Corrección de la doble imposición en dividendos y ganancias de capital (con compensación de pérdidas) modulando la tarifa Sistema especial para ahorro en pensiones con exención hasta la percepción (EET)	Neutralidad rentas salariales, autónomos, pequeñas y grandes empresas, capital Focalizar los beneficios fiscales por actividad, no por dimensión; no tipos reducidos Simplificación para reducir costes indirectos Compensación íntegra de pérdidas Exención en el Impuesto sobre la renta de los autónomos de la “rentabilidad normal” de los activos afectos y gravamen a tarifa general (incluyendo cotizaciones sociales equivalentes a las del trabajador) Igualación de los tipos aplicables al trabajo y a los beneficios distribuidos
Integración impuestos y prestaciones sociales: - Integrar en la tarifa la imposición sobre rentas salariales con las cotizaciones sociales (empleado –principalmente- y empleador) - Simplificar el sistema de prestaciones sociales y de deducciones fiscales	Gravamen global de todas las transferencias de riqueza (donaciones y herencias) Complejidad administrativa: second-best (no gravamen o limitación de la RRA) Gravamen de la “plusvalía del muerto” Gravamen de la vivienda según las pautas del ahorro	Aplicación a la tributación societaria de una deducción por fondos propios (ACE), sin elevar el tipo nominal Compensación de la pérdida recaudatoria con el gravamen de bases menos móviles que el capital (trabajo; consumo).

**Source:** prepared by the author

Figure 3 summarizes some of the main recommendations: maintain a homogeneous but simple encumbrance of all sources of income in a single base with the correction of double taxation, integrate, to the extent possible, social security services and contributions, promote neutrality with respect to savings at the personal level (through the exemption of “normal income-yielding capacity” and entrepreneurial level (through a deduction for financing with its own funds), and use of the encumbrance of wealth transfers as closing element of the system. In sum, vis-a-vis more radical options proposed in the past (such as the substitution of the personal income encumbrance with the encumbrance of tax at that same level), the Report opts for an intermediate solution and, in principle, with less practical inconveniences, although without deviating from the orthodoxy as regards the concept of efficiency in taxation. The report itself as well as its adaptation to Spain are available in Internet and are recommended to reflect and get to know in greater detail the many relevant contributions included in this document.

Without going into too much detail, the model which we could currently consider as **“standard”** as regards the configuration of the tax system and sponsored by the main international institutions, proposes: to expand the bases –by eliminating tax expenditures -; reducing rates; by promoting homogenous indirect taxation –without

differentiation of rates according to products in VAT -; and introduction of incentives to savings -in general, through lower taxation of capital - and investment in Research and Development –as exception to the elimination of tax incentives -. All of the foregoing, on occasions accompanied by a reduction of non-salary costs of the labor factor –social contributions by employers, fundamentally would form what has been called “friendly taxation” with growth.

Lastly, although it is not specifically a proposal for the reform of the tax system, it is necessary to point out in this section the consolidation of the trend to implement “**Tax Rules**” to preserve budgetary stability. To the extent such rules are effective, they clearly condition the response, at least within short and medium term, which can be given to the questions posed in this paper.

### **3.2. The configuration of international taxation**

The OECD’s **BEPS** (Base Erosion and Profit Shifting) initiative is currently the basic framework for fighting against international tax fraud and avoidance within a cooperative approach. It identifies the main forms of evasion (transfer pricing, hybrid mechanisms, abuse of agreements, manipulation of financing costs, etc.) and proposes alternative for reducing the most harmful effects. However, its practical application is not exempt from problems, due to the definition of its objectives, the establishment of means of solutions and the commitments required from the participating countries.

In view of this option, a proposal has recently appeared; that is, the **Destination Based Cash-Flow Taxation** (DBCFT), which in addition to being an academic development, it constitutes a relevant element of the program presented at the elections by the top level executive of the first world power. In an extremely summarized manner (and, therefore, necessarily incomplete), the proposed alternative is based on two elements.

On the one hand, the calculation of the tax base would be the cash-flow, understood as the difference between payments and collection from nonfinancial activities. Interest would not be considered; neither collected or paid, and the purchase of fixed assets would be fully deductible at the time of payment.

On the other, there would be border tax adjustment similar to that made in the case of VAT, consisting in that payments abroad and imports in general would not be deductible, while revenues from exports would be exempt.

In this way, one endeavors to restrain erosion of the tax bases and displacement of benefits to low taxation territories (abuse in the payment of interest intended for other jurisdictions, delocation of patents for displacing taxation, transfer pricing), while at the same time eliminating the complexity of income taxes on traditional corporations in the treatment of the amortization of assets, “inefficiency” in the treatment of the different sources of financing of the entrepreneurial activity (deductible interest vis-a-vis nondeductible dividends, although the existence or not of this problem really depends



on the mechanisms of integration with the taxation of personal income) and one thus avoids the displacement of the production of national companies to other territories.

Given these potential advantages, one must take into account that this tax would substitute the current Corporate Income Tax, with which its effects would be equivalent to providing a subsidy to exports, in a percentage equal to the rate of said tax, while introducing an additional encumbrance on nondeductible imports (a “tariff”, in the same percentage). Commercial agreements would be seriously affected and, in principle, it could give way to “comercial wars”. In addition, in its theoretical configuration –and accompanied by a reduction in the taxation of wages -, it would be equivalent to a single rate value added tax, encumbering consumption “at destination”. In other words, it would cease to have the characteristics of a direct tax on income to acquire those of a consumption tax, with the resulting distributive consequences. On the one hand, proposals usually do not specify what would be the relationship with the income tax at the personal level, something that would be essential for determining the greater part of its effects on equity and efficiency. On the other hand, by not taxing the benefit in the usual terms, it could remain outside the sphere of the current provisions of the agreements to avoid international double taxation, thereby distorting the investment and location decisions. Lastly, the transition from one model to the other would involve significant management inconveniences (what to do with already incurred investments in assets; how to deal with financing decisions made prior to its entry into force? etc.) and of an economic nature (what would be its effect on the companies currently dependent on imports due to established economic reasons; how would one transfer to internal prices the increase in the price of imports; how would the rates of exchange react?; etc.), without it being possible a priori to anticipate how the different countries would react (is the proposal equally interesting to all of them? How to deal with the export of natural resources? Should they be tax exempt in the country of origin? What happens with countries dependent on tourism, wherein internal prices are essential for the operation of their balance of payment on being equivalent to their exports, etc.?).

Although there is yet no certainty regarding the possibility that this proposal may end up becoming a law, it is essential to analyze, discuss and reflect on its possible consequences; since there is no doubt that they would be of great importance.

An option -totally contrary in its orientation and contents to the above – to avoid the main problems derived from international taxation is the proposal for introducing a **unique corporate tax based** in the EU, already discussed in the previous section. This proposal, with theoretical background in the Ruding Report (1992), endeavors to solve the obvious problems faced by highly integrated economies, with freedom of commercial movements and capital when it comes to preserving their tax autonomy. However, its practical application in the EU has repeatedly clashed against mistrust (and veto capacity on fiscal issues) of the member states, for which reason in the last proposal made the requirements are less severe, opting for being limited to the coordination of the legal definition of the bases at the European level, and leaving for subsequent phases their consolidation and joint encumbrance.

Vis-a-vis these reform proposals aimed at the future, what is already a reality is the extension of **electronic commerce and other digital economy modalities** such as the so-called “collaborative economy”. All of this has resulted in significant changes in the business models; it is no longer easy to identify the simple buyer-seller duality; one must take into account the figure of the “affiliates” and the sales platforms. The delocation of activities for tax purposes is much simpler and there are clear difficulties for identifying the taxpayers and, even, conceptual and census problems when defining them. In this situation, the EU has introduced recent changes in the taxation of electronic commerce, by generalizing the destination principle, eliminating the minimum thresholds for taxing each remittance and simplifying, in a parallel manner, the administrative obligations of the companies (through the so-called “one-stop-shops”).

On the other hand, the tax administrations are beginning to use more advanced technological instruments for identifying the transactions and the individuals involved, tracing the web and adding and analyzing the results, acting to a certain extent, in the same manner as the private companies in their commercial exploitation of the so-called “big data”.

Lastly, I have decided to include in this section at least a brief reference to two complementary elements I consider relevant. First of all, the use of “**tax amnesties**” as part of the tax policy following episodes of flight of capital, which in my opinion continues to be a very customary practice. As we stated before, these measures may be fully justified after the crises that caused the evasion and they may even be profitable. However, within long term they constitute a perverse incentive for the person who will fail to comply in the future, will weaken the tax morale of the honest taxpayers and are a symptom of structural weaknesses in the functioning of a society and an economy. Secondly, and somehow in the contrary sense, there is the “**exit-tax**” phenomenon introduced in numerous legislations and whose purpose is to tax concealed surplus value not encumbered in a tax jurisdiction in the event of it being transferred to another of the taxpayer’s countries. This tax figure is relatively new and has caused controversy, especially in an area with freedom of establishment such as EU. However, it is being revealed as a fundamental element for ensuring the principle of territoriality in the encumbrance, while at the same time showing the deficiencies of the current system for calculating the generated income.

### **3.3. Taxation alternatives according to income sources and uses**

The search for new tax bases for improving or transforming the tax systems has generated proposals on the side of encumbrance of sources as well as uses of the income.

Beginning with the uses, given the increasing role performed by **VAT**, the concern for its distributive effects and the inefficiency of the mechanisms used to remedy them (exemptions and reduced rates), proposals have arisen for “**personalizing**” **your encumbrance** which may be classified according to two options: introduction of a mechanism that may allow for focusing the exemption on certain individuals (this thus

inverts the logic used in the universal system applied in most of the countries and instead of identifying the goods and services considered of social interest and thereafter introduce multiple rates and/or exemptions to the tax base to revert the regressiveness of VAT, one begins with the identification of the population one wishes to benefit and subsequently this population is exempt from the tax when it consumes this selected group of goods and services); eliminate all the exemptions and reduced rates and establish a monetary compensation intended to correct the regressive effects of VAT for a specific group of taxpayers. The theoretical proposal by Ainsworth, the Digital VAT - (D-VAT in its original proposal), and the Japanese experience, are framed within the first option, while the Canadian experience and the theoretical proposal of P-VAT (Personalized VAT) would be framed within the previously noted second solution.

Also within the sphere of the consumption tax there are different experiences of **taxation of what we can generally call “junk food –or drink”**, under the form of excise taxes on specific goods as a means (complementary to other preventive, information and education actions) for reducing consumption of products that are harmful to health, taxes that are criticized by some for their interventionist component and their regressive consequences, on which there is already certain evidence in relation to their design and effects.

Lastly, **green taxation** continues to be a way of exploration and consolidation. On the one hand, its small scale use on specific products appears to have a potential effect on the modification of behaviors (taxes on plastic bags, containers, residues, vehicles, water consumption, etc.), while its application on the main pollution sources (energy, transportation, production) is faced with greater resistance because of its potential negative effects on competitiveness and, in some cases, lower income, as well as for the difficulty of its application in the “extended” contaminating sectors or with greater technical difficulty for controlling contaminating emissions.

Continuing on to the new alternatives for encumbering the income sources, the latest of innovations would be **the “taxation of robots”**, a proposal which has created debate even though it has not been realized. This reaction is understandable given the accumulation of studies that anticipate the elimination of a huge number of current jobs as a result of the technological revolution underway or which, at least point out the possible existing risks, especially within short/medium term. However, at present I believe the debate should serve more to create awareness of the accelerated transformation of the labor world and with it, of the salaries and the greater part of tax bases which –directly or indirectly – fall on them, thus obliging us to consider what is the future of taxation in view of the urgent needs for financing income substitution and education policies to which the transformation of technological relations may lead us.

In fact, the recent world crisis had already opened the discussion on the direction being taken by the distribution of income, with authors such as **Piketty** warning against its accumulation resulting from the increasing rate of return and capital productivity in the globalized and technologically unified markets. As a solution to this process, this author

proposes the recovery of **taxation of capital in the form of wealth or net worth**, if it were possible at the international level and with some high rates.

Facing this proposal, there are still initial alternatives of **global taxation of income and net worth** that would seek to combine in a single encumbrance the explicit income (in a homogeneous manner for all the sources of income) with the encumbrance of the implicit income of the personal net worth, thereby correcting double taxation of declared income, as well as “double non-taxation” of income from capital which, at present, fully or partially escapes the encumbrance. Of course, in order to be effective, a global encumbrance such as that proposed, anchored on the knowledge of the taxpayers’ net worth, would require greater information management capacity on the part of the tax administration, with ultimately the same necessary capacity for fighting against tax fraud. In addition, this proposal should be coordinated through the introduction of neutral and equitable long-term savings incentives—through the creation of personalized savings accounts -, with the reform of corporate taxation, for reinforcing the role of Corporate Tax as a complement of Income Tax and with the transformation of the Inheritance and Donations Tax, to avoid double taxation of average and low incomes and not to put at risks transfers truly related to a productive activity.

### **3.4. Subnational financing.**

To conclude, we should not disregard financing of the levels of administration that are closer to citizens, with a view to increase the co-responsibility of these administrations toward them, by rendering parallel the decentralization of expenditure and revenue competencies.

Although this topic deviates us from the essence of the discussion regarding the options for the reform of the tax system, it is worthwhile, at least to highlight its connection and importance. A special cause of concern is the phenomenon of the large urban areas which concentrate a large number of the population in most of the countries and are responsible for the greater part of public services that are closest to the daily life of this population.

Currently, the financing structure of the subnational governments of the region shows less decentralization of taxes than the OECD’s mean and an increasing weight of the transfers. The subnational tax revenues are mainly derived from indirect taxes on consumption and sales, recurring taxes on real estate ownership and taxes on business and automotive vehicle licenses. In view of this situation and within the framework of an integral reform of the tax systems, one could explore **ways of participation in personal income taxation** which, although nonexistent in Latin America, is the main source of the financial autonomy in the OECD’s more advanced local governments, fundamentally in the Nordic countries.

## **4. DOCUMENTARY REFERENCES**

### **PANORAMA IN LATIN AMERICA AND THE CARIBBEAN / OECD**

[CEPAL, OXFAM \(2016\) “Tributación para un crecimiento inclusivo”](#)  
[OCDE, CEPAL, BID, CIAT \(2017\) “Estadísticas Tributarias en América Latina y el Caribe 2017”](#)  
[OECD, CIAT, IDB \(2016\) “Taxing Wages in Latin America and the Caribbean”](#)  
[J.R. Afonso \(2016\) “Imposto da renda baixo e diferenciado”](#)  
[Hanni, Martner, Podesta \(2015\) “El potencial redistributivo de la fiscalidad en América Latina”](#)  
[Gómez-Sabaíni, Moran \(2013\) “Política Tributaria en AL”](#)  
[Cobham, A. & Janský, P. \(2017\) “Global distribution of revenue loss from tax avoidance: Re-estimation and country results”](#)  
[Pecho, Peláez y Sánchez \(2012\) “Estimación del incumplimiento tributario en América Latina”](#)  
[Barreix, Benitez, Pecho \(2017\) “Revisiting personal income tax in Latin America: Evolution and impact”](#)  
[CIATdata](#)

### **GLOBAL STRUCTURE OF THE TAX SYSTEM**

[Meade Report The structure and reform of direct taxation IFS \(1978\)](#)  
[Mirrless, J. \(Dir.\) \(2011\): Tax by design. Mirrlees Report. Institute for Fiscal Studies.](#)  
[El Informe Mirrlees: opciones para España - Fundación Ramón Areces \(2014\)](#)  
[OCDE \(2017\) Fiscal policy and the cycle in Latin America](#)  
[OCDE Tax Web](#)  
[FMI “Growth-friendly” Fiscal Policy](#)  
[European commission TAXUD](#)

### **INTERNATIONAL TAXATION**

[Base erosion and profit shifting \(BEPS\)](#)  
[“Regional meeting on challenges in the sphere of international taxation” AECID-GIZ- CIAT Antigua, Guatemala, November 21-23, 2016](#)  
[Auerbach, Devereux, Keen, Vella \(2017\) “Destination-Based Cash Flow Taxation”](#)  
[Made in America: Destination-Based Cash Flow Taxation \(DBCFT\). CIATBlog](#)

[U.S. Department of Commerce Economics and Statistics Administration \(2014\) "What is made in America"](#)  
[Compensation of employees/GDP, USA\(1929-2015\)](#)  
[Common Consolidated Corporate Tax Base \(CCCTB\)](#)  
[Digital Single Market - Modernising VAT for cross border e-Commerce](#)  
[González García \(2017\) "El control del comercio electrónico y la economía colaborativa" \(Próximo número de Revista de Administración Tributaria CIAT/AEAT/IEF, nº 42, 2017\)](#)  
[Tax Amnesties : Theory, Trends, and Some Alternatives – IMF](#)  
[Exit tax. Anti Tax Avoidance Package. European Commission \(2016\)](#)  
[More on Exit Tax \(2015\)](#)  
[Ruding \(1992\) Report of the Committee of Independent Experts on company taxation. Executive summary](#)

## **TAXATION ACCORDING TO SOURCES AND USES OF INCOME**

[La personalización del IVA](#)  
[La imposición verde](#)  
[Impuestos sobre la "comida basura"](#)  
[¿Impuestos sobre los robots?. CIATBlog](#)  
[Piketty \(2014\) Capital in the 21<sup>st</sup> century](#)  
[Díaz de Sarralde, Garcimartín \(2015\) ¿Impuesto Global Renta/Riqueza?](#)

## **SUBNATIONAL FINANCING**

[OCDE Fiscal Federalism Web](#)

## EXPERIENCE OF COUNTRY TAX ADMINISTRATION

**Michale Snaauw**

Assistant Commissioner  
Canada Revenue Agency

**Contents:** Executive summary. 1. Background. 2. Results so far. 3. The key to success. 4. Moving forward

### EXECUTIVE SUMMARY

Offshore tax evasion and tax avoidance have become more complex, global and aggressive thereby presenting increasing challenges to tax administrations around the world. In response, the Government of Canada has made a commitment to crack down on international tax non-compliance, and the Canada Revenue Agency (CRA) is addressing these challenges on multiple fronts to ensure that the tax system is responsive and fair for all Canadians.

Tackling this global problem takes a firm commitment and the effective use of tools and partnerships to identify and bring into compliance those who try to cheat or misuse the system. In recent years, including proposals contained in the last three federal budgets, the Government of Canada has introduced more than 90 measures to improve the fairness and integrity of our tax system.

The federal government made significant investments in the CRA totalling more than \$1 billion for service improvements and to support our compliance and collections programs.

With new resources from these federal budget investments, the CRA has increased its number of auditors and enhanced its risk assessment tools to leverage new information and identify high risk taxpayers. The CRA has increased the number of audit teams focused on large multinational corporations, increased the number of auditors assigned to offshore non-compliance and high net worth individuals and increased the number of auditors focusing exclusively on promoters of tax schemes. In fact, the CRA has made promoters of tax schemes and offshore tax evasion the focus of the Agency's Criminal Investigations Program and several investigations are underway.

The CRA already has seen success on this front — with over C\$218 million in third party penalties against promoters and tax preparers who advised their clients to participate in aggressive or illegal tax arrangements, plans or schemes — and will continue to increase the application of penalties to all cases of serious non-compliance.

With increased information gathering capabilities and better tools at their disposal, tax administrations have access to more information than ever before. This information is invaluable in the help to identify and address international tax non-compliance at all

levels. This paper will highlight some of the work that Canada is doing to tackle tax evasion and avoidance with special emphasis on new tools, efforts and initiatives.

## **1. BACKGROUND**

Globalization has benefited many countries' economies, boosting trade and foreign direct investment, supporting growth, creating jobs and fostering innovation. Economic growth as a result of globalization has contributed to the tax base.

The globalization of financial transactions has also provided opportunities for those seeking to conceal some, or all of their wealth, and to evade or avoid declaring taxable income. Modern technology has made it easier for corporations to shift profits to low-tax countries and for wealthy individuals to move funds internationally to bank accounts that are undeclared to tax authorities. As can be seen from the various data leaks in recent years, offshore tax evasion and aggressive tax avoidance schemes have become more complex, global and unrestricted.

The Canada Revenue Agency (CRA) is responsible for the administration of tax, benefit, and credit programs on behalf of federal, provincial and territorial governments, and First Nations in Canada. In executing this mandate, the CRA directs its main efforts to the provision of taxpayer services and the enforcement of compliance.

Canada has over 1200 large corporate groups and CRA has a number of strategies in place to identify and address tax risks among this taxpayer population base.

Canadians, like many nationals from other countries, have been named in leaked financial documents that expose the possible methods and schemes through which individuals can exploit offshore tax regimes. While the vast majority of the 29 million individual Canadian taxpayers voluntarily comply with their tax obligations, the CRA has been making concerted effort to better understand the individual non-compliant population.

A number of proactive legislative and administrative measures have or are being put in place to identify high risk transactions and individuals, such as enhanced reporting requirements, business intelligence technology, nudge letters and new targeted compliance approaches.

### **1.1 What have we done?**

Over the last four years, the Canadian government has made substantial investments towards its commitment to cracking down on international tax evasion and avoidance.

These investments and initiatives can be grouped as:

1. Enhanced reporting requirements



2. Initiatives that clarify and streamline forms, processes and initiatives that produce leads and data
3. Initiatives to increase audit capacity and specialisation to respond to the increasing amount of data and offshore focus
4. Initiatives to extract/derive and refine actionable business intelligence from multiple data sources to expand coverage and develop an understanding of the compliance of taxpayer populations.
5. Increased international engagement and exchange of information.

## **1.2 The right structure and resources to tackle international tax avoidance and evasion**

A new International, Large Business and Investigations Branch has been established to focus exclusively on international tax, aggressive tax planning, large business, criminal investigations, and to develop strategies to combat offshore tax evasion and avoidance. Importantly, as well as dedicating more resources and specialization to the audit function, the agency has been developing better intelligence to enhance its understanding of non-compliant populations.

### **1.3 Audit capacity**

Recently, the CRA has hired 100 additional senior auditors to conduct audits focused on high-risk multinational corporations, and the CRA has also created a Promoter Compliance Centre of Excellence staffed with two dozen auditors dedicated to identifying new tax avoidance schemes. This is expected to result in a twelve-fold increase in the number of tax schemes examined by the CRA.

### **1.4 Criminal Investigations**

As part of its compliance continuum, the CRA administers a Criminal Investigations Program (CIP), which gives the federal agency additional tools to bring offenders to justice.

In 2012, CRA embarked on a transformation of its criminal investigation program in order to improve focus on the more serious cases of tax evasion. The program went from being delivered in over 30 offices across the country to 6 offices. Employees were retrained and jobs were re-classified to add more focus on forensic accounting. During the transition, as expected, inventories and referrals to the public prosecutor decreased significantly. However, the CRA has seen the focus shift to cases that involve significant tax evasion – such as those with an international element, tax schemes aimed at defrauding the government, as well as those involving money laundering, terrorist financing or the underground economy. These cases are met with serious court fines, a criminal record, jail time and publicity in media across the country.

Early results show that the transformation has delivered what was expected and the CRA's criminal investigative actions have resulted in a significant increase in the average fines and the number and length of jail terms awarded by the courts.

Under the *Income Tax Act* and the *Excise Tax Act*, Canadian tax evaders can face court fines of between 50 and 200 per cent of the taxes evaded, as well as up to five years in jail. Those who are charged with fraud under Section 380 of the Criminal Code, however, could face jail time of up to 14 years.

Furthermore, convictions by the CRA for tax evasion are published in local, regional and national media to increase the awareness of the Agency's efforts to combat tax evasion at home and abroad, educate Canadians on tax schemes so that they can avoid them and deter tax evasion by demonstrating the consequences of non-compliance. In addition, fingerprints of individuals convicted of tax evasion are recorded and are available to law enforcement agencies, including some foreign law enforcement agencies which could restrict an individual's foreign travel.

## **1.5 Access to the right tools and information**

Within the umbrella of an Agency-wide business intelligence strategy, the offshore program has developed a framework<sup>1</sup> to develop and deliver actionable offshore business intelligence. The CRA collects and creates a significant amount of data in carrying out its mandate to administer tax and benefit programs. An important part of the CRA's strategic plan is to maximise the use of different data sources, such as international exchanges and third party information. An offshore business intelligence roadmap has been developed to help ensure that all third party data are used, in conjunction with other CRA data, to identify high risk taxpayers.

The business intelligence strategy will seek to utilize information from sources such as:

- 1) Offshore Tax Informant Program
- 2) Electronic Funds Transfers
- 3) Foreign Income Verification Statement forms
- 4) Information requirements regarding unnamed persons
- 5) Country by country reporting / Base Erosion Profit Shifting (BEPS)
- 6) Common Reporting Standard (CRS) and Exchange of Information

## **1.6 Offshore Tax Information Program (OTIP)**

The Offshore Tax Informant Program (OTIP) was launched in 2014 to allow the CRA to pay a reward to individuals who provide credible and specific details about major international tax non-compliance. If the CRA assesses and collects more than C\$100,000 of additional federal taxes using this information, the reward will be between 5% and 15% of the associated federal tax, excluding interest and penalties. Since inception the CRA has signed over 27 contracts with informants and started over 200 audits.

---

<sup>1</sup> Gartner's Business Analytics Framework, pub: 20 September 2011 – was used as a the foundation for the Offshore Business Intelligence Framework : [http://www.gartner.com/imagesrv/summits/docs/na/business-intelligence/gartners\\_business\\_analytics\\_219420.pdf](http://www.gartner.com/imagesrv/summits/docs/na/business-intelligence/gartners_business_analytics_219420.pdf)

The OTIP program takes comprehensive steps to protect personal information and the identity of informants to the fullest extent possible as required by law. As with similar tax informant programs in other jurisdictions, it is expected that the program will take between 3 to 5 years to fully realise results in the form of taxes collected.

## **1.7 Electronic Funds Transfer (EFT) information**

As of January, 2015, Canadian financial intermediaries (i.e. banks, credit unions and money service businesses) began reporting to the CRA incoming and outgoing international Electronic Funds Transfers (EFT) of C\$10,000 or more. This new mandatory reporting requirement helps the CRA to better identify Canadian resident taxpayers who may be participating in international aggressive tax avoidance and who may be attempting to conceal income and assets offshore.

EFT information is also being used to study specific offshore locations and certain financial institutions. The Agency had committed to reviewing 100% of EFTs from four jurisdictions in 2016-17 and four jurisdictions a year going forward. High risk transactions will be selected for further review and compliance actions, as appropriate.

## **1.8 Enhanced foreign income verification statement (form T1135)**

In addition to the significant information collected by EFTs, the requirements for reporting of specified foreign property held overseas were amended in 2013 to provide the CRA with additional information<sup>2</sup>. The revisions require taxpayers to provide detailed information of a taxpayer's "specified foreign property", names of specific foreign institutions, countries in which offshore assets are located, and foreign income earned. The enhanced data on foreign property is being compared against the EFT data in order to identify potential high risk taxpayers who attempt to conceal assets offshore.

## **1.9 Information requirements regarding unnamed persons – offshore holdings**

Information requirements regarding unnamed persons are an important part of the CRA's ongoing offshore audit and risk assessment work. The requirements are being used to identify taxpayers using offshore accounts associated with Canadian financial institutions or entities.

An unnamed requirement for information is a court authorized action that allows the CRA to challenge schemes designed to avoid paying or reporting tax on income. For example, the CRA can file an application in the courts for authorization to issue an unnamed persons requirement to a third party such as a domestic bank to identify the names of account holders who hold foreign assets or are involved in foreign financial transactions.

---

<sup>2</sup> In 2013 the CRA made changes to Form T1135 to include more detailed information about Canadians' foreign property and assets. The additional information is complementing the CRA's other compliance and intelligence gathering tools used to combat international tax evasion and aggressive tax avoidance.

## **1.10 Country by country reporting / Base Erosion Profit Shifting (BEPS)**

The CRA signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS which is an agreement to share information with treaty partners on Base Erosion and Profit Shifting action item 13 Country by Country reporting.

The Base Erosion and Profit Shifting (or BEPS) Project aims to stop multinational enterprises from minimizing their taxes inappropriately by shifting profits away from the countries where the income-producing activities take place to jurisdictions of little or no economic activity.

The country by country reports will provide high-level overviews of the global operations of large multinationals to enhance transparency and assist tax administrations in performing more effective risk assessments.

Canada has passed the necessary domestic legislation to enforce reporting compliance, developed electronic forms to promote electronic filing, published guidelines for stakeholders and taxpayers, is developing the necessary infrastructure to exchange the information securely and risk assess the information that it will receive.

## **1.11 Common Reporting Standard (CRS)**

In 2018 the CRA will begin receiving information through the Common Reporting Standard (CRS) initiative. Through this initiative, financial institutions in 100 participating jurisdictions will be required to collect and report financial information on non-residents, including dividend, interest and account balances. The information received through the CRS will be in a standardized format and will enhance the CRA's ability to identify previously undisclosed foreign assets or income.

## **1.12 Communications and engagement**

To ensure a tax system that is responsive and fair to all Canadians, our approach to tackling international tax evasion and aggressive tax avoidance also includes recognizing the importance of improving our communications with Canadians. The Agency has focused its communication efforts both internally and externally.

For CRA externally focused communication, the Agency communications plan sought to:

1. Inform and positively influence public perception that the Agency is fair and an effective tax administration that has well-managed programs that are delivering on the Government's investments to protect the tax base from tax cheats.
2. To inform and reassure the public that high wealth taxpayers are subject to greater scrutiny and consequences.

3. Deter multinational corporations and high-wealth individuals and their representatives/tax intermediates from participating in offshore tax evasion/aggressive tax avoidance activities; and,
4. Promote voluntary disclosures (VDP) to correct tax affairs and offshore tax informant program (OTIP) to help crack down on tax evasion/avoidance.

A formal communications package was prepared for the launch of the CRA initiatives to address offshore non-compliance and a CRA website landing page was made available to inform potential informants, taxpayers and their advisors of CRA actions.

In order to promote public awareness both as part of any approach to transparency and as a deterrent to potential offshore evasion and avoidance, the CRA regularly updates Canadians on current schemes that don't comply with the *Income Tax Act* through its website, tax alerts, news releases, and via social media such as Twitter. Also, the CRA seeks partnerships in the tax preparation and accountancy sectors as well as with community groups that may be able to amplify messages to vulnerable communities.

Internal communication to employees is also key and efforts have been made to make sure that the changes to programs are clear to staff and that there is awareness of the new tools and measures available. Timely internal communications was prepared in advance of organizational changes and there are additional activities focused on particular stakeholder groups.

### **1.13 Engaging external expertise**

In order to build on the Agency's efforts to crack down on international tax evasion and avoidance, the Minister of National Revenue, Diane Lebouthillier, announced the creation of an independent advisory committee on offshore tax evasion and aggressive tax planning. The Offshore Compliance Advisory Committee (OCAC)<sup>3</sup> is comprised of independent experts with significant legal, judicial and tax administration experience.

The members of the committee will provide input to the Minister and the CRA on administrative strategies to help alleviate and discourage offshore non-compliance.

The Committee has already examined the Canadian Voluntary Disclosures Program (VDP), and proposed overall tightening of the VDP to ensure fairness of the tax system, notably in order to limit the repeated use of this program by sophisticated taxpayers who wish to minimize what they owe and restrict the circumstances in which it can be used. CRA is currently leveraging the Offshore Compliance Advisory Committee's recommendations to review the VDP parameters.

---

<sup>3</sup> The OCAC is chaired by Dr. Colin Campbell. Dr. Campbell is currently Associate Professor of Law at Western University and a published author on tax matters. The Committee's Vice-Chair is Kimberley Brooks, Associate Professor of the Schulich school of Law at Dalhousie University. Ms. Brooks, a member of the Canadian Tax Foundation Board of Governors and a member of the International Fiscal Association, practiced law in Toronto and the United Kingdom

## **2. RESULTS SO FAR...**

New funding to crack down on tax evasion and fight tax avoidance since 2013 is expected to return C\$2.6 billion in revenue over five years.

Since EFT reporting requirements were introduced on January 1<sup>st</sup>, 2015 to January 31, 2017, 28.6 million EFT reports have been received. The value of this information has enabled a number of different business areas within the CRA to identify outgoing and incoming funds transfers and to assess whether potential non-compliance is occurring. For example, the CRA is focusing resources on examining taxpayers' transactions to specific jurisdictions and financial institutions of concern.

The CRA is also developing technology to automate the matching of EFT data, and to enable the integration of other available CRA data. An automated system will accurately match taxpayers to EFT records and integrate the data with existing CRA data. This will allow comprehensive risk assessment of approximately 13 million EFT transactions per year, assisting in the identification of taxpayers that are at the highest risk of being non-compliant. The intent is to ensure broad use of the EFT data within the CRA which will be accomplished by continued training and outreach.

In relation to criminal investigations, between 2011 and 2016, 508 taxpayers were convicted for tax evasion. These cases involved approximately \$120 million in federal tax evaded and court sentences totalling C\$40 million in court fines and 2,930 months of jail time. Of these tax evasion convictions, 42 had links to money and/or assets held offshore involving C\$34 million in federal taxes evaded, court fines of C\$12 million, and 734 months of jail time.

## **3. THE KEY TO SUCCESS**

### **a. Our people**

The CRA has undergone significant changes in recent years with the retirements of many of our experienced staff members and the onboarding of new staff to meet its commitments to the Government of Canada.

To achieve the right workforce mix to meet the challenges facing the Agency, the CRA's recruitment strategy supports our commitment to strike the right balance between internal staffing and external recruitment. We need to have the right mix of technical and leadership expertise, coupled with fresh perspectives and diverse experience. Having a diverse workforce helps foster innovative thinking and creative solutions.

The way we do our work is changing and this requires a new way of thinking, doing, and leading. It is critical that we focus on the workforce the CRA will need to achieve its business objectives in the coming years and to adopt a hiring culture to secure the talent needed for the future.

In response to the growth of information available to detect tax evasion and avoidance, the CRA recognises that it will need a workforce that is comfortable with analysing increase volumes of data, and knows how to utilise data in a predictive manner to strengthen service and compliance. From administrative and clerical to specialized professionals, the CRA will need to continue hiring workers who continuously refresh what they know, learn new things to stay adaptable, and keep abreast of current and upcoming developments in offshore compliance.

The CRA offers individual learning plans for employees with access to training courses that are constantly being developed and updated. Courses include training to increase the Agency's expertise in examining offshore transactions, on auditing complex cases where particular legal structures or tax treaties may be involved, criminal investigative techniques and related forensics and informatics capabilities.

As part of a longer term approach to ensure the CRA's people have appropriate skills to tackle the increasing complexities of offshore tax evasion and avoidance, the CRA is currently in the process of recruiting additional staff, some with different skill sets than traditionally found internally, in order to institutionalize new skills that will enable the Agency to better detect and reduce offshore tax evasion and avoidance.

#### **b. Innovation and efficient use of resources**

The CRA has made improvements to address challenges associated with data, skills, and tools. Improved Information Technology (IT) is being used to help manage increased data volumes. Within the technology branch of the CRA, a business intelligence renewal initiative identifies IT tools to support the current and forecasted business intelligence needs. The team dedicated to offshore detection has worked with the business intelligence renewal initiative to identify and procure software to assist its data mining, analysis and reporting requirements. Dedicated programs focus on business intelligence solutions, data acquisition and business intelligence projects.

The CRA uses risk-assessment tools, analytics, leads, and third-party data to detect and address non-compliance. More detailed and accurate risk-assessment and profiling of the taxpayer population allows for the implementation of a more effective and resource-efficient risk-based approach, targeting skilled resources to the highest risk populations for audit.

The Agency is also encouraging innovative approaches to engaging with non-compliant taxpayers to incentivize a change in behaviour. Identifying non-compliance as early as possible can allow for prompt intervention, create opportunities to correct non-compliance and to prevent future non-compliant behaviour. Where taxpayers are assessed as low risk, the CRA may engage and 'nudge' them towards compliance.

Nudge, which is rooted in behavioural economics, seeks to overcome behavioural barriers by changing how choices are presented to people to facilitate better decisions.

Nudge techniques have been demonstrated to hold significant power to improve public policy and public administration outcomes. CRA's nudge-related work has, in general, focused on increasing the rate of filing and payment compliance.

### **c. International cooperation**

Locating funds overseas necessitates comprehensive international cooperation and exchange of information. The CRA is looking to build on existing international cooperation arrangements and initiatives. Canada has a large treaty network composed of 92 tax treaties, 22 tax information exchange agreements (TIEAs), and is a signatory to the multilateral Convention on Mutual Administrative Assistance in Tax Matters. These treaties and agreements promote more comprehensive and more effective international cooperation through the exchange of information.

In addition, the CRA is engaged in a number of bi-lateral and multi-lateral projects where CRA works with other tax authorities in other jurisdictions such as the Organisation for Economic Co-operation and Development (OECD), particularly the Task force on Tax Crimes and Other Crimes and the Joint International Taskforce on Shared Intelligence and Collaboration (JITSIC). The JITSIC Network establishes a platform for increased exchange of information, co-operative cross-border collaboration and coordinated case work.

Actively engaging internationally, the CRA aims to gain a greater understanding of the non-compliant population which may be engaging in offshore tax evasion or avoidance.

## **4. MOVING FORWARD....**

The CRA will continue to make investments in people and technology. Over the next few years, the Agency will work to improve its business intelligence capacity in an effort to improve our risk scoring.

The CRA will continue to expand current projects, such as the EFT jurisdiction projects, as well as identify new opportunities to identify non-compliant populations. The recent government investments will be used to fund new specialized teams to tackle these new initiatives.

The CRA will continue to collaborate both internally, with key stakeholders in Canada and with its domestic and international partners to ensure that we have the information we need to fulfill our commitments.

Also, in an effort to ensure Canadians are confident in the CRA's ability to identify and correct non-compliant behaviours in this country, the Agency will continue to communicate our actions and successes. Transparent communication of our efforts will also act as a deterrent to those taxpayers who continue to seek ways to avoid or evade paying their fair share.



## **CURRENT MAIN CHALLENGES OF THE TAX ADMINISTRATIONS LARGE BUSINESS AND INTERNATIONAL DIVISION**

**Virginia Tarris**  
Tax Law Specialist  
Internal Revenue Service  
(United States)

**Content :** Summary. 1. Introduction. 2. Globalization. 3. Digitalization - the rewards and the risks. 4. Financial resources.

### **SUMMARY**

Tax administrations are facing increased challenges as the taxpayer community becomes more global and the use (and abuse) of the Internet increases. As the collection of taxes has shifted to an increasingly electronic world, the skill set of the IRS employee has continually evolved. More and more data is received every year and the Internal Revenue Service (IRS) is looking for the most effective ways of turning the new data into useful intelligence (for example, to enable the IRS to identify areas of risk or identify patterns of noncompliance).

The increase in the IRS's responsibilities is coming at the same time as the decrease in the IRS's budget. While addressing the challenges of a decreased budget may force certain efficiencies, at some point the efficiencies are maximized and without additional resources there is a risk of decreasing quality – whether manifested in the lack of infrastructure to administer taxes or the personnel necessary to provide the appropriate level of taxpayer service.

The IRS is addressing these challenges through its movement towards a Future State, where taxpayers can access self-service assistance on-line through IRS.gov and restrict the use of in-person or telephone service to those cases where electronic assistance is not possible or sufficient. As the work at the IRS changes, the skill set of employees must also change. With increased attacks on the technology and increased risks of identity theft and refund fraud, the IRS must invest in technology in order to protect taxpayer data. The IRS has taken a number of steps to address these challenges. However, continuing work is needed, and the budget reduction only makes these challenges more difficult.

## I. INTRODUCTION

The world is getting smaller every day – or at least it seems to be. In 1522, survivors of the first single circumnavigation of the world arrived in Spain after a three-year voyage.<sup>1</sup> In 1872, Jules Verne published *Around the World in Eighty Days* as a fantasy;<sup>2</sup> in 1890, the journalist Nellie Bly completed the journey in 72 days.<sup>3</sup> In 1992, the supersonic *Concorde* completed the journey in less than a day and a half.<sup>4</sup> On a daily basis, we challenge ourselves to improve the past and strive to do things better, faster and easier.

Many tax administrations are facing the challenges that arise from activities that occur outside their borders, and the IRS is no exception. More taxpayers file tax returns with international issues. As goods and services developed in the United States are in demand throughout the world, companies take different approaches to make these products available. Many companies transfer assets, both tangible and intangible, outside U.S. boundaries to establish businesses or reorganize themselves outside the United States. The increase in the availability and use of the Internet also results in increasing globalization. The IRS needs information located in other jurisdictions to ensure that taxpayers comply with their U.S. filing obligations.

Digitalization of the world is also increasing. The Internet is everywhere. People use it to buy and sell goods and services. The Internet makes it easy to transfer money, pay bills, buy airplane tickets, and make hotel reservations, all from the comfort of home or a coffee shop. It also may make it harder to trace these same transactions, which can increase the challenges of preventing tax evasion. Tax administrations are developing processes to address these challenges as well.

In addition to increased globalization, resources are decreasing, at least for the U.S. Internal Revenue Service (IRS). As a result, the IRS needs to do more with these diminished resources, while facing an ever-expanding workload. It is developing procedures to maximize the use of electronic resources to provide both services and information. It is addressing the challenges from a limited training budget by increasing virtual training and integrating outside training resources.

The changes arising from globalization also affect the IRS workforce. Knowledge of international issues by all IRS examiners is necessary. We need more employees who can address data challenges, including transferring information electronically between jurisdictions in a secure manner, keeping the information received confidential, and

---

<sup>1</sup> <http://www.history.com/topics/exploration/ferdinand-magellan>

<sup>2</sup> <http://www.notablebiographies.com/Tu-We/Verne-Jules.html>

<sup>3</sup> [Nellie Bly Online](#)

<sup>4</sup> <http://www.concordephotos.com/history-of-concorde.html>

making good use of the data once received. We compete with private industry for the most talented employees.

This paper will discuss challenges that the IRS is facing from globalization, digitalization, and reduced resources. It includes a summary of some of the forms on which the IRS collects information that it uses to conduct risk assessments and better identify the taxpayers to examine that pose the highest risks of noncompliance.

## 2. GLOBALIZATION

Tax administrations are facing unique challenges as they address an increasingly global taxpayer community. Multinational enterprises (MNEs) represent a large proportion of global gross domestic product with intra-firm trade now representing a growing proportion of overall trade.<sup>5</sup> Improvements in technology and the increase in global activity allow businesses to operate in geographic locations that are distant from their customers and provide services or digital products over the internet. Sophisticated tax planners take advantage of the current environment by identifying areas for legal arbitrage opportunities. These factors have led to MNEs feeling more confident in their ability to take aggressive tax positions.<sup>6</sup> Large MNEs are not the only ones benefiting from the current international tax system. At the root of all enterprises are individual taxpayers, who are also navigating today's international tax environment and potential gaps between their home jurisdictions and other countries.<sup>7</sup> In a 2014 report, updated in 2016, the Global Forum on Transparency and Exchange of Information for Tax Purposes stated that "Vast amounts of money are kept abroad and go untaxed to the extent that taxpayers fail to comply with their tax obligations."<sup>8</sup>

Underlying this behavior is the inevitable mismatch created by variations in domestic laws between jurisdictions. While taxation is at the core of a country's independent sovereignty, the interaction between the laws and regulations of various jurisdictions creates gaps and even friction in certain cases. Doing business outside the borders of a taxpayer's country of tax residence is not a new phenomenon. However, the globalization of operations is increasing, as transportation becomes faster, communications become virtually instantaneous, and operations that once required the personal touch can now be completed with the click of a key. Taxpayers appear more

---

<sup>5</sup> OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing, 7, available at <http://www.oecd.org/tax/beps/action-plan-on-base-erosion-and-profit-shifting-9789264202719-en.htm>. [hereafter "2013 Action Plan"]

<sup>6</sup> *Id.* at 7-8.

<sup>7</sup> OECD presents outputs of OECD/G20 BEPS Project for discussion at G20 Finance Ministers meeting, available at <http://www.oecd.org/tax/oecd-presents-outputs-of-oecd-g20-beps-project-for-discussion-at-g20-finance-ministers-meeting.htm>. [

<sup>8</sup> Automatic Exchange of Financial Account Information, Background Information Brief, updated January 2016, 2, available at <http://www.oecd.org/tax/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Brief.pdf>. The United States had indicated that "It is difficult to quantify the amount of assets being held offshore or the rate at which the industry is growing. It is estimated that several trillion dollars in assets worldwide are held in offshore tax havens. Presumably, transfers from the U.S. represent a large share of this wealth. One authority has estimated the annual revenue loss to the U.S. at a minimum of \$100 billion." See <https://www.irs.gov/businesses/small-businesses-self-employed/abusive-offshore-tax-avoidance-schemes-talking-points>.

and more able to take advantage of benefits from international operations – whether operating benefits such as lower wage costs or financial benefits such as lower taxes or the immediate electronic transfer of funds to another country. For similar reasons, more individuals are living and/or working outside the U.S. borders.

In its most recent Strategic Plan, the IRS identified the expanding global tax environment and changing business models as one of the major trends affecting the IRS.<sup>9</sup> Businesses are adopting more complex structures and the IRS must tailor its services to ensure that the IRS helps these businesses understand and meet their tax filing obligations.<sup>10</sup>

Sovereign jurisdictions have their own rules regarding activities within their borders that result in potentially conflicting tax rules. As a result, double taxation may occur. Jurisdictions, including the United States, enter into tax agreements that outline how jurisdictions will deal with each other and their respective tax residents when double tax arises. Double tax treaties are comprehensive and deal with many tax issues, such as when income earned in another jurisdiction becomes taxable and the extent to which certain income paid from one jurisdiction to another may benefit from a reduced level of tax. Tax Information Exchange Agreements (TIEAs) generally provide only for the exchange of information between jurisdictions, which may assist a jurisdiction in appropriately taxing the income of a tax resident.

#### **A. Exchange of information to aid compliance and respond to evasion**

The United States relies on a voluntary system of tax compliance. Taxpayers report and pay their taxes with no direct enforcement and minimal interaction with the government.<sup>11</sup> The voluntary compliance rate overall is approximately 84%.<sup>12</sup> A “tax gap” exists when taxpayers do not pay voluntarily and on time the taxes that would be due if the tax law were correctly applied to the facts of the taxpayers’ situations.<sup>13</sup> The average annual tax gap for 2008 - 2010, the most recent years for which reliable information is available, is over \$400 billion.<sup>14</sup> Part of this tax gap results from unpaid U.S. tax liability on cross-border transactions by U.S. or foreign persons.<sup>15</sup>

---

<sup>9</sup> Internal Revenue Service, Strategic Plan FY 2014-2017, available at <https://www.irs.gov/pub/irs-pdf/p3744.pdf>, pg. 4 (“Strategic Plan”). The IRS had also identified “accelerating globalization” as a major trend in its Strategic Plan for 2009 – 2013. See <https://www.irs.gov/pub/irs-prior/p3744--2009.pdf>, pg. 10. It identified “globalization” as an external factor affecting the achievement of the vision of the IRS in the Strategic Plan 2005-2009. See <https://www.irs.gov/pub/irs-prior/p3744--2004.pdf>, pg. 9.

<sup>10</sup> *Id.*

<sup>11</sup> U.S. Department of the Treasury, *A Comprehensive Strategy for Reducing the Tax Gap* (September 26, 2006), pg. 2, available at <https://www.treasury.gov/press-center/press-releases/Pages/hp111.aspx>.

<sup>12</sup> U.S. Department of the Treasury, *Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance* (July 8, 2009), pg. 2, available at [https://www.irs.gov/pub/newsroom/tax\\_gap\\_report\\_final\\_version.pdf](https://www.irs.gov/pub/newsroom/tax_gap_report_final_version.pdf).

<sup>13</sup> *Id.*, Appendix, “Understanding the Tax Gap,” i.

<sup>14</sup> IRS, *The Tax Gap*, available at <https://www.irs.gov/uac/the-tax-gap>. Although the average annual gross tax gap is actually estimated at \$458 billion, the IRS expects to recover about \$52 billion eventually through late payments and enforcement actions.

<sup>15</sup> Treasury Inspector General for Tax Administration (TIGTA), *A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap*, Ref. Number

While it is perfectly legal for U.S. taxpayers to hold money offshore, it is illegal for a taxpayer not to disclose substantial offshore holdings, not to report income earned in the United States but “hidden” offshore, and not to include income earned offshore.<sup>16</sup>

Over the past 15 years, there have been many stories about the use of offshore accounts. Congress has held hearings on the use of private banks for anonymous account holdings.<sup>17</sup>

As individuals and businesses live and operate outside the U.S. borders, it often becomes difficult for the IRS, the U.S. tax authority, to use documents and information only located within the United States to understand a taxpayer’s assets, financial situation, or global activities. Often the records necessary to provide this information – for example, wage records or bank account statements – are located outside of the United States, and the IRS can access these records only if the foreign jurisdiction provides the information. Effective transparency through the exchange of information with another jurisdiction provides increased information. Transparency for U.S. tax purposes involves knowing about the taxable income of U.S. taxpayers, both individuals and businesses alike, wherever the income is earned or located. Increased knowledge about taxable income increases both compliance and enforcement efforts, which, in turn, should increase tax revenue.

There are several approaches to the work needed to achieve transparency, from unilateral to bilateral to multilateral approaches. In the unilateral approach, the United States acquires the information in a one-way transaction – such as from the taxpayer or from a foreign jurisdiction. In the bilateral approach, the actions involve the exchange of information between two jurisdictions as a result of a bilateral agreement. These bilateral agreements include double tax conventions and tax information exchange agreements. Multilateral transparency occurs when jurisdictions enter into an exchange of information agreement with more than two jurisdictions. The result of a multilateral agreement can be a uniform platform for providing information, although the information still flows in a bilateral manner, that is, from one jurisdiction to another. For example, the United States is a signatory to the convention on Mutual Administrative Assistance in Tax Matters (Multilateral Convention).<sup>18</sup> The Convention was developed jointly by the OECD and the Council of Europe in 1988 and amended by Protocol in 2010. The

---

2009-IE-R001 (January 27, 2009), pg. 1, available at <https://www.treasury.gov/tigta/ieereports/2009reports/2009IER001fr.pdf>. This report analyzes the international tax gap as a general concern, not for a particular year.

<sup>16</sup> Government Accountability Office, GAO-07-237, *Additional Time Needed to Complete Offshore Tax Evasion Examinations*, (March 2007), pg. 4, available at <http://www.gao.gov/assets/260/258533.html>

<sup>17</sup> The Senate Permanent Subcommittee on Investigation of the Committee on Homeland Security and Governmental Affairs Report has held many hearings. Titles of reports include *Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities* (November 1999); *Role of U.S. Correspondent Banking in International Money Laundering* (March 2001); *Tax Haven Abusers: The Enablers, The Tools, and Secrecy* (August 2006); and *Tax Haven Banks and U.S. Tax Compliance* (2008).

<sup>18</sup> Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters, available at <http://www.oecd.org/ctp/exchange-of-tax-information/convention-on-mutual-administrative-assistance-in-tax-matters.htm>. The United States signed the Protocol to the Convention, in 2010, but the Protocol has not yet been ratified by the U.S. Senate.

Convention is the most comprehensive multilateral instrument available for all forms of tax co-operation to tackle tax evasion and avoidance, a top priority for all countries.

In addition, the IRS has collaborated on many multilateral projects designed to increase transparency. The largest multilateral group working to increase transparency with the exchange of information process is the Global Forum on Transparency and the Exchange of Information for Tax Purposes (Global Forum).<sup>19</sup> The Global Forum has 139 members on an equal footing, and it is the premier international body for ensuring the implementation of the internationally agreed standards of transparency and exchange of information in the tax area. Through an in-depth peer review process, the Global Forum monitors that its members fully implement the standard of transparency and exchange of information that they have committed to implement. The Global Forum first focused on the exchange of information on request. However, it has now expanded the scope of its work to include the automatic exchange of information.

In all of these approaches, the United States believes information should be available for use by tax administrations and be safeguarded to the maximum degree. Most bilateral and multilateral exchange agreements provide for the exchange of information for tax purposes as well as requirements regarding the confidentiality of the information that will be exchanged.<sup>20</sup>

## **1. Exchange of information on request**

To meet the challenges to the proper enforcement of tax laws of the United States caused by the increase in cross-border flows of capital or the increased presence of U.S. taxpayers in foreign jurisdictions, we must rely more and more on international co-operation between jurisdictions. The exchange of information on request is one of the two internationally agreed standards for exchanging information which were implemented by the Global Forum.<sup>21</sup> As provided in the Model U.S. Double Tax Convention, the U.S. competent authorities and the exchanging partner will exchange foreseeably relevant information in order to carry out the provisions of tax convention.

## **2. Automatic exchange of information**

The Automatic Exchange of Information (AEOI) is the second of the two internationally agreed standards for the exchange of information of the Global Forum.<sup>22</sup> The automatic exchange of information is not a new concept. However, the information received was often not in a useful format to the recipient jurisdiction. The United States began the more deliberative automatic exchange of information with the implementation of FATCA

---

<sup>19</sup> See <http://www.oecd.org/tax/transparency/>.

<sup>20</sup> See Article 26 of the United States Model Income Tax Convention, available at <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf>

<sup>21</sup> <http://www.oecd.org/tax/transparency/about-the-global-forum/>

<sup>22</sup> *Id.*



in 2010.<sup>23</sup> The United States began to develop a common transmission platform for FATCA information with the development of the International Data Exchange Service. In 2013, the G20 expressed its support to develop a new multilateral standard on the automatic exchange of information and its support for the OECD work on the automatic exchange of information as the new global standard.<sup>24</sup> The OECD established a program on the Automatic Exchange of Information (AEOI) that would develop a standard reporting mechanism.<sup>25</sup> In February 2014, the OECD issued a single global standard (the “Common Reporting Standard”) for the automatic exchange of information.<sup>26</sup> It sets out the financial account information to be exchanged, the financial institutions that need to report, the different types of accounts and taxpayers covered, and the common due diligence procedures to be followed by financial institutions. The OECD indicated at that time that the new standard “recognises the catalytic role that implementation of the US Foreign Account Tax Compliance Act (FATCA) has played in the G20 move towards automatic exchange of information in a multilateral context.”<sup>27</sup> Under the CRS procedures, account information would be uploaded by the reporting jurisdiction and downloaded by the receiving jurisdiction.<sup>28</sup> Over 100 jurisdictions have already agreed to implement the Common Reporting Standard, with some jurisdictions reporting as early as 2017.<sup>29</sup>

Even though it has not committed to implement the CRS at this time, the United States participates in the Global Forum work on the automatic exchange of information in recognition of the importance of increasing transparency.<sup>30</sup> For example, the United

<sup>23</sup> FATCA is discussed in more detail below.

<sup>24</sup> Communiqué of G20 Finance Ministers, April 2013, paragraph 14, available at <http://www.g20.utoronto.ca/2013/2013-0419-finance.html>; G20 Leaders’ Declaration, September 2013, paragraph 51, available at <http://www.g20.utoronto.ca/2013/2013-0906-declaration.html>. At the Global Forum meeting in Jakarta, Indonesia, in November 2013, the Global Forum agreed to establish a new group on automatic exchange of information to take forward the Global Forum’s work to monitor and review the implementation of automatic exchange of information consistent with the G20’s request. Statement of Outcomes, available at <http://www.oecd.org/tax/transparency/about-the-global-forum/meetings/ENG%20Jakarta%20Statement%20of%20Ourcomes.pdf>, paragraph 15.

<sup>25</sup> See <http://www.oecd.org/tax/transparency/automatic-exchange-of-information/>.

<sup>26</sup> <http://www.oecd.org/tax/oecd-delivers-new-single-global-standard-on-automatic-exchange-of-information.htm>

<sup>27</sup> *Id.* The Common Reporting Standard (CRS) was incorporated into a lengthier publication, *Standards for Automatic Exchange of Financial Account Information*, issued in July 2014. <http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-account-information-for-tax-matters-9789264216525-en.htm>

<sup>28</sup> This AEOI program used as a beginning resource much of the evaluative and IT support work that had been completed in connection with FATCA: an evaluation of a jurisdiction’s confidentiality practices, the IDES common reporting standard, etc.

<sup>29</sup> <http://www.oecd.org/tax/automatic-exchange/commitment-and-monitoring-process/AEOI-commitments.pdf>.

Although the United States has not committed to the implementation of the Common Reporting Standard, a footnote in the March 2017 OECD Secretary General Report to the G20 Finance Ministers notes that “[t]he United States has indicated that it is undertaking automatic information exchanges pursuant to FATCA from 2015 and has entered into intergovernmental agreements (IGAs) with other jurisdictions to do so. The Model 1A IGAs entered into by the United States acknowledge the need for the United States to achieve equivalent levels of reciprocal automatic information exchange with partner jurisdictions.”

<sup>30</sup> IRS Commissioner Koskinen stated in early 2016 that the United States should use the OECD’s common reporting standard instead of the Foreign Account Tax Compliance Act reporting requirements so the country is operating on a common transmission system. See Laura Davidson, “Information Reporting: Koskinen: U.S. at Disadvantage Without Common Reporting,” *Daily Tax Rep. (BNA)* No. 50, at G-5, (March 15, 2016)

States has been working closely with the OECD to implement a Common Transmission System for the exchange of financial account information called for in the Common Reporting System.

In addition to reporting information about foreign accounts, over 100 jurisdictions, including the United States, are committed to the automatic exchange of Country-by-Country Reports. As discussed below, this information will be provided by the largest multinational enterprises, will be shared with jurisdictions in which these enterprises operate through subsidiaries, and can be used for high-level risk assessment and to improve the implementation of tax rules relating to transfer pricing.<sup>31</sup>

## **B. Reporting foreign activity to aid compliance**

Having information about taxpayer assets or activities helps the IRS conduct risk assessments, match data, and better determine which taxpayers and which activities may deserve more review. As global activities expand, it also may become necessary to exchange some of this information automatically, as discussed above, in a particular format, and have the means to analyze the raw data received to determine which activities and taxpayers need to be reviewed further. This section will discuss some of the key ways the IRS collects information on global activities.

### **1. Foreign account tax compliance act reports**

The Foreign Account Tax Compliance Act (FATCA) was enacted in 2010.<sup>32</sup> It generally requires that foreign financial institutions and certain other non-financial foreign entities report on the foreign assets held by their U.S. account holders or be subject to withholding on certain payments made to the financial institutions.<sup>33</sup> In addition, certain U.S. persons may have to report information about their foreign financial accounts and foreign assets.<sup>34</sup>

U.S. taxpayers began to file Form 8938, Statement of Specified Foreign Financial Assets, for the 2011 tax year.<sup>35</sup> Foreign financial institutions began to report information about accounts held by certain U.S. taxpayers in 2015, the same year the United States began to exchange account information with certain foreign jurisdictions.<sup>36</sup> To achieve

---

<sup>31</sup> <http://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/country-by-country-reporting.htm>

<sup>32</sup> Public Law No. 111-147, sections 501(a) and 511

<sup>33</sup> Internal Revenue Code (IRC) section 1471. Withholding of tax would be required on the payment of passive income such as interest, dividends and royalties. IRC section 1473(1)

<sup>34</sup> IRC section 6038D

<sup>35</sup> Only individuals were required to file Form 8938 until 2016. Beginning with the 2016 tax year, certain domestic entities also must report information about their foreign assets on Form 8938. T.D. 9752, 81 Fed. Reg. 8838 (February 23, 2016)

<sup>36</sup> <https://www.irs.gov/uac/newsroom/irs-announces-key-milestone-in-fatca-implementation-u-s-begins-reciprocal-automatic-exchange-of-tax-information-under-intergovernmental-agreements>



this exchange process, the IRS successfully and timely developed an information system infrastructure, procedures, and data use and confidentiality safeguards to protect taxpayer data while facilitating reciprocal automatic exchange of tax information with certain foreign jurisdiction tax administrators as specified under the intergovernmental agreements (IGAs) implementing FATCA.<sup>37</sup>

## 2. Country by Country Reports

While taxation is at the core of a country's independent sovereignty, the interaction between the laws and regulations of various jurisdictions may create gaps and even friction. In 2012, the G20 leaders noted the need to prevent base erosion and profit shifting, which led to a request to the OECD to develop an action plan aimed at addressing such issues in a coordinated and comprehensive manner.<sup>38</sup> In 2015, the OECD issued its final report identifying 15 actions to address base erosion and profit shifting (BEPS).<sup>39</sup> BEPS Action 13, *Transfer Pricing Documentation and Country-by-Country Reporting*, set out the need for certain large multinational enterprises to report about their activities and the jurisdictions in which they operate.<sup>40</sup> This information will be exchanged automatically with relevant jurisdictions, which may then use the information to perform high-level risk analyses and follow up with further inquiries if necessary.<sup>41</sup>

The IRS and U.S. Treasury issued final regulations in June 2016 regarding the obligation of U.S. MNEs to complete and file Form 8975, Country-by-Country Report, and Schedule A (Form 8975), Tax Jurisdiction and Constituent Entity Information, to comply with the Country-by-Country (CbC) requirements.<sup>42</sup> This CbC information will be used for high-level risk assessments, and statistical analysis.

---

<sup>37</sup> See the Reciprocal Model 1A Agreement at <https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx>

<sup>38</sup> <http://www.g20.utoronto.ca/2012/2012-0619-loscabos.html> (paragraph 48); <http://www.g20.utoronto.ca/2012/2012-121105-finance-en.html> (paragraph 21); <http://www.g20.utoronto.ca/2013/2013-0216-finance.html> (paragraph 20). The action plan was presented to the G20 at the July 2013 meeting and was supported by the G20 finance ministers. <http://www.g20.utoronto.ca/2013/2013-0720-finance.html>. See 2013 Action Plan, *supra* note 5.

<sup>39</sup> <http://www.oecd.org/tax/beps/beps-actions.htm>

<sup>40</sup> <http://www.oecd.org/tax/transfer-pricing-documentation-and-country-by-country-reporting-action-13-2015-final-report-9789264241480-en.htm>

<sup>41</sup> The OECD is developing additional guidance on the use of CbC data.

<sup>42</sup> TD 9773, 81 Fed. Reg. 42482 (June 30, 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-06-30/pdf/2016-15482.pdf>

### **3. Foreign bank and financial account reports**

The Currency and Foreign Transactions Reporting Act of 1970, commonly referred to as the Bank Secrecy Act, is an anti-money laundering law. The law requires a “resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency.”<sup>43</sup> As a result, United States persons with a financial interest in or signature authority over at least one financial account located outside of the United States in excess of \$10,000 are required to disclose this information to the Financial Crimes Enforcement Network (FinCEN).

The disclosure of this financial interest or signature authority is made by electronically preparing and filing FinCEN 114, Report of Foreign Bank and Financial Accounts (FBAR). A person who holds a foreign financial account may have a reporting obligation even when the account produces no taxable income.<sup>44</sup>

### **4. U.S.-owned foreign corporations**

The IRS requires all U.S. taxpayers who are officers, directors, or shareholders in certain foreign corporations to file Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations. This form requests ownership information for foreign corporations, an income statement, a balance sheet, and information about ownership in other foreign entities. Schedules to accompany Form 5471 require information about accumulated profits of controlled foreign corporations, transactions between controlled foreign corporation and shareholders or other related persons, and the organization or reorganization of foreign corporation, and acquisitions and dispositions of its stock.

### **5. Foreign-owned U.S. corporations**

The IRS requires all foreign entities and individuals with at least a 25% ownership in a U.S. entity to file Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business, and report information about these U.S. entities. This form requires information about the foreign shareholder, related parties, and transactions between the reporting company and foreign related parties. In 2016, the IRS and U.S. Treasury issued regulations to require reporting on Form 5472 by foreign owners of U.S. disregarded entities.<sup>45</sup>

---

<sup>43</sup> 31 U.S.C. section 5314

<sup>44</sup> The person may also be subject to the reporting rules of FATCA. The IRS provides a chart to help taxpayers understand if they need to file Form 8938 to comply with FATCA, FinCEN Form 114 to comply with the FBAR requirements, or both forms. See <https://www.irs.gov/businesses/comparison-of-form-8938-and-fbar-requirements>

<sup>45</sup> TD 9796, 81 Fed. Reg. 89849 (December 13, 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-12-13/pdf/2016-29641.pdf>.

## **5. U.S.-Owned foreign trusts**

The IRS requires U.S. owners of certain foreign trusts to file Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner. This form collects information about the foreign trust and its U.S. owners as well as its income and a balance sheet. U.S. persons who transfer property to a foreign trust must file Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts.

## **6. U.S.-Owned foreign partnerships**

The IRS requires certain owners of foreign partnerships to report information on Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships. The U.S. owners report ownership in controlled foreign partnerships, transfers to foreign partnerships, acquisitions, dispositions, and changes in foreign partnership interests.

## **7. Offshore voluntary disclosure program**

The IRS established the first Offshore Voluntary Disclosure Program (OVDP) in 2009 to address the challenges from unreported offshore accounts.<sup>46</sup> This program enables taxpayers to report ownership in foreign accounts and file tax returns for prior years.

Penalties apply, which can be significant in some cases, but this enables taxpayers to become compliant with tax and FBAR reporting obligations and continue to be compliant. It provided another OVDP in 2011<sup>47</sup> and in 2012.<sup>48</sup> In 2014, the IRS revised and expanded the 2012 program and provided for a streamlined filing procedure for taxpayers whose failure to file prior tax returns was non-willful.<sup>49</sup> More than 55,800 taxpayers have participated in offshore disclosure programs since 2009, and the IRS has collected more than \$9.9 billion.<sup>50</sup> In addition, another 48,000 taxpayers have used the streamlined filing procedures, paying approximately \$450 million in taxes, interest, and penalties.<sup>51</sup>

---

<sup>46</sup> <https://www.irs.gov/uac/2009-offshore-voluntary-disclosure-program>

<sup>47</sup> <https://www.irs.gov/uac/2011-offshore-voluntary-disclosure-initiative>

<sup>48</sup> <https://www.irs.gov/uac/2012-offshore-voluntary-disclosure-program>

<sup>49</sup> <https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012-revised>

<sup>50</sup> <https://www.irs.gov/uac/newsroom/irs-committed-to-stopping-offshore-tax-cheating-remains-on-dirty-dozen-list-of-tax-scams-for-2017>

<sup>51</sup> *Id.*

## **8. Summary**

The information collected on these forms contributes to the information the IRS can use to make appropriate risk assessments. However, a challenge continues in addressing how to take all of this raw data and transform it into intelligent information that can assist in making risk assessments.

## **3. DIGITALIZATION - THE REWARDS AND THE RISKS**

The development and increasing expansion of the use of the Internet has changed the way we do business. More and more individuals conduct their business over the Internet including ordering goods, accessing bank accounts, and communicating with others. The existence of the Internet also facilitates the development of new products such as virtual currency, which bring their own set of challenges, including how to identify and track the use of these virtual products and how to tax these new types of products.<sup>52</sup> While digitalization facilitates a global economy and has revolutionized the way that companies are able to work and interact with their customers and clients, it increases the risk of abuse of the system and potential threats to the labor force. Finally, the underlying question remains, how reliable is the information received through electronic channels and what do we do with all of it?

### **A. The Rewards of Digitalization**

Two hundred years ago, it might have taken two months to transfer information from the United States to Europe. It depended on the winds, the captain of the ship, and whether storms would blow the ship off course. Today, information can be transferred instantaneously. Massive amounts of data might be transferred – today, rather than trunks of paper, we only need a few clicks of a mouse.

#### **1. Immediate Access**

The use of the Internet facilitates immediate access to transactions. The Internet is available 24 hours a day, 7 days a week, 365 days a year. An individual can access an account, order a book, or transfer money at 3 a.m. The Internet doesn't take vacations and does not take weekends off. The Millennials almost treat the internet – through their smart phones - as an extension of their life.

#### **2. Cost Savings**

Transactions are often cheaper using the Internet. For example, it costs more than \$1 to send a paper refund check, but only a dime for each direct deposit made.<sup>53</sup> Information

---

<sup>52</sup> Strategic Plan, *supra* note 9, pg. 4

<sup>53</sup> <https://www.irs.gov/individuals/get-your-refund-faster-tell-irs-to-direct-deposit-your-refund-to-one-two-or-three-accounts>

from returns filed on paper needs to be transcribed by IRS employees; information from returns filed electronically is available immediately. As a result, the Internet reduces costs for individuals, business and tax administrations.

## **B. The Risks of Digitalization**

However, few things are problem free. Having easy access to the Internet is not always a benefit and comes with particular risks.

### **1. Cybersecurity**

For the sixth consecutive year, the Treasury Inspector General for Tax Administration (TIGTA) has designated *Security for Taxpayer Data and IRS Employees* as the number one management and performance challenge facing the IRS.<sup>54</sup> TIGTA is required by law to annually assess and report on the adequacy and security of IRS information technology. The findings in this report can serve as a basis for technology improvements in the future.

The increased usage of the Internet increases the risk that the system will be hacked. In 2015, the IRS identified unauthorized attempts to access the “Get Transcript” web application.<sup>55</sup> Criminals used taxpayer-specific data acquired from non-IRS sources to gain unauthorized access to information on approximately 100,000 tax accounts through the “Get Transcript” application. This data included Social Security information, date of birth, and street address.<sup>56</sup> The IRS shut down the Get Transcript application for several months until additional security measures could ensure that only the taxpayer involved could request and obtain a transcript.

As return processing has lost the personal touch, the first-level of defense against fraud from a person reviewing a return has disappeared. New procedures are needed to spot check for accuracy at the time the return is filed. There are sometimes competing goals of making the online system easy for taxpayers to use while ensuring that appropriate levels of verification are provided to prevent hacking. Responding to identity theft – whether through increased review or providing more personal support when a breach happens – takes away resources that otherwise could be used to provide taxpayer service or increase enforcement efforts.

---

<sup>54</sup> TIGTA, Ref. No 2016-20-094, *ANNUAL ASSESSMENT OF THE INTERNAL REVENUE SERVICE INFORMATION TECHNOLOGY PROGRAM* (September 30, 2016), pg. 7, available at <http://www.treasury.gov/tigta/auditreports/2016reports/201620094fr.pdf>.

<sup>55</sup> <https://www.irs.gov/uac/prepared-remarks-of-commissioner-koskinen-before-the-council-for-electronic-revenue-communication-advancement-spring-conference>

<sup>56</sup> <https://www.irs.gov/uac/newsroom/irs-statement-on-the-get-transcript-application>

Cybersecurity challenges also increase as more information is transferred electronically to other countries, whether the transfer is automatic (for example, FATCA data) or in response to a specific request for information. The transmission process needs to remain secure and the stored data needs to be marked as treaty data protected from disclosure by the confidentiality rules.<sup>57</sup>

## **2. Identity theft and refund fraud**

Identity theft occurs when someone wrongfully obtains and uses another person's personal data in a way that involves fraud or deception, typically for economic gain.<sup>58</sup> The increased use of the Internet makes the theft of personal information easier.<sup>59</sup>

Identity theft for employment purposes generally involves the theft of a single identity (a name, a Social Security number (SSN), or both) to enable the individual to work in the United States. The employer usually reports the income and taxes on a Form W-2 filed with the IRS. While the identity thief may not file a tax return, the individual who is the lawful owner of the SSN may file a tax return to report the wages he or she earned. The IRS's Automated Underreporter (AUR) Program's match of the taxpayer income reported on third-party information returns<sup>60</sup> to amounts reported by taxpayers on their individual income tax returns would disclose the discrepancy resulting in understated income. The IRS then contacts the legal owner of the SSN to increase reported income and request additional taxes.<sup>61</sup> TIGTA reviewed the IRS's actions in assisting victims of employment-related identity theft in 2016 and determined that, while the IRS had made progress in addressing employment-related identity theft, substantial work was still needed.<sup>62</sup>

Identity theft tax refund fraud occurs when an individual uses another person's name and Taxpayer Identification Number (usually an SSN) to file a fraudulent tax return that claims a tax refund. Even if the IRS detects this fraud during its review process, it faces the lengthy and costly task of pursuing the thief to recoup refunds made. In tax year

---

<sup>57</sup> For example, FATCA data is transmitted securely using the International Data Exchange Service. See <https://www.irs.gov/businesses/corporations/international-data-exchange-service>.

<sup>58</sup> <http://www.justice.gov/criminal/fraud/websites/idtheft.html>

<sup>59</sup> Identity theft remains on the IRS' list of "Dirty Dozen" tax scams in 2017. See <https://www.irs.gov/uac/newsroom/identity-theft-remains-on-dirty-dozen-list-of-tax-scams-irs-states-tax-industry-urge-people-to-be-vigilant-against-criminals>.

<sup>60</sup> The AUR Program matches taxpayer income and deductions submitted on information returns by third parties, e.g., employers, banks, or brokerage firms, against amounts reported by taxpayers on their individual income tax 1 returns to identify discrepancies. The AUR Program routinely identifies more than 20 million individual tax returns that contain such discrepancies each year. See TIGTA, *Automated Underreporter Program Tax Assessments Have Increased Significantly; However, Accuracy-Related Penalties Were Not Always Assessed When Warranted* (May 8, 2015), pg. 1, available at <https://www.treasury.gov/tigta/auditreports/2015reports/201530037fr.pdf>.

<sup>61</sup> TIGTA, Ref. No. 2016-40-065, *Processes Are Not Sufficient to Assist Victims of Employment-Related Identity Theft* (August 10, 2016), pg. 1, available at <https://www.treasury.gov/tigta/auditreports/2016reports/201640065fr.pdf>

<sup>62</sup> *Id.*, p. 2

2013, TIGTA identified 568,329 undetected potentially fraudulent tax returns with tax refunds totaling more than \$1.6 billion, a reduction of more than \$523 million from the prior year.<sup>63</sup> However, the false reporting of wages and withholding continues to account for the largest amount (\$1.3 billion) of undetected potentially fraudulent tax return refunds. In December 2015, Congress enacted legislation modifying the filing dates of certain returns and statements for employee wage information and nonemployee compensation.<sup>64</sup> As a result, all Forms W-2 and W-3 as well as any returns or statements reporting nonemployee compensation must be filed on or before January 31 of the year following the calendar year to which the returns relate.<sup>65</sup> The first year for this new reporting deadline is 2017. This new deadline will make it easier to match the information on the employee and employer copies of the W-2s and properly account for taxes paid and refunds due to taxpayers.

Direct deposit of refunds also offers criminals the ability to quickly receive fraudulent tax refunds without the challenge of negotiating a tax refund paper check.<sup>66</sup> Limiting the number of tax refunds that can be directly deposited to the same tax account could minimize losses associated with fraud. Effective January 2015, the IRS limited the number of refunds electronically deposited into a single financial account or pre-paid debit card to three. The fourth and subsequent refunds automatically will convert to a paper refund check and be mailed to the taxpayer.<sup>67</sup> TIGTA identified programming errors that resulted in 5,447 requested direct deposits totaling more than \$13.4 million that were not converted to a paper refund check as required.<sup>68</sup> It notified the IRS of these problems early in the processing year and two errors were corrected. One additional error was scheduled to be completed later in the processing year.<sup>69</sup>

In 2012, the IRS implemented a program allowing financial institutions to reject direct deposit tax refunds based on mismatches between the account name and the name on the tax return. By September 30, 2013, financial institutions had returned 20,051 refunds totaling more than \$66 million.<sup>70</sup>

---

<sup>63</sup> TIGTA, Ref. No. 2017-40-017, *Efforts Continue to Result in Improved Identification of Fraudulent Tax Returns Involving Identity Theft; However, Accuracy of Measures Needs Improvement* (February 7, 2017), pg. 1 available at <https://www.treasury.gov/tigta/auditreports/2017reports/201740017fr.pdf>

<sup>64</sup> Public Law No. 114-113, Div. Q, section 201

<sup>65</sup> New IRC section 6071(c). The Form W-2 already had to be provided to the employee by January 31.

<sup>66</sup> TIGTA, Ref. No. 2008-40-182, *Processes Are Not Sufficient to Minimize Fraud and Ensure the Accuracy of Tax Refund Direct Deposits* (September 25, 2008), p. 7, available at <https://www.treasury.gov/tigta/auditreports/2008reports/200840182fr.pdf>

<sup>67</sup> <https://www.irs.gov/individuals/direct-deposit-limits>

<sup>68</sup> TIGTA, Ref. No. 2016-40-008, *Continued Refinement of the Return Review Program Identity Theft Detection Models Is Needed to Increase Detection* (December 15, 2015), pg. 9, available at <https://www.treasury.gov/tigta/auditreports/2016reports/201640008fr.pdf>

<sup>69</sup> *Id.*

<sup>70</sup> Testimony of J. Russell George, Treasury Inspector General for Tax Administration, *Oversight Hearing – Internal Revenue Service*, before the Committee on Appropriations, Subcommittee on Financial Services and General



The IRS organized a Security Summit Group with tax industry and state tax authorities to combat identity theft.<sup>71</sup> The Summit partners' priorities for 2017 remain focused on enhanced authentication procedures, improved information sharing, heightened cybersecurity and greater education and outreach to the public.<sup>72</sup>

Another type of refund fraud occurs when taxpayers decrease income, inflate deductions, or claim tax refunds based on credits (such as the Earned Income Tax Credit) that are either over-inflated or not authorized.<sup>73</sup> Congress enacted legislation to address the refund fraud issue relating to improperly issued credits for child tax credits or the earned income tax credit. Section 6402 of the Internal Revenue Code, which provides the authority to issue credits or refunds, was amended to provide that no credit or refund will be made to a taxpayer before February 15<sup>74</sup> if any part of the credit relates to the child tax credit or the earned income tax credit.<sup>75</sup> This delayed refund date may have an effect on early return filing. IRS filing statistics for the week ending February 3, 2017, indicated that the number of refunds made in 2017 was nearly 62 percent less than the number of refunds made for the same period in 2016.<sup>76</sup> By March 10, 2017, the difference was only a 5 percent reduction in refunds.<sup>77</sup>

---

Government, U.S. House of Representatives (February 26, 2014), at <http://docs.house.gov/meetings/AP/AP23/20140226/101771/HHRG-113-AP23-Wstate-GeorgeJ-20140226.pdf>, p. 17. Other steps that the IRS has taken to reduce the effect of identity theft and attempted refund fraud include: IRS Identity Theft Indicator Codes; Tax Return Filters (over 200 in the 2017 filing year); Identity Protection PIN; and Applying Data Patterns to Prevent Future Identity Theft. Criminal Investigation is involved in several initiatives designed to help taxpayers who are victims of identity theft and to prevent identity theft or the refund fraud attempts that may result from such identity theft. They include: Identity Theft Enforcement Sweeps and Law Enforcement Assistance Program.

<sup>71</sup> <https://www.irs.gov/uac/newsroom/commissioner-koskinens-statement-on-the-security-summit-group-public-awareness-campaign>

<sup>72</sup> <https://www.irs.gov/individuals/taxes-security-together>

<sup>73</sup> Inflated refund claims, falsely padding deductions and falsely inflating income to increase credits are three of the 2017 "Dirty Dozen" tax scams. See <https://www.irs.gov/uac/newsroom/falsely-inflating-refund-claims-on-the-irs-dirty-dozen-list-of-tax-scams-for-2017>, <https://www.irs.gov/uac/newsroom/irs-annual-dirty-dozen-list-of-tax-scams-to-avoid-includes-falsely-padding-deductions>, and <https://www.irs.gov/uac/newsroom/irs-includes-falsifying-income-scam-in-2017-list-of-dirty-dozen>.

<sup>74</sup> The provision stipulates the date as "the 15th day of the second month following the end of the tax year," but most individuals have a tax year that ends December 31. IRC section 6402(m)

<sup>75</sup> See the Instructions for Form 1040, page 6, available at <https://www.irs.gov/pub/irs-pdf/i1040gi.pdf>

<sup>76</sup> <https://www.irs.gov/uac/newsroom/filing-season-statistics-for-week-ending-february-3-2017>. Comparisons are imperfect because the 2016 filing season began on January 19 while the 2017 filing season began on January 23, thus adding 4 more days to the comparative processing time in 2016. The IRS stated on its website that "Early season refund numbers and dollar amounts are affected by the new law requiring refunds involving the Earned Income Tax Credit and Additional Child Tax Credit to be held until the later part of February. Many taxpayers claiming these credits traditionally file during the opening weeks of tax season."

<sup>77</sup> <https://www.irs.gov/uac/newsroom/filing-season-statistics-for-week-ending-march-10-2017>. It should also be noted that the 2016 filing season had four more processing days at this point, which affects the comparisons.



### 3. Concerns about Availability of Internet Access to All

The National Taxpayer Advocate, the “voice of the taxpayer” within the IRS,<sup>78</sup> has recommended for many years that the IRS develop an online account system for taxpayers.<sup>79</sup> Many people have access to computers to conduct their daily affairs. However, the IRS cannot ignore the service needs of a significant portion of the taxpayer population who still require more personalized service options, such as face-to-face or telephone services, due to preference or lack of access to the Internet.<sup>80</sup>

The National Taxpayer Advocate has expressed her concern that, while it may be tempting to move taxpayer service toward superficially lower-cost self-assistance options, any efforts to significantly reduce personal service options may ultimately impair voluntary compliance.<sup>81</sup> While offering online services will address the needs of some taxpayers, the IRS should research exactly what taxpayers want online and in person and make the appropriate adjustments.

### 4. New Challenges from Digitalization

As the use of the internet increases, challenges arise as individuals find ways to use the Internet. An example of such a challenge is virtual currency. Virtual currency is a medium of exchange that operates like a currency in some environments but does not have all the attributes of real currency. In particular, virtual currency does not have legal

---

<sup>78</sup> <https://www.irs.gov/advocate>

<sup>79</sup> See, for example, the 2012 Annual Report to Congress, MSP # 14, *The IRS is Striving to Meet Taxpayers' Increasing Demand for Online Services, Yet More Needs to be Done*, pg. 251, where the National Taxpayer Advocate states: “For example, the IRS would benefit from an online account access program that would initially allow taxpayers to view the status of their accounts and eventually enable them to interact directly with the IRS.” This report is available at <http://www.taxpayeradvocate.irs.gov/2012-Annual-Report/FY-2012-Annual-Report-To-Congress-Full-Report.html>

<sup>80</sup> 2015 Annual Report to Congress, MSP #5, *TAXPAYER ACCESS TO ONLINE ACCOUNT SYSTEM: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak With an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online*, pg. 56, available at <https://taxpayeradvocate.irs.gov/reports/2015-annual-report-to-congress/full-report>

<sup>81</sup> *Id.* To realize the benefits of an online taxpayer account application, the IRS must address the following issues:

Develop an overarching online strategy that focuses on taxpayer service needs and preferences rather than merely business or budget demands; Incorporate existing third-party and TAS research on service needs and preferences into its Future State vision; “Do Digital Right” by ensuring the online account provides taxpayers with a service they need in the format they need; otherwise taxpayers may lose interest and not return to the site; Acknowledge the real consequences of strong and necessary e-authentication standards - with about one-third of users passing the multi-factor e-authentication security measures, getting taxpayers through the “front gate” is half the battle; and

Prioritize practitioner access, authority, and preferences for the online account. 2016 Annual Report to Congress, MSP #7, *ONLINE ACCOUNTS: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*, pgs. 121 – 122, available at <https://taxpayeradvocate.irs.gov/reports/2016-annual-report-to-congress/full-report>

tender status in any jurisdiction.<sup>82</sup> A convertible virtual currency can be exchanged for real currency.<sup>83</sup> All of this activity takes place without any paper documents.

When a new use for the Internet is developed, the IRS must address the tax issues associated with it. For example, in 2013, the Government Accountability Office (GAO) recommended that the IRS issue more guidance on virtual currencies to mitigate the risk of noncompliance.<sup>84</sup>

Because virtual currency is only virtual, detecting when it is used for the purchase of goods or services can be difficult.<sup>85</sup> The OECD recognized the challenge of virtual currencies in its work on Base Erosion and Profit Shifting.<sup>86</sup>

## 4. FINANCIAL RESOURCES

### A. Increasing responsibilities, including unfunded mandates

The role of the IRS is to administer the tax system. However, as the government entity with the most contact with U.S. persons, the IRS is also used to implement social programs that may have little to do with taxes. Further, in some cases Congress enacts legislation that requires the participation of the IRS even though Congress provides no additional resources to the IRS to pay for the additional work.

Two recent examples of this type of unfunded mandate are the Affordable Care Act (ACA) and the Foreign Account Tax Compliance Act (FATCA). Participation in the ACA health insurance exchanges was encouraged by the imposition of a fee if an individual did not purchase health insurance. The implementation of this requirement resulted in

---

<sup>82</sup> As long ago as 1995, the U.S. Congress recognized that “Some ‘cyberpunks’ have suggested that the ultimate e-cash will be a currency without a country.” *The Future of Money*, HEARING BEFORE THE SUBCOMMITTEE ON

DOMESTIC AND INTERNATIONAL MONETARY POLICY OF THE COMMITTEE ON BANKING AND FINANCIAL SERVICES HOUSE OF REPRESENTATIVES, October 11, 1995, pg. 46

<sup>83</sup> Statement of Jennifer Shasky Calvery, Director, Financial Crimes Enforcement network, U.S. Department of the Treasury, before the U.S. Senate Committee on Homeland Security and Government Affairs, November 18, 2013, available at <https://www.fincen.gov/news/testimony/statement-jennifer-shasky-calvery-director-financial-crimes-enforcement-network-0>

<sup>84</sup> Government Accountability Office, *VIRTUAL ECONOMIES AND CURRENCIES: Additional IRS Guidance Could Reduce Tax Compliance Risks*, GAO 13-516 (May 2013), pg. 17. See <http://www.gao.gov/products/GAO-13-516>. The IRS issued Notice 2014-21, 2014-16 I.R.B. 938. It provides that virtual currency is treated as property for U.S. tax purposes. As a result, any payments made with virtual currency must be taken into account in the same way as payments with U.S. currency: payments for wages using virtual currency are income; payments for the transfer of property could result in the recognition of capital gain or loss. See <https://www.irs.gov/uac/newsroom/irs-virtual-currency-guidance>.

<sup>85</sup> <https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf>; <https://www.fincen.gov/sites/default/files/2016-08/20131118.pdf>

<sup>86</sup> OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, pgs. 43 and 44, available at [http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report\\_9789264241046-en#.WNKbVaq7q1s#page3](http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report_9789264241046-en#.WNKbVaq7q1s#page3)

the addition of three lines on Form 1040, Individual Income Tax Return: one to report the “individual responsibility” payment (the cost of not having health insurance)<sup>87</sup> and two relating to the net premium tax credit (the refundable premium credit to help individuals afford the insurance).<sup>88</sup> In addition, new forms were developed to calculate the premium tax credit,<sup>89</sup> to claim an exemption from the requirement to purchase health insurance,<sup>90</sup> and to report health insurance coverage,<sup>91</sup> the additional Medicare tax,<sup>92</sup> and the net investment income tax.<sup>93</sup> Developing forms also requires developing instructions and worksheets to ensure that the amounts are correctly calculated and entered on the tax return. In addition to its impact on health insurance, of course, provisions in the ACA legislation also required the development or revision of other tax forms and instruction, such as the adoption tax credit<sup>94</sup> and the indoor tanning services and medical device excise tax.<sup>95</sup> Developing and revising forms requires the revision of information technology systems to ensure that the systems are appropriately revised to capture the new line information and not to confuse the old line information. The IRS spent over one billion dollars for the information technology changes required by the ACA.<sup>96</sup> Outreach is required, to ensure that both taxpayers and tax preparers understand the changes to appropriately complete the tax returns.<sup>97</sup>

Similarly, FATCA also required the development of forms for reporting by both U.S. persons<sup>98</sup> and foreign financial institutions.<sup>99</sup> The IRS made substantial technology investments to implement the on-line registration process and the on-line International Data Exchange Services for secure transmission of FATCA data. In addition, resources

---

<sup>87</sup> Form 1040, Line 61, required by IRC section 5000A

<sup>88</sup> Form 1040, Lines 46 and 69, required by IRC section 36B

<sup>89</sup> Form 8962

<sup>90</sup> Form 8965

<sup>91</sup> Forms 1095-A, 1095-B, 1095-C

<sup>92</sup> Form 8959

<sup>93</sup> Form 8960

<sup>94</sup> Form 8839

<sup>95</sup> Form 720. The excise tax on medical devices was suspended for 2 years at the end of 2015, requiring a revision to Form 720.

<sup>96</sup> Tax Notes Today, *Tax Analysts Exclusive: Conversations: Koskinen Looks to Future of Tax Administration*, IRS Budget, December 14, 2016, Doc 2016-24229, (“Koskinen Conversation”)

<sup>97</sup> For example, the IRS has several You Tube videos on the Health Care Law, the Shared Responsibility Provision, and the Premium Tax Credit. See <https://www.irs.gov/uac/videos>. The IRS Nationwide Tax Forums offered every year have included presentations on ACA issues. See <https://www.irs.gov/tax-professionals/irs-nationwide-tax-forum-information>.

<sup>98</sup> Form 8938

<sup>99</sup> Form 8966.

are necessary to write regulations and other guidance, develop and administer the evaluation of confidentiality in other jurisdictions, and analyze the data received, to name three areas requiring additional resources.

In addition to responding to new mandates, the IRS also has an increasing workload due to the need to respond to challenges such as identity theft and refund fraud. For example, to eliminate refund fraud, the IRS could simply delay issuing refunds until it has confirmed the legitimacy of the refund. However, this delay might last 12 to 18 months and penalizes honest taxpayers who rely on their refund check for living expenses. To speed up legitimate refunds while stopping fraudulent refunds requires action by the IRS. These actions require both financial and human resources. However, the IRS is seeing success in this area: new people reporting stolen identities on federal tax returns in 2016 fell by more than 50 percent, with nearly 275,000 fewer victims than in 2015.<sup>100</sup>

New challenges arise that must be addressed. For example, virtual currency is a multi-billion dollar economy.<sup>101</sup> While the IRS has issued guidance on virtual currencies, TIGTA has identified gaps in guidance, which it would like addressed. While the IRS agreed with the recommendation to provide updated guidance, it also indicated that guidance allocation decisions are based on available resources and competing funding priorities.<sup>102</sup>

Another challenge faced by the IRS is cybersecurity. Commissioner Koskinen recently reported that the IRS computer systems are attacked over one million times a day.<sup>103</sup> To deal with these attacks, the IRS has increased authentication requirements, which requires diverting time and money from other objectives.

## **B. Diminishing budget**

The highest budget ever provided to the IRS was in 2011, when the budget was \$12,358,877,000. At that time the IRS had 94,709 average positions<sup>104</sup>. Over 70 percent of the IRS budget is for the workforce.<sup>105</sup> In 2011, the IRS processed 234,567,000 tax

---

<sup>100</sup> <https://www.irs.gov/uac/newsroom/irs-security-summit-partners-expand-identity-theft-safeguards-for-2017-filing-season-build-on-2016-successes>

<sup>101</sup> GAO, *Virtual Economies and Currencies: Additional IRS Guidance Could Reduce Tax Compliance Risks*, *supra* note 84.

<sup>102</sup> TIGTA, Ref. No. 2016-30-083, *As the Use of Virtual Currencies in Taxable Transactions Becomes More Common, Additional Actions Are Needed to Ensure Taxpayer Compliance* (September 21, 2016), pgs. 11, 12, 14

<sup>103</sup> Koskinen Conversation, *supra* note 96.

<sup>104</sup> The reference to “average positions” means the average number of full-time equivalent positions actually used to conduct IRS operations. It excludes positions funded by reimbursements from other federal agencies and private entities for services performed for these external parties. See Table 30, footnote (1) in the annual IRS Data Book for this definition. Data Books and other statistics are available on <https://www.irs.gov/uac/tax-stats>

<sup>105</sup> Koskinen Conversation, *supra* note 96

returns (individual, corporate, partnership, information, estate and trust) and collected a net \$2 trillion dollars.<sup>106</sup> Since 2011, the budget and the number of employees have decreased, but the number of returns processed has increased; there are 10 million more taxpayers since 2010.<sup>107</sup>

The chart below shows the annual changes in the number of tax returns processed, the budget, the net collections, and average positions since 2011.

Fiscal Year	Tax returns processed <sup>108</sup>	Annual budget <sup>109</sup>	Annual net collections (tax payments less refunds) <sup>110</sup>	Average positions <sup>111</sup>
2011	234,567,000	\$12,358,877,000	\$1,999,071,767,000	94,709
2012	237,345,000	\$12,059,409,000	\$2,150,891,380,000	90,280
2013	240,076,000	\$11,597,560,000	\$2,490,703,698,000	86,974
2014	239,875,000	\$11,591,007,000	\$2,690,755,432,000	84,133
2015	243,249,000	\$11,395,839,000	\$2,899,404,567,000	79,890
2016	244,246,000	\$11,707,422,000	\$2,907,303,017,000	77,924
Change 2011 to 2016	9,679,000 increase	\$651,455,000 decrease	\$908,231,250,000 increase	16,785 decrease
% change	4.1% increase	5.3% decrease	45% increase	17.7% decrease

Through efficiencies, the IRS has been able to continue to decrease the cost of collecting revenues. In Fiscal Year 2016, the total cost of collecting \$100 decreased to \$0.35.<sup>112</sup>

<sup>106</sup> The “net collected” represents gross collections less refunds for the specific tax year. It does not include amounts collected or refunded in a later tax year when a taxpayer files an amended return or is audited by the IRS.

<sup>107</sup> Koskinen Conversation, *supra* note 96.

<sup>108</sup> Table 2 of the Data Book for the specified year

<sup>109</sup> Table 29 of the Data Book for the specified year

<sup>110</sup> Table 1 of the Data Book for the specified year

<sup>111</sup> Table 29 of the Data Book for the specified year

<sup>112</sup> Table 29, 2016 IRS Data Book, available at <https://www.irs.gov/pub/irs-soi/16databk.pdf>

However, despite efficiencies, the reduced IRS budget has affected both tax service and tax collection. In 2014, GAO reported to Congress that IRS budget cuts have resulted in significant staffing declines and uneven performance. GAO analyzed 5 years of budget information (fiscal years 2009 through 2014).<sup>113</sup> It concluded that planned performance in enforcement and taxpayer service decreased or fluctuated, the level of telephone service fluctuated, and average wait times almost doubled over the 5-year period. GAO found that legislative mandates and priority programs such as the ACA and identity theft have caused increased workloads. It noted that the IRS absorbed the budget cuts through savings and efficiencies but also by reducing, delaying, or eliminating services.<sup>114</sup>

To accommodate budget cuts, projects were delayed and employee training was substantially reduced.<sup>115</sup> Although some budget cuts can be mitigated by increased efficiencies from technology, at some point there are no more efficiencies to gain, and the ability of the IRS to function (by providing services and collecting taxes) suffers.<sup>116</sup> The IRS did “more with less” for a period of time, but now it is doing “less with less.”<sup>117</sup>

### **C. Increased on-line services; decreased telephone, personal service**

Since 2010 the IRS annual budget has decreased while the number of taxpayers and the areas that the IRS is involved in have increased. One impact of the reduced budget is a reduction in employees who provide taxpayer service; this affects both telephone calls answered and the ability of the IRS to provide in-person service at taxpayer assistance centers. The IRS must find cost-efficient ways to serve the taxpayer. In response to this need, the IRS is transitioning to a Future State for tax administration. The IRS Future State is designed to prepare the IRS to adapt to the changing needs of taxpayers.<sup>118</sup>

---

<sup>113</sup> Government Accountability Office, GAO-14-534R, *INTERNAL REVENUE SERVICE: Absorbing Budget Cuts Has Resulted in Significant Staffing Declines and Uneven Performance* (April 21, 2014), available at <http://www.gao.gov/products/GAO-14-534R>

<sup>114</sup> *Id.*, page 4

<sup>115</sup> Delayed projects include technology projects relating to Information Reporting and Document Matching and the Return Review Program. *Id.*, page 21. Training costs decreased by 83 percent over the 5 year period. *Id.*, pg. 22. This reduction in training costs was identified by the National Taxpayer Advocate as one of the most serious taxpayer problems in her 2013 Annual Report to Congress. See MSP #3, *EMPLOYEE TRAINING: The Drastic Reduction in IRS Employee Training Impacts the Ability of the IRS to Assist Taxpayers and Fulfill its Mission*, available at <http://taxpayeradvocate.irs.gov/2013-Annual-Report/full-2013-annual-report-to-congress.html>

<sup>116</sup> Koskinen Conversation, *supra* note 96

<sup>117</sup> *Id.*

<sup>118</sup> <https://www.irs.gov/uac/newsroom/future-state-initiative>

## 1. Future State

The IRS is utilizing advances in technology to move the entire taxpayer experience to a new level. At the same time, it acknowledges that taxpayers may still need one-on-one assistance by phone or in-person.<sup>119</sup>

The IRS Future State is built around six strategic themes and a focus area of strengthening cybersecurity and eliminating identity theft. The six themes are:

- Facilitate voluntary compliance by empowering taxpayers with secure innovative tools and support
- Understand non-compliant taxpayer behavior and develop approaches to deter and change it
- Leverage and collaborate with external stakeholders
- Cultivate a well-equipped, diverse, skilled and flexible workforce
- Select highest value work using data analytics and a robust feedback loop
- Drive more agility, efficiency and effectiveness in IRS operations.<sup>120</sup>

### a. Focusing resources around the most strategic issues

The IRS Future State focuses on taxpayers and how to provide the services they need in the way that works for them. A key part of this effort is for taxpayers to have a more complete online experience to ensure IRS interactions efficiently utilize limited IRS in-person resources to more easily serve those who need one-on-one assistance.

Personal assistance remains a critical part of any IRS Future State. The IRS will maintain telephone service and taxpayer assistance centers, but the increased opportunities for on-line assistance will save these personal services for individuals who cannot find help on-line. For example, every person who accesses “Where’s My Refund” on-line – which provides exactly the same information about the status and timing of a tax refund as a telephone service provider would have provided – reduces the number of telephone calls. By reducing the number of taxpayers calling with routine questions, the IRS can address taxpayer complaints about long waits for telephone assistance. Taxpayers also now have to make a taxpayer assistance center appointment, which should have the benefit of providing a more structured experience.<sup>121</sup>

Another goal of improving taxpayer service focuses on improving the enforcement side of the equation. To meet its enforcement goals the IRS needs to be faster and smarter.

---

<sup>119</sup> <https://www.irs.gov/uac/newsroom/irs-future-state>

<sup>120</sup> *Id.*

<sup>121</sup> <https://www.irs.gov/help-resources/contact-your-local-irs-office>



With a more modern system, the IRS can identify problems when a return is filed – instead of contacting a taxpayer years after the fact while the meter is running on potential interest and penalties. The IRS should interact with taxpayers as soon as possible to address non-compliance issues so they are corrected without costly follow-up contacts or labor-intensive audits.

This early issue identification effort also helps in the ongoing battle over the use of stolen identities to file fraudulent tax returns. The IRS remains focused on providing greater security in the future by pursuing more ways to protect taxpayers and ensuring it is interacting with the right person. Improving identity authentication and safeguarding the confidentiality of data received remains important ongoing issues.

### **b. Deselection**

Another concept of the Future States is to “select highest value work using data analytics and a robust feedback loop.”<sup>122</sup> The IRS can use improved information to focus its resources constructively. The inverse of selecting “highest value work” is deselecting lower value work. In the past, the IRS may have used statistical information, such as amount of gross income, to select taxpayers for audit without any indication that audit issues existed. However, with limited resources, time spent auditing compliant taxpayers is time wasted unless the audit provides the IRS with useful information. To maximize resources, the IRS will decide which taxpayers it will not audit – such as those taxpayers who are consistently compliant or whose audits consistently produced very small adjustments. Those taxpayers may be audited from time to time, but, in general, the IRS will focus on tax returns that seem riskier based on a pre-audit analysis.

### **c. Tailored treatment streams**

In addition to making better decisions about which taxpayers to audit, the Future State provides that the IRS will operate effectively and efficiently. This conforms to the LB&I Future State structure that includes identifying specific, tailored treatment streams to achieve the intended compliance outcomes.<sup>123</sup> These tailored treatment streams might include sending letters requesting information or clarification rather than automatically initiating an audit.<sup>124</sup>

## **2. Review of on-line services**

The IRS is moving toward a complete taxpayer account. This includes the ability to file an income tax return on-line, either through Free File software, available to taxpayers

---

<sup>122</sup> <https://www.irs.gov/uac/newsroom/irs-future-state>

<sup>123</sup> <https://www.irs.gov/pub/irs-utl/d11809--2016-01-00.pdf>; See <https://www.irs.gov/businesses/large-business-and-international-launches-compliance-campaigns>

<sup>124</sup> For the types of questions that the IRS might ask the taxpayer in a letter, see <https://www.irs.gov/individuals/understanding-your-irs-notice-or-letter>



whose 2016 income is below \$64,000 or through Free File Fillable Forms, available to everyone, where the taxpayer makes most of the calculations.<sup>125</sup>

After satisfying the appropriate authentication requirements, a taxpayer can go online to:

- Find the balance due
- Pay any outstanding balance
- Complete an installment agreement
- Find out the refund status
- Get a transcript<sup>126</sup>

The IRS is also improving the way information is provided to taxpayers. The IRS provides two interactive programs on IRS.gov that taxpayers can use to find the answers to general questions. The Interactive Tax Assistant program follows a guided question-and-answer format that identifies selections depending on a taxpayer's answers to questions.<sup>127</sup> Tax Trails helps taxpayers find answers to general tax questions on tax credits, deductions, taxable income, and other tax topics through another question-and-answer format.<sup>128</sup> The IRS also provides helpful videos on YouTube<sup>129</sup> and provides assistance through other mobile applications.<sup>130</sup>

The IRS is actively working on a program called Taxpayer Digital Communications. This will provide a more modern, efficient and secure way to communicate and transfer digital documents and will help the IRS resolve taxpayer issues more efficiently. The taxpayer will register on the on-line system and then can communicate with the IRS over the Internet.<sup>131</sup>

---

<sup>125</sup> <https://www.irs.gov/uac/free-file-do-your-federal-taxes-for-free>

<sup>126</sup> Koskinen Conversation, *supra* note 96. Information about online tools and resources available to the taxpayer are listed at <https://www.irs.gov/help-resources/telephone-assistance>.

<sup>127</sup> <https://www.irs.gov/uac/interactive-tax-assistant-ita-1>

<sup>128</sup> <https://www.irs.gov/individuals/tax-trails-main-menu>

<sup>129</sup> <https://www.irs.gov/uac/videos>

<sup>130</sup> <https://www.irs.gov/uac/irs-new-media-1>

<sup>131</sup> The Taxpayer Digital Communication program is described in the Privacy Impact Assessment Statement on the IRS website at <https://www.irs.gov/pub/irs-utl/tdc-pia.pdf>. Commissioner Koskinen also referred to the Taxpayer Digital Communication program as an example of the type of service improvement that the IRS was testing. See Written Testimony of John A. Koskinen Before the Senate Finance Committee on the 2017 Filing Season and IRS Operations (April 6, 2017), available at <https://www.irs.gov/uac/newsroom/written-testimony-of-john-a-koskinen-before-the-senate-finance-committee-on-the-2017-filing-season-and-irs-operations-april-6-2017>.

## 5. WORKFORCE

The IRS identified “sustaining a skilled and talented workforce” as a major trend affecting the IRS in the Strategic Plan for 2014-2017.<sup>132</sup> Employees are the most valued asset in effective tax administration.<sup>133</sup> The IRS is continually challenged with the task of maintaining a workforce with diverse, advanced skill sets to respond to the increasing complexities of tax administration and the increased demand for varied taxpayer services.<sup>134</sup> The IRS continues to face the challenge of massive workforce retirements, which creates a knowledge management challenge. The reduction of the IRS budget has resulted in a staffing decline, with an increase in work for remaining employees. In addition, the future workforce also needs to be prepared to interact with an increasingly diverse population including taxpayers who speak different languages.<sup>135</sup>

TIGTA identified “Human Capital” as one of the 10 most serious management and performance challenges facing the IRS from Fiscal Year 2002 through Fiscal Year 2016.<sup>136</sup> In its first assessment of the IRS’s progress in addressing its human capital challenges, TIGTA noted that “the work performed by IRS employees continually requires greater expertise as tax laws become more complex, manual systems used to support tax administration become computer based, and attempts to evade compliance with the tax laws becomes more sophisticated.”<sup>137</sup> Although it was not identified as one of the top 10 challenges for Fiscal Year 2017, TIGTA indicated that “human capital remains a serious underlying issue that impacts all 10 of the Major Management Challenges.”<sup>138</sup> Lower budgets and reduced staffing has affected the IRS’s priority program areas, including customer service and enforcement activities.<sup>139</sup>

---

<sup>132</sup> Strategic Plan, *supra*, note 9, pg. 8. The IRS has identified workforce issues as a challenge in each of the four Strategic Plans issued since 2001. Strategic Plan for 2009 – 2013, *supra* note 9, pg. 9; Strategic Plan 2005-2009, *supra* note 9, pg. 10; Internal Revenue Service, Strategic Plan 2000 – 2005, pg., 55, available at <https://www.irs.gov/pub/irs-prior/p3744--2001.pdf>.

<sup>133</sup> Strategic Plan, *supra*, note 9, pg. 16

<sup>134</sup> *Id.*, pg. 8

<sup>135</sup> *Id.*, pg. 9

<sup>136</sup> TIGTA, Ref. No. 2013-10-017, *Improvements Have Been Made to Address Human Capital Issues, but Continued Focus Is Needed* (January 11, 2013), Highlights, available at <https://www.treasury.gov/tigta/auditreports/2013reports/201310017fr.pdf>. All TIGTA reports on Management and Performance Challenges since 2007 are available on TIGTA’s website at [https://www.treasury.gov/tigta/oa\\_management.shtml](https://www.treasury.gov/tigta/oa_management.shtml)

<sup>137</sup> TIGTA, Ref. No. 2009-10-118, *To Address Its Human Capital Challenge, the Internal Revenue Service Needs to Focus on Four Key Areas*, (August 19, 2009), pg. 1, available at <https://www.treasury.gov/tigta/auditreports/2009reports/200910118fr.html>. The general guidelines for IRS recruitment are set out in IRM 6.332, available at [https://www.irs.gov/irm/part6/irm\\_06-332-001.html](https://www.irs.gov/irm/part6/irm_06-332-001.html)

<sup>138</sup> [https://www.treasury.gov/tigta/management/management\\_fy2017.pdf](https://www.treasury.gov/tigta/management/management_fy2017.pdf), pg. 2

<sup>139</sup> *Id.*

## A. Recruitment

TIGTA has indicated that “the recruitment and retention of skilled employees is critical to the maintenance of a high-quality workforce.”<sup>140</sup> The IRS needs to have “the right people in the right place at the right time to provide taxpayers with top-quality service and to enforce the law with integrity and fairness to all.”<sup>141</sup>

As the business environment changes, it is essential for the IRS to evaluate the type of employee skills necessary for it to accomplish its mission. As electronic services expand, and cybersecurity and updated technology, including data analysis, becomes more critical, the IRS must evaluate the skills needed to address today’s information technology and cybersecurity issues by hiring more specialists in those areas and fewer data transcribers. Since these issues and challenges are not unique, the IRS must compete with the private sector for the technology experts, especially those with cybersecurity experience. This is challenging for many reasons, including the ability to hire, the need to develop new or adaptable position descriptions, the timing of hiring, and salary caps.

For the IRS to remain agile and competitive, it must identify the skill sets needed for the tasks at hand and adjust its recruitment efforts to hire the right person for the right job. With this comes funding challenges as there are increased salaries for different positions. For example, an experienced cybersecurity specialist’s salary is higher than a data transcriber’s salary. Although it is a one-for-one difference in positions, the total cost is higher.

The increased globalization of business also impacts the skillsets required by new employees and how they are recruited. Transfer pricing issues account for approximately 46 percent of LB&I’s international issues inventory and 71 percent of the potential dollar adjustment amounts of all international issues.<sup>142</sup> To properly address transfer pricing issues, the IRS needs economists, attorneys, and international examiners. In the past, examiners were “grown” within the organization; however, the IRS now looks to hire auditors with international and transfer pricing experience to minimize training down time. The IRS is also shifting to “just in time training” on specific issues rather than attempting to train all employees in a general area. As the IRS receives more data automatically, including information from financial institutions to comply with FATCA or information about multinational enterprises to comply with Country-by-Country Reporting, the IRS will need better data analytics, which requires contributions from skilled employees. In addition to storing the data securely, new work includes the ability to transmit data outside the United States securely, retrieve and analyze the data, use different schema, and make use of the data. For example, we

---

<sup>140</sup> TIGTA, Ref. No. 2013-10-017, *supra* note 136, Highlights

<sup>141</sup> *Id.*

<sup>142</sup> TIGTA, Ref. No. 2016-30-090, *Barriers Exist to Properly Evaluating Transfer Pricing Issues* (September 28, 2016), pg. 18, available at <https://www.treasury.gov/tigta/auditreports/2016reports/201630090fr.pdf>.

may need to manage the data to look for patterns that may not be immediately apparent.

Today's employees must be nimble and able to address today's complicated tax challenges and move from issue to issue as the challenges arise. For example, the Data Solutions group within the office of the Assistant Deputy Commissioner, Compliance Integration improves the efficiency and flexibility of data delivery required for effective tax administration. Over the last ten years, the group has moved to an "adaptive model" of project delivery, where the business has a need, but the product is difficult to define and must be flexible.

The adoption of the adaptive model, specifically the transition to the Agile model,<sup>143</sup> have made it unnecessary to have any of the technical skills previously relied on. Now Project Management and IT technical skills are a requirement for employees. The deployment of Fourth General Language Tools, which reduce the overall time, effort, and cost of software development, have also changed the type of employee recruited for. It is incredibly important to have Project Management expertise to manage the processes, and IT expertise to do the actual development work. It is also important to have expertise that hasn't traditionally been collected together within the same group to understand the potential of, and take advantage of, the technology. The functional alignment of most organizations (attorneys manage attorneys, engineers manage engineers) is not the right structure for a project or portfolio management office.

The skills required to nimbly take advantage of technology are not traditional skills and tend to be misunderstood or not appreciated by traditional management functions.

Further, since these skills are outside the traditional organizational structure, there are no career paths for these skills. Congress recently enacted the Program Management Improvement Accountability Act, which requires the Office of Management and Budget to set government-wide standards for program and project management.<sup>144</sup> This should eventually change the landscape and improve our ability to recruit top quality talent. In addition, retaining talent is a concern as private industry is realizing the value of data science and the adaptive project development model. Most IRS Information Technology employees could dramatically increase their income in private industry.

## **B. Education and training**

One of the strategic themes of the IRS Future State is a well-equipped, diverse, skilled and flexible workforce. Developing this high caliber of employee requires training. The decrease in training budget has required greater creativity in training our workforce.

---

<sup>143</sup> Strategic Plan, *supra* note 9, pgs. 12 and 21. The "Agile Model" is a methodology that anticipates the need for flexibility and applies a level of pragmatism into the delivery of the finished product. It focuses on keeping processes simple, testing often, and delivering functional pieces of a new process as soon as they're ready. The goal of agile development is to build upon small changes as a project progresses.

<sup>144</sup> Public Law No. 114-264

Similarly, as the impact of digitalization of the economy continues to evolve, the skills with which we equip employees must also be creative so as to ensure they are adaptable to ever changing challenges.

TIGTA noted that the IRS training budget has decreased substantially since 2010; between FY 2010 and FY 2013, the total training budget decreased nine fold from \$181.4 million to \$21 million.<sup>145</sup> In 2013, the National Taxpayer Advocate identified the reduction in training as one of the most serious problems facing taxpayers.<sup>146</sup> As a result, it has become more difficult to ensure that employees have the requisite training, especially when the type of challenges, that is, international and / or complex transactions which they may encounter, have changed and will continue to evolve.

All IRS examiners should be able to identify both domestic and international issues and to properly examine such returns. Even though the training budget has decreased, the IRS continues to recognize the importance of training and provides training in many forms.

### **1. New Hire Training**

The IRS provides substantial in-house training for new hires. This training ranges from the standard training provided to every new employee to the specialized training provided to an employee hired to review complex transfer pricing cases. Some training is designed to provide foundational concepts – diversity, harassment, unauthorized access to confidential information, etc. Some training is designed to prepare the individual for the specific job they were hired to perform.

### **2. Annual Training**

Employees have mandatory annual training to ensure certain concepts are continually reinforced, such as preventing the unauthorized access of taxpayer information, harassment, and ethics violations, etc. Some of this training is virtual through on-line platforms such as Live Meeting and Saba. A limited amount of training is provided in house and often this format must be justified. Some training is provided through pre-packaged or pre-recorded programs.

### **3. Global Awareness Training Module**

The IRS has prepared a Global Awareness Training Module for International Examiners that is available on its public website.<sup>147</sup> This training module raises the awareness of

---

<sup>145</sup> TIGTA, *Several Changes Sought by the Internal Revenue Service Restructuring and Reform Act of 1998 Remain a Challenge*, Reference Number: 2016-IE-R005 (March 28, 2016), page 21, available at <https://www.treasury.gov/tigta/ierreports/2016reports/2016ier005fr.pdf>

<sup>146</sup> 2013 Annual Report to Congress, MSP #3, *supra* note 115, pg. 40.

<sup>147</sup> [https://www.irs.gov/pub/irs-utl/Global\\_Awareness\\_Training\\_for\\_IEs.pdf](https://www.irs.gov/pub/irs-utl/Global_Awareness_Training_for_IEs.pdf)

International Tax Examiners (ITEs) to important considerations associated with tax treaties and the global tax administration environment. The module provides general information to an ITE making a cross-border tax adjustment that might result in double taxation and explains what is needed to sustain a cross-border tax adjustment under bilateral income tax treaties. It also provides an overview of the role of the examiner in global tax administration. It includes information on transfer pricing, tax treaties and how they operate, the role of the Competent Authority and the Mutual Agreement Procedures article of treaties,<sup>148</sup> and the OECD BEPS project.

#### **4. On the job training**

To facilitate on-the-job and just-in-time training, LB&I has Practice Units as well as other virtual training available. Subject matter experts in Practice Areas conduct training on a number of Practice Units every month through SABA, which provides a limited amount of group participation and talking. In addition, employees can participate in any on-line course offered through SABA. The IRS participates in Learn and Lead 24x7, an extensive online library for the employee's personal and professional development. The content is available in a variety of formats to meet the various learning styles of the employees and include courses, books, videos, simulations, and audio recordings. Material is available on business skills, leadership, IT, desktop, well-being topics and much more. Some training can be taken at any time, while other training is mandatory and addresses a specific issue. For example, after LB&I revised Publication 5125, Large Business & International Examination Process, in 2016, it required all LB&I employees to take an on-line course on the new examination process. Similarly, the IRS identified a need for training on virtual currencies and both LB&I and Criminal Investigation provided the training.<sup>149</sup>

#### **5. IRS learning portal**

The IRS has developed the IRS Learning Portal.<sup>150</sup> This is a service-wide online platform to provide employees with a gateway to access the full range of learning products and services that facilitate training, development, curriculum, and the appropriate career path.

IRS employees can also participate in a degree program at a college or university through the IRS College Credit Program.<sup>151</sup> In addition, the IRS also provides a certain number of courses for academic credit.<sup>152</sup>

---

<sup>148</sup> The Mutual Agreement Procedure is set out in Article 25 of the United States Model Double Tax Convention, available at <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf>

<sup>149</sup> TIGTA, Ref. No. 2016-30-083, *supra* note 102, pg. 3

<sup>150</sup> The IRS Learning Portal was originally called the IRS University, and the transition to the IRS Learning Portal represents a new approach to training and career development.

<sup>151</sup> <https://organization.ds.irsnet.gov/sites/HCOIRSU/SitePages/Home.aspx>

The Office of Personnel Manager makes available to all federal workers a program with certain universities that offers federal employees reduced tuition rates to pursue post-secondary education. The agreement provides tuition reduction and other incentives.<sup>153</sup>

## **6. Outside training**

The IRS also provides employees with the opportunity to attend pre-approved outside training with organizations such as the American Bar Association or the American Institute of Certified Public Accountants. This training, which may be a one- or multi-day program, provides employees with the opportunity to stay up-to-date on changes that affect the job with the IRS and an opportunity to interact and engage with practitioners.

## **6. CONCLUSION**

Just as industry and technology constantly evolve to adapt to changes, so must the IRS evolve in the way it does business. With increasing responsibilities and decreasing resources, the IRS must ensure that it hires individuals with the right skill sets who can quickly identify issues and work with taxpayers. The IRS also must recognize the increased involvement of the Internet in everyone's life and adjust the types of issues that it addresses and the way it provides services to taxpayers. Technology is becoming a larger part of every aspect of the IRS's business model and we need to ensure that we have the right resources to address these challenges.

---

<sup>152</sup> <http://e-learning.web.irs.gov/collegecredit/index.html>. This program requires the employee to complete online Skillssoft courses and take a final exam. These exams will be administered by IRS Proctors located at ACE-Authorized IRS Testing Sites.

<sup>153</sup> <http://mits.web.irs.gov/News/20160725HTLReducedTuitionRates.htm>

## INFORMATION EXCHANGE BETWEEN THE TAX ADMINISTRATIONS

**Paulo Cirilo Santos Mendes**

General Coordinator of Programming and Studies  
Federal Revenue  
(Brazil)

**Contents:** Summary. 1. Introduction: action and reaction. 2. The Secretariat of Federal Revenues of Brazil (RFB) before and after the Multilateral Convention (MLC). 3. Regularization of assets abroad: a practical effect. 4. Data base of the Brazilian tax administration. 5. Automatic exchange of financial and other type of information: Brazilian rules. 6. Brazilian structure for the exchange of information: 7. Automatic exchange: an opportunity . 8. TIN: key element for greater effectiveness in the exchange. 9. Cases that should be considered in greater depth: a new (old) challenge. 10. Use of public data: CIAT's DIP system. 11. Automatic exchange: derived risks. 12. Conclusion.

### SUMMARY

This paper shares the general guidelines of the Secretariat of Federal Revenues of Brazil's (RFB) treatment of the exchange of information with other tax administrations. The structure available at the RFB is discussed, considering the assumptions that are adopted as well as the challenges perceived, mainly following the increasing exchange anticipated after the entry into force of the Multilateral Convention (MLC). Also shown are data that prove the importance of the automatic exchange as well as the relevance of an exhaustive analysis, including the use of public data prior to sending a request for assistance to a foreign tax administration. Lastly, CIAT is recognized for promoting the exchange of experiences between the countries in relation to this issue and it is noted that Brazil is not only interested in learning the best practices, but is also willing to collaborate with its partners.



## 1. INTRODUCTION: ACTION AND REACTION

Cooperation between tax administrations is not a new issue, as we all know; nevertheless, the recent past has brought innovations that improve this cooperation process at levels never imagined before. The benefits shown are within everybody's reach, whether it be countries that did not have a broad network of treaties that supported those exchanges, as well as those that already had a larger network.

As it often happens, humanity extracts teachings from tragedies and seeks mechanisms to evolve. In the first year of the XXI century, the two towers of the *World Trade Center* were knocked down, an event which momentarily paralyzed our contemporary society. However, it was not only the buildings that fell, but also barriers and limitations between the countries started to fall, thus pointing out the need for greater integration, even in the sphere of tax information exchange.

This process gave way to new frameworks and more recently, of great importance is the broad multilateral cooperation agreement for speeding up collaboration between the tax administrations. The Multilateral Convention on Mutual Administrative Assistance in Tax Matters, which shall hereinafter be referred to as Multilateral Convention (MLC), is an important framework for everyone's action. If the purpose of the exchange is the search for adequate taxation, knowing the assets of its taxpayers in other countries, especially the financial assets, allows for identifying indications of tax evasion whose resources may serve several purposes. Thus, there is the possibility of a more effective management of the tax risks. We are all aware of the effectiveness of the *follow the money* strategy.

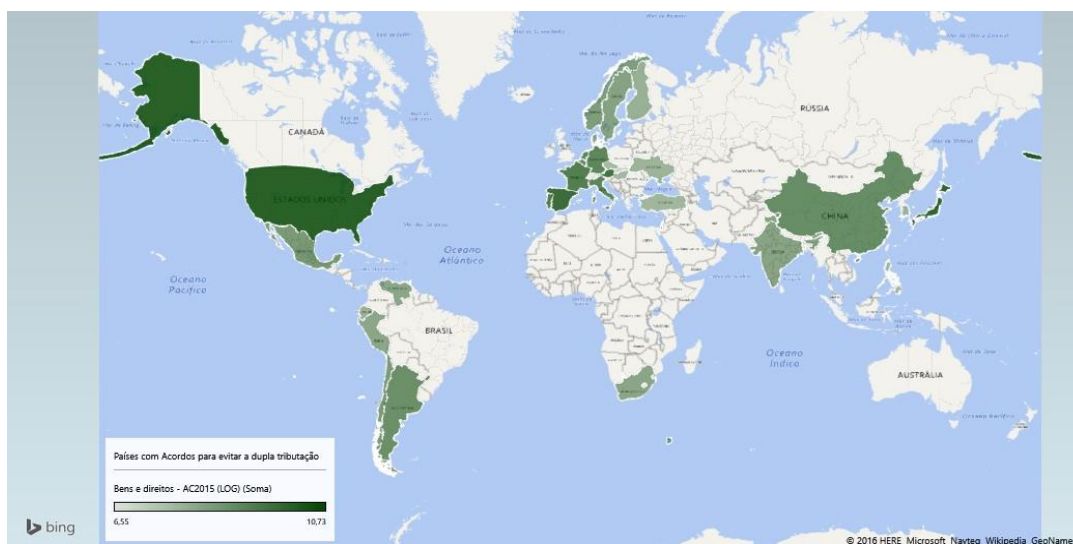
## 2. SECRETARIAT OF FEDERAL REVENUES OF BRAZIL (RFB) BEFORE AND AFTER THE MULTILATERAL CONVENTION (MLC)

Brazil has entered into agreements for avoiding double taxation (*Double Taxation Agreement* - DTA) with 33 countries, which list appears in the annex. In these agreements, specific provisions for the exchange of information support the exchange between Brazil and the other contracting State. In general the method used is the exchange upon request, given a specific previously identified situation. In addition to the DTAs, there is in force since 2013, an agreement for the exchange of tax information (*Tax Information Exchange Agreement* – TIEA) with the United States of America.

The 2015 data of the Brazilian tax administration (RFB) de 2015, which were compiled in August 2016, indicate that Brazilian individuals declared having assets in these 34 countries of some R\$ 136.3 billion, or approximately US\$ 34.9 billion dollars, according to the rate of exchange at the end of 2015. Graph 1 summarizes

the distribution of the net worth in those countries. A logarithmic scale was used to indicate, in the shade of the same color, the representation of each jurisdiction.

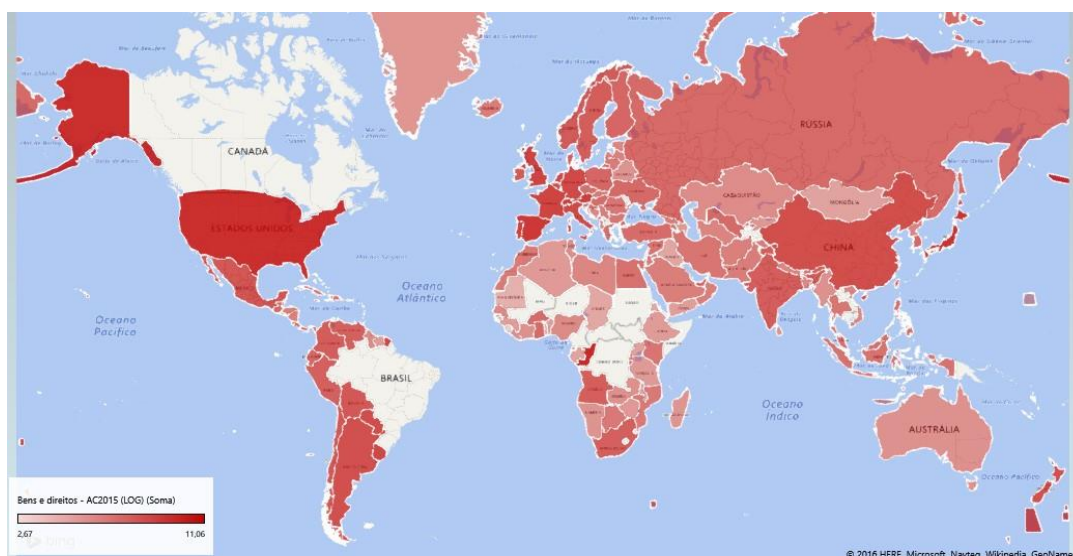
Graph 1: Net worth declared by individuals in the countries with agreement



On analyzing the total net worth abroad declared by Brazilian individuals in the same period the amount determined was R\$ 265.9 billion, or approximately US\$ 68.1 billion. Net worth was declared in 205 countries or jurisdictions and 20.1% of the total was in the United States of America. Another 35. 4% was in three places: British Virgin Islands, Bahamas and Cayman Islands.

Graph 2 shows, also in a logarithmic scale, the distribution of this net worth abroad.

Graph 2: Net worth declared by individuals abroad



As of the entry into force of the MLC, the network of countries and jurisdictions which rendered possible the exchange of information increased significantly, with the subsequent increase in the tax administration's efficiency and the greater risk for delinquent taxpayers.

### **3. REGULARIZATION OF ASSETS ABROAD: A PRACTICAL EFFECT**

It is important to point out that the consolidated studies shown in graphs 1 and 2 did not consider the values regularized by the Brazilians based on Law N° 13.254 of January 13, 2016. The individuals and corporations with tax domicile in Brazil at 31/12/2014, based on the provision of said legal regulations, could regularize assets abroad which had not been declared before the control bodies – the tax administration and the central bank -, through the specific filing and payment of the tax and fine for a total amount of 30% of the assets which had not been declared to the authorities abroad.

The program was open until October 31, 2016 and at the end of said period, almost 25,000 individuals and some hundred corporations actually filed the respective return and paid the corresponding amounts of tax and fine, thereby complying with the requisites for adhering to the special exchange and tax regularization system, by virtue of the provision in the first paragraph of article 5 of Law 13.254 of 2016. The total amount of regularized assets exceeded R\$ 150 billion, or approximately US\$ 57 billion, taking into account the rate of exchange determined by law at 12/31/2014.

There is a new opportunity underway for regularizing assets maintained abroad, as determined by the Brazilian parliament, for which reason the updating of data filed will take place further on.

It is important to note that the Brazilian press highlighted in particular the expansion of the tax information exchange based on the MLC. The Brazilian tax administration recalled that the anticipated mechanisms under development for the automatic exchange between countries afford more information for tax management, something which undoubtedly influenced the decision of each of the taxpayers to take the legal opportunity to regularize his assets abroad.

Although it may not be possible to measure the exclusive effect of this new cooperation system in each taxpayer's final decision, undoubtedly it is possible to consider that the regularization of assets by the Brazilians, is a specific example of a benefit arising from the new established order.

#### **4. DATA BASE OF THE BRAZILIAN TAX ADMINISTRATION**

The Brazilian tax administration has been investing for a long time in the massive capture of data for adequate risk management. In 2017, it will be ten years since Brazil established the Digital Public Accounting System – (SPED) thereby migrating accounting records from paper to the digital sphere. There are several related programs, such as Accounting, Tax Accounting and Electronic Invoices. The Secretariat of Federal Revenues receives those various documents and allows the tax authority, the fiscal auditor, to work with them directly from his work station, which results in productivity benefits in various working processes, going through the strategic follow-up of large taxpayers (in Brazil approximately 10,000 corporate taxpayers represent almost 70% of spontaneous collection), the selection of taxpayers to be examined and thereafter the auditing.

The financial data are also being captured by the Secretariat of Federal Revenues directly from the financial institutions during the past two decades. The data of all the customers of a bank are periodically sent (twice a year) to the tax administration for a risk management action which is based on the total amount of debits and credits transacted monthly. To be aware of the flow of transactions is relevant and better than working solely with the balance at the end of the fiscal year.

In relation to events starting in 2016, Dimof<sup>1</sup>, the accessory obligation until then in force was discontinued and substituted with another, e-Financiera<sup>2</sup>, following the SPED pattern. The purpose of this change was to satisfy the needs of the Secretariat of Federal Revenues, as well as the search for simplification sought by the tax administration, since the new obligation must in the future be focused on capturing the greater part of the data provided by the financial institutions.

In addition to the financial and accounting data, many others are systematically provided by the Secretariat of Federal Revenues, which allows the Brazilian tax administration to have a wider view of the economic and fiscal situation of the Brazilian taxpayers.

#### **5. AUTOMATIC EXCHANGE OF FINANCIAL AND OTHER TYPES OF INFORMATION: BRAZILIAN RULES**

The evolution of the obligation in force also allowed for adjusting the capture of data by the Secretariat of Federal Revenues with a view to the automatic

---

<sup>1</sup> Dimof: Information Return on Financial Transactions, established through Normative Instruction RFB Nº 811, of January 28, 2008.

<sup>2</sup> E-Financiera: Accessory obligation established through Normative Instruction Nº 1.571, of July 2, 2015, to provide information on financial transactions of interest to the Secretariat of Federal Revenues of Brazil (RFB)

exchange of financial accounts based on the agreement between Brazil and the United States of America, under FATCA, as well as to allow Brazil to capture the necessary data for complying with the commitment assumed with other countries, through the *Common Reporting Standard* - CRS.

The MLC, regulatory support of the CRS, entered into force in Brazil on 01/10/2016, and became effective in 2017. In order to comply with the automatic exchange of banking information based on the CRS, the Secretariat of Federal Revenues amended the regulatory standard<sup>3</sup>, basically with the guidelines so that the filing institutions could adequately provide the information of the e-Financiera obligation.

It is important to be aware of the Brazilian reality, which differs from other countries due to specific reasons. In 1996, the Brazilian legislator introduced a tax on the movement or transmission of values and credits and rights of a financial nature (CPMF)<sup>4</sup>, which led the tax administration to establish an accessory obligation to capture data from all the customers of the financial entities. This tax ceased to be collected in 2008. In any case, risk management based on the financial flow of resources managed by the banks had already been consolidated and the regulation supporting the data capture continues in force.

Following the establishment of commitments for the automatic exchange under the FATCA and CRS rules, the Secretariat of Federal Revenues only adjusted its capture, while maintaining the equal treatment provided in the Brazilian Federal Constitution, since the obligation to provide the data cover all the users of its services.

This system used by Brazil allows for prompt attention to foreign demands, with the data already available in the internal systems of the Secretariat of Federal Revenues. It is not necessary to request detailed banking data to the financial institutions. Generally, it is enough to confirm that a taxpayer of interest to the foreign State operates in the institution and it is now possible to report on the financial flow, by bank, in a quick internal consultation. This is exactly the management process applied to all individuals and corporations that move resources in Brazilian banks.

The Brazilian system of periodic financial data capture affords another advantage of interest to the Secretariat of Federal Revenues and also to the foreign administrations. If a taxpayer moves his tax domicile abroad without giving immediate notice to the filing financial institution, the latter simply does not identify its customer's data as reportable in the automatic exchange process, but rather the tax administration will normally receive these data. Thus, when the relationship abroad is subsequently identified, the respective financial movement will have

---

<sup>3</sup> Normative Instruction RFB Nº 1.680, of December 28, 2016.

<sup>4</sup> CPMF, provided by Law Nº 9.311, of October 24, 1996.

been already reported to the Secretariat of Federal Revenues, which may quickly share this information, without the need to notify the bank.

In all cases, risk management based on financial flow data appears to be insufficient for auditing purposes, either in Brazil or abroad. Then there are normative provisions for requesting detailed returns.

Specifically, to respond to requests based on international cooperation agreements, Brazil adjusted its internal regulation in 2014, expressly anticipating that the foreign need is a motivation for the Secretariat of Federal Revenues to make administrative requests to financial institutions according to paragraph XII of article 3 of Decree Nº 3724, of January 10, 2001<sup>5</sup>.

The automatic exchange with the support of the MLC, as it is known, is not limited to financial data. Other rules are established in the general sphere, as is the case of the country-by-country report (CbC). Bearing in mind the commitment acquired by several States, Brazil has already issued regulations for carrying out this automatic exchange<sup>6</sup>, thereby establishing the obligation for the Brazilian taxpayers.

## **6. BRAZILIAN STRUCTURE FOR THE EXCHANGE OF INFORMATION**

The Secretariat of Federal Revenues of Brazil deals with internal taxes as well as with the customs area, for which reason the General Coordination of International Relations (Corin) acts in response to the demands of these two areas. However, in this paper, the processes of the internal tax area will be specifically discussed.

Corin manages the Exchange of information, the intermediation of requests received from abroad and those made by Brazil to its partners. The General Coordination evaluates the regulatory aspects that govern the agreements and guides the technical areas in the treatment of specific cases.

The Secretariat of Federal Revenues is organized according to centralized structures, responsible for the guidelines in each area, and in decentralized structures that have their operational directions. Corin is part of the centralized structure of the Secretariat of Federal Revenues.

### **6.1. Evolution in the assistance process**

The assistance process by Brazil, of the requests from the foreign tax administrations, has evolved in recent years. Given the large internal data base

---

<sup>5</sup> Amended through Decree Nº 8303 of September 4, 2014.

<sup>6</sup> Normative Instruction RFB Nº 1681, of December 28, 2016.

available for prompt Access by the fiscal auditor, with a view to a faster analysis and bearing in mind the specialization of a team, the pertinent requests began to be addressed to an area of the central unit linked to examination of the Secretariat of Federal Revenues, that is, the General Coordination of Programming and Studies (Copes).

For a significant part of the items included in a specific request, the experience showed that it was possible for the Copes fiscal auditor to undertake a technical analysis and with it, simplify the assistance to be provided to the petitioner. Copes does not carry out external auditing procedures. In any case, the tax authority may have internal access even to the taxpayer's fiscal accounting, which allows for producing responses with useful elements for the case being examined.

It is known that a response exclusively based on internal data may not be sufficient to respond to all the elements of a given external request. Therefore, the process cannot be conclusive in this central unit linked to examination, and thus, it is necessary to send the case for complementary evidence to the operational team of the Secretariat of Federal Revenues.

In any case, whenever it may be considered useful, Corin will provide the petitioner partial evidence, since the information may support the actions of the foreign tax authorities by directing their efforts.

## **6.2. Partial results**

This new system has resulted in considerable benefits in the response time of the foreign requests. The Corin studies indicate that the average time went down from 204 days in 2014, to 49 days in 2016.

In addition, the Brazilian Secretariat of Federal Revenues has received information from other countries regarding the usefulness of the information provided through this new system.

In fact, the specialization of a team tends to provide quality gains. The quick approach with fiscal data extracted from the systems, especially in the case of Brazil, which has a considerable base, ends up allowing an effective action by the foreign country, with benefits for all.

## **7. AUTOMATIC EXCHANGE: AN OPPORTUNITY**

Even though the automatic Exchange of tax information was already a practical reality among some states, Brazil was not using this form of cooperation. With the new method agreed at the world level, this modality is incorporated in the risk management routine, thereby providing significant benefits.

A specific example is derived from the automatic exchange with the U.S., under FATCA, already in force since September 2015. The data received allow for identifying specific situations of omission of assets abroad, and the ax procedures are underway in order to confirm the tax irregularities. Most certainly the same information will be obtained from other countries, on the basis of the CRS.

In addition to the automatic exchange of financial data and of the also already mentioned exchange base don the CbC, other automatic rules based on the MLC may be established, either at the multilateral or even bilateral level. The bases for a greater integration among the tax administrations have been defined.

It is worth recalling that the MLC is not limited to support the automatic exchange, but rather allows, if agreed between two States and there is no regulatory obstacle in the respective internal legislations, for establishing mutual assistance to obtain data prior to the entry into force of the MLC for the contracting States.

Brazil has expressed its interest in extending this mutual assistance to prior events, and is prepared to sign the corresponding memorandums of understanding with the interested States.

## **8. TIN: KEY ELEMENT FOR GREATER EFFECTIVENESS OF THE EXCHANGE**

Said opportunity for expanding risk management explains why it is important that the data be correctly associated with the tax identificación number (TIN) of the individual or corporation whose information is being provided. Since the TIN was not necessary in the first exchanges within the framework of the FATCA, the Brazilian tax administration required additional efforts for correctly identifying the taxpayers of interest. In any case, this data becomes obligatory in the future, thereby allowing faster action by each tax administration.

The TIN is obligatory in Brazil for practically all tax purposes. This number is still widely used in daily life and beyond the limits of the specific tax interest, thus becoming an element defined by economic agents as data requested in the great majority of private registries. In contributing to its widespread use, the Brazilian tax administration has signed agreements with various public agents, thereby allowing for real time consultation of its registry base for specific purposes.

As a result of these associations, agreements with the civil registry offices already allow that a TIN be assigned to a newborn when issuing the birth certificate and that number will accompany him throughout his life, since a single TIN number is allowed for a person in Brazil. Although it is not obligatory to register the TIN at birth time, this system, which was voluntarily established since December 1, 2015, has reached in 2016, over a million certificates issued with TIN. By February 28, 2017 there were 1,496,302 certificates issued with the participation of 51% of the



registry offices throughout the country. Rio de Janeiro was the first State of the Federation which had all of the registry offices participating in this process.

As another specific example of its use for tax deduction purposes in the pension plans of a dependent, the individual income tax required the TIN of said dependent if the latter was at least 12 years old. Previously, the obligatory minimum age was 14 years.

Undoubtedly, the massive use of the TIN is of interest to every tax administration and an essential element for greater effectiveness in the exchange of tax information between countries, thus requiring that attention be paid to the regulations for determining the obligatoriness of capturing said data; not only the TIN of a resident in a specific country, but also the TIN of a foreigner.

In Brazil, some obligations already require that filers capture the TIN data of foreigners carrying out specific transactions with Brazilian counterparts. As example, there is the obligation of identifying the foreign counterpart involved in service or intangible transactions, as provided in Siscoserv<sup>7</sup>.

Attention should be given to initiatives for tending toward the establishment of a TIN regional, or even world pattern. Within the financial sector, the LEI (*Legal Entity Identifier*), is known by all.

These initiatives will imply adjustments in the systems with a greater or lesser costo to all those involved, which suggests significant difficulties of a practical nature. They are valid initiatives, although their massive adoption within short ter is not anticipated.

Thus, the internal definition in every State, becomes ever more important in order that the TIN of foreigners be duly reported in the transactions they carry out and subsequently sent to the respective tax administrations.

## **9. CASES TO BE CONSIDERED IN GREATER DEPTH: A NEW (OLD) CHALLENGE**

The automatic exchange is established as a first (and for many, new) source of data. Each tax administration now has an indicator, currently massive, which will allow a better selection of taxpayers. The data must be analyzed from the perspective of indicating a reasonable interest, to then, if appropriate, seek the assistance of another tax administration in the additional investigation.

---

<sup>7</sup> Siscoserv: Integrated Service of Foreign Trade of Services, Intangibles and Other Transactions that may bring about Changes in the Net Worth.

It is essential to act with good judgment in this request for assistance. Since each tax administration will have a larger amount of data, the principles and rules that govern the exchange of information should be observed with the usual rigour, to thus identify the cases of real interest, with unquestionable fiscal relevance.

The Brazilian tax administration is aware of the need to observe these parameters, since it deems it disproportionate to request the support of its partners abroad to consider cases of little interest from the fiscal standpoint. The incorporation of a foreign administration calls for exhausting the possible verifications in the requesting country and likewise that the events investigated may be of significant tax relevance.

## **10. USE OF PUBLIC DATA: CIAT'S DIP SYSTEM**

A very useful analysis in the process of selecting cases to be investigated consists of the verification of the public information that is available, either in the bases of the public or private entities, or even in news that may be recovered in Internet.

In this sense, in collaboration with CIAT, Brazil developed the platform for facilitating access to public data in a specific country, which may probably be of interest to its partners. It is known as the DIP Project, whose technology was shared with CIAT experts in 2016. A network of facilitators is being developed and once the transfer is formalized, the platform will allow for making inquiries from the interested party's work station.

Such inquiries, undoubtedly, will assess the selection process and may optimize the internal work, in addition to avoid unnecessary requests to other countries. For example, it will be possible to determine whether there are real estate registries of an individual in Brazil, or consult the list of debtors of the National Treasury, including the amount of the debt.

At times, a search through Internet will suffice to verify, for example, that an individual has passed away and the tax interest ceases to exist, depending on each country's internal legislation and the event being investigated.

## **11. AUTOMATIC EXCHANGE: RESULTING RISKS**

If the automatic exchange, as already mentioned, affords an opportunity, it may also represent a risk for the tax administrations involved, if additional requests go beyond the current working capacity.

Brazil, on becoming aware of the possible increase of requests received, has tried to structure itself to successfully respond to the foreign requests.

Copes, as examination area in the central unit responsible for the initial evaluation of the requests received at Corin, specialized itself in the search for data in its own internal systems and seeks to provide fiscal information of interest.

In addition, the teams of the decentralized units are being oriented to give priority to the requests they may receive.

It is deemed timely to consider the need that each tax administration undertake a reevaluation of its structure, since the trend is that there will be an increase in the requests they will be receiving.

In any case, it is evident that each tax administration has limits in its capacity for providing assistance and, therefore, if there is a significant increase in the number of requests, there is the risk that the average response time may increase significantly, thereby affecting the action of the petitioner.

These perspectives simply reinforce the attention which each competent authority should give to the analysis of cases for which it requests external cooperation. It is thus ratified that it is ever more essential for the petitioner to evaluate the tax relevance of each request in order to avoid requests that may involve cases of less interest which may affect the appropriate management of requests related to cases of greater tax potential.

Even in this process of cooperation between tax administrations Brazil has been careful in focusing its requests on data for auditing by the Brazilian authority, and not in requests that could demand auditing by the foreign partner whose cooperation is requested. This is another important aspect to be taken into account to avoid transferring to the foreign administration a significant part of the audit that corresponds to the petitioner. The principle of cooperation is the exchange of data, with possible technical demonstration of aspects of the regulation of the country where the transaction under analysis takes place, but it should not represent a heavy burden for the partner administration.

## **12. CONCLUSION**

The new world order, with the significant expansion of the exchange between tax administrations, should be constantly discussed, since it offers opportunities and challenges to each participating State. The convergence toward the rational and balanced use of these international agreements will allow significant advances in each country's risk management, with greater quality, as a result of the international assistance.

CIAT, on allowing these discussions, plays an important role in the collective development of this new order, which will not only be based on the written rules, but will also be promoted by the best practices developed, with each tax

administration endeavoring to respond to the requests from their partners and at the same time, understanding the evidence received to assist them in the audit work carried out internally.

Brazil is willing to continue contributing to this debate in multilateral forums and bilateral associations, by sharing its experiences, its reality and the challenges that must yet be overcome, since there is a constant evolution. The Secretariat of Federal Revenues of Brazil seeks to know the reality of its partners and expects to constantly learn with them. The future is built in the present and the partnership is the key to success.

## COLOMBIAN EXPERIENCE IN THE DEVELOPMENT OF TECHNOLOGICAL TOOLS TO IMPROVE THE SERVICE TO CITIZENS

**Cecilia Rico Torres**  
Director  
Revenue Management Directorate  
(Colombia)

**Contents:** Overview. 1. Scope. 2. Background. 3. Best practices. 4. Recommendation. 5. Conclusions. Bibliography. Annexes

### OVERVIEW

The provision of the public service with high quality standards is a duty of the State constitutionally enshrined in the policy letter of 1991, framing the responsibility of guaranteeing the fundamental rights of citizens to go against the administration. The tax authority stands as protagonist in daily procedures that should make citizens, making payable therefore having high standards in care to citizens. Prior, how best to establish mechanisms for access is to implement technological strategies that respond to the needs that arise in fulfilling the duty to pay tax in their formal and substantial dimensions.

In addition to known computer mechanisms and the use of existing resources in every tax system, is a choice of administrations undertake different technological alternatives that strengthen the relationship with citizens and generate trust. The present document presents experiences that have led to substantial improvements in terms of service to the taxpayer in Colombia, implementations ranging from the consolidation of a solid structure of channels of service, policy changes aimed at facilitating procedures until the realization of trade services and web series to generate empathy with the fiscal issues within the generality of the population taking advantage of its idiosyncrasy and cultural identity.

### 1. SCOPE

This document aims to provide an overview on the main achievements of the National Tax and Customs Directorate of Colombia DIAN, regarding the application of information technology to facilitate the management of structural procedures in compliance with tax obligations.

In this sense, the adjustments to the institutional service model are described, based on self-management and voluntary compliance with tax obligations and integrating the development of online services as a fundamental tool for the modernization of the organization.

The model focused its efforts on the following components:

- Prioritization of the procedure under the scheme to identify, attract and retain the taxpayer's voluntary compliance
- Focus the management of assistance on three components: inform, educate and assist.
- Joint strategies of service and control according to the voluntary compliance behavior of the taxpayer.
- Strengthening the service in each of its elements: People, processes, technological infrastructure, legal and physical security

The ultimate goal of the service model and technological advances is to deepen the knowledge of the taxpayer and increase the confidence of citizens in the fiscal management. In this view, the prioritization of the development of online services has facilitated the fulfilment of the obligations and improved the taxpayers' assistance, including the following achievements, among others:

- On-line consultation of databases for the submission of returns.
- Electronic filing of the returns.
- Availability of payment online
- Online access to the taxpayer's personal information
- Registration and update of the tax single registry - RUT online
- Online resolutions of invoicing authorization

## **2. BACKGROUND**

In Colombia, the implementation of the information technologies for the improvement of the attention of taxpayers, is supported in four action lines:

1. Public policy for the service of the Citizen (National Council of Economic and Social Policy "CONPES" 3649 of 2010 and 3785 of 2013<sup>1</sup>.
2. The implementation of the Online Government Strategy
3. Single Information System of Procedures - SUIT
4. Single Model for Revenue, service and automated Control - MUISCA

### **2.1 The national policy of service to the citizen**

The model surges from the identification of the dissatisfaction of the citizens against the quality of the services provided by the public administration, as well as the negative perception of citizens with respect to its efficiency and probity, determined in the 2010 document CONPES 3649 (APA). Its overall objective is aimed at confidence-building and the improvement of the levels of satisfaction of citizens with respect to the services provided by the national entities.

---

<sup>1</sup> National Council of Economic and Social Policy "CONPES" is an entity assessing the government on issues of economic and social development and is in charge of studying and recommend general policies in these areas

This document presents a diagnosis with the identification of four structural problems of the management of service to the Citizen and the objectives for improvement, especially the problematic axis 3, referred to the *persistence of weaknesses in the management of public service approach to the citizen*, which proposes "the creation of tools for obtaining relevant information: taxpayer requests with respect to procedures, frequency and time of attention".

To enhance the management of service to the citizen, the segmentation of customers must be assumed rigorously, since it is a strategy of approach to the identification, attraction, satisfaction and loyalty of taxpayers toward voluntary compliance, articulating both the service and the control.

On the other hand, the National Policy of efficiency at the service of the Citizen was adopted in the document CONPES 3785 of 2013. The overall objective is to improve the effectiveness, collaboration and efficiency of the Executive branch institutions to the national agenda, and their capacities to respond timely and accurately to the requests of the citizens.

For this purpose the efficient public management model to the Service of the Citizen is adopted, whose purpose is to improve both the quality management and the provision of services provided by public entities. The above, taking into account that this model integrates the internal processes with the capacities of institutions to serve the citizens, materializing the administrative development policies set out in the Decree 2482 of 2012 especially those of transparency, participation, service to the Citizen and administrative efficiency; complemented by the strengthening of institutions in components "inner window and outer window".<sup>2</sup>

## **2.2 Implementation of the online governmental strategy**

The online Government is the name given to the strategy of Electronic Government (e-government) in Colombia, which began in 2000 with the presidential directive 002 and was strengthened with the issuance of the Decree 1151 of 2008, defining the General guidelines of the strategy. The purpose of the strategy is to ensure better communication and interaction with the Citizen under four major challenges:

- Offering the best on-line services to citizens.
- Achieving excellence in management
- Empowering and building trust among citizens.
- Promoting and facilitating actions required to advance the sustainable development objectives - SDO, facilitating the effective respect of rights through the use of ICT.

The implementation of this strategy is based on four main themes:

---

<sup>2</sup> From Office y Back office

- **ICT Information technology and telecommunications for the open Government**, which seeks to build a more transparent and collaborative State, where citizens participate actively in decision-making through ICT.
- **Technology of information and communication technology ICT services:** It seeks to create the best procedures and online services to respond to the most pressing needs of the citizens.
- **Technology of information and communication technology ICT management:** It seeks a strategic use technology to make the administration more effective.
- **Security and privacy of information:** It seeks to save the data of the citizens.

Regarding the implementation of the strategy of Online Government at DIAN, the following actions that have had greater impact and benefit to taxpayers are highlighted:

**Information online:** In the institutional portal [www.dian.gov.co](http://www.dian.gov.co), the citizen can consult all the information relating to the Mission of Dian, its strategic planning; procedures and services linked to the unique procedures SUIT information system; spaces of interaction; budget execution for years; organizational structure; Contact Directory; related regulations; News and recruitment; tax calendar; administrative projects to receive comments from citizens; link to tables of economic activity and customs tariff consultations; information that is structured under the standards of accessibility, safety and ease of access.

**Online interaction:** Enabling two-ways communication tools of between public servants, organizations, citizens and businesses. The service PQRS and denunciations, Chat, Forum, social networking, are made available among others.

**Online transactions:** Notifications of administrative acts, free forms to download, copy of the RUT, password recovery, online payment, virtual presentation of returns, scheduling of appointments, registration and update of the RUT, the exogenous information, pre-validators, consultation of the RUT status, electronic invoicing, invoice number, verification of the authenticity of emails, among others.

### 2.3 Single Information System of Procedures - SUIT

The SUIT (*Spanish: Sistema Único de Información de Trámites*) is the administration system of electronic procedures and other administrative procedures (OPAS in Spanish) for managing the information, so that the Citizen can have access to information requirements and the procedure of each process quickly, at low cost and without intermediaries. DIAN currently has 69 procedures and three OPAS published in the SUIT.



## **2.4 Single Model for Revenue, Service and Automated Control - MUISCA**

The National Tax and Customs Directorate of Colombia has proposed as a strategy of the organization from the year 2004 to overcome the challenges represented by the world economy of the 21st century, recognizing its comprehensive ability, viewing its potential, reducing waiting times and increasing productivity so that to ensure the collection of the State, through the development of the Unique Automated Revenue Model And Service Control -MUISCA, which sought to integrate, facilitate, streamline and simplify the procedures used by the entity.

Its implementation was an organizational and process engineering that from its beginnings had as objective to generate benefits for the tax, customs and currency exchange Administration, emphasizing those aspects that have an impact on the detection and reduction of fraud, evasion and technological modernization.

Model:	Represents the new way of managing.
Unique:	Integrates people, areas, concepts, data and management
Income:	Responsible for the collection
Service:	Facilitates the compliance with duties and the exercise of rights
Control:	Measures, prevent and adjust the behavior and management
Automated:	Uses technology to enhance the management

The MUISCA is a management model that aims to fulfill the Mission of the entity, allowing to manage comprehensively the organization, with strong emphasis on the management of processes, people, resources, and information technology, which is the most important innovation. The MUISCA management model's principles are: It is integral, unique and adaptable to change.

In the year 2006, with the implementation of the digital certificate, electronic computer services become available to customers for the virtual presentation of returns and exogenous tax, customs and currency exchange information. And in 2006 also, a unit dedicated to providing assistance and guidance to the taxpayer was created.

Different services for the collection, control, tax refunds, accounting tasks have been developed to replace the earlier applications. Currently, the agency works in the construction of the services associated with the country's operation of foreign trade under the framework of the new customs regulation issued in 2016.

## **3. BEST PRACTICES**

### **3.1 Technologies in the promotion of voluntary compliance**

Undoubtedly, it is far less expensive for the tax administration to collect via voluntary taxpayer compliance, without having to incur costs associated with the use of coercive power supported the legal powers for the collection of the tax obligations. And it is much

better if accompanied by technological developments that facilitate compliance, making it less cumbersome for the taxpayer. Among the computer developments

#### **4.1.1. Service processing and submission of returns**

In its redirection towards a better service process, DIAN is committed to help media users to fill out and pay the different obligations, based on the quality of the taxpayer, customs user or foreign exchange customer, through new forms and mechanisms that allow optimizing time and resources for a fast fulfilment of those responsibilities.

Service processing of the returns is available for all registered customers and which must comply with the obligation to formal declared; Likewise, those who have the electronic signature or the older digital certificate may, once completed the return, perform the signature, submission and payment of the obligation in a virtual way.

The most important benefits of the service are:

- Complete gradually the form, correcting the information before generating the final form, even in different times and places
- Save costs in obtaining forms
- Monitor, detect and promptly correcting errors in identification, rates, rates, deadlines, as well as arithmetic errors
- Permanent traceability to the generated documents and the status
- Automatic entry of the information to the computer services of the institution
- Service with permanent availability, 7 days a week 24 hours a day

A systematic growth in electronic tax returns is observed between 2012 and 2016, from 4.2 to 5.7 million (graphic 1 of annex) result of the delivery of about 200,000 digital signatures per year while in customs issues, the dynamics of the flow of returns is largely influenced by the behavior of foreign trade.

#### **4.1.2. Electronic service of information presentation, sending files**

This service allows the user to fulfill the obligation to submit tax information, customs or foreign exchange information to DIAN via electronic form (see graph 2). In this way, the DIAN offers not only the possibility of easy access to new services, but also speed and security in the presentation of the information. In addition, the entity framed their processes within the guidelines of the Act 962 of 2005, concerning the simplification of procedures to the public authorities.

To facilitate this process, the National Tax and Customs Directorate has designed educational aid (videos, tutorials, guides) for the proper use of the new service.

The most important benefits of this service are:

- Electronic transmission of mass information.

- Safe electronic filing of information to DIAN, without intermediaries or physical displacement,
- Guarantee of origin which implies that the declarant is the one who presents information and not another person.
- Information protection against alteration or manipulation by third parties.
- In addition, DIAN offers the pre-validating, computer tool with which allows formatting files in the technical specifications established by DIAN with the advantage of minimizing formatting errors.

### **3.2 Technologies to facilitate access to procedures**

From the numbers on the volume of taxpayers using face-to-face channels, the electronic computer services received priority, to reduce costs of face-to-face attention, taking as a reference that from the composition of the taxpaying population in which only a third party use the information and telecommunications technologies, it is necessary to keep the face-to-face channel, particularly for the 2.4 million individuals, but gradually reducing its use.

#### **4.2.1 Updating the Single Tax Registration (RUT) – Online RUT**

The Tax Registration Number- RUT- is the unique mechanism to identify, locate and classify customers managed by DIAN, established in article 555-2 of the National Tax Statute and regulated by the Unique Decree 1625 of 2016 in its articles 1.6.1.2.1 to 1.6.1.2.26. The Registration is the process of greater demand in the agency, not only for registration and obtaining of the TIN but for its update; While it does not lose validity, it must be updated whenever a change is generated in the reported data as it is the case of the address change, phones, email, economic activity, tax responsibilities or customs qualities, information of legal representation, partners or members of executive boards, fiscal assessor, accountant and trade facilities.

The Single Tax Registration is created in the year 2004 with the Decree 2788 of the same year, at that time all the formalities had to be managed in person at the points of contact of the DIAN or in the registration at the Chambers of Commerce. In the year 2007 with the implementation of the digital certificate, the online service update of the RUT for taxpayers (individual and legal entities) equipped with the digital certificate is enabled, being until that date a small universe of customers (2000) that could use the service compared to all the registered taxpayers who were requesting the procedure.

Between 2007 and 2012 the service coverage was extended, with the gradual growth of taxpayers with digital certificate. However in 2012 with the issuance of the Decree Law 00019 (Anti procedures) gives opening to online update service of the RUT to individuals of the simplified VAT regime, without the need of having the digital certificate to perform the update process. In 2013, through the Decree 2460, DIAN expanded the RUT online update to all individual submitting an income tax return, or paying the tax on consumption and in general to all registrants of the RUT online update service.

As a result of this regulatory simplification of the formality, the % of online procedures increased rapidly, going from 3% of the total number of procedures in 2012 to 78% in 2017 as can be seen on graphs 4 and 5, a procedure that initially includes the online updates of the RUT by type of taxpayer and subsequently the online updates versus the total RUT procedures.

With this modernization of access to the procedure, some of the following benefits obtained are:

- Saving time and travels of taxpayers to the points of contact, optimizing the attention of the face-to-face channel focused now on the procedure of registration in the TIN that requires visiting only once to the point of care, known as point-of-contact.
- This information is updated immediately.
- Quality of information: each customer knows what information is in our database and when it should be updated.
- Security of information with authentication keys to access the service and the possibility of changing it without external help.
- Consultation service of the updates history and possible printing in PDF of the current certificate's copy in just two steps.
- Timely, efficient and effective online service for the customer
- Decongestion of the points of contact of face-to-face attention
- Service with permanent availability, 7 days a week, 24 hours a day

#### **4.2.2. Copy of the RUT for different public and private procedures**

40% of people who used the face-to-face channel needed to obtain a copy of the RUT well for labor related purpose or for provision of services or contracts. We designed a service that allows obtaining such copy in two simple steps from the website, reducing the influx of individuals to contact points.

#### **4.2.3. Online service of invoice number approval:**

The invoice number approval is a technical control system of the income production activity in accordance with article 684-2 of the tax statute, regulated in 1996 through Resolution 3878. For 20 years the procedure could be exclusively made in person at the DIAN's points of contact, so that the taxpayers had to request it using a format establishing the type of Invoicing (paper, computer, POS or electronics) and the number series for the support of sales transactions, while Dian issued a resolution authorizing the entirety of the series requested by the customer.

In 2016, in order to facilitate the fulfillment of tax obligations, such as invoicing, DIAN implements from August 1, with the issuance of resolution 55 of 2016, the new numbering of Online Invoicing service for customers who have to issue the invoice or equivalent document, whereby the invoicing taxpayer has to perform the authorization, habilitation

and disablement requests, and obtain the invoice number authorization online and immediately.

Graph No. 6 provides statistics on the amount of paperwork managed from the year 2012 through 2016, before the implementation of the online service. Similarly, it presents the comparison per year and the average per month, which highlights the substantial increase of interactions as a result of the implementation of the invoice number online service, which has allowed to know better the behavior of customers in the use of number series (see graphic 7).

Among the benefits of this new service are:

- The procedure is 100% online
- Virtual access to all taxpayers forced to invoice or send an equivalent document
- Saving cost and optimizing time for the taxpayer, who can request the authorization of invoice number from his home or office.
- Timely, efficient and effective online service for the taxpayer.
- Decongestion of the points of contact of face-to-face attention.
- Control of Invoice number ranges allowed to each taxpayer according to the risk profiling based on volume of operations, economic activities, Invoicing, revenue, heritage and fulfilment of tax obligations
- Service with permanent availability, 7 days a week 24 hours a day

#### **4.2.4. Electronic signature**

The electronic signature is a set of electronic data which accompany or are associated with an electronic document and whose core functions are:

- Identify the taxpayer unequivocally.
- Ensure the integrity of the signed document, it is to say that it is exactly the same as the original and has not suffered any manipulation or alteration.
- Ensure the exclusivity of the signed document. The data that the signer uses to generate the signature are unique and exclusive, and therefore subsequently, the document signature cannot be denied in an eventual process of tax determination of request by DIAN.

The legal basis for the electronic signature in Colombia is specified in law 527 of 1999 and defines it as "numeric value that attaches to a data message and which, using a known mathematical procedure linked to the key to the initiator and to the text message, allows determining that this value has been obtained exclusively with the initiator's key and the initial message has not been modified once the transformation is effected".

With the change from the Digital Certificate to Electronic Signature, now only with the combination of an electronic identity and a single-use password, users can sign their returns, leaving aside the use of magnetic files for validation. From the year 2006 to November 2016, DIAN delivered digital certificate for free to taxpayers, and for the sake

of modernization and facilitation in their formal obligations, DIAN is currently implementing since November 2016 the electronic signature.

Among the most important benefits of the electronic signature are:

- Issues of configuration and compatibility with Java virtual machine and Web browser are removed.
- Saving cost and time in the configuration of the computer equipment.
- The risk of loss of the signature disappear, because the taxpayer won't have to store any type of file, it must only remember his password to sign.
- The costs of shifting to the points of contact are avoided for renewing the mechanism in case of lost password or file damage with extension .epf.
- Facilitates compliance with formal obligations through self-management.
- Service with permanent availability, 7 days a week 24 hours a day

The electronic signature, as the old digital certificate, has a term of 3 years from its activation date, by which, with the purpose of avoiding customers using time and travel to and from the points of contact, the online service allows taxpayers during the month prior to the expiration the renewal of the signature instrument online, procedure which is presented in the graph number 8.

### **3.3 Good practices in service and tax culture through the use of technology**

New technologies have generated new challenges in the way the States deal with their responsibility towards society. These challenges also have become opportunities to build trust and good communication between the citizens and the State, not only on issues associated with the internal management of institutions, but in the solution of problems and the satisfaction of needs and improvement in the citizens' quality of life.

Likewise, these advances in information and communications technologies have transformed and diversified the citizen's way of expression, with more direct and better empowerment. They are the beneficiaries of public policy and decision making, which involve them increasingly and actively in the construction and validation of tax administrations.

The challenge to establish a relationship of communication in two-way was answered here, which in turn, translates into an opportunity to give responsibility for searching, creating and developing mechanisms and channels to strengthen the efficiency, effectiveness and visibility of the tax policy.

From 2010, in Colombia the penetration and use of the internet has been growing unprecedented. During the past four years, it went from 2.2 million internet connections to 8.8 million, i.e., that 96% of the country has fiber optic, today 8 of every 10 Colombians under 55 have access to the internet and 54% of internet users use it every day, an average time of 2.6 hours a day. 96% have profiles on different social networks: 31% have a Twitter account and 98% have a Facebook profile. (Ministry of information technologies and communications, 2015, p. 24)

The company Gigya conducted a study during the period April - June 2014 to know the preferences in the use of social media by citizens around the world; the results for South America and Central America showed that Facebook is the undisputed leader in the preferences with 82%, followed by Google + 11%, and Twitter has 5% of preferences.

This scenario suggests that the tax administrations' participation should go far beyond transactional portals, and web pages, because these are no longer sufficient to interact with the new citizens. Digital citizens move on social networks, create their own information tools, and feed them daily with data and knowledge from new social channels of participation. The challenge is to generate alternatives within social networks that stimulate confidence and boost the citizen's capacity of listening and monitoring, the need to develop new skills, new attitudes and sensibilities. Therefore, the new forms of governance must be oriented to the development of governmental management's actions fitting for today's society.

Social networks benefit to the Citizen and to the tax administration by selecting information according to the profile and particular interest, at the right time in which the events are generated or created needs. Consequently, it will be crucial to enhance and develop the ability of listening what citizens have to say to the tax administration. Listening means to learn to accept criticism, to build trust and respect.

In this sense, the National Tax and Customs Directorate has since 2014 designed and developed a social networking strategy based on four cornerstones: information, guidance, education and service. The latter stands as the base of the strategy to be aimed to develop social networks Facebook and Twitter on the first channel of attention and consultation of citizens-taxpayers, offering value added as attention in real time. This will result in an improvement in the service experience to not having to make trips to the tax administration, form in line or wait a long time to make their inquiry or procedure; at the same time there will be a significant decrease in resources in time and money.

Likewise it brings other benefits to the tax administration, such as increased confidence with citizenship through the positioning and increase in the favorable image of the customer service, strengthening social networks as a reliable, efficient and effective channel, with low-cost operation.

Graphs 9 and 10 show statistics relating to the growth of the Community (Facebook and Twitter) since its creation in 2014 until 2017, growing from 19,990 to 116,554 users and in the case of Twitter from 33, 783 to 64,100.-In addition, the management of messages received through each of the social networks of DIAN: Facebook, Twitter and YouTube, has tripled during the period (graph number 11 of the annex).

By the year 2015, DIAN decides to follow an *Inbound Marketing* strategy, through the combination of several digital marketing actions, such as branded content<sup>3</sup> and presence

---

<sup>3</sup> Consist in generating contents linked to a brand, to connect the Brand to the consumer (De Aguilera et Baños, 2014. P.155)

on the social networks. This strategy would make possible to engage taxpayers in a non-intrusive way and provide value in relation to the tax administration. With the Branded Content, DIAN created a web series called "what is promised is due", which would make possible to connect the tax administration to the citizen.

The tax payment being an issue often unpopular citizens, DIAN Web series format is based on a situation comedy or Sitcom, which tries to convey the message of voluntary taxation in a funny, educational and didactic way, to position the tax contribution and services culture of DIAN in a playful manner, taking advantage of the idiosyncrasies and cultural identity. All chapters are available to the public on the YouTube channel of the National Taxes and Customs Directorate.

In the era of digital citizenship the purpose of DIAN is approaching the Citizen customer in a friendly way, identifying their needs in the field of communication and content. A tax administration which the Citizen can approach with confidence.

#### **4. RECOMMENDATION**

In the light of the results obtained with the use of information and telecommunication technologies in the areas of taxpayer assistance and collection, it is important that tax administrations make a diagnosis of the procedures with greater demand and on that basis, design and implement a strategy of technological, administrative and regulatory rationalization in order to simplify requirements to facilitate the citizen's voluntary compliance with obligations, which will result in an increase in revenues and the taxpayer satisfaction. And at the same time, depending on the segment of taxpayers, reinventing the way of communicating the messages with the requirements of procedures for fulfilment of tax obligations, using recreational resources such as contests and services fairs where the portfolio of formalities is in one single place, available comedies that generate empathy with the taxpayer and which at the same time amuse and inform, guide and educate on duties and requirements.

#### **5. CONCLUSIONS**

- The Tax and Customs Directorate of Colombia has identified the need to transform the relationship administration-taxpayer, considerably improving the dialogue with the citizen-taxpayer and perfecting the service portfolio offered by the institution and from the diagnosis, undertook changes in attention to the taxpayer and customs user.

Two essential aspects are part of this project that has been running:

The use of technological advances in the different assistance devices and  
The development of the Tax Culture



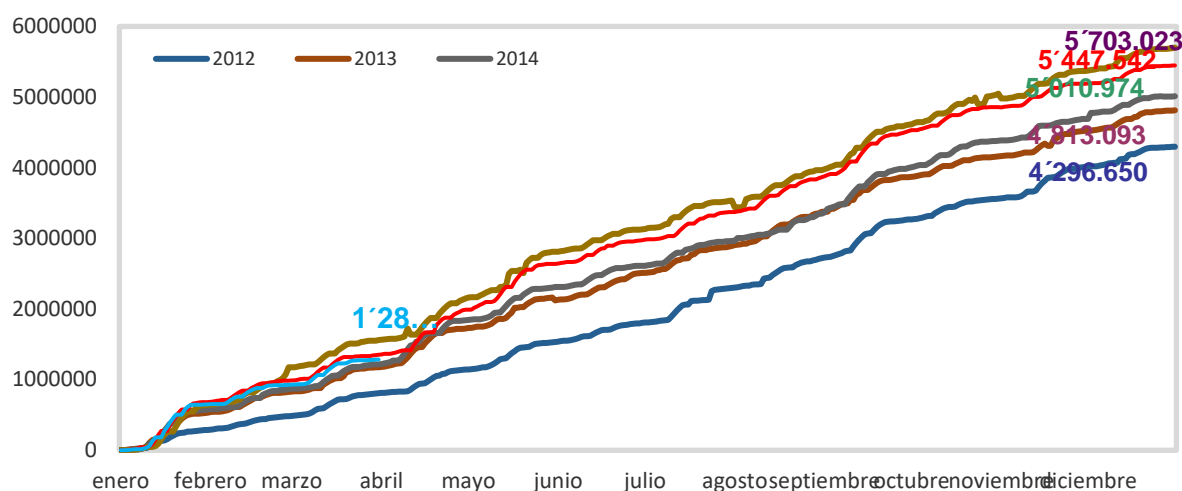
- Assistance strategy to the citizen-taxpayer focuses on facilitating the fulfilment of his/her obligations, expanding information and assistance services and introducing new technology.
- The main objective is to develop a closer, more balanced and trustful relationship with citizens, focused on the tax culture.
- Improvement in the fulfillment of obligations, which is achieved in that the means for an easy fulfillment of the obligations are provided.
- Substantial increase in online procedures. The development of different services using the portal without having to navigate to points of face-to-face attention translates into increased on-line procedures.
- Progressive decrease of number of taxpayers who visit face-to-face attention centers and consequently decongestion the facilities.
- Extension of the number of taxpayers that make use of online services.
- A constant dynamic must be maintained to promote improvements not only from the technological aspect, but which must combine friendly tools and products that generate empathy with the taxpayer, as occurs with the series "what is promised is due", available on You Tube, which uses cultural comedies and novels to insert messages of tax procedures as well as the use of social networks and the tax contribution culture.
- The tools to be developed should consider a simple language, avoid confusing the taxpayer, motivating them to self-help.
- It should use the means available for assessing the perception, valuing, incorporating modern methodologies for measuring the improvement in service.

## **BIBLIOGRAPHY**

- De Aguilera, Joaquin et Baños Miguel, Branded Entertainment: cuando el Branded content se convierte en entretenimiento. ESIC Editorial, 2016
- Dirección de impuestos y Aduanas Nacionales, Subdirección de gestión de Asistencia al Cliente, documento "modelo de Servicio Institucional - 2016
- Dirección de impuestos y Aduanas Nacionales, Subdirección de gestión de Asistencia al Cliente, Informe de Comisión Mixta 2010-2017
- Ministerio de Tecnologías de la Información y las Comunicaciones. Estrategia de Gobierno en línea. 2017
- Ministerio de Tecnologías de la Información y las Comunicaciones. Informe de gestión al Congreso de la República 2015, 2015)

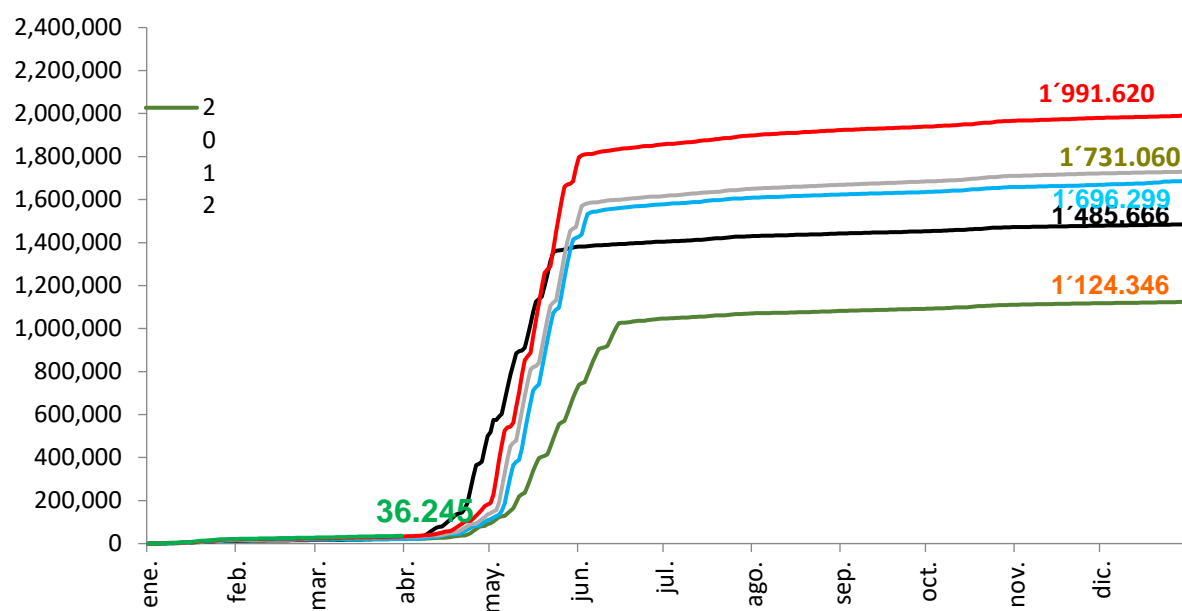
## ANNEXES

**Graph 1 (Tax returns presented online)**



Source: Sub-directorate of Information Technologies and Telecommunications Management 2017

**Graph 2 (requests submission of mass information by sending files)**



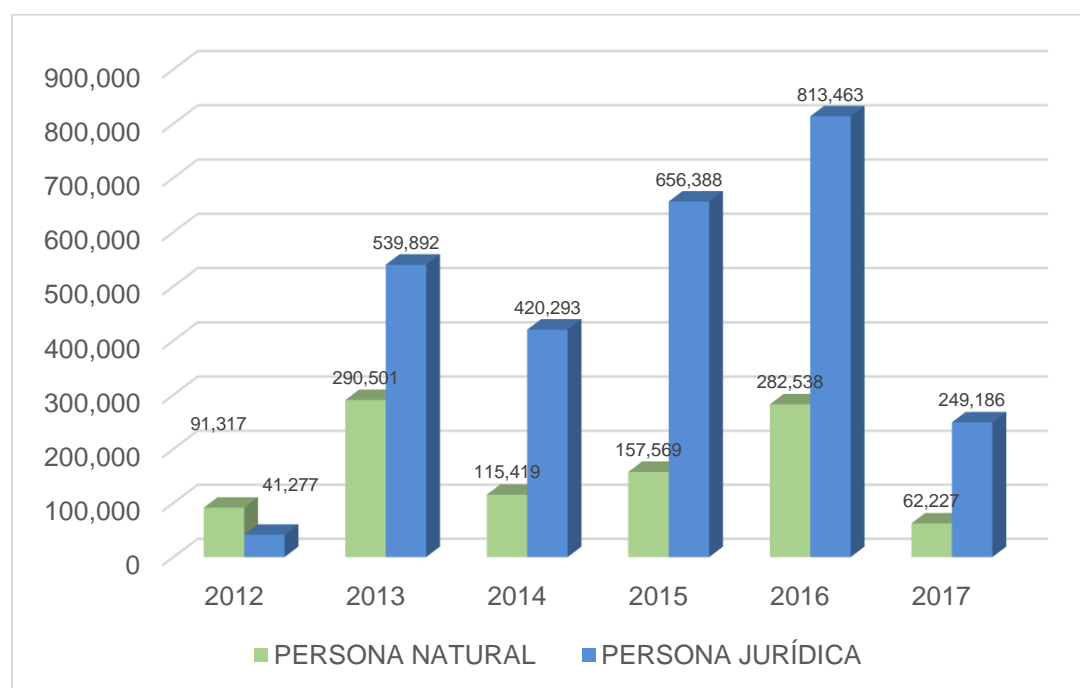
Source: Sub-directorate of Information Technologies and Telecommunications Management 2017

**Graph 3**

INVOICING PROCEDURES YEAR 2012 TO 2016 *			
CONCEPT	TOTAL PROCEDURES	AVERAGE PER YEAR	
AUTHORIZATIONS	723.044	144.608	
ALLOTMENTS	662.135	132.427	

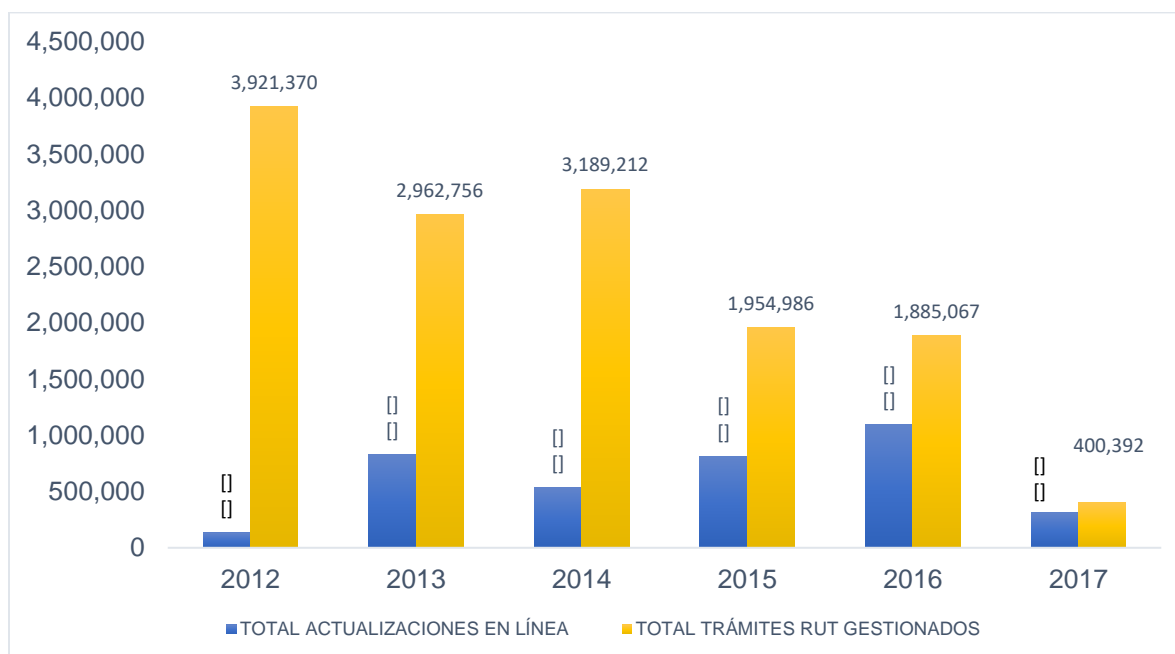
Source: Sub-directorate of Information Technologies Management, Operational Analysis online service 2017

**Chart 4 (updates of TIN online by type of taxpayer)**



Source: Sub-directorate of Information Technology Management date 31 March 2017

**Chart 5 (updates online versus Total procedures TIN )**



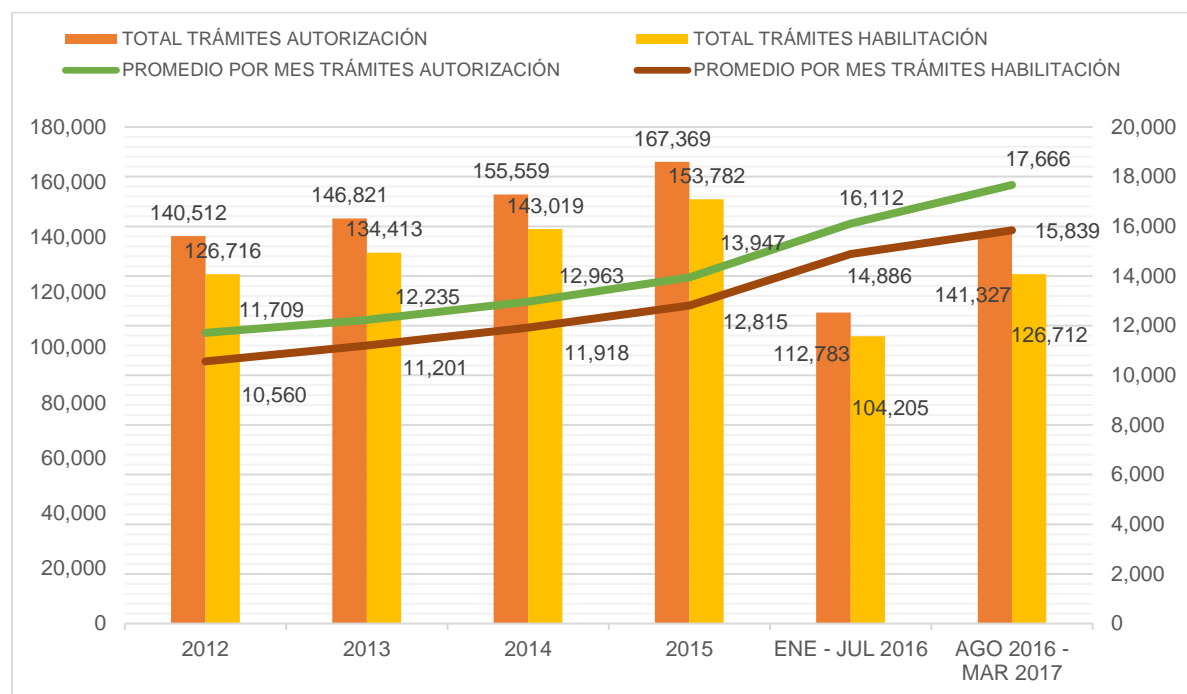
Source: Sub-Directorate of Information Technology Management cut-off date 31 March 2017

**Graph 6 (Invoicing procedures 2012-2016)**

INVOICING PROCEDURES YEAR 2012 TO 2016 *			
CONCEPT	TOTAL PROCEDURES	AVERAGE PER YEAR	
AUTHORIZATIONS	723.044	144.608	
ALLOTMENTS	662.135	132.427	

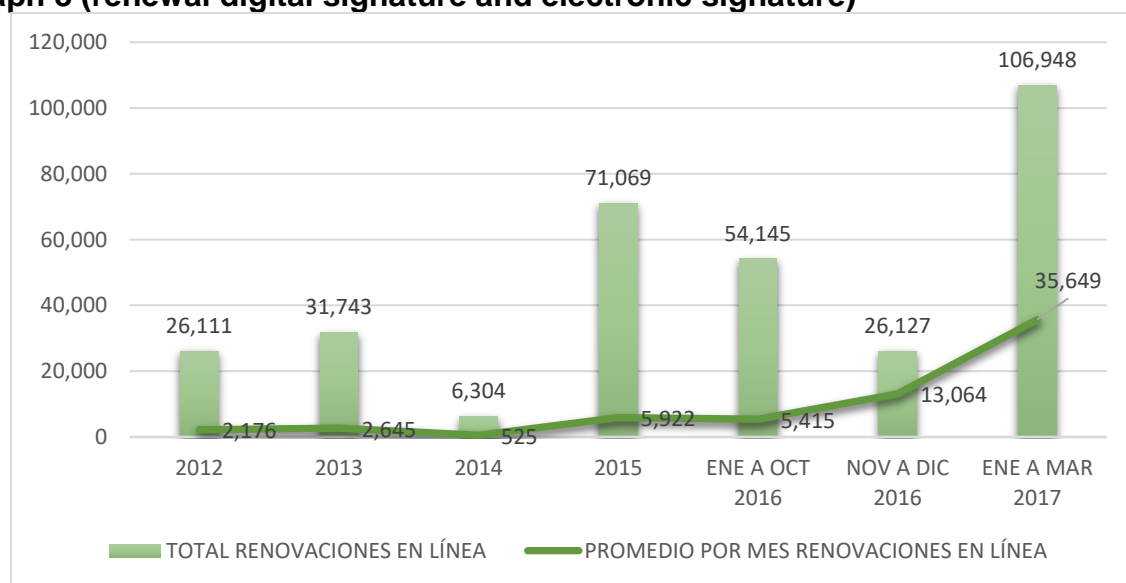
Source: Sub-directorate of Information Technology Management cut-off date 31 March 2017

**Graphic 7 (procedures)**



Source: Sub-Directorate of Information Technology Management, cut-off date on 31 March 2017

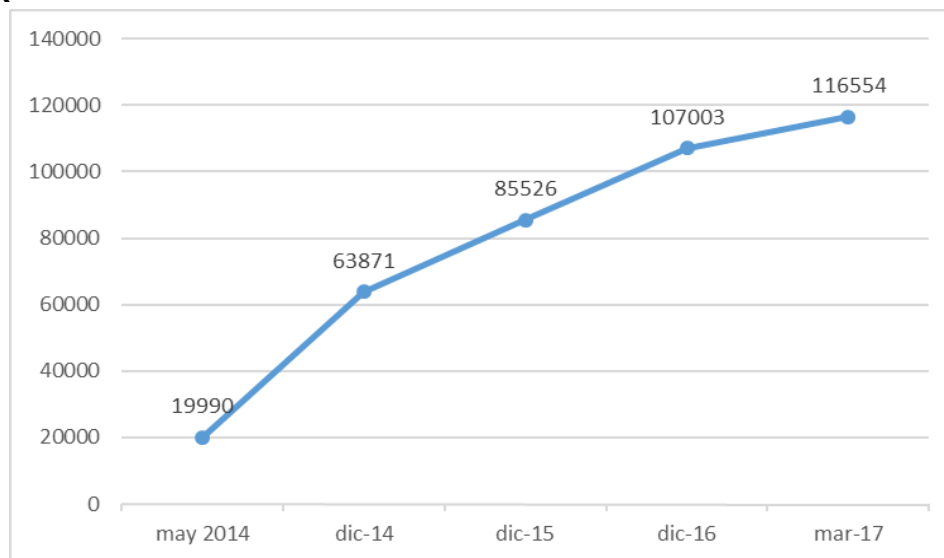
**Graph 8 (renewal digital signature and electronic signature)**



Source: Sub-Directorate of Information Technology Management - Cut-off date 31 March 2017

### Graph 9 (Facebook-social networks)

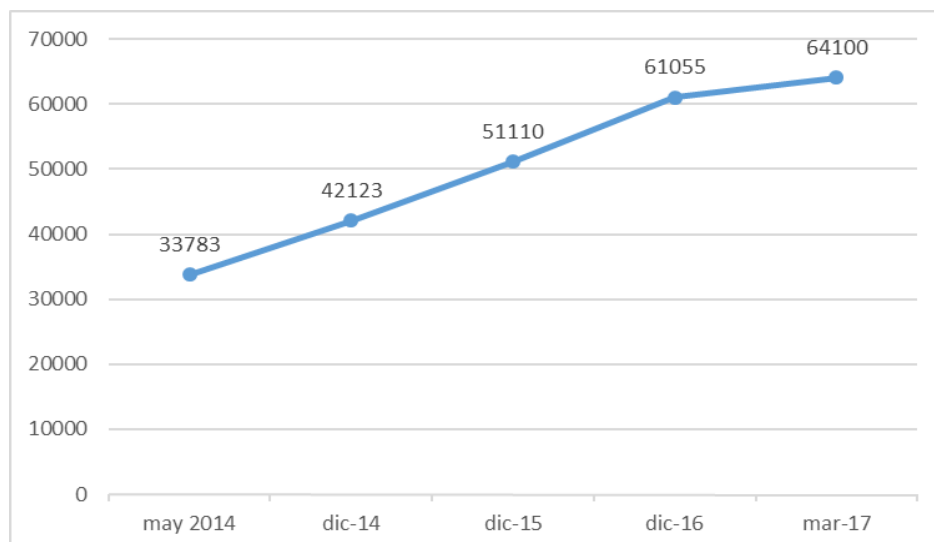
#### Facebook



Source: Coordination of Service Channels Management, Sub-Directorate of Customer Assistance, 2017

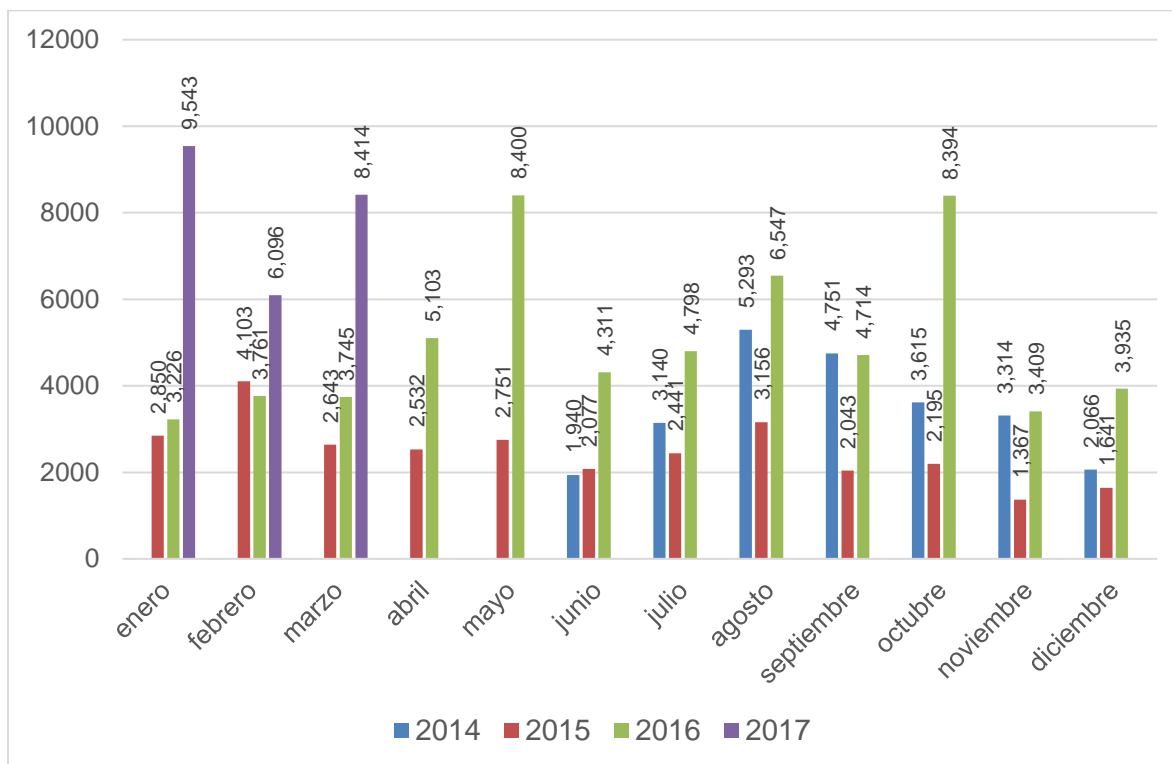
### Graph 10 (social networks - twitter)

#### Twitter



Source: Coordination of Service Channels Management, Sub-Directorate of Customer Assistance, 2017

**Chart 11 (Annual growth of messages)**



Source: Coordination of Service Channels Management, Sub-Directorate of Customer Assistance, 2017

## NEW PARADIGMS IN THE USE OF RISK MODELS

**Theodoro Setzer**

Assistant Deputy Commissioner International  
Internal Revenue Service  
(USA)

**Contents:** Summary. 1. Introduction. 2. Beginning of future state. 3. Governance.  
4. Conclusion

### SUMMARY

The Internal Revenue Service and its Large Business and International Division are responding to challenges through the adoption of new future state models that will improve tax administration in the United States. These models will ensure that the IRS can strategically apply scarce resources to a wide range of issues while still providing better and faster customer service to taxpayers.

On February 8, 2016, the LB&I division re-aligned as a first step in its transition and began adoption of a campaign model. Campaigns are a move towards issue-based compliance work. Thus, LB&I's campaign risk assessment model signifies a shift in its operational and risk models. Through the campaign model LB&I can better adapt to evolving tax risks, identify and address areas of non-compliance, and obtain and integrate feedback to improve compliance efforts. The campaign model allows for the strategic deployment and re-deployment of resources as needed.

This paper lays out the motivation behind this future state model, the guiding principles, the development of LB&I's campaign model, and the tools available to taxpayers and tax administrations to facilitate compliance through this shift. It also addresses the governance structures that will oversee this new approach and identifies some of the key benefits and relevant challenges. While the IRS is still transitioning into this future state model, much important work has been done to ensure a strong foundation has been laid for this work.

### 1. INTRODUCTION

In an ideal world, tax administrations would have sufficient labor and financial resources to audit all non-compliant taxpayers as well as a sophisticated analytical program that would sift through the entire taxpayer population to identify these non-compliant taxpayers. All audits would produce substantial tax adjustments, which would justify all the audit work. Taxpayers would respond to these compliance efforts and over time the instances of non-compliance would go down.

Unfortunately, we do not live in an ideal world. It is often difficult to determine who is a compliant taxpayer and who is a non-compliant taxpayer. Tax administrations have



neither the time nor the resources to audit even a sizable percentage of taxpayers, much less identify who those taxpayers should be. In the United States, most taxpayers are voluntarily compliant; they include all income on their tax returns and pay all the tax they owe.<sup>1</sup> Some taxpayers are inadvertently non-compliant – they did not understand that certain income was taxable or they did not realize that they needed to file an income tax return. Some taxpayers are deliberately non-compliant – they took unsupportable tax positions or they knowingly omitted income from a tax return. Other taxpayers fall somewhere in the middle.

It is not a good use of tax administration resources to audit an already compliant taxpayer. The problem, then, is how to find the non-compliant taxpayer and skip over the compliant taxpayer. In previous years, the IRS continually audited a certain number of taxpayers and hoped the fear of losing the “audit lottery” would motivate the rest of the taxpayers to be compliant. However, relying on taxpayer behavior still does not identify the taxpayer who should be audited.

Most tax administrations are relying on technology more and more often to help them determine which taxpayer they should audit. This technology may be software that matches both sides of a transaction – the payer and the recipient – to ensure that both parties treat the transaction in the same way. The technology also could be in the form of data analytics – sifting through volumes of data to look for patterns or other evidence of non-compliance. It could be a combination of data and resources – examiners identify patterns that suggest non-compliance and technology searches for instances where the pattern appears.

## **2. BEGINNING OF FUTURE STATE**

The world is changing and taxpayer expectations are changing with it. To look at the future in a more comprehensive way, the IRS has begun to implement a Future State vision for its tax administration, and a critical part of that vision is working with the wider tax community. This is an evolving and long-term effort.<sup>2</sup> The IRS Future State initiative is designed to prepare the IRS to adapt to the changing needs of taxpayers.<sup>3</sup>

The IRS is utilizing advances in technology to move the entire taxpayer experience to a new level. This transformation must be done in a way that meets the needs of taxpayers and the tax community in an efficient and effective manner while respecting taxpayer rights. At the same time, taxpayers may still need one-on-one assistance by phone or in-person.<sup>4</sup>

---

<sup>1</sup> The IRS estimates that the voluntary compliance rate is over 81 percent. See *The Tax Gap* at <https://www.irs.gov/uac/the-tax-gap>.

<sup>2</sup> IRS Future State, <https://www.irs.gov/uac/newsroom/irs-future-state>. [hereafter “IRS Future State”]

<sup>3</sup> Future State Initiative, <https://www.irs.gov/uac/newsroom/future-state-initiative>. [hereafter “Future State Initiative”]

<sup>4</sup> IRS Future State, *supra* note 2.

The IRS Future State is built around six strategic themes and a focus area of strengthening cybersecurity and eliminating identity theft. The six themes are:

- Facilitate voluntary compliance by empowering taxpayers with secure innovative tools and support
- Understand non-compliant taxpayer behavior and develop approaches to deter and change it
- Leverage and collaborate with external stakeholders
- Cultivate a well-equipped, diverse, skilled and flexible workforce
- Select highest value work using data analytics and a robust feedback loop
- Drive more agility, efficiency and effectiveness in IRS operations<sup>5</sup>

A central concept of the Future State focuses on taxpayers and how to provide the services they need in the way that works for them. Taxpayers should expect the same level of service when dealing with the IRS in the future as they have now from their financial institution or retailer. A key part of this effort is for taxpayers to have a more complete online experience for their IRS interactions. The idea is that taxpayers would have an account at the IRS where they or those they authorize, can securely log in, get the information about their account, and interact with the IRS as needed. This approach ensures the efficient use of limited IRS in-person resources — such as phone service — to more easily serve people and tax professionals who need one-on-one assistance. This personal assistance remains a critical part of any IRS Future State.

Another goal of improving taxpayer service focuses on improving the enforcement side of the equation. To meet its enforcement goals the IRS needs to be faster and smarter. With a more modern system, the IRS can identify problems in tax returns when a return is filed – instead of contacting a taxpayer months after the fact while the meter is running on potential interest and penalties. The IRS should interact with taxpayers as soon as possible to address issues so that issues can be corrected to ensure compliance while reducing the need for costly follow-up contacts or labor-intensive audits.

This issue identification effort from the outset could also help in other areas as well, such as the ongoing battle over the use of stolen identities to file fraudulent tax returns. The IRS remains focused on providing greater security in the future by pursuing more ways to protect taxpayers. This will ensure that the IRS is interacting with the right person. Improving identity authentication is a major goal going forward. Safeguarding the confidentiality of data received remains an important ongoing issue.

To better serve taxpayers, the IRS needs to align its organizations to help meet the needs of each specific taxpayer group in the most effective and efficient method possible.<sup>6</sup> Business units<sup>7</sup> need to develop projects tied to the larger Future State effort

---

<sup>5</sup> Id.

<sup>6</sup> Future State Initiative, *supra* note 3.

<sup>7</sup> There are four operating divisions to serve specific taxpayer groups plus other units such as Privacy, Government Liaison, and Disclosure; Criminal Investigation; Information Technology; and Return Preparer Office. See [www.irs.gov/uac/todays-irs-organization](http://www.irs.gov/uac/todays-irs-organization).

with a goal of improving taxpayer service, better equipping employees, and achieving compliance outcomes. Different business units may have different ways of addressing the Future State, as the divisions have different taxpayer bases and service needs. For example, the customer base for the Wage and Investment Division is the individual taxpayer who files Form 1040 to report wages and other types of taxable income. It serves more than 125 million customers and accounts for 94 million individual tax returns. The Small Business and Self-Employed Division serves small businesses (those with assets under \$10 million) and the self-employed individual taxpayer. It serves approximately 57 million taxpayers. The customer base for the Tax Exempt and Government Entities division includes not-for-profit organizations, municipalities, universities, and employee plans. Finally, the Large Business and International Division serves corporations, subchapter S corporations, and partnerships with assets of more than \$10 million, as well as individuals with international filing responsibilities. While the taxpayer group may be smaller in number, the tax dollars involved are significant. As part of its discussion of what the Future State means to the different business units, the IRS included a one-page flow chart showing the effect of the future state on each IRS operating division.<sup>8</sup>

To put these efforts at moving towards an IRS Future State in focus, this paper will discuss the work being completed by the Large Business & International Division (LB&I) to re-align its organization and way of doing business to better address these six priorities.<sup>9</sup> Notably, the IRS Future State's taxpayer online service focus may not be of as much concern to the LB&I stakeholder as to other taxpayers, primarily because the taxpayer base of LB&I often uses third-party tax advisers more than online services on the IRS website. Still, the remaining priorities are equally as important for large businesses as for small businesses and individuals.

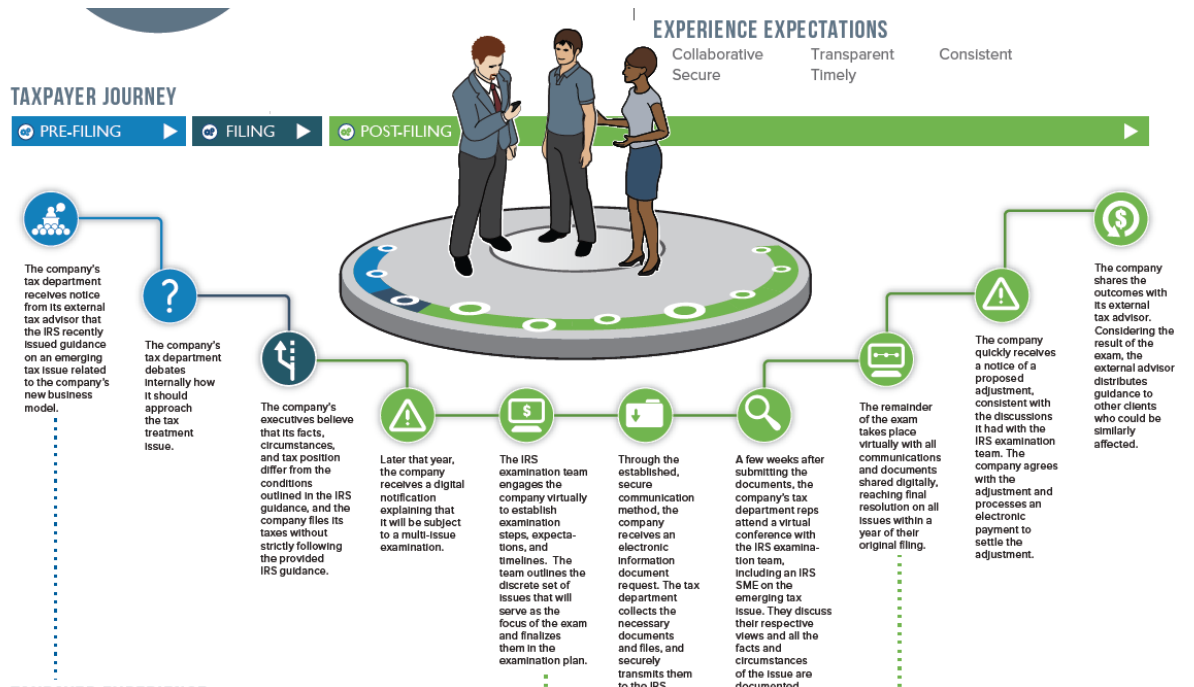
For a large business taxpayer, this Future State graphic<sup>10</sup> depicts the expected taxpayer journey for a fictional large domestic airline company ("Pacific Northwest").

---

<sup>8</sup> For links to options for how the Future State would affect the 4 main operating divisions at the IRS, see <https://www.irs.gov/uac/newsroom/future-state-and-irs-activities>.

<sup>9</sup> A majority of the publicity surrounding the future state affects the Wage and Investment Division, as individual taxpayers filing Form 1040, Individual Income Tax Return, are supervised within this division. For example, see the discussion of the National Taxpayer Advocate in the recent 2016 Annual Report to Congress, available at <https://taxpayeradvocate.irs.gov/reports/2016-annual-report-to-congress/about-the-report>, which included a "Special Focus IRS Future State" section.

<sup>10</sup> Taken from *Large Business Taxpayer Experience of the Future*: <https://www.irs.gov/pub/newsroom/irs-large-business-vignette-version-a.pdf>.



As depicted in the picture, as part of the transition away from an ongoing IRS audit presence, Pacific Northwest receives guidance from the IRS on what to expect regarding future IRS interactions. In this scenario, Pacific Northwest employs one of the large accounting firms to advise the company on its tax liability and has an internal tax department to manage its books. The new Future State process is designed to be collaborative, secure, transparent, timely, consistent, and leverage on experience. Correspondence between the IRs and the taxpayer can occur digitally with little burden for the taxpayer. The IRS has additional taxpayer-facing capabilities than in the past, which include partnership strategy and relations, stakeholder outreach and education, digital content management, privacy and security management, and digital taxpayer account management. As a result of this new approach the taxpayer's journey is transformed. The permanent on-site audit team for Pacific Northwest is a thing of the past.<sup>11</sup>

### A. The large business and international future state

On February 8, 2016, the LB&I division structure was re-organized to support four Guiding Principles: Flexible, Well-Trained Workforce; Selection of Better Work; Tailored Treatments; and an Integrated Feedback Loop. This re-alignment will help LB&I to evolve into an environment where the combined intellect of the LB&I workforce can be brought to bear upon the compliance issues LB&I faces as an organization and help determine where to focus the time and attention of LB&I's employees.<sup>12</sup> Before the

<sup>11</sup> Id.

<sup>12</sup> FY2017 Focus Guide, Document 11809, <https://www.irs.gov/pub/irs-utl/d11809--2017-03-00.pdf>. [hereafter "FY2017 Focus Guide"]

reorganization, LB&I assigned its examiners to organizations that focused on particular industries or types of taxpayers.<sup>13</sup> However, the number of returns filed from 2011 to 2015 increased 20 percent (from 220,543 to 265,218 returns), while the number of examiners decreased 17 percent (from 5,064 to 4,201 examiners) during the same period.<sup>14</sup> This resource-intensive arrangement is difficult to sustain.

LB&I's new approach to compliance will be in the form of "Campaigns," which are intended to articulate observed or perceived noncompliance, describe expectations of compliance and create specific plans to move toward expected compliance.<sup>15</sup> With this movement towards campaigns, LB&I is looking to change taxpayer behavior while also changing how the division selects its work as well as how LB&I applies its resources. Rather than having continuous audits of companies, some of whom are compliant, LB&I will focus on developing an agency-wide approach to risk management and focus on the areas (rather than a specific taxpayer) where non-compliant behavior may be present. Thus, each campaign is a holistic response to an item of known or potential compliance risk. LB&I will use campaigns to identify, prioritize and allocate resources to compliance risks within the LB&I taxpayer filing population. Campaigns are intended to identify more productive returns to audit and lessen the burden on compliant taxpayers by addressing risk through a variety of potential treatment streams.<sup>16</sup> LB&I intends to make every campaign public so long as it does not impair tax administration to do so.

The reorganized LB&I is divided into five Subject Matter Practice Areas, four Geographic Compliance Practice Areas, a Program and Business Solutions function, an Assistant Deputy Commissioner, International, and an Assistant Deputy Commissioner, Compliance Integration. A Practice Area is a group of employees organized together to focus on one or more areas of expertise. In recognition of the need to have everyone trained and able to focus on both domestic and international issues, although perhaps at different levels of expertise, the positions of Deputy Commissioner and Deputy Commissioner International were combined. This is expected to increase skill-sharing. The new structure reflects a single LB&I organization, minimizes disruption to the extent possible, improves synergy and increases skill-sharing by aligning professionals with the same or similar areas of focus, and balances span of control.<sup>17</sup>

## **B. LB&I future state framework: the 4 guiding principles**

As discussed earlier, LB&I was reorganized to support four guiding principles. These guiding principles conform to the goals of the overall IRS Future State.

---

<sup>13</sup> Treasury Inspector General for Tax Administration (TIGTA), *The Large Business and International Division's Strategic Shift to Issue-Focused Examinations Would Benefit From Reliable Information on Compliance Results*, Reference Number 2016-30-089, September 14, 2016, pg. 1, available at <https://www.treasury.gov/tigta/auditreports/2016reports/201630089fr.pdf>. [hereafter "TIGTA, Ref. No. 2016-30-089"]

<sup>14</sup> Id. at 2.

<sup>15</sup> FY2017 Focus Guide.

<sup>16</sup> TIGTA, Ref. No. 2016-30-089, 1, *supra* note 13.

<sup>17</sup> Austin, Rosen, and Ryba, *IRS: Out With Audits, In With Campaigns: LB&I Reorganizes—Again*, Daily Tax Report (BNA), J-1 (March 3, 2016). [hereafter "IRS: Out With Audits"]

## **1. Flexible, Well-trained workforce**

The first guiding principle in the new LB&I Future State is a flexible, well-trained workforce. Employees are expected to be trained in both domestic and international issues to better identify all issues. Such training will be “just in time” and can coincide with campaign issues to ensure an adequately trained workforce for the issues under consideration. This will help LB&I cultivate an environment of continuous learning to support a flexible workforce.<sup>18</sup> Learning is a continual process that comes from ongoing self-development, team learning, knowledge sharing, and mentoring.<sup>19</sup> All employees have the opportunity to receive technical training to support compliance campaigns.

Some of the technical training is provided through the use of “Practice Units.”<sup>20</sup> Practice Units are documents developed through internal collaboration and serve as both job aids and training materials. Each Practice Unit is written with input from the experience and expertise of those who have dealt with the subject matter in practical settings, such as during examinations. Many of these Practice Units have been released to the public on IRS.gov and thus also serve as aids for taxpayers.<sup>21</sup> Practice Units provide IRS staff with explanations of general international tax concepts as well as information about a specific type of transaction and the topics covered will expand in the future. LB&I is launching a Virtual Library bookshelf that will house the Practice Units, including those in draft form and those already available on IRS.gov.<sup>22</sup>

## **2. Selection of better work**

The second guiding principle in the new LB&I Future State is the selection of better work. In recent years many returns were selected for audits based on computer scoring.<sup>23</sup> However, during fiscal years 2006 through 2015, LB&I’s no-change rates for corporations filing Form 1120 were as high as 35% (in 2015), but never lower than 25% (in 2009).<sup>24</sup> Factors contributing to these high no-change rates include growing complexities in return filings, shrinking IRS resources, and inefficient and outdated processes for selecting returns for examinations.<sup>25</sup> LB&I needs to know the issues with the highest compliance risk for the commitment to an issue-focused approach to be

---

<sup>18</sup> TIGTA, Ref. No. 2016-30-089, 15, *supra* note 13.

<sup>19</sup> FY 2017 Focus Guide, *supra* note 12.

<sup>20</sup> There were formerly referred to as “International Practice Units”.

<sup>21</sup> See the list of publically available Practice Units here [www.irs.gov/businesses/corporations/international-practice-units](http://www.irs.gov/businesses/corporations/international-practice-units).

<sup>22</sup> See, for example, [https://www.irs.gov/pub/int\\_practice\\_units/iso\\_c\\_01\\_03.PDF](https://www.irs.gov/pub/int_practice_units/iso_c_01_03.PDF).

<sup>23</sup> TIGTA, Ref. No. 2016-30-089, 13.

<sup>24</sup> *Id.* at 14. No-change rates for partnerships and corporations filing Form 1120S were even higher in all years.

<sup>25</sup> *Id.* The no change rates also may reflect the mandatory audits required by the Joint Committee on Taxation where large refunds are involved.



successful.<sup>26</sup> Campaign development is designed to identify those issues where compliance risks may be greatest, which may result in increased tax receipts.

LB&I will improve the workload selection by using data analytics to uncover anomalies, hidden patterns, correlations and other insights.<sup>27</sup> The use of data analytics provides accuracy, speed, and efficiency. As an example, LB&I may use a data process that stores and manages unstructured data to facilitate sampling for workload classification. This process, and others under development, will facilitate the analytics to develop and support campaigns to help LB&I select better work with intended compliance outcomes. The use of resources to audit compliant taxpayers is an inefficient use of time and personnel unless the experience helps to identify real compliance risks going forward.

LB&I's examination plan will shift to a focus on "new starts," which may be identified through campaigns. LB&I will identify the right issues and develop them using the right resources and will monitor a high level closure plan that measures the division's core work in four return categories: Large Business, International Individual, Global High Wealth, and Foreign Payment Practice.<sup>28</sup> The IRS is moving away from the continuous audit process in the coordinated industry case program and moving toward an approach that will target areas for examination based on compliance risks.<sup>29</sup>

### **3. Tailored treatment streams**

Historically, LB&I has focused most of its technical time and resources (examiners, specialists, and managers) on conducting examinations. In the campaign model, LB&I has moved away from focusing on examinations as the main means of addressing non-compliance to looking at alternative tailored treatment streams. The use of tailored treatment streams improves flexibility to address current and emerging issues and achieve better compliance outcomes. LB&I hopes to improve voluntary compliance with new opportunities such as outreach, soft contacts, and published guidance.<sup>30</sup> The tailored treatments allow LB&I to consider certainty of noncompliance, whether there are variations on the specific issue where there is no risk or the risk is limited, understand the volume and value of the risks and then identify the possible responses. The alternative tailored treatments help LB&I be flexible and approach each particular risk in a specific way that addresses current and emerging issues and achieves better compliance outcomes.<sup>31</sup>

LB&I currently has treatment streams that it will continue to use, including Fast Track, Industry Issue Resolutions, and Pre-Filing Agreements.<sup>32</sup> LB&I will also review the

---

<sup>26</sup> Id. at 5.

<sup>27</sup> FY2017 Focus Guide, *supra* note 12.

<sup>28</sup> Id.

<sup>29</sup> Hoover, Big Business May Get 'Soft' IRS Touch On Compliance, [www.law360.com/articles/793657/big-business-may-get-soft-irs-touch-on-compliance](http://www.law360.com/articles/793657/big-business-may-get-soft-irs-touch-on-compliance).

<sup>30</sup> FY2017 Focus Guide, *supra* note 12.

<sup>31</sup> O'Donnell, Prepared Remarks, TEI-SJSU High Tech Tax Institute (November 7, 2016).

<sup>32</sup> FY2017 Focus Guide, *supra* note 12.

Compliance Assurance Process (CAP) to determine its viability in the future state. Since the CAP program is resource-intensive and focuses on real-time audits of the more compliant taxpayer,<sup>33</sup> the program may need to be discontinued.<sup>34</sup> Using FATCA data to enhance compliance of United States taxpayers with financial investments abroad will expand as the IRS receives more reports from foreign financial institutions. Using an integrated set of tailored treatment streams will improve flexibility to address current and emerging issues and achieve compliance outcomes.

LB&I has also changed its procedures for the taxpayers that will be examined, the details of which are outlined in revised Publication 5125, Large Business & International Examination Process,<sup>35</sup> and incorporated in the Internal Revenue Manual.<sup>36</sup> An examination will have three distinct phases: a planning phase, an execution phase, and a resolution phase.<sup>37</sup>

#### **4. Integrated feedback loop**

LB&I's processes are evolving, as the organization is now continually evaluating campaign ideas from the work force and will continually assess and adapt as necessary its work processes over the coming months and years. This process involves incorporating components of LB&I's historical risk assessment process along with lessons learned as the campaign-based approach expands. The continual collection and analysis of data and feedback will enhance LB&I's ability to focus, plan and execute work and promote innovation and feedback-based improvement. LB&I engages its employees through an internal "Getting It Right Together" webpage, where employees provide feedback on existing and planned work. LB&I also uses two-way communication, town halls, and other methods to increase feedback.<sup>38</sup> LB&I wants to ensure that its employees have the opportunity to share and connect with others working similar issues. LB&I will engage in active dialogue and fact sharing when dealing with taxpayers in audits and will seek ongoing issue discussions that will include acknowledgement of the facts to ensure accurate tax determinations. LB&I wants to ensure that all of its employees feel comfortable identifying risks and proactively managing risks to mitigate impact within the LB&I organization.

---

<sup>33</sup> TIGTA, *The Compliance Assurance Process Has Received Favorable Feedback, but Additional Analysis of Its Costs and Benefits Is Needed*, Reference Number: 2013-30-21 (February 22, 2013), available at <https://www.treasury.gov/tigta/auditreports/2013reports/201330021fr.pdf>.

<sup>34</sup> General Accountability Office, *HIGH-RISK SERIES, Progress on Many High-Risk Areas, While Substantial Efforts Needed on Others*, 17-317 (February 15, 2017), 505, available at <http://www.gao.gov/products/GAO-17-317>.

<sup>35</sup> Large Business & International Examination Process, <https://www.irs.gov/pub/irs-pdf/p5125.pdf>.

<sup>36</sup> Internal Revenue Manual 4.46, LB&I Examination Process, available at [https://www.irs.gov/irm/part4/irm\\_04-046-001.html](https://www.irs.gov/irm/part4/irm_04-046-001.html).

<sup>37</sup> These 3 phases are very similar to the "Pre-Filing, Filing, and Post-Filing" Taxpayer Journey outlined by the IRS in the division discussion of the Future State. See <https://www.irs.gov/uac/newsroom/future-state-and-irs-activities>.

<sup>38</sup> FY2017 Focus Guide.



## **C. Campaign model**

LB&I's processes are evolving and it is now continually evaluating campaign ideas from the workforce. LB&I will assess and adapt, as necessary, our work processes over the coming months and years to reflect the new campaign model. During this time, LB&I will continue to incorporate components of historical risk assessment processes along with lessons learned as it expands the campaign work. The restructuring of LB&I to support the shift to the use of the four guiding principles will provide flexibility for the most efficient and effective use of our resources in addressing compliance risk. This section describes many of the factors motivating this decision.

### **1. Limited resources, unlimited challenges**

The IRS has a finite set of resources with which to address the growing number of challenges impacting tax administration. The overall IRS budget has decreased since 2011, which has led to a decrease in employees. Simultaneously the number of returns the IRS is processing has increased and there are 10 million more taxpayers since 2010.<sup>39</sup> Budget cuts have forced divisions such as LB&I to reassess how it conducts its business and what measures to take to ensure that efficiency and effectiveness of tax administration does not suffer.

LB&I's campaign-based approach is an effort to focus resource application on particular issues of strategic importance through specific coordinated plans. In articulating campaign requirements LB&I has to consider how it is using its limited resources and prioritize between different issue areas. This effort will move the organization to a more "issue-focused" approach for allocating examination resources.

The campaign model will also assist LB&I in redeploying its resources against different campaigns over time as substantial noncompliance in one risk area is addressed and campaigns end. The resources previously applied to that campaign can be shifted to focus on other areas of risk that develop or require further attention. Ensuring this agility of resource distribution will not be easy and LB&I intends to adjust processes, share information, and collaborate to achieve the goal of creating a system that can apply its limited resources against its unlimited challenges.

### **2. Fairness**

In utilizing a campaign model, LB&I ensures an approach that protects the tax base for the public and also treats individual taxpayers fairly. By identifying a particular issue as a campaign, LB&I is not suggesting that every instance of that issue reported by a taxpayer is de facto non-compliant; LB&I is instead signaling that a particular issue area is in need of additional attention in a thoughtful and coordinated way. Each campaign will have a range of "treatment streams" that outline the potential techniques and tools available to address the underlying issues of non-compliance. Treatment streams might

---

<sup>39</sup> Tax Analysts Exclusive: Conversations: Koskinen Looks to Future of Tax Administration, IRS Budget, December 14, 2016.

include options such as examinations, soft letters, form changes, education, and communication outreach, etc. Some of these treatment streams will be less resource intensive. For example, soft letters are an opportunity for taxpayers to self-correct while clarifications or other changes to tax forms may make compliance easier by making the forms easier to fill out. The variety of approaches will ensure LB&I can protect the tax base of the public but will also help it treat taxpayers fairly across all spectrums. The campaign approach focuses on addressing the particular issues of highest significance through campaigns rather than focusing solely on taxpayers based on some other criteria such as size or location.

Feedback loops will be used to monitor when the goal of fairness is met. As part of the campaign model, LB&I will continue to seek out and integrate internal and external feedback into each campaign as appropriate. With this approach the tax system protects public resources while also approaching taxpayers consistently based on their risk-profile.

### **3. Identify and treat noncompliance**

In attempting to identify current and new areas of noncompliance, LB&I continues to rely upon its greatest resource, its own employees. Every LB&I employee is encouraged to submit compliance issues for evaluation to determine whether LB&I should expend further resources to develop a particular issue into a campaign. An online portal allows employees to share their ideas for consideration. Leadership throughout the LB&I organization vets the subjects and coordinates with the relevant geographic and subject matter experts to work through the task of determining which risks presented require some of LB&I's limited resources. These ideas and input from employees is critical because it helps LB&I to leverage the vast knowledge of its own workforce in order to identify where resources are best spent to maximize the compliance impact on its taxpayer population.

Thus, LB&I plans to use the combined input of its workforce and data analysis to identify areas of noncompliance and strategically focus resources to these areas. Overall, Campaigns are intended to achieve the following objectives:

- Identify specific areas of potential noncompliance,
- Identify intended compliance outcomes,
- Identify specific, tailored treatment streams to achieve those outcomes,
- Identify the resources needed to execute these tailored treatment streams,
- Identify training, guidance, mentors, and other support needed, and
- Effectively use feedback from employees to quickly modify the approach as needed.<sup>40</sup>

As such, each campaign is the culmination of an extensive effort to redefine large business compliance work and build a supportive infrastructure inside LB&I. The

---

<sup>40</sup> IRS: Out With Audits, supra note 17.

campaign development process requires strategic planning and deployment of resources, training and tools, metrics and feedback. LB&I is investing the time and resources necessary to build well-run and well-planned compliance campaigns in an effort to improve overall efficiency.<sup>41</sup>

On January 31, 2017, LB&I announced thirteen campaigns as part of its initial rollout. The launch of these campaigns was a significant milestone for LB&I's transition to its Future State model. These campaigns were identified through extensive data analysis, suggestions from IRS compliance employees and feedback from the tax community. They were elevated from initial ideas and went through a rigorous review and evaluation process.

These campaigns support LB&I's efforts to improve return selection, identify issues representing a risk of non-compliance, and make the greatest use of limited resources.<sup>42</sup> However, they do not reflect the top priorities but are the first group that was completed for release. The thirteen campaigns<sup>43</sup> cover a broad number of tax areas within LB&I's purview and focus on the following topics:

- Internal Revenue Code 48C Energy Credits
- Offshore Voluntary Disclosure Program Declines/Withdrawals
- Domestic Production Activities Deduction, Multi-Channel Video Program Distributors (MVPD's) and TV Broadcasters
- Micro-Captive Insurance
- Related Party Transactions
- Deferred Variable Annuity Reserves & Life Insurance Reserves IIR
- Basket Transactions
- Land Developers – Completed Contract Method
- TEFRA Linkage Plan Strategy
- S-Corporations Losses Claimed in Excess of Basis
- Repatriation
- Form 1120-F Non-Filer
- Inbound Distributors

As the list reflects, campaigns will cover a range of large business and international issues. As part of the campaign effort, LB&I leaders are engaging with the tax community to assist with work on these areas to best meet the needs of the taxpayers as well as tax administration. In response to the interest of taxpayers, practitioners, and the press, LB&I is collaborating with stakeholders to share information related to campaigns and better educate the public.<sup>44</sup> A series of webinars are being held to provide insight to the cultural changes taking place in LB&I because of the movement to

---

<sup>41</sup> Large Business and International Launches Compliance Campaigns, <https://www.irs.gov/businesses/large-business-and-international-launches-compliance-campaigns>.

<sup>42</sup> Id.

<sup>43</sup> LB&I has provided a brief description of each campaign topic and identified the part of the organization it will be overseen by and the lead executive on its website. Id.

<sup>44</sup> Compliance Campaign Webinars, <https://www.irs.gov/businesses/compliance-campaign-webinars>.

a campaign model as well as to engage stakeholders with consistent messaging.<sup>45</sup> Partners in these webinars include legal, executive, and accounting associations as well as large accounting firms. The first and second 75-minute webinars focused on the campaign process, how campaigns are being implemented and how they will impact taxpayers and was conducted by the Assistant Deputy Commissioner, Compliance Integration (ADCCI) and Director of the Enterprise Activities Practice Area. Additional webinars will detail each of the thirteen compliance campaigns launched. All these upcoming webinars will be open to the public and free of charge.

LB&I's move toward issue-based examinations and a campaign process allows the division to decide which tax issues that present risk require a response while maintaining flexibility on the best steps to achieve compliance.<sup>46</sup> They mark a significant change in the way LB&I will be conducting tax administration but also the beginning of an ongoing relationship with taxpayer.

#### **D. Tools available to taxpayers and tax administrations to facilitate compliance**

Tax administrations want to maximize voluntary taxpayer compliance and need to identify appropriate non-compliant taxpayers as quickly and as easily as possible to help them focus their resources on the appropriate taxpayer groups. This work is facilitated by increasing analysis of data received, by taking steps to identify possible non-compliant taxpayer behavior, and by making it as easy as possible to comply with tax laws.

##### **1. Appropriate analysis of data**

As the increased automatic exchange of different types of information begins, jurisdictions will receive more and more data. The biggest challenge then becomes what to do with the data. There must be an appropriate way to analyze the data, so that the raw data moves to information which then becomes intelligence. Data analysis helps with matching information from third party reports with taxpayer information and identifies areas of risk where follow-up with the taxpayer is required. Data analysis of Country by Country reporting information, for example, is designed to help with top level risk analysis and deselect compliant taxpayers and select non-compliant taxpayers for further action. The information technology infrastructure of many countries continues to develop to both receive and appropriately analyze data. As more and more data is received automatically, it also becomes more important to appropriately safeguard the receipt and use of the data and prevent both the inappropriate disclosure and the misuse of the data.

LB&I established a "Compliance Planning and Analytics" workgroup with four subgroups: Research, Planning and Workload, Filtering, and International Individual

---

<sup>45</sup> Id.

<sup>46</sup> Large Business and International Launches Compliance Campaigns, <https://www.irs.gov/businesses/large-business-and-international-launches-compliance-campaigns>.

Compliance (IIC) Planning and Workload Delivery. LB&I also has a group of “Computer Audit Specialists” who analyze computerized data for audits.<sup>47</sup> The IRS has a Research, Applied Analytics, and Statistics (RAAS) group, which serves as a research function for data analysis.<sup>48</sup> The IRS has a number of data analytics systems for tax purposes, such as identifying refund fraud and identity theft.<sup>49</sup> The IRS has had simple data matching programs, such as the TIN matching program for third party reports, for a number of years.<sup>50</sup>

These various data analysis programs help the IRS identify areas of possible risk and underreporting, which enables it to focus its resources on non-compliant taxpayers.

## **2. Bilateral APAs**

Certainty about the tax treatment of a tax transaction before the taxpayer engages in the transaction is beneficial. It supports accurate financial reporting and allows for appropriate planning. One area in which the IRS has worked for over 25 years is transfer pricing. The IRS introduced the Advance Pricing Agreement (APA) program in 1991.<sup>51</sup> In the APA program, the taxpayer and the IRS work together to agree on an appropriate transfer pricing method for a determined number of years in the future. If the taxpayer files its tax return consistent with the transfer pricing method agreed on, the IRS agrees not to make any transfer pricing adjustments for the transactions covered in the APA.<sup>52</sup> The APA process increases the efficiency of tax administration by encouraging taxpayers to come forward and present all the facts necessary for a proper evaluation of their covered transactions and to work towards a resolution of these issues in a spirit of openness and cooperation. The APA process lessens the burden of compliance by giving taxpayers greater certainty regarding their covered issues and promotes the principled resolution of these issues by allowing for their discussion and resolution in advance before the consequences of such resolution are fully known to either taxpayers or the IRS.<sup>53</sup>

---

<sup>47</sup> See <https://www.irs.gov/businesses/specialists>.

<sup>48</sup> The Offices of Research and of Statistics of Income are part of the RAAS group. For a list of all offices within RAAS, see page 71 of the 2016 IRS Data Book, available at <https://www.irs.gov/pub/irs-soi/16databk.pdf>.

<sup>49</sup> See, for example, <http://www.forbes.com/sites/metabrown/2016/01/28/analytics-and-the-irs-a-new-way-to-find-cheaters/#65ac04075b8b>.

<sup>50</sup> On-Line Taxpayer Identification Number (TIN) Matching Program, Publication 2108A, <https://www.irs.gov/pub/irs-pdf/p2108a.pdf>. There are very specific provisions about privacy. See, e.g., Internal Revenue Manual 11.3.39 Computer Matching and Privacy Protection Action, [https://www.irs.gov/irm/part11/irm\\_11-003-039.html](https://www.irs.gov/irm/part11/irm_11-003-039.html).

<sup>51</sup> Rev. Proc. 91-22, 1991-11 I.R.B. 1.

<sup>52</sup> Rev. Proc. 2006-9, 2006-2 I.R.B. 278, available at [http://www.irs.gov/irb/2013-50\\_IRB/ar12.html](http://www.irs.gov/irb/2013-50_IRB/ar12.html). The scope of the APA program has expanded over the years and now includes the resolution of transfer pricing issues as well as other issues arising in income tax treaties or the Code or Regulations where transfer pricing may be relevant, including the determination of income effectively connected with a trade or business within the United States. Rev. Proc. 2008-31, 2008-23 I.R.B. 1133, Sec. 3, available at [http://www.irs.gov/irb/2008-23\\_irb/ar07.html](http://www.irs.gov/irb/2008-23_irb/ar07.html).

<sup>53</sup> Notice 2013-79, 2013-50 I.R.B. 653, available at [http://www.irs.gov/irb/2013-50\\_IRB/ar12.html](http://www.irs.gov/irb/2013-50_IRB/ar12.html).

There are three types of APA: a unilateral APA is an agreement between the IRS and the taxpayer only; a bilateral agreement is between the IRS and a foreign jurisdiction; a multilateral agreement includes an agreement between the IRS and more than one foreign jurisdiction. In a unilateral APA, the transfer pricing method that the taxpayer must use in preparing its federal income tax return is agreed on. However, this does not settle the transfer pricing method in a foreign country where the taxpayer operates. As a result, the taxpayer often wants a bilateral APA.<sup>54</sup> If the United States has a tax treaty with a foreign country that contains a mutual agreement procedure (MAP) provision similar to Article 25 in the OECD Model Convention, the IRS and the foreign jurisdiction can work together to sign a bilateral APA that provides agreement on the taxpayer's transfer pricing method for both countries. By the end of 2016, taxpayers had executed a total of 1,597 new, renewed, or revised APAs. Over 64 percent of these agreements (1,023) were bilateral.<sup>55</sup>

While bilateral APAs are generally preferable to unilateral APAs because they provide taxpayers with certainty in both countries and eliminate the need to audit the transaction for a certain period of time, it is possible to achieve a similar goal with a unilateral APA. In October 2016, the Internal Revenue Service announced that U.S. taxpayers with maquiladora operations in Mexico will not be exposed to double taxation if they enter into a unilateral advance pricing agreement (APA) with the Large Taxpayer Division of Mexico's Servicio de Administración Tributaria (SAT) under terms discussed in advance between the U.S. and Mexican competent authorities.<sup>56</sup> Because the transfer pricing framework adopted under SAT's program was discussed and agreed upon with the U.S. competent authority in advance, the transfer pricing results set forth in unilateral APAs executed between SAT and Mexican affiliates of U.S. taxpayers pursuant to this program will be regarded as "arm's length" under section 482 of the Internal Revenue Code.<sup>57</sup>

### 3. Forms and publications

There are several reasons for the development/revision of forms. Three of the most prevalent reasons are: statutory or regulatory requirements; risk management; and taxpayer assistance. Taxpayers are more compliant if they can easily access the forms they need to file and if they can understand how to complete the form. Risk assessment is easier when riskier behaviors are identified earlier.

**Statutory requirements:** Congress passes tax laws that often increase or improve reporting requirements. As a result, the IRS must develop the forms necessary to gather

---

<sup>54</sup> Id. at Sec. 2.08.

<sup>55</sup> Announcement 2017-03, *APMA Statutory Report 2016*, Table 2, 2017-15 IRB 1077 (April 10, 2017), available at <https://www.irs.gov/pub/irs-irbs/irb17-15.pdf>.

<sup>56</sup> IRS Announces Position on Unilateral APA Applications Involving Maquiladoras, <https://www.irs.gov/uac/newsroom/irs-announces-position-on-unilateral-apa-applications-involving-maquiladoras>.

<sup>57</sup> Id.

the information required by the statute. A recent example of a form being developed to comply with statutory requirements is credit card payment reporting.

**Credit card payment reporting:** Overall taxpayer compliance rates increase substantially when there is third party reporting.<sup>58</sup> In 2008, Congress added a provision to the Internal Revenue Code<sup>59</sup> requiring banks and credit card companies to report payments.<sup>60</sup> Form 1099-K, Merchant Card and Third Party Network Payments, was developed in response to this Congressional mandate. Correct matching of third-party information and taxpayer information provided on Form 1099-K (by the third party) or on the income tax return (by the taxpayer) reduces the risk of underreporting income and facilitates compliance.

**Regulatory requirements:** The Department of Treasury and the IRS often issue regulations to administer a tax law or other fiscal requirement. One example is the regulations that require annual country-by-country reporting issued in June 2016 to respond to BEPS Action 13.<sup>61</sup> As a result of the reporting regulations, the IRS has developed and issued draft versions of Form 8975, Country-By-Country Report; Form 8975 (Schedule A), Tax Jurisdiction and Constituent Entity Information; and the Instructions to Form 8975 to receive required information.<sup>62</sup>

**Risk management:** In addition to developing forms to respond to statutory mandates by Congress, the IRS also develops forms that focus on identified compliance risks. For example, Schedule UTP (Form 1120), Uncertain Tax Position Statement, was issued for the first time for the 2010 tax year. Schedule UTP asks for information about tax positions that affect the U.S. federal income tax liabilities of certain corporations that issue or are included in audited financial statements and have assets that equal or exceed \$10 million. When FIN 48 was initially announced in 2006, the IRS stated that it would use the FIN 48 disclosure as a roadmap to detect audit issues.<sup>63</sup> However, the IRS introduced Schedule UTP in 2010 to get more, better-detailed information about a company's UTPs. Specifically, Schedule UTP requires the reporting company to list all UTPs individually (rather than in an aggregate disclosure, as previously done). UTPs are defined by FIN 48's guidelines, but they also include tax positions that do not have a tax reserve because the company expects to litigate the position. At the time Schedule UTP was introduced, then-IRS Commissioner Douglas Shulman stated that two of the

---

<sup>58</sup> IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study, <https://www.irs.gov/uac/irs-releases-new-tax-gap-estimates-compliance-rates-remain-statistically-unchanged-from-previous-study>. For example, the compliance rate for reporting wages and salaries is 99%; the compliance rate where there is little or no third party reporting is less than 60%.

<sup>59</sup> IRC § 6050W.

<sup>60</sup> Pub. Law N. 110-289, section 3091, Returns Relating to Payments Made in Settlement of Payment Card and Third Party Network Transactions, available at <https://www.congress.gov/110/plaws/publ289/PLAW-110publ289.htm>.

<sup>61</sup> 26 CFR Part 1, TD 9773, Country-by-Country Reporting, <https://www.gpo.gov/fdsys/pkg/FR-2016-06-30/pdf/2016-15482.pdf>.

<sup>62</sup> These draft forms and instructions are available at <https://apps.irs.gov/app/picklist/list/draftTaxForms.html>.

<sup>63</sup> FIN 48 Implications - LB&I Field Examiners' Guide, available at <https://www.irs.gov/businesses/corporations/fin-48-implications-lb-i-field-examiners-guide>.



goals for Schedule UTP are to “cut down the time it takes to find issues and complete an audit” and to “help us prioritize taxpayers for examination.”<sup>64</sup> It is clear that the purpose of Schedule UTP is to be an additional audit tool for the IRS.<sup>65</sup>

**Taxpayer assistance:** In addition to developing forms to comply with statutory requirements or facilitate compliance or improve risk assessment, the IRS also revises forms and instructions to assist taxpayers to file their tax returns accurately. Recommendations for form improvements come from many sources, including taxpayers themselves, IRS employees, and outside groups. For example, the Taxpayer Advocacy Panel (TAP) is a diverse group of citizen volunteers who listen to taxpayers, identify taxpayers’ issues, and make suggestions for improving IRS service and customer satisfaction.<sup>66</sup>

The Information Reporting Program Advisory Committee (IRPAC) was established in 1991. The primary purpose of the IRPAC is to provide a public forum for the IRS and members of the information reporting community in the private sector to discuss relevant information reporting issues. IRPAC issues a report every year. The report includes recommendations about changes to regulations and other non-form guidance as well as recommendations about changes to forms and instructions to improve taxpayer compliance.<sup>67</sup>

#### 4. Base erosion and profit shifting work

While taxation is at the core of a country’s independent sovereignty, the interaction between the laws and regulations of various jurisdictions may create gaps and even friction. The G20 finance ministers asked the OECD to develop an action plan that would aim to address such issues in a coordinated and comprehensive manner. The OECD published the *Action Plan on Base Erosion and Profit Shifting*<sup>68</sup> in July 2013 and provided a timeline for the work. The plan was organized around three pillars: 1) introducing coherence in the domestic rules that affect cross-border activities; 2) reinforcing substance requirements in the existing international standards, to ensure alignment of taxation with the location of economic activity and value creation; and 3)

---

<sup>64</sup> Prepared Remarks of IRS Commissioner Doug Shulman to the American Bar Association, <https://www.irs.gov/uac/prepared-remarks-of-irs-commissioner-doug-shulman-to-the-american-bar-association>.

<sup>65</sup> Robert Lee, *Reactions to Schedule UTP*, Strategic Finance Magazine, January 1, 2017, <http://sfmagazine.com/post-entry/january-2017-reactions-to-schedule-utp/>.

<sup>66</sup> Taxpayer Advocacy Panel, <https://www.improveirs.org/our-work/>. The panel is demographically and geographically diverse, with at least one member from each state, the District of Columbia, and Puerto Rico. It also serves as a focus group that makes recommendations to the IRS and the National Taxpayer Advocate. TAP members conduct outreach to solicit suggestions or ideas from citizens, and serve on project committees working with IRS program owners on topics important to taxpayers and the IRS.

<sup>67</sup> For example, in the 2016 report IRPAC recommended regulatory changes as well as form improvements. See, e.g., 2016 Information Reporting Program Advisory Committee (IRPAC) Public Report, <https://www.irs.gov/tax-professionals/2016-irpac-public-report>.

<sup>68</sup> OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, available at <https://www.oecd.org/ctp/BEPSActionPlan.pdf> [hereafter “2013 Action Plan”].



improving transparency, as well as certainty for businesses and governments.<sup>69</sup> The 2013 Action Plan outlined 15 actions to address international tax avoidance. At its core the 2013 Action Plan identified where “the interaction of different tax rules leads to double non-taxation or less than single taxation.”<sup>70</sup> The final BEPS package was presented to the G20 Finance Ministers in October 2015 for approval.<sup>71</sup> At the G20 meeting held in Shanghai in February 2016, the leaders endorsed the inclusive framework proposed by the OECD for the global implementation of the BEPS project and encouraged all relevant and interested non-G20 countries and jurisdictions that commit to implement the BEPS project, including developing countries, to join in the framework on an equal footing.<sup>72</sup>

As tax administrations work to implement the 15 actions identified in the BEPS project they will rely on mechanisms to encourage transparency through unilateral and multilateral relationships to reinforce innovative approaches to addressing today’s ongoing challenges. Minimum standards were agreed in particular to tackle issues in cases where no action by some countries would have created negative spill overs (including adverse impacts of competitiveness) on other countries. All OECD and G20 countries have committed to consistent implementation in the areas of fighting harmful tax practices (Action 5), preventing treaty shopping (Action 6), Country-by-Country Reporting (Action 13), and improving dispute resolution (Action 14).<sup>73</sup> Members of the inclusive framework will develop a monitoring process for the four minimum standards that will ensure that all members, as well as jurisdictions of relevance, will comply with the standards in order to ensure a level playing field.<sup>74</sup>

#### **a. BEPS Action 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance**

The OECD identified the availability of harmful preferential regimes as a key pressure area relating to base erosion and profit shifting in the 2013 report *Addressing Base Erosion and Profit Shifting*.<sup>75</sup> BEPS Action 5 identified two priority areas relating to harmful tax practices: (1) requiring substantial activity for any preferential regime and (2) improving transparency.<sup>76</sup> The second priority on improving transparency includes the

---

<sup>69</sup> OECD presents outputs of OECD/G20 BEPS Project for discussion at G20 Finance Ministers meeting, available at <http://www.oecd.org/tax/oecd-presents-outputs-of-oecd-g20-beps-project-for-discussion-at-g20-finance-ministers-meeting.htm> [hereafter BEPS discussion at G-20].

<sup>70</sup> 2013 Action Plan, *supra* note 69, at 10.

<sup>71</sup> BEPS discussion at G-20, *supra* note 70.

<sup>72</sup> G20 Finance Ministers and Central Bank Governors Meeting Communiqué, February 27, 2016 <http://www.g20.utoronto.ca/2016/160227-finance-en.html>.

<sup>73</sup> OECD, BEPS – Frequently Asked Questions, Top 10 FAQs about BEPS, <http://www.oecd.org/tax/beps/beps-frequentlyaskedquestions.htm>.

<sup>74</sup> OECD, About BEPS and the inclusive framework, <http://www.oecd.org/tax/beps/beps-about.htm>.

<sup>75</sup> OECD (2013), *Addressing Base Erosion and Profit Shifting*, <http://www.oecd.org/tax/addressing-base-erosion-and-profit-shifting-9789264192744-en.htm>.

<sup>76</sup> OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – Final Report*, OECD/G20 Base Erosion and Profits Shifting Project, OECD Publishing, Paris, 23, <http://dx.doi.org/10.1787/9789264241190-en>. [hereafter “Action 5 Report”]

compulsory spontaneous exchange of information on certain rulings.<sup>77</sup> The Action 5 Report sets out the agreed framework for the transparency framework. This includes six categories of taxpayer-specific rulings which in the absence of compulsory spontaneous exchange of information could give rise to BEPS concerns. One of these six categories is unilateral advance pricing agreements (APAs) or other cross-border unilateral rulings in respect of transfer pricing.

The Action 5 report acknowledges that “there is no suggestion that a unilateral advance pricing arrangements (APAs) program is by itself a preferential regime.”<sup>78</sup> However, exchanging rulings increases transparency and facilitates making fully informed decisions.<sup>79</sup> A lack of transparency can lead to BEPS if jurisdictions have no knowledge or information on the tax treatment of a taxpayer in a specific country and that tax treatment affects the transactions or arrangements undertaken with a related taxpayer resident in their country.<sup>80</sup> The IRS is providing unilateral APAs to foreign jurisdictions in accordance with the provisions of BEPS Action 5 and is receiving rulings from other jurisdictions.<sup>81</sup>

On 1 February 2017, the OECD released the Terms of Reference and Methodology for peer reviews on the Action 5 standard for the exchange of information on tax, which will be conducted by the Forum on Harmful Tax Practices (FHTP) with all members participating on an equal footing.<sup>82</sup> The Action 5 Report mandated that an annual review of jurisdictions’ compliance with the transparency framework would be undertaken, starting at the beginning of 2017. The first review will take place in 2017.<sup>83</sup>

#### **b. BEPS Action 13: transfer pricing documentation and country-by-country reporting**

Many countries have established transfer pricing documentation rules to establish the appropriate valuation of cross-border transactions between associated enterprises for tax purposes.<sup>84</sup> Governments have responded to the increased volume and complexity of intra-group trade through greater scrutiny of transfer pricing activities, resulting in

---

<sup>77</sup> Id. at 45.

<sup>78</sup> Id. In 2004 the Forum on Harmful Tax Practices (FHTP) considered both the Netherlands Advance Pricing Agreement/Advance Tax Ruling Practice and the Belgium Advance Tax Rulings Practice and concluded that these regimes are not considered by the FHTP to constitute harmful tax practices. See *Project on Harmful Tax Practices: The 2004 Progress Report*, available at <http://www.oecd.org/ctp/harmful/30901115.pdf>.

<sup>79</sup> Id.

<sup>80</sup> OECD (2017), *BEPS Action 5 on Harmful Tax Practices: Transparency Framework Peer Review Documents*, OECD/G20 Base Erosion and Profits Shifting Project, OECD Publishing, Paris, <http://www.oecd.org/tax/beps/beps-action-5-harmful-tax-practices-peer-review-transparency-framework.pdf>. [hereafter “Transparency Framework Peer Review Documents”]

<sup>81</sup> Gregory, *APA: IRS to Exchange Summaries of Unilateral APAs Abroad*, 210 DTR G-6 (October 31, 2016).

<sup>83</sup> Id.

<sup>84</sup> See <http://www.oecd.org/ctp/transfer-pricing/transfer-pricing-guidelines.htm>.

significant taxpayer compliance costs.<sup>85</sup> Yet, tax administrations often find transfer pricing documentation to be less than fully informative and not adequate for their tax enforcement and risk assessment needs.<sup>86</sup> To resolve some of these issues, Action 13 is the effort to re-examine the existing transfer pricing documentation and establish a system of reporting a multinational enterprise's (MNE) group allocation of income, taxes, and business activities on a tax jurisdiction-by-jurisdiction basis.<sup>87</sup>

Country-by-Country Reports (CbCR) will be filed annually and will include for each tax jurisdiction in which the MNEs do business, the amount of revenue, profit before income tax, income tax paid and accrued, number of employees, stated capital, retained earnings, and tangible assets in each jurisdiction.<sup>88</sup> The CbCRs are to be filed in the jurisdiction of tax residence of the ultimate parent entity and will be shared between jurisdictions through automatic exchange of information, pursuant to appropriate exchange of information agreements.<sup>89</sup> The IRS has developed Form 8975, Country by Country Report, and Schedule A (Form 8975), Tax Jurisdiction and Constituent Entity Information, to capture the appropriate information from U.S. parent MNEs.<sup>90</sup>

The new Country-by-Country Reporting requirements are to be implemented for fiscal years beginning on or after January 1, 2016, and apply to MNEs with annual consolidated group revenue equal to or exceeding EUR 750 million (approximately US\$ 821 million).<sup>91</sup> The FTA has developed implementation guidelines for the exchange of CbC reporting and the first round of reporting and self-assessment begins in 2017.<sup>92</sup>

The U.S. Treasury Department and the IRS believe that the information received from other jurisdiction on CbCRs will assist in better enforcement of U.S. tax laws by providing greater transparency regarding the operations and tax positions of taxpayers. A platform for sharing this information, such as IDES or the Common Transmission System, will be used to safely transmit encrypted information to an intended recipient.

---

<sup>85</sup> Action 13: 2015 Final Report, *Transfer Pricing Documentation and Country-by-Country Reporting*, 11 available at <http://www.oecd.org/tax/transfer-pricing-documentation-and-country-by-country-reporting-action-13-2015-final-report-9789264241480-en.htm>. [hereafter "Action 13: 2015 Final Report"]

<sup>86</sup> Id.

<sup>87</sup> Id. at 9.

<sup>88</sup> Id.

<sup>89</sup> Id. at 10.

<sup>90</sup> Draft Form 8975, "Country-by-Country Report" and Draft Schedule A to Form 8975, "Tax Jurisdiction and Constituent Entity Information" are available at <https://www.irs.gov/pub/irs-dft/f8975--dft.pdf> and <https://www.irs.gov/pub/irs-dft/f8975sa--dft.pdf>. These are early release drafts and are not for filing.

<sup>91</sup> The U.S. threshold is \$850 million. Countries participating in BEPS will review the implementation of the new standard and reassess no later than 2020 whether modification are needed to the information reported. Action 13: 2015 Final Report, supra note 86 at 10.

<sup>92</sup> OECD (2016), *Guidance on the Implementation of Country-by-Country Reporting – BEPS Action 13*, available at <http://www.oecd.org/tax/beps/guidance-on-the-implementation-of-country-by-country-reporting-beps-action-13.pdf>.

CbCRs will be a helpful new tool for high-level transfer pricing risk assessment purposes and efforts to improve transparency. They may also be used by tax administrations in evaluating other BEPS-related risks and, where appropriate, for economic and statistical analysis. Countries have agreed that the information in the CbCR should not be used as a substitute for a detailed transfer pricing analysis of individual transactions and prices based on a functional analysis and a full comparability analysis. The information in the CbCR does not constitute conclusive evidence on its own that transfer pricing is or is not appropriate; as a result, the information in a Country-by-Country Report should not be used by tax administrations to propose transfer pricing adjustments based on a global formulary apportionment of income.<sup>93</sup>

To ensure that the CbCR information is used appropriately, the OECD developed Terms of Reference and a methodology for the peer review process for participating jurisdictions.<sup>94</sup> The Peer Review process is a three-phase process that begins in 2017. Each phase focuses on a different key aspect of the jurisdiction's implementation of CbCR.

### **c. BEPS Action 14: making dispute resolution mechanisms more effective**

Competent Authorities are facing increased pressure as governments increasingly scrutinize cross-border transactional flows to assure a strong revenue base in times of fiscal constraint. The information exchanged in accordance with Actions 5 and 13, as well as information exchanged under the general treaty provisions, may provide jurisdictions with more information to make risk assessments. Nevertheless, Competent Authorities are expected to ensure that tax and international principles are properly applied to minimize incidents of double taxation, unintended double non-taxation and taxation otherwise not in accordance with applicable tax conventions.<sup>95</sup> To do so, they must often work together to identify and address areas of disagreement. Collaboration in a multilateral setting is an effort for countries to come together to get to the right answer in their problem-solving work. The Mutual Agreement Procedure (MAP) is one mechanism for resolving such issues around double taxation by having Competent Authorities meet to discuss areas of concern and arrive at a solution.

By working together to improve and expand upon existing programs for resolving tax issues effectively and efficiently countries can improve tax transparency.<sup>96</sup> In part this is because each Competent Authority's ability to realize success is closely dependent on the efforts of other Competent Authorities.<sup>97</sup>

---

<sup>93</sup> Action 13: 2015 Final Report, *supra* note 86 at 16.

<sup>94</sup> OECD (2017), *BEPS Action 13 on Country-by-Country Reporting – Peer Review documents*, available at <http://www.oecd.org/tax/beps/beps-action-13-on-country-by-country-reporting-peer-review-documents.pdf>.

<sup>95</sup> See FTA MAP Strategic Plan, OECD, at 1 available at <http://www.oecd.org/tax/forum-on-tax-administration/map-strategic-plan.pdf>.

<sup>96</sup> *Id.*

<sup>97</sup> *Id.*

Action 14 includes measures aimed at strengthening the effectiveness and efficiency of the MAP process. The aim of Action 14 is to minimize the risks of uncertainty and unintended double taxation by ensuring the consistent and proper implementation of tax treaties, including the effective and timely resolution of disputes regarding their interpretation or application through the MAP process.<sup>98</sup> Countries agreed to improve how they approach dispute resolution, including the adoption of a minimum standard with respect to the resolution of treaty-related disputes, committing to its rapid implementation, and agreed to ensure its effective implementation.

The implementation of the minimum standard will be evaluated through a peer monitoring mechanism to ensure that the commitments embodied in the minimum standard are effectively satisfied, and that all jurisdictions that commit to the minimum standard will undergo reviews pursuant to that monitoring mechanism. By participating in this evaluation process, multilateral engagement will offer a tool for bringing transparency to the dispute resolution process and provide a means for identifying areas of improvement. The OECD issued the minimum standards and peer review documents<sup>99</sup> and the first round of peer reviews has begun.<sup>100</sup>

The minimum standard includes specific measures that countries will take to ensure that they resolve treaty-related disputes in a timely, effective, and efficient manner. The elements of the minimum standard relate to the following three general objectives: 1) Countries should ensure that treaty obligations related to the mutual agreement procedure are fully implemented in good faith and that MAP cases are resolved in a timely manner; 2) Countries should ensure that administrative processes promote the prevention and timely resolution of treaty-related disputes; and 3) Countries should ensure that taxpayers that meet the requirements of paragraph 1 of Article 25 of the OECD Model Tax Convention can access the mutual agreement procedure.

### 3. GOVERNANCE

Any new initiative requires governance oversight to ensure appropriate adjustments are made and to correct misdirections as soon as possible. Governance plays a critical role in the development of the campaign model, to ensure that the model is developed appropriately and that there is ongoing oversight to incorporate feedback once it has been implemented.

---

<sup>98</sup> Action 14: 2015 Final Report, *Making Dispute Resolution Mechanisms More Effective*, available at <http://www.oecd.org/ctp/making-dispute-resolution-mechanisms-more-effective-action-14-2015-final-report-9789264241633-en.htm>, 9.

<sup>99</sup> OECD (2016), *BEPS Action 14 on More Effective Dispute Resolution Mechanisms – Peer Review Documents*, available at <http://www.oecd.org/tax/beps/beps-action-14-on-more-effective-dispute-resolution-peer-review-documents.pdf>.

<sup>100</sup> The review schedule is available at on the OECD website, <http://www.oecd.org/tax/beps/beps-action-14-peer-review-assessment-schedule.pdf>.

LB&I is developing a governance structure for the campaign process to ensure that the issues that were thought to present risk do actually present risk, as well as to determine whether LB&I should adjust its approach to any noncompliance. Such adjustments may occur through the contracting, expanding or recalibrating of the relevant data queries to try and identify risk. A governance structure also provides oversight over the adequacy of on-the-job training and reference materials as well as whether the treatment streams require further refinement. It will allow for each campaign to accommodate feedback and adjust contemporaneously.

The campaign development process ensures that proposed campaign ideas are reviewed at various levels of the organization for technical and strategic purposes. Potential campaign ideas are elevated to the office of Assistant Deputy Commissioner, Compliance Integration (ADCCI). The ADCCI reports to the LB&I Deputy Commissioner and oversees the Compliance Integration Council (CIC). The CIC reviews full campaign proposals and ensures that logistical and operational considerations are agreed upon by LB&I's senior leadership before a campaign idea is approved. The CIC works to align the discussions around campaign resources, tools, and strategy.

As part of the campaign development process an LB&I executive is designated as the official executive lead. After a campaign is finalized this point of contact is listed on the LB&I website in an effort to transparently provide taxpayers with information about the relevant leadership for each campaign.<sup>101</sup> Taxpayers can provide their feedback to the tax examiners they are interacting with, but they also have the name of an executive to contact to share feedback or elevate issues.

Each campaign has the possibility of treatment streams that range from examinations to alternative options such as soft letters, tax form changes or guidance. As a result it may take many months to know whether each campaign is functioning as intended or whether adjustments are required to achieve compliance objectives. It remains possible that a compliance risk may exist with no non-compliance; LB&I may determine that taxpayers are compliant in areas it anticipated as being non-complaint. Part of the feedback loops requires remaining aware of this possibility and providing feedback immediately if stated objectives are not being met or if the risk turns out to be significant with widespread non-compliance. The governance structure of the campaign model will ensure the campaign adjusts to accommodate that feedback to ensure results are achieved or resources are reallocated where no longer needed.

LB&I's decision to have governance structures in place from campaign proposal to implementation to eventual wind down of the campaign is a reflection of the need for oversight and monitoring to achieve effective results. This supports the concept of the agile model.

---

<sup>101</sup> Large Business and International Launches Compliance Campaigns, <https://www.irs.gov/businesses/large-business-and-international-launches-compliance-campaigns>.



## **I. Benefits and Relevant Challenges**

As LB&I implements its Future State vision it is faced with a series of benefits and challenges to consider. These include the benefits to tax administrators and taxpayers of tax certainty and the possibility to deselect taxpayers who do not represent high-risk profiles in an effort to utilize resources efficiently. In contrast, LB&I faces the challenge of restructuring how it approaches workload and focusing on those taxpayers that are most in need.

### **A. Tax Certainty**

In July 2016, Angel Gurría, the Secretary-General of the OECD, noted that tax policymakers are facing the challenge of designing tax policies to enhance tax certainty.<sup>102</sup> When identifying some of the sources of tax uncertainty and addressing those specific issues, he noted that the causes of uncertainty are varied and can arise at any time from the drafting of tax policy to tax administration and enforcement. While Gurría was focusing on tax policy, his concerns can be extended to tax enforcement and administration of the rules. For example, Gurría noted that “complexity, lack of clarity, inconsistency and frequency of changes have all been cited as ways in which tax policy can affect both existing and future investments.”<sup>103</sup> These issues also impact the effectiveness of tax administration.

As part of its BEPS work the OECD acknowledged that tax certainty must also factor into the new environment. BEPS Action 14, which calls for effective dispute resolution mechanisms to resolve tax treaty-related disputes, recognizes that the actions to counter BEPS must be complemented with actions that work to ensure certainty and predictability for business.<sup>104</sup> In October of 2016, the OECD received a strong endorsement from both G20 Leaders and Finance Ministers to further work on solutions to support certainty in the tax system with the aim to promote investment, trade, and balanced growth.<sup>105</sup>

LB&I has been cognizant of the unique opportunity that tax administrators have in trying to promote tax certainty, both for tax administrators and taxpayers alike.

---

<sup>102</sup> Angel Gurría, G20 Chengdu High-Level Tax Symposium – remarks at session 2: Increasing tax certainty to promote investment and trade in a world where value creation is changing. <https://www.oecd.org/g20/topics/taxation/g20-chengdu-high-level-tax-symposium-remarks-at-session-2-increasing-tax-certainty.htm>.

<sup>103</sup> Id.

<sup>104</sup> Id.

<sup>105</sup> OECD launches business survey on tax certainty to support G20 tax agenda, <http://www.oecd.org/ctp/tax-policy/oecd-launches-business-survey-on-tax-certainty-to-support-g20-tax-agenda.htm>.

## **B. Deselection and other forms of coordination**

LB&I's campaign model will narrow the focus of resources to specific areas of non-compliance, increasing the possibility of both non-selection and deselection of a taxpayer who lacks those non-compliant factors. When incorporating the guiding principle "Selection of Better Work" into its risk model, LB&I is also considering how to gather better information from its taxpayers so it can accurately risk assess and focus its efforts and resources on high-risk taxpayers.<sup>106</sup> With additional transparency from taxpayers through new data sources such as Country-by-Country Reports and improvements to data analytics, LB&I can better analyze and understand its taxpayer base. Combining this additional information with the campaign model that focuses on issues of significant non-compliance, LB&I can deselect some taxpayers that do not require that level of attention because they represent limited risk. Thus, in developing its risk model LB&I believes it is important to determine if there are ways to deselect certain taxpayers so as to avoid deploying resources where it is unnecessary. The process of deselecting requires transparency on both ends, but can be a key factor in obtaining tax certainty.

Similarly, efforts are underway for tax administrations and taxpayers to explore possibilities to work collaboratively to undertake a risk assessment and select or deselect issues. With transparency between the taxpayer and the tax administration new opportunities for coordination across tax administrations are available to address and resolve non-compliance. As other jurisdictions also adapt their approach to risk as a result of the new information available from the BEPS Action items, jurisdictions can work together to utilize the data to better understand taxpayers and their risk profiles. Of course, this is premised on tax administrations having a common fundamental understanding of international issues so that tax administrations are equipped to collaboratively confront today's challenges. The need for a globally aware staff extends to countries with all levels of capacity. Countries can all benefit from having their employees aware of fundamental international tax issues and having a strong foundation in global awareness as they approach their tax administration duties.<sup>107</sup>

There are practical challenges to deselection and multilateral engagement that LB&I and potential partner jurisdictions will need to work through. For example, there could be timing issues related to when information becomes available compared with when examination cycles begin or the deselection process can take place. LB&I will also need to determine what type of data is needed and how it can be analyzed to decide whether to deselect a taxpayer's position on particular issues. This may be a resource-intensive exercise up front as LB&I transitions to the campaign model and will need to be refined over time as data sources and systems change and evolve.

---

<sup>106</sup> IRSAC, 2016 IRSAC Large Business and International Report, <https://www.irs.gov/tax-professionals/2016-irsac-lbi-report>.

<sup>107</sup> See [https://www.irs.gov/pub/irs-utl/Global\\_Awareness\\_Training\\_for\\_IETs.pdf](https://www.irs.gov/pub/irs-utl/Global_Awareness_Training_for_IETs.pdf) for the "Global Awareness Training for International Tax Examiners" a training module on critical fundamental global concepts.



### **C. Restructured work**

Foundational changes do not happen overnight or without some effort. The movement to the Future State and its campaign model requires a cultural shift for LB&I employees. The challenge of implementing this model is that it is premised on changes to how employees approach and analyze taxpayers and thus how they approach their work. This includes the need to be adaptable in both skillset and subject matter expertise to match the areas of actual non-compliance. The success of the campaign model is dependent on LB&I ensuring its employees make these fundamental shifts.

To assist in this work, LB&I is developing training tailored to the focus of each of the campaigns. This training will help to train or retrain employees in new areas as needed. At the same time, some components of LB&I work will remain the same. For example, LB&I must continue to uphold taxpayer rights as listed in the taxpayer bill of rights.<sup>108</sup> The taxpayer bill of rights outlines the key principles that taxpayers can expect in their engagement with the IRS. Thus, even as LB&I redefines and restructures its work it will need to do so with sensitivity to the expectations and rights of its taxpayer population.

### **D. Focus on taxpayers who need help**

Not all taxpayers are able to achieve compliance automatically; rules can be difficult to navigate and with growing complexities to the environment, engagement with taxpayers may be needed to move them from non-compliant to compliant behavior. By having a better sense of the risk profiles of taxpayers, LB&I can pinpoint specific issues requiring resources and attention as a guideline to change taxpayer behavior. Deselection and refocusing the relationship between LB&I and taxpayers can help us focus our limited resources on those who need assistance the most in the ways that are most likely to positively impact them.

As each campaign moves beyond enforcement through examinations only, treatment streams will offer alternative approaches to addressing non-compliance. For example, soft letters could educate taxpayers and assist them in resolving noncompliance issues without the need for a full examination. Furthermore, LB&I's effort to seek out and address the needs of taxpayers to help them move towards compliance falls in line with the IRS future state goal of improving taxpayer services.

## **4. CONCLUSION**

LB&I's movement to the future state as part of the IRS's Future State vision is changing the way tax administration is conducted in the United States. The division is harnessing the combined intellect of the LB&I team to make intentional decisions about compliance risks we will respond to, how we will respond and how we will know success. These new efforts rely on a change to risk assessment by relying on data analytics to better address areas of significant non-compliance, incorporating internal and external

---

<sup>108</sup> Taxpayer Advocate Services, Taxpayer Bill of Rights, <https://taxpayeradvocate.irs.gov/taxpayer-rights>.

feedback to obtain effective results and modify the approach as needed, and will open up new challenges and benefits for LB&I's work. It will help LB&I overcome the fact that it is not operating in an ideal world and will move LB&I closer to ensuring that taxpayers are paying the correct amount of tax and have greater certainty in their tax positions and that limited LB&I resources are appropriately focused on non-compliant taxpayers.

## **NEW PARADIGMS IN THE USE OF RISK MODELS: BEST PRACTICES TO STRENGTHEN TAX INTELLIGENCE**

**Fernando Barraza Luengo**

Director  
Internal Revenue Service  
(Chile)

**Contents:** 1. Introduction. 2. Management model of tax compliance in Chile. 3. Relevant aspects of implementation and technical installation. 4. Preliminary results. 5. Change management. 6. Ongoing challenges.

### **1. INTRODUCTION**

The Internal Revenue Service had historically managed tax compliance relying mainly on the traditional model of transactions control, which focuses on the analysis of the returns and subsequent detection of those presenting non-compliance elements, which leads to mostly corrective actions, such as audits, even if the reasons for non-compliance may have different causes or origins. In short, it was a risk analysis which aimed to select cases to be audited or reviewed once a tax breach had occurred.

As of the year 2014 we began to include the principles of the management model based on risks as cornerstones of the operation, which seek to manage the tax system in a holistic manner with the aim of increasing the levels of compliance with tax obligations, through the strengthening of the taxpayer's analysis and the causes that explain the breaches. This combines the application of structural preventive and corrective actions, which allows a wide range of treatment activities prior to carrying out audits.

The implementation of this approach was driven by Act N ° 20.780 of 2014 ("tax reform that modifies the income taxation and introduces different adjustments in the tax system"), which allowed carrying out various projects for the enhancement and institutional modernization of this service and other tax administration areas, in order to generate tools to facilitate tax compliance, promote the protection of taxpayers, and ensure that institutions have the resources and tools needed to control the fulfillment of tax obligations. Later, and with the same goal of facilitating tax compliance, Act N ° 20.899 of 2016 (which "Simplifies the system of income taxation and perfect other tax laws") was added, in order to simplify the tax system and, therefore, facilitate more voluntary compliance.

Given the above considerations, and considering the various reports associated with compliance based on risk management<sup>1</sup>, the tax compliance management model being used in Chile is based on the concept of non-compliance as a multi-factorial phenomenon where the taxpayer's behavior is influenced by the industry in which the business or activity operates, and by economic, sociological, as well as psychological determining factors, which vary depending on the territory, sector or respective segment. This multi-factorial differentiation, in the case of Chile, was also considered necessary due to cultural and geographical differences which certainly affects factors of compliance and non-compliance varying along the 4,300 kilometers of our country.

Therefore, this model promotes an improved knowledge of the taxpayer and their environment, with the objective of designing and implementing processes and procedures to identify individual causes that explain the form and intensity of breach and correlated with the taxpayer's risk level.

In order to implement this model, implicit tax behavior of these multiple factors have been considered in the strategic management process and strategic objectives have been defined for ensuring tax compliance.

The following describes how the model was implemented in its different stages, their practice, some operational results and the change management that has been needed, such as the incorporation of the model activities in the workload from various officials, which is one of the main challenges.

## **2. MANAGEMENT MODEL OF TAX COMPLIANCE IN CHILE**

This management model based on risks, as mentioned above, is a process that has as a main focus the analysis of taxpayers' behaviors, from the activities carried out, the levels of tax compliance and the causes that explain the tax breaches, all in order to generate actions for improving the compliance in the most efficient manner.

However, the analysis of transactions continues to be a key aspect of tax compliance, thus combining these results with those obtained from the analysis of the taxpayers' general behavior results in different indexes, such as a global or personal taxpayer's risk indicator and a specific or transactional, and by combining both we may develop treatment programs that consider different types of structural preventive and/or corrective tax compliance actions.

---

<sup>1</sup>See: *Managing and Improving Tax Compliance* (Guidance Note: <http://www.oecd.org/tax/administration/33818656.pdf>), Information Note: <http://www.oecd.org/tax/administration/42490764.pdf>), *Compliance Risk Management Guide for Tax Administrations*([http://ec.europa.eu/taxation\\_customs/sites/taxation/files/resources/documents/common/publications/info\\_docs/taxation/risk\\_managt\\_guide\\_en.pdf](http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/common/publications/info_docs/taxation/risk_managt_guide_en.pdf))

From this quick look into the behavior of the taxpayer and the characteristics of transactions carried out, analytical tools have been designed, and are presented as follows.

## **2.1. Stages of compliance risk management process**

The process is a cycle consisting of 5 stages, where the result of the last stage allows providing feedback to the process and thereby improve the actions to follow in the next cycle. These stages are described below.

- ***Stage 1: IDENTIFYING.***

This stage corresponds to the identification of the non-compliance risks, for which it is necessary to previously identify the tax obligations (legal or administrative), the relevant taxpayer segments and the occurrences of tax breaches.

The tax liability corresponds to the link established by law between the Treasury and the taxpayer and determines the duty to comply with certain requirements or performing certain actions. These obligations can be classified in four dimensions<sup>2</sup>:

- Registry (linked to register the taxpayer and identifying the life cycle),
- Information (related to the correct and timely delivery of personal or third parties information)
- Return (submission of the tax returns forms)
- Payment (Completion of the payment and/or withholdings of taxes)

The knowledge of the taxpayers, in particular their attitude toward the compliance with the tax obligations, allows establishing treatment strategies that are most effective for improving their specific levels of compliance and their environment. This is because an evasive or avoidance behavior left untreated can spread to other taxpayers or generate unfair competition with respect to those who want to comply.

As a result of this integral analysis of the taxpayer and its behavior, it is possible to identify groups that are of interest to the tax administration, either by economic activity or the type of tax that they pays, or their type of behavior, which allows determining the common characteristics, the factors affecting the levels of compliance and finally, the relevant measures of treatment or mitigation.

---

<sup>2</sup> To adapt this classification to the organizational culture of the SII, the definition given in the aforementioned paper was adjusted.

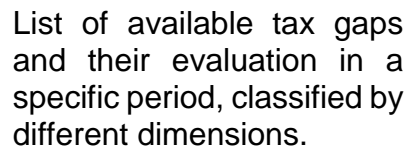
Given these different provisions and requirements to comply with tax obligations that taxpayers have, it is possible to identify the tax breaches corresponding to the difference between the level of compliance observed or detected with the expected level of compliance. In the same way, it is possible to estimate the risk of non-compliance as a combination between the probability that the breach occurs and the possible consequences if the breach take place.

### **Implementation methodology of the SII**

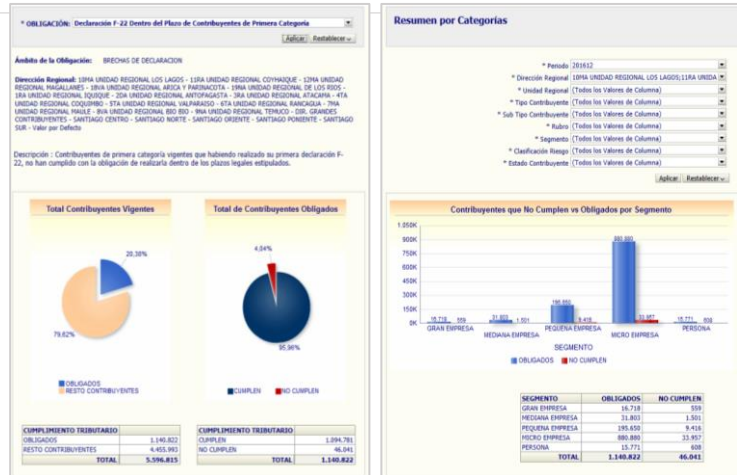
The implementation of this phase of the process has been gradual and focusing efforts:

- Tax obligations presenting gaps whose mitigation influences in decreasing other gaps, have been identified within each dimension, which generates a greater impact. Within these obligations have been considered:
  - a. Within the Registration dimension: the gap of inactive taxpayers, i.e. who have not submitted on time and meet the conditions to do so.
  - b. Within the dimension return:
    - i. Reduce the gap of taxpayers who do not submit form 29 (VAT return and monthly payment).
    - ii. Reduce the gap of taxpayers who do not declare form 22 (annual income tax return and payment).
  - c. Within the dimension information: reduce the gap of taxpayers who do not declare certain returns per year associated with the income operation process.
  - d. Within the dimension of payment: reduce the gap generated by the unpaid debt through control actions
- Different segments of interest have been identified, which has allowed strengthening the services and specify control strategies for those taxpayers. These segments include:
  - - a. High income or high wealth taxpayers
    - b. Business groups present in the country
    - c. Electronic invoicing
    - d. Informal trade
    - e. Tax intermediaries
    - f. Relevant regional segments
    - g. Economic segments
- 30 indicators of tax gaps have been calculated allowing viewing their evolution for different economic sectors, regions or segments of interest. Additionally, we need to have complete and accurate records and information in order to faithfully reflect the levels of tax compliance.

Executive summary of compliance according to different dimensions (for example: type of taxpayer, size and regional distribution)



Summary for every tax obligation, which allows seeing the total number of taxpayers that are compliant and the total that is in default, compared with the taxpayers' total or or different groupings.



This map of gaps is automated in a technological platform of analysis managed by the Chilean tax administration. For its construction and proper operation, it is based on a system of annotations or attributes that originate in different processes of care, assistance and supervision, performed by the offices or virtual offices available. Given the above, it is essential that the different operational areas or care systems promote their permanent and timely update, in order for this tool to show reliably the global levels of compliance with the tax system or those of the segments subject to study.

- **Stage 2: ANALYZING.**

It corresponds to the analysis of the behaviors of taxpayers or segments. This analysis should cover from a general characterization of a group of taxpayers to the identification of their risks of non-compliance.

- The first stage, the characterization, allows specifying common characteristics for each segment identified, general as well as fiscal, for example, the associated economic sectors, territorial distribution, and the magnitude of the operations, the present tax regimes and the tax allowances used. They must also identify the tax obligations associated with each segment and calculate their compliance, through the associated tax gaps. As mentioned above, to facilitate this analysis, an automated system of attributes and indicators is being used.
- Then, the most relevant risks of breach of each segment, to inquire about the characteristics, patterns, causes and factors that facilitate these breaches, consequences and other manifestations of the phenomenon associated with the identified risks.



Each identified risk should be described fully, whereas information that sustains it (weakened tax liability, level of non-compliance, with associated rules), the analysis of the external causes that favor failure (associated with the attitude of the taxpayer influenced by conditions specific to the activity carried out, the industry in which it operates, economic, psychological and sociological variables), the analysis of internal causes (associated with policies and/or definitions of tax administration) , the description of the direct consequences of breach, their evaluation (based on likelihood and consequence of the breach) and treatments that improve this kind of behavior.

### **SII's implementation methodology**

The implementation of this stage has dealt with considering the defined segments of interest. On the one hand, centrally, it worked based on segments of interest of national importance (as listed in step 1) and, on the other, with segments of interest of regional relevance, which has allowed an implementation at all levels of the organization.

For the purposes of the general taxpayers, in addition to the aforementioned information, characterization has been estimated an indicator of **global risk**, which is defined as the risk intrinsic taxpayers associated with their willingness to comply with all tax obligations and has been classified into 4 levels: high risk, medium risk, risk low and key, according to the combination between probability of occurrence and associated consequences (as shown in the following figure).



In the second stage, for the identification of **specific risks**, which are those that are associated with particular transactions, different processes of gathering information on the ground have been completed, to confirm and/or detect the taxpayers' characteristics, the relevant aspects of each business, patterns, causes or factors that facilitate these breaches (or others). Given this analysis different treatments that help to mitigate or eliminate the causes that provoke these risks have been proposed. This information is embodied in an instrument called a specific risk file.

**The Specific risks** have been classified into 5 levels: low, moderate, significant, high and severe, according to the combination between probability of occurrence and associated consequences (as shown in the following figure).

		PROBABILIDAD DE OCURRENCIA				
		RARO	IMPROBABLE	MODERADO	PROBABLE	MUY PROBABLE
CONSECUENCIAS	EXTREMAS	ALTO	ALTO	SEVERO	SEVERO	SEVERO
	MUY ALTAS	ALTO	ALTO	ALTO	SEVERO	SEVERO
	ALTAS	SIGNIFICATIVO	ALTO	ALTO	ALTO	ALTO
	MEDIAS	MODERADO	MODERADO	SIGNIFICATIVO	SIGNIFICATIVO	SIGNIFICATIVO
	BAJAS	BAJO	BAJO	MODERADO	MODERADO	SIGNIFICATIVO

On the other hand, to treat each specific risk, programs of treatment are designed, dealing with the causes in proportion to the gravity of the breaches (considering the classification of risk assigned to the taxpayer). These programs are composed of different actions of treatment, which can be of facilitation, simplification, assistance and/or control and seek to eliminate, reduce, transfer, prevent or correct a tax breach.

Treatment actions selected to perform are defined based on the estimated causes and risks of non-compliance, the overall performance of the taxpayer and the availability of resources. According to the scope and purpose that supports every action, they can be classified into:

- **Structural actions:** aimed to resolve situations of general or cross tax behavior.
- **Preventive actions:** aimed to promote higher levels of compliance and avoid the breach of an obligation.
- **Corrective actions:** they are used for taxpayers who show detected non-compliance or those who have risk levels exceeding the criteria defined by the strategy.



These actions constitute a wide range of possibilities available to manage and improve the levels of tax behavior, which will result in higher tax benefits and, therefore, for society. On the other hand, the proportionality of the implementation of the treatment actions, with regard to the profile of the



Once the specific risks are defined for treatment (prioritized and sorted), we proceed to consolidate the risks for each taxpayer and based on the defined treatment policy, treatments are assigned to apply to every taxpayer using an algorithm that summarizes a series of business<sup>3</sup> rules.

As in previous stages, treatment actions are incorporated into an integrated platform that delivers a treatment proposal for taxpayers including profiling, analysis and prioritization of risks to be treated.

- ***Stage 4: TREATMENT.***

This stage corresponds to the execution of the actions of treatment defined in earlier stage, which arise from a preliminary proposal made by the electronic platform, which must be validated and supervised before its effective use by the operational areas of tax compliance.

As indicated in paragraph "Stage 1: identify", the relevant segments are considered, as well as comprehensive treatment programs that contain different treatment activities which interrelate for obtaining the greatest possible impact.

### **Implementation methodology of SII**

According to the planning process that is described in the next item, for each year is defined a number of treatment actions that can be enforced, given the central and regional operational capacities. Based on this information and taking the allocation of treatment action as input to each taxpayer in the stage of prioritization) cases are scheduled to the various operational units offices (preventive and/or corrective actions), as appropriate. Structural actions are transformed into projects that are managed by each unit of the central level depending on their competencies.

Some of the structural and remedial, preventive treatment actions that have been made are:

#### *Structural actions:*

- Proposed pre-filled VAT statement
- Re-design the VAT withholding system
- Installation of a comprehensive strategy for the control of high wealth taxpayers

---

<sup>3</sup> Examples of rules include: not to apply treatments to the same taxpayers in two periods in a row, number of risks presented by each taxpayer, level of gaps that presents each taxpayer, delivery capacity of treatments, among others.

*Preventive action:*

- E-alerts
- Online controls of returns
- Pop-up messages

*Corrective actions:*

- Tax compliance field checks
- Reviews of compliance
- Audits

An important aspect of these actions is that they should be proportional to the risk phenomenon that we need to mitigate according to the technical tax compliance behavior of the taxpayer. This way, when they observe good levels of tax compliance, the differences that are detected will generally be treated through corrective actions at distance, while if they have significant gaps in compliance, they would have to be reviewed in a personalized way and applying all actions and penalties allowed by law.

- ***Stage 5: EVALUATE.***

Corresponds to the monitoring and follow-up of the results of the actions of treatment, which means to evaluate the quality of the processes implemented, the actions of treatment carried out, the evolution of tax gaps and institutional projects.

It is relevant for the institution to maintain consistency and traceability of the process, for example, if the treatment of a certain specific risk is being defined, this risk should be effectively treated in the respective operational areas, in order to control the deviations between the risk to be treated and effectively treated risks.

The evaluation of this tax compliance management process measures both the effectiveness of performed actions such as their efficiency, considering the whole process.

For the full installation of the compliance risk-based model, the execution of activities will not be considered under criteria other than the proportional risk mitigation.

**Implementation methodology of SII**

The evaluation of this model's implementation has been approached from different points of view:

- At the strategic level, evaluate the evolution of the most relevant tax gaps. These breaches are identified in the institutional Balance Scorecard, on the map of breaches and other internal management tools used in the institution. By way of example, if a taxpayer segment has a specific non-compliance gap that is higher than the national average, actions are to be taken to approach the segment closer to the national average.
- At the tactical level, the implementation and results of the actions of treatment carried out are constantly measured, both in their execution (associated procedures) and their results (gaps).
- At the operational level, the execution of planned actions carried out is evaluated, in order to provide feedback to tactical and strategic teams and improve the next process.

In each of the above instances, goals and performance indicators are monitored at local and central levels, as well as via qualitative assessments of each of the stages of the methodology.

This information is transformed into a stream of feedback to have a continuous improvement process in the next working cycle.

### **Key concepts**

- **Map of breaches**
- **Classification of global or personal risk of the taxpayer**
- **Specific or transactional risk map**
- **Risk matrix**
- **Comprehensive treatment programs**
- **Indicators and targets of tax compliance**

## **2.2. Tax compliance management plan**

In general terms, as described in the previous section, the implementation of this management model has meant both the creation of standardized work methods and generating equipment at central and regional level to support with risk issues and adaptation of the computer systems. It has also involved the establishment of targets and structural indicators denoting changes in tax compliance levels more than the specific impact of audits. From these guidelines, three interrelated instruments appear:

- A strategic tax compliance plan with a medium-term range pointing to what will be the overall framework which will govern the actions to control and encourage

tax compliance and discouraging non-compliance during the tax period, with the respective expected strategies to implement.

- An operational plan of tax compliance where different actions are established to account for the strategic plan, with an indication of those responsible, expected milestones, products and goals.
- A Public Plan of Tax Compliance Management, which, according to the current Strategic Plan, is disseminated to the Chilean community.

The following is the structure in which these plans are generated and some examples for each section.

### **2.2.1. General framework**

This section of the plan includes the main elements that should be considered for the implementation, because it considers the working process and the emphasis that should be followed each year. The above considers that these elements or guidelines can be maintained over time, focusing more on some kind of action or adapting the focus

By way of example, from the year 2015 to date, the following relevant elements have been considered:

- Identification of groups of taxpayers that are important at the regional and/or national level. This is in order to identify, analyze and define the common characteristics in each of them, their behavior, and the associated economic sectors, factors that can have an impact on their behavior and establish the necessary treatment actions in accordance with their risk level.
- Strengthening of collaborative actions to promote tax compliance. This seeks to create partnerships with those groupings representative of economic sectors that can deal with situations that do not favor their tax compliance.
- Cooperation and international coordination on the basis of the BEPS Action Plan, which considers the implementation and coordination of 15 actions designed to protect the national tax base and combat aggressive tax planning.

### **2.2.2. Strategies for tax compliance**

Given the general framework described earlier, this section of the plan provides strategies to be carried out during the year. They are designed taking into consideration the main taxes, the taxpayers groups of interest

and those international guidelines, seeking to cover both the field of simplification and prevention of non-compliance, as well as their correction.

By way of example, from the year 2015 to date, the following strategies have been implemented:

- Comprehensive strategy in VAT. The emphasis of each year have been put on different topics always focused on reducing this tax evasion, inside of which are informal trade, changes of subject, exports and the respective chosen returns, analysis of suppliers' chains, improvements in the information of electronic tax documents.
- Comprehensive strategy for the income. Emphasis is placed on issues such as: control of fees vouchers and exempt invoices, sub-reported income, improvements in the returns of third parties, intra – group operations.

Other strategies implemented have been:

- Strategy for specific segments. At this point the identification of segments that are relevant at the national level, such as national or international economic groups or people of high net worth.
- Strategy for specific segments. At this point, each region selects a set of taxpayers which is of regional importance and applies the methodology of work that allows characterizing them and treat them according to their level of risk.

### **3. RELEVANT ASPECTS OF IMPLEMENTATION AND TECHNICAL INSTALLATION.**

No doubt the policy changes introduced by the tax<sup>4</sup> reform allowed revise strategies of treatment, the respective processes and incorporate different actions of treatment in addition to traditional audits. For example, the ability to make expeditious remote contacts without it means an audit or the signing of agreements for the promotion of tax compliance with associations or business interest groups.

Based on the above, a complete update of the strategic map and map of institutional processes has been carried out, in such a way that the management of tax compliance based on risk analysis is incorporated into all areas of the institution.

---

<sup>4</sup> Law N ° 20.780 of 2014 and law N ° 20.899 of 2016



The restructuring of the Organization is added as important aspect, particularly at the central level, which allowed to shelter new equipment analysis and risk consolidation, specialized teams in specific risks segments such as high wealth and high income, and including networks such as the remote control, electronic control and control of aggressive behavior.

We have also substantially reformulated or update of the internal organization in line with the guidelines of the model.

In particular, the following specific products that support the adoption of this model include:

- Different computer systems have been modified to improve data capture and/or management of information, the fundamental input for the study of the behavior of taxpayers. It also facilitates delivery of information by taxpayers, which increases the probability of voluntary compliance.
  - Examples of these improvements are the electronic file, allowing taxpayers to provide distance and manage the delivery of supporting documentation required from different processes control; the tax folder, which enable relevant information that can be used and verified by a third party at the request of each taxpayer.
- Various management tools which allow tracking the tax compliance have been implemented, what facilitates decision making.
  - For example, the map of breaches (described in point 2.1, stage 1), where 30 gaps have been implemented so far.
  - On the other hand, the integrated system of tax compliance (SICT) which allows consulting all sources of information on taxpayers and also allows access to and care of all these sources. This system allows to consult all identification data, the submitted returns and even the taxpayer's current processes.

#### **4. PRELIMINARY RESULTS**

The first results of this implementation can already be seen from different perspectives:

- The map of breaches<sup>5</sup>, based on the technological platform used, has allowed tracing taxpayers, showing that 'low risk' taxpayers represent 68% of all taxpayers, while the "key" taxpayers are 6%, "medium-risk" are 25% and those of "high risk" are the remaining 1%.

---

<sup>5</sup> Data from the tax period: December 2016.

- The definition and characterization of segments of taxpayers of interest at the national and regional levels, considering each treatment plans specific that they intend to improve their compliance.
  - At the regional level, we have identified at least 20 segments of interest, among which are taxpayers of productive sectors, services, intermediaries and others who use specific tax franchises
  - At the national level segments associated with specific economic sectors have been identified (e.g., financial sector) and sectors that share specific characteristics of taxation (e.g., level of assets)
- Working groups have been formed together with different groups of taxpayers, establishing conventions for the promotion of tax compliance.
- Measures that simplify tax compliance have been implemented, thanks to the new powers that have been granted to the service.
  - Example of this is the simplified electronic rotation term procedure for those taxpayers who do not have movements in more than 36 period, nor tax debt or outstanding tax or assets balances.

From this period of 2017 the baselines for tax compliance have been established, so that the goals and indicators reflect changes in the levels of tax compliance gaps and risk levels, setting a term of 3 years to achieve the proposed goals.

## **5. CHANGE MANAGEMENT**

As evidenced above, for the purposes of generating all the changes mentioned, it has been necessary to generate and encourage changes within the institution, structural as well as operational changes.

- Formal changes in the organizational structure of the institution. For example
  - The creation of a new sub-department of taxpayer assistance, which has as main purpose to develop policies and special programs to provide support, information and assistance to smaller companies and other taxpayers of scarce economic movement, in order to facilitate tax compliance.
  - The re-design of the Sub-directorate of control to incorporate the management of specific risks based on institutional and comprehensive tax compliance processes.
- Generation of formal instances of governance so that the multidisciplinary teams can interact inside the institution, evaluating permanent implementation of the model and the results to be obtained from the different treatment actions.

These instances include the senior national management, a strategic Committee that defines the issues to be addressed in the Tax Compliance Management Plan of (described in 2.2); officials of tactical level, that a tactical Committee establishes specific subjects for the Plan and provides support at the national level for the implementation of the different actions, and officials at regional level, where a regional operational Committee monitors and assesses the progress of the implementation of the model.

The combination of the functions of these committees allows an alignment and permanent coordination of the different teams within the institution, which facilitates the installation of this model in the institutional work.

- Formalization of the procedures associated with each stage of the tax compliance management model, which includes the definitions used, associated processes and instructions relating to each phase.
- Implementation of a new platform of tax behavior analysis, within which the tax breach map, global risk map, and the map of specific risks, are considered, all being interrelated, to make the prevention and treatment of actions more efficient.
- Generation of skills within the institution, through the generation of multidisciplinary work instances that allow applying the methodology operationally and/or through internal training courses for updating the knowledge and sharing experiences to improve future actions.
- Plan of implementation in the operational units, through the change of paradigms regarding the actions that must be performed to taxpayers, in particular, those that already are should not be treated with audits but with another type of treatment actions.
- Dissemination of the implementation and results of the tax compliance management plan, to raise awareness of citizens in general and within the staff, about strategic matters and report with respect to the diversity and scope of the actions of treatment to be implemented in order to reduce tax compliance gaps.

## **6. ONGOING CHALLENGES.**

Despite all the progress that has been made to date, the Internal Revenue Service is in permanent search for improvements in internal and/or external processes as well as services that can be provided to taxpayers, always having as a general purpose ensuring tax compliance. Based on the above, the main challenges that have been taken include: the application of non-jurisdictional control, the promotion of the electronic relationship that exists with the taxpayers, the systematic

treatment of the avoidance and the active participation in the BEPS Action Plan, which are described briefly below.

### **6.1. Non-jurisdictional control**

Tax reform has given the faculty to the heads of office of order control, in office or remotely, of taxpayer or entities domiciled, resident or established in Chile, even if they are of another jurisdictional territory, when latter carried out operations or transactions with related parties that are being currently controlled, allowing you to perform auditing processes comprehensively taxpayers thus reducing the administrative formalities.

In addition, the use of this new ability from the perspective of assistance to taxpayers allows better attending those who have a permanent address product of their own economic activity (example of the individual entrepreneur who is carrier of freight by road). Also, from an operational perspective, it facilitates the workload by balancing the different operational units to the extent that the administrative resolutions or audits could be derived to units with lesser workloads.

### **6.2. Promotion of electronic relationship**

Several amendments to the legislation, have allowed the service to move forward in the use of technology, both in the improvement of control processes and services offered to taxpayers to facilitate the fulfillment of tax obligations.

Part of the challenges that have been taken at this point are:

- Elimination of maintenance and sending of the purchases and sales information by replacing it with a detail of purchases and sales by the service, where the taxpayer may supplement information, facilitating tax compliance and saving the times of preparation and maintenance of the sales registry.
- Generation of a pre-filled proposal of form 29 of VAT by Internet, which seeks to facilitate the fulfillment of tax obligations and reduce errors in the registry of credits and debits from electronic tax documents.
- Elimination of the physical stamping of documents for those taxpayers who have continuing good tax compliance levels, and can do so via the Internet.
- Facilitation of tax compliance for taxpayers subject to art. 14 ter of the income tax law (small companies), through pre-filling their income tax return and training them via e-learning, among others, which encourages the incorporation of taxpayers to this simplified scheme and decrease the administrative burden associated with the fulfillment of tax obligations.

- Electronic tax control, which seeks to implement efficient and effective control to the digital commerce; national sales by Internet and international sales, mainly of intangibles, and the characterization of the accounting and comprehensive business management (ERP) systems used by taxpayers.
- Implementation of actions at distance, enabling to efficiently administer the human and technical resources. These actions include electronic notices (whose objective is to remind the taxpayer with respect to pending breaches or of their tax obligations), remote controls of income returns (whose objective is to inform taxpayers about inconsistencies that present their tax income returns and that, given their nature and low risk, can be resolved without having to go to the offices) and pop-up messages (which consist of the generation of electronic alerts personalized for each taxpayer that allow knowing the tax obligations, anomalies, or pending service situations).
- Cross utilization of electronic records with legal probative weight, which are gradually being used in different control actions that are carried forward and allows taxpayers upload or upload their background without having to move to a territorial office.

### **6.3. Treatment of tax avoidance**

The incorporation of a General Anti-Avoidance Standard, which defines that there is avoidance in cases of abuse or simulation, seeks that taxpayers comply with the principle of legality and maintain the correct legal distribution of the tax burden between them.

Given these new powers, the Internal Revenue Service will monitor the levels of tax compliance and will have special interest in those transactions that are considered to be atypical or unusual, such as:

- Cases in which the tax benefits of the transaction or planning are out of proportion.
- The scheme or transaction carried out seems only justified because "it produces a good tax effect" and is not understood by senior management or the business owners.
- The signature of unusual business contracts is required.
- Schemes involving circulating funds, goods, or goods between the same companies even if there is no economic explanation, except produce a tax advantage.
- The use of a regime of zero or low taxation, usually a tax haven, or of societies without staff or functions, that mobilize significant funds or assets, out of proportion with the project.

Following the recommendations and good international practices in this field, especially in the framework of the OECD and instances of coordination of the tax

administrations from different countries, a "***Tax schemes catalogue***"<sup>6</sup> with a list of situations that could be analyzed and studied in order to specify if they constitute aggressive tax planning or tax avoidance. The document was based on situations and specific cases which arose in the past years, with the aim that it could be as a true reference guide for taxpayers about the structures and planning to be studied to evaluate whether they pursue evading their tax obligations and generate artificial and disproportionate tax benefits.

On the other hand, the regulation establishes the possibility to taxpayers so they can check whether acts, contracts, business or economic activities that they present before the service could be configured or not any of the hypotheses of abuse of legal form or simulation referred to the General Anti-Avoidance Standard. This procedure has been used by various taxpayers and, in the effort to promote prevention, collaboration and shared knowledge of the situations between taxpayers and the service, the answers to these questions are published on the website without identifying the taxpayers involved.

#### **6.4. BEPS**

In regards to cooperation and international coordination matters, the Service actively participates in the BEPS Action Plan led by OECD, which focuses on the tax planning that only seek to exploit legal loopholes allowing the artificial transfer of profits to low or nil taxation jurisdictions, resulting in little or no tax paid, which weakens the equality and integrity of the tax system. This Plan considers the implementation and overall coordination of 15 actions<sup>7</sup> designed to protect the national tax base and combat aggressive behavior.

In addition to the progress made in actions related to interest and international financial expenditures between related companies, the information obtained through the voluntary regime of disclosure of assets and incomes abroad, ongoing coordination and exchanges of information take place with other tax administrations, based on different specific agreements to avoid international double taxation and/or the exchange of information and collecting the information needed to carry out different actions. In particular, the Multilateral Convention on Mutual Assistance in Tax Matters will enter into force, allowing the exchange of information with more than 100 jurisdictions.

Additionally, the control of cross-border transactions will be continued with related companies in different taxpayers segments, where operational conditions do not have the proper economic justification and fail to comply with the Arm Length Principle; and as part of action 13 of the Plan, we will work collaboratively with the multinational companies that must declare their income taxes and country by

---

<sup>6</sup> [http://www.sii.cl/destacados/reforma\\_tributaria/catalogo\\_esquemas\\_tributarios.pdf](http://www.sii.cl/destacados/reforma_tributaria/catalogo_esquemas_tributarios.pdf)

<sup>7</sup> <http://www.oecd.org/tax/beps/beps-actions.htm>

country results, whose information will be exchanged through the specific platform that OECD will make available to this effect.

## **EXPERIENCE OF COUNTRY TAX ADMINISTRATION**

**Miguel Palumbo**

Director

Collection and Related Controls Division

General Directorate of Taxation

(Uruguay)

**Contents:** 1. Presentation. 2. Overview of the massive or extensive controls. 3. Extensive control in Uruguay. Perception of risk

### **1. PRESENTATION**

Uruguay, officially the Oriental Republic of Uruguay, is a country in South America, located in the eastern part of the American South Cone. It is bounded on the Northeast by Brazil, to the West with Argentina and has coasts on the Atlantic Ocean to the Southeast and on the Río de la Plata to the South. It covers 176 215 km<sup>2</sup>, being the second smallest country in South America in terms of territory. According to data from the INE in 2013, the population of Uruguay is 3.407 million.

It is a presidential Republic subdivided into 19 departments. The capital and most populous city in the country is Montevideo, with 1.3 million inhabitants.

The economy of Uruguay is dominated by its export-oriented agricultural sector and a developed industrial sector. The sector of services (financial, logistics, transport, and communications) is important, as well as the thriving information and communication technologies industry, in particular the development of software and related services. Another of the principal economic resources of the country is tourism: The nation has a coast line on the Río de la Plata and the Atlantic ocean dotted with spas, which include Punta del Este and Piriapolis.

According to the World Bank, the GDP of Uruguay was \$53.44 billion USD in 2015. In recent years there is an evolution of revenue collection above the GDP's growth. Real GDP's growth was 0.98% in 2015, while the actual increase observed in the collection was 1.03%. Consumption taxes accounted for 60.4% of the total revenue of DGI in 2015. Of these taxes, the largest part corresponds to VAT (49.8%) and the remaining 10.6% corresponds to the IMESI.



Cuadro 1. Impuestos administrados por la DGI: recaudación del año 2016 al cierre del mes DICIEMBRE								
Cuadro comparativo con la recaudación del año 2015 al cierre del mismo mes. Valores en millones de pesos.								
Impuestos	Recaudación acumulada en el año 2015 al			Recaudación acumulada en el año 2016 al			Variación (en %)	
	a precios corrientes	a precios de diciembre 2016	Participación (en %)	a precios corrientes	a precios de diciembre 2016	Participación (en %)	a precios corrientes	a precios constantes
<b>1) Impuestos a</b>	<b>165.630</b>	<b>184.025</b>	<b>60,4%</b>	<b>177.274</b>	<b>179.645</b>	<b>57,8%</b>	<b>7,0%</b>	<b>-2,4%</b>
IVA	136.652	151.821	49,8%	147.000	148.972	47,9%	7,6%	-1,9%
Interno	82.385	91.578	30,0%	94.466	95.738	30,8%	14,7%	4,5%
Importacio	53.487	59.376	19,5%	51.699	52.387	16,9%	-3,3%	-11,8%
IVA Mínimo	780	867	0,3%	836	847	0,3%	7,2%	-2,3%
IMESI	28.978	32.204	10,6%	30.274	30.673	9,9%	4,5%	-4,8%
Combustibl	14.296	15.875	5,2%	15.181	15.373	4,9%	6,2%	-3,2%
Tabacos y c	5.779	6.425	2,1%	6.144	6.228	2,0%	6,3%	-3,1%
Automotore	4.073	4.531	1,5%	3.946	4.000	1,3%	-3,1%	-11,7%
Resto IMESI	4.829	5.373	1,8%	5.003	5.072	1,6%	3,6%	-5,6%
<b>2) Impuestos a</b>	<b>85.858</b>	<b>95.397</b>	<b>31,3%</b>	<b>104.175</b>	<b>105.597</b>	<b>34,0%</b>	<b>21,3%</b>	<b>10,7%</b>
IRAE	34.162	37.974	12,5%	44.983	45.607	14,7%	31,7%	20,1%
IMEBA	1.459	1.619	0,5%	1.502	1.521	0,5%	3,0%	-6,0%
IRPF	40.620	45.141	14,8%	46.594	47.225	15,2%	14,7%	4,6%
Categoría I	5.819	6.461	2,1%	6.759	6.840	2,2%	16,1%	5,9%
Categoría II	34.800	38.681	12,7%	39.835	40.385	13,0%	14,5%	4,4%
IASS	5.744	6.366	2,1%	6.575	6.651	2,1%	14,5%	4,5%
IRNR	3.873	4.298	1,4%	4.521	4.594	1,5%	16,7%	6,9%
<b>3) Impuestos a</b>	<b>17.696</b>	<b>19.661</b>	<b>6,5%</b>	<b>19.662</b>	<b>19.894</b>	<b>6,4%</b>	<b>11,1%</b>	<b>1,2%</b>
Impuesto al	16.094	17.884	5,9%	17.937	18.152	5,8%	11,4%	1,5%
Impuesto a l	1.602	1.777	0,6%	1.725	1.742	0,6%	7,7%	-2,0%
<b>4) Impuestos c</b>	<b>517</b>	<b>575</b>	<b>0,2%</b>	<b>534</b>	<b>541</b>	<b>0,2%</b>	<b>3,3%</b>	<b>-5,9%</b>
<b>5) Otros impu</b>	<b>2.172</b>	<b>2.408</b>	<b>0,8%</b>	<b>2.272</b>	<b>2.301</b>	<b>0,7%</b>	<b>4,6%</b>	<b>-4,4%</b>
<b>6) Impuestos c</b>	<b>39</b>	<b>44</b>	<b>0,0%</b>	<b>29</b>	<b>30</b>	<b>0,0%</b>	<b>-25,2%</b>	<b>-31,7%</b>
<b>7) Multas, reca</b>	<b>2.407</b>	<b>2.670</b>	<b>0,9%</b>	<b>2.665</b>	<b>2.698</b>	<b>0,9%</b>	<b>10,7%</b>	<b>1,1%</b>
<b>8) Total Bruto</b>	<b>274.318</b>	<b>304.781</b>	<b>100,0%</b>	<b>306.611</b>	<b>310.707</b>	<b>100,0%</b>	<b>11,8%</b>	<b>1,9%</b>
<b>9) Devolución</b>	<b>-24.644</b>	<b>-27.316</b>	<b>-9,0%</b>	<b>-27.291</b>	<b>-27.604</b>	<b>-8,9%</b>	<b>10,7%</b>	<b>1,1%</b>
<b>10) Total Neto</b>	<b>249.675</b>	<b>277.465</b>	<b>91,0%</b>	<b>279.320</b>	<b>283.103</b>	<b>91,1%</b>	<b>11,9%</b>	<b>2,0%</b>

## **2. OVERVIEW OF THE MASSIVE OR EXTENSIVE CONTROLS**

Extensive control aims to manage non-compliance and inconsistencies in a more rapid and widespread manner, and with significant computer support. It is therefore a fast control, general, systematic, specific, short-term, limited and highly computerized.

It is an important tool to promote voluntary compliance by taxpayers and as a form of preventing future breaches.

It must be complemented with intensive inspection, although for certain groups of taxpayers it may be the only existing control, given their tax profile and low level of fraud risk.

## **3. EXTENSIVE CONTROL IN URUGUAY**

The implementation of this type of controls is aimed to increase the perception of risk, to improve collection, in addition that in some cases it is also used as a way to educate taxpayers to avoid certain mistakes and at the same time facilitate voluntary compliance.

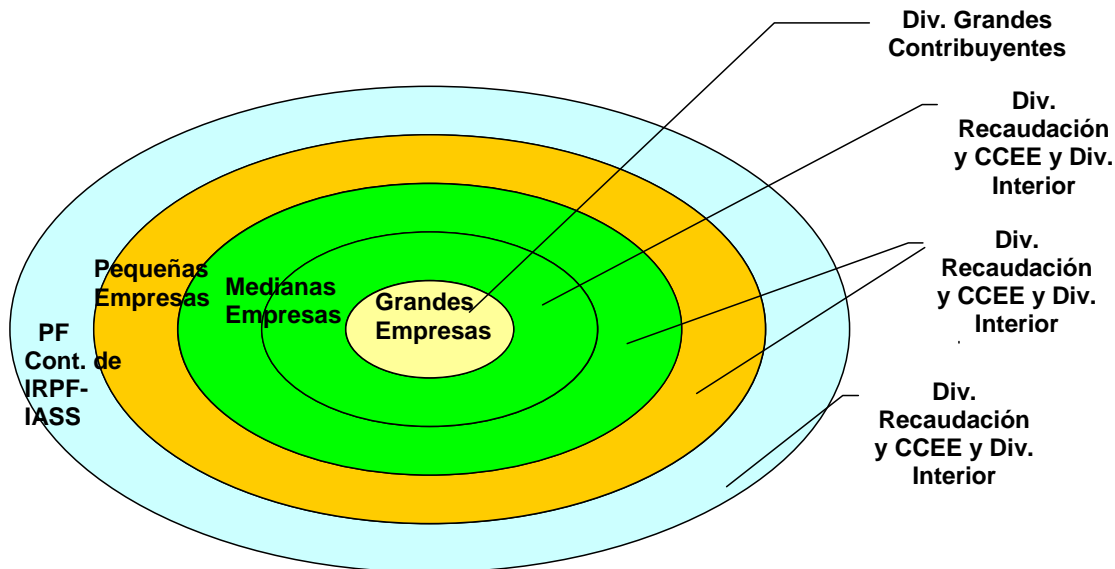
The type of controls to be carried out determines which areas of the Administration will carry them out, according to the tasks assigned, massive controls or extensive controls, and according to the location: task of the collection and extensive controls department (for taxpayers of Montevideo) as well as the interior division (taxpayers whose residence is in the interior of the country); intensive control are under the Audit Division. However the Large Taxpayers Division performs both types of controls to the taxpayers that it manages.

### **3.1 Universe of taxpayers**

The universe of taxpayers is divided into the following groups:

1. Large Taxpayers: administered by the Large Taxpayers Division (336 taxpayers)
2. Medium to large (CEDE Group - special controls of companies): administered by the Collection and Extensive Controls Division through the Extensive Controls Department in Montevideo and the Interior Division in the countryside (15,241 taxpayers).
3. Small and medium (Non-CEDE Group): administered by the Collection and Extensive Controls Division in Montevideo and the Interior Division in the countryside. In this group we can differentiate the Non-Cede (294,507 taxpayers), the small enterprises (36,613 taxpayers) and the Single Tax (40,803 taxpayers).

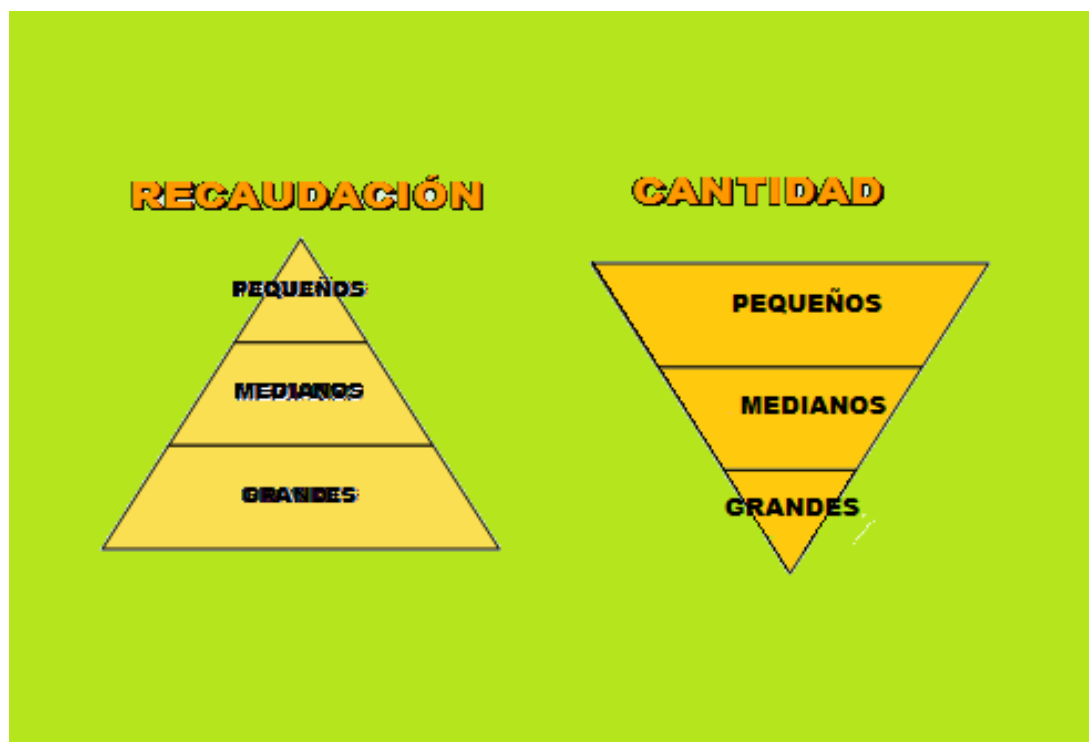
4. Taxpayers for the income tax and IASS (Assistance to Social Security tax) are managed by the Collection and Extensive Controls Division in Montevideo and by the Interior Division in the countryside.



Small and medium-sized enterprises are most of the taxpayers and do not concentrate the bulk of the collection. To these, massive controls aimed to encompass a large number of taxpayers are usually applied, usually in small or medium size, and sometimes large, because they have a lower cost for the Administration, leaving intensive controls for those smaller groups of taxpayers, such as large taxpayers, which account for the highest percentage of total revenue, or carry out activities that warrant greater scrutiny, since the non-detection of a fraud at that level would have a major cost for society.

Therefore the benefit-cost relation is essential in defining what types of controls and to whom they apply.

The great mass of taxpayers is concentrated in small and medium-sized groups (Non-CEDE), which constitute almost 86% of their total amount, but only bring 20% of gross revenue, and while Large and Medium-large (CEDE and Large Taxpayers) are 4% of the total number of taxpayers they provide 80% of gross revenue. The remaining 10% of taxpayers correspond to the single tax group.



The different types of controls to apply are usually distributed as follows on the graph below, according to taxpayers' importance, in terms of the risk and the collection levels represented by each group:



## 3.2 Types of massive controls carried out

There are basically 4 types of massive controls:

1. Control of omitted in tax returns (D/J)
2. Control of defaulters
3. Control of inconsistencies
4. Control and authorization of income tax and Social Security tax credits refunds

### 3.2.1. Control of omitted in tax returns:

According to the obligations marks of taxpayers, they are controlled to comply with the obligation of submission of returns that corresponds to them.

### 3.2.2. control of defaulters:

This type of control includes:

- **Debit-credit:** Controlling that the taxes that arise from the returns are paid, the credits are crossed with debits
- **Payment deadline:** Controlling that payments have been made within the expected deadlines

### 3.2.3 Control of inconsistencies:

The information contained in the returns is checked for consistency with the taxpayer's information and information provided by third parties. Examples:

- VAT imports
- IRAE, PAT, ICOSA prepayments
- IRAE FICTO Agricultural taxpayers.
- IRAE - FRANJAS taxpayers
- IMEBA- IRAE Agricultural taxpayers
- Inconsistencies in VAT sales
- Inconsistencies of PIT and IASS

The inconsistency of the information occurs when there are differences by comparing the data provided by the taxpayer in his statements with the information received by the Administration (obtained through reporting of exogenous information, by the Administration itself or by taxpayers themselves in their statements).

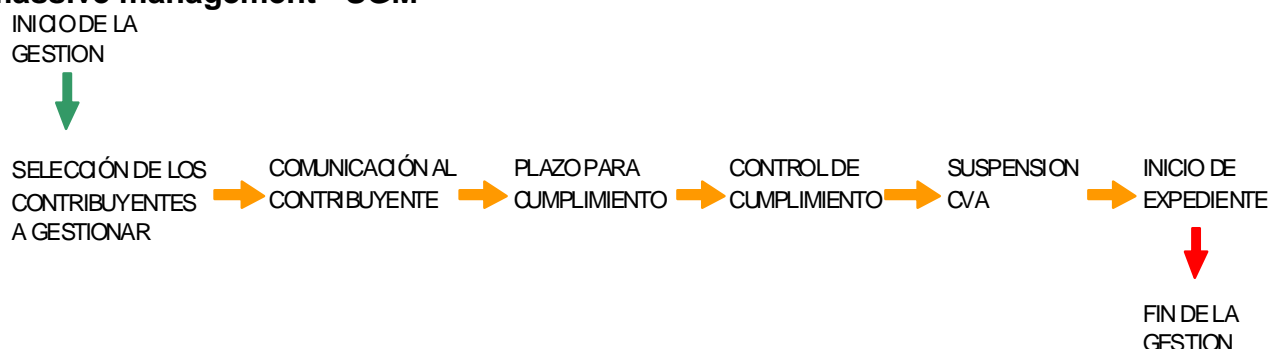
It applies also to the data provided by respondents in their statements, regarding the inconsistencies committed against technical specifications indicated by the Administration (information quality control), and also with regard to the information contained in the statements presented and reported by other taxpayers (e.g. information provided by withholding agents and which arises from the withholdings).

### **3.2.4 Control and authorization of credits refunds from Income Tax and Social Security contributions:**

Income tax and IASS credits refunds are checked by computerized control, prior to the accreditation of such tax credits in the collaborating entities and/or financial institutions (Public and Private Banks).

If the credit is not authorized, the taxpayer is informed at the time of trying to collect it, that he should visit our offices to resolve the inconsistencies that were identified.

### **3.3 Basic Diagram of the procedure followed in the extensive controls or massive management - SGM**



This is the basic scheme followed through the massive management process. A computerized MMS (massive management system) is used for the execution of the different stages

#### **3.3.1 Massive Management System (SGM in Spanish)**

It is the system that sustains the massive management process, from selection, the uploading of breaches to manage on the management database and the subsequent monitoring of procedures.

It includes 3 modules:

- 1. Selection**
- 2. Follow-up**
- 3. Consultations**

### 3.3.1.1 Selection

The selection of taxpayers to manage is defined within the system and this allows the updating of noncompliance data at any time by the user.

To the effects of the selection and management process of taxpayers, a series of material parameters are handled, defined according to the following scheme:



The definition of the crossing of information, period timing and execution request, the analysis and approval of the breaches to manage are based on the resources available in the area of process implementation (Dept. CCEE) and the burden of the selection approval passing to the follow-up module from the management database is within the scope of the planning departments (PEC Div. and POR Dept.).

However, at the level of the area that implement the process (CCEE Dept.) the selection is performed manually through specific restrictions assigned by the system to certain non-compliances, according to a very particular casuistry that requires a previous study for the purpose of confirming that their management is required.

The processing of the crossing, creating the Management Base, is under the Computer Division

### 3.3.1.2 Follow-up

This is the module basically used by the management area (CCEE Dept.), to track the actions in process.

For each type of management (omitted, delinquent, Debit-Credit, etc.) a type of procedure is defined.

Within the follow-up module, the different status of the breaches in process are indicated, as well as also some checkmarks.

The system uses certain markings which are assigned to breaches by the user or the system in order to undertake certain actions during their management process.

Based on the management type and the stage of the procedure, changes of status are made and/or the corresponding markings are entered.

Some of these status are placed by the system and others by users, the same goes for markings.

The follow-up passes through different stages:

- **Analysis of the taxpayers to manage:** review breaches to approve the issuance of summons and/or communications
- **Issuing and sending the summons and/or communications to the taxpayer:** The computer department issues the summons, they are sent by the CCEE Dept. and the communications are generated through the computer system.
- **Face-to-face meeting:** to obtain updated information and carry out the corresponding actions.
- **Computerized control of compliance:** Once the period established in the procedure after the summons and/or the communication, the POR Department runs a new crossing (2nd intersection). It updates the status and the markings defined for each type of procedure.
- **End of the process:** the user performs all the actions planned according to the markings established for each type of process (e.g. suspension or rehabilitation of the CVA) and, when applicable, the collection procedure is started.

Examples of **Stages** that can be applied to each breach processed:

- **Pending charge:** Status of breaches entered at in the database for which no determination has been made.
- **To process:** when updating, the system assigns this status to breaches that meet the requirements of parameter A.
- **Not to process:** when updating, the system assigns this status to the breaches that do not meet parameter A, which implies taking no action in this case.
- **Summoned to proceed:** the system assigns this status to request the issuance of summons or communications.
- **Not summoned to proceed:** the user assigns this status when the computer Dept. reports that it could not issue the summons.
- **Complied:** the user assigned this status if the breach is solved via face-to-face meeting with the taxpayer.



- **Not applicable:** the user assigns this status when he or she estimates that there was an error or an exception to the criteria adopted in the crosses of data.
- **Regularized:** the system assigns this status when the computerized control (2nd crossing) confirms that the breach was regularized.
- **Judicial Procedure:** the user assigned this status after opening a file for trial.

Examples of **Markings** that are used:

- **Summons:** indicates breaches to mention.
- **ACGS Suspension /Disable ACGS:** indicates the breaches that prompted the suspension or disqualification of the ACGS (annual certificate of good standing, i.e. compliance with the tax obligations).
- **ACGS Suspension to be lifted:** : indicates that the taxpayer has no more breaches pending, generated in the last 5 years, and his ACGS must be rehabilitated if there no other pending suspensions.
- **Credit certificates:** indicates that the taxpayer has credit certificates, requested or held, for an amount greater than or equal to the debt.
- **Investment project:** indicates that the taxpayer has an investment project pending or that a customer will provide him credits in that regard.
- **Communicate in details:** the detail of the procedure will be communicated to the taxpayer
- **Communicate without detail:** indicates that the pending process will be communicated to the taxpayer but not the details.
- **Answer:** it indicates that the taxpayer may be able to reply with predefined answers, which are used for some of the procedures initiated.
- 

### 3.3.1.3 Consultations

Through consultations, the system allow analyzing the compliance with undertaken efforts and plan future actions. For certain controls, the query can be performed filtered by date, by Administrative Management Unit (UAG) and by Taxpayers' Group. The number of taxpayers and the amount managed are shown in the following table.

The Administrative, Planning and Management areas have access to these consultations.

State	Description	Non-compliances		Taxpayers
		Quantity	Amount	
Completed steps				
11	JUDICIAL PROCEEDINGS	0	0	0
8	COMPLIED	53	3.253.684	29
7	DOES NOT CORRESPOND	186	172.787.469	71
9	REGULARIZED	138	1.614.864	40
3	SUMMONED TO MANAGE	7	-1.738.090	7
13	NOT SUMMONED TO MANAGE	0	0	0
SUBTOTAL		384	175.917.927	147
Uncompleted procedures				
3	SUMMONED TO MANAGE	29	2.647.854	14
13	NOT SUMMONED TO MANAGE	0	0	0
2	TO MANAGE	4	297,652	3
SUBTOTAL		33	2.945.506	17
TOTAL		417	178.863.433	164

### 3.3.2. Management System Indicators

At the same time, the SGM provides information captured by the indicators' panel of DGI. This is consulted by the management team and allows analyzing the progress of the procedures and compare them with the planned and projected goals.

### 3.4 Communication of Massive Controls

Technological advances have allowed improvements in communication between the tax administration and taxpayers. The communications system is a tool to inform about situations in which the Administration must safeguard the tax secrecy without forcing the taxpayer to visit the office. The aim of this tool is:

- Improve communications
- Provide information to taxpayers
- Preserve the tax secrecy

The tool is accessed through the DGI online services and with the prior logging by the taxpayer with a password. Whenever a communication arrives to the message box, an email is generated that is sent to the e-mail address of the taxpayer, warning that he or she has a new communication to be read.

At the same time, some of these communications provides the taxpayer with the possibility of responding, detailing their views or differences regarding the motive behind

the control. This form creates a " dialogue " between the taxpayer and the office, and may be able to fix the problem, resolving differences without having to physically travel to the DGI's offices and preserving the tax secrecy at all times.

### **3.5. Some data**

Electronic invoicing: From the year 2012 the DGI is implementing and universalizing the e-invoice. Thus, in July 2015, a chronogram was set, which extends to the year 2019, compelling taxpayers to enroll gradually into the e-invoice scheme according to their sales levels. We currently have 5,678 taxpayers in this regime, which generates different types of controls and opens the opportunity to new crossed controls.

Taxpayers compelled to be in the regime are controlled for:

- Joining the program
- send their daily reports and
- That the reports match the issued documentation.

In this way, we can obtain the necessary information of quality to carry out various crossings between different taxpayers. Because the entry into the regime is gradual and the number of taxpayers in the regime is still limited, this year we will start with the experience of crossing data between some selected taxpayers.

However, crosses have already been performed between the information of the electronic transmitter itself. The amount of VAT for sales declared by a taxpayer in his VAT sales return included in its own electronic invoicing. This crossing gave good results in terms of collection and learning for the taxpayers.

Control in special regimes: they refer to the situation where the taxpayer are registered in a preferential tax regime that does correspond to them, in particular, cases of "tax dwarfism". The control of the proper use of these regimes should generate positive impacts both the perception of risk and the reputation of the DGI, since it is closely linked to the concept of tax justice (in the sense that the tax legislation applies equally for all). The DGI should make sure that it has the necessary information and tools to properly control the exploitation of these regimes by taxpayers. This may involve the adoption of strategies both in the field of information capture and, eventually, in the normative area.

In this sense, two efforts were carried out:

- Agro Management: taxpayers who paid their taxes via the preferential IMEBA regime but had to pay under IRAE depending on the amount of withholdings. Online Communication.
- IPE Management: taxpayers who pay the minimum VAT regime or Single tax but should have to do so through the general regime. From a total of 590 taxpayers, 70% completed the corresponding modification after receiving the communication.

#### 4. PERCEPTION OF RISK

The perception of risk, understood as the probability to be controlled for each taxpayer, means in general, and in particular when facing dilemmas of tax compliance, is something unobservable to the DGI from their usual sources of information. Similarly, the incidence of the DGI's actions - and in particular the actions of control - on the perception of risk is still more difficult to observe. For this it would be necessary to conduct surveys before and after carrying out the actions, which would imply generating a permanent surveying process of the taxpayers, a situation that doesn't seem sustainable.

Recently, in the latest survey of costs of compliance organized by the DGI (June 2016), we included questions related to the risk perception. The survey showed interesting results to measure and characterize the perception of risk by taxpayers. Among the most important point in this section are the following:

To the question "In your opinion, for a company like yours, what is the probability (from 0% to 100%) that the tax returns of the current year are audited at least once in the next three years?" more than 55% of those surveyed responded indicating probabilities of 50% or higher values. The distribution of responses (values of probability between 0% and 100%) does not present significant differences by type of taxpayer, is very similar both to individuals and legal entities, and segments CEDE, non-CEDE and Small Business. Ultimately, it would seem that the perception of risk by taxpayers is already relatively high among the majority of taxpayers. Another interesting aspect in relation to this question is that the portion of taxpayers responding in probability of being audited equal to or greater than a 0.5 value is significantly higher - in terms statistics-among the taxpayers who responded to have been subject of an action of control by the DGI in the past 12 months. This seems to be a quite clear indication that control measures - in general - influence positively the perception of risk.

On the other hand, to the question "In your opinion, if a company that evades decide to double the evaded amount, what effect would it have on the probability of being audited?" almost two thirds of respondents replied that the probability "would increase much" and another 15% that "would increase little". Ultimately, about 82 per cent considered that the probability of being audited increases as the level of non-compliance grows. In other words, there would be a perception by the majority of taxpayers that their individual tax behavior is a relevant factor on the probability of being audited.

To the extent that this type of queries become systematic it will be possible to consolidate a characterization of the risk perception by taxpayers, and this will be very useful for designing control strategies.

## ANALYSIS OF BEHAVIORAL CHANGE RESULTING FROM MASSIVE PLANS

**Michael Snaauw**

Assistant Commissioner  
Canada Revenue Agency  
(Canada)

**Contents:** 1. Introduction. 2. ADAD Pilot. 3. Nudge Pilot. 4. Lessons Learned. 5. Future directions. 6. Conclusion. Appendix

### 1. INTRODUCTION

#### Canadian Context

The Canadian tax system is administered by the Canada Revenue Agency (CRA) and is founded on self-assessment and voluntary compliance. For this system to function effectively, it must be, and be perceived to be, fair. In designing and delivering programs and services, fairness and integrity are CRA's guiding principles, impacting decisions and underscoring conduct. Tax laws are applied to all taxpayers in a fair and equitable manner at all levels, regardless of their economic status. The CRA has long recognized the value of **service** in a self-assessment tax system, because with the right tools and information, most taxpayers will voluntarily comply with tax laws by filing and paying on time, or making acceptable payment arrangements. The CRA continually improves and enhances its service offerings to keep pace with the taxpayer demand for services that are fast, efficient, and convenient. At the same time, the CRA's longstanding approach has been to direct taxpayers to the most affordable and accessible channel to meet their service needs. Ideally, this results in improved service, greater levels of voluntary compliance, and lower administrative costs for both the CRA and taxpayers. Approximately 95% of taxpayers pay on time.

#### Legislative Requirements; Filing & Payment Obligations

Individual taxpayers are obliged to file their personal income taxes annually, whereby all income is declared, and tax is paid to CRA as a percentage of their income, according to their income bracket. The CRA follows up with late filers after their filing due date. The traditional follow up is to send a standard soft letter and deliver telephone contact from the call centre.

In collections, CRA's strategies to contact non-compliant individuals typically involve sending a standard soft letter or making a telephone call between 40 and 65 days from the date of the assessment, depending on the risk associated with the account. Cases

not resolved through letters or phone calls, as well as complex cases, are sent directly to a collections officer for action.

Employers and businesses play an important role in Canada's tax system by withholding taxes and deductions such as employee payroll deductions, at source.

Payroll accounts (employers) are obliged to report all amounts of payroll deductions they withhold on behalf of employees and remit any amounts owing. If employers have no withholdings for employees, they are also required to advise the CRA, so that no subsequent action is taken. New monthly payroll accounts (employers) must report and remit their deductions by the 15th day of the month, following the month the deductions were withheld.

CRA's collection strategies to contact non-compliant employers (payroll) typically involve sending a standard soft letter or making a telephone call approximately 28 days from the date of the assessment, depending on the risk associated with the account. Cases not resolved through letters or phone calls, as well as complex cases, are sent directly to a collections officer for action.

Goods and Services Tax / Harmonized Sales Tax (GST/HST) registrants have a legal obligation to file returns and report any amount they collected on behalf of CRA, regardless if they have tax payable or not. New quarterly GST/HST registrants must file and remit any tax 30 days after the end of each reporting quarter.

The collection strategies for business GST/HST accounts are similar to those for payroll accounts; a standard soft letter is sent, or a telephone call is made approximately 28 days from the date of the assessment, depending on the risk associated with the account. Cases not resolved through letters or phone calls, as well as complex cases, are sent directly to a collections officer for action.

A lack of understanding of their tax obligations can lead individuals or new businesses with no experience nor guidance from third parties, to be unintentionally non-compliant.

### **Interventions Influencing Taxpayer Behaviour**

In 2006, an internal audit study which reviewed non-compliance issues relating to late filing and remitting of GST/HST registrants, recommended the development of proactive intervention strategies in an effort to positively influence taxpayer behaviour towards filing and remitting compliance. A report from the Office of the Auditor General supports the importance of taking early action in collecting tax debts as aging accounts often are resource intensive and become problematic over time. The report noted that the sooner action is taken, the more likely it will result in collection of the debt.

By 2008, the CRA adopted a more proactive approach by examining the effect of behavioral economics on voluntary compliance, and strengthened service by providing timely and accessible information regarding taxpayers' obligations. Significant investment

was made toward data mining efforts, which led to predictive models, and revisions to the business rules engine, to effectively triage accounts and leverage the use of automated strategies to resolve cases in a more timely manner.

This paper presents two proactive interventions which were implemented by the CRA from 2011 to 2016 in the form of pilot projects; the Automatic Dialling Announcing Device (ADAD) pilot and the Nudge pilot. These proactive interventions were designed to focus on proactive measures that would influence compliant behaviour, with the objective of reducing intake of accounts to the debt management level. Given their ease of implementation, success, and continued relevance, versions of these interventions continue to be used today.

### ADAD Pilot

The CRA conducted a pilot project in which a device known as ADAD, delivered outbound automated messages using voice broadcasting. ADAD messaging is an intervention in the form of a reminder, which is a method of nudging. Sunstein, a behavioral economist at Harvard, emphasizes ten widely adopted nudging methods (Sunstein, 2014), the use of reminders being one such method.

The ADAD reminder helps taxpayers to understand their obligations, and overcome the possibility of forgetfulness. It reminded them of their remitting and filing deadlines, and also informed and educated them of new information and options to influence filing and remittance compliance. It also aimed to induce permanent change in compliant behaviour with repeated reminders, which is supported by nudging theories.

This pilot project targeted two specific segments of the taxpayer population:

- I. New employer payroll registrants (monthly remitters), and
- II. New GST/HST registrants (quarterly filers).

Previous to this pilot project the CRA did not contact new registrants to remind them specifically of their tax filing obligations.

In May 2010, CRA launched Phase I of the pilot project. The objective was to determine if ADAD could be used to increase compliance among new GST/HST and Payroll registrants by delivering an automated telephone reminder of the recipient's first remitting deadline.

Phase I of the pilot project resulted in a statistically significant improvement in compliance in the month the ADAD call was made. Phase II, which measured the future filing compliance behaviour of these same registrants, revealed that a single ADAD call did not result in sustained compliance.

This gap in addressing long-term compliance behaviour led to Phase III. From May 2012 to January 2013, a second randomized controlled experiment was conducted to measure whether multiple reminders resulted in improved compliance beyond the final reminder.

## Nudge Pilot

Nudging is a concept in behavioural science which seeks to gently influence individual behaviour, while leaving the freedom to choose other options. Nudging was applied in this pilot by adding nudge verses to the standard soft letters, designed to influence tax compliance. CRA tested for variances in compliance between no nudge, the standard soft letter nudge, and letters with different “nudge verses”.

**Phase I** of the Nudge Pilot was conducted in January 2015 and revealed that sending such a letter improved compliance. Adding a nudge message to the standard letter seemed to improve the amount collected. Given its success, **Phase II** was conducted in March 2016 with the same objectives, but to a different target population. This pilot did not reveal the same results, but it did confirm that sending a letter, with or without a nudge message, does produce improved compliance results.

What follows is an in-depth look at these two interventions.

## 2. ADAD PILOT

### Phase I

#### Objective

Apply statistical principles to determine if an automated ADAD reminder of the recipient’s first remitting deadline, increased filing compliance among new Payroll and GST/HST registrants.

#### Methodology

#### **Target Population**

New monthly payroll and new quarterly GST/HST registrants with an available business phone number.

#### **Two-Stage Sampling Design**

Stage 1: 50% of new monthly payroll and new quarterly GST/HST registrants were **randomly selected** to create a payroll group and a GST/HST group.



Stage 2: From the groups above, two sample groups were randomly selected; a control group and an experimental group.

The campaigns captured new monthly payroll registrants over nine (9) months, and new quarterly GST/HST registrants over three (3) reporting periods, covering both peak and non-peak periods, from May 2010 to January 2011. Filing and remitting information was collected during the campaign, on a monthly basis for payroll registrants, and quarterly for GST/HST registrants, for each phase.

## Results

### **Overall Payroll Filing Compliance**

Based on the sample of all new payroll registrants selected for the pilot project, the overall filing compliance rate was 41%.

<b>Total Compliant</b>	<b>Total Non-Compliant</b>	<b>Total Sample Registrants</b>
3,588	5,212	8,800
41%	59%	100%

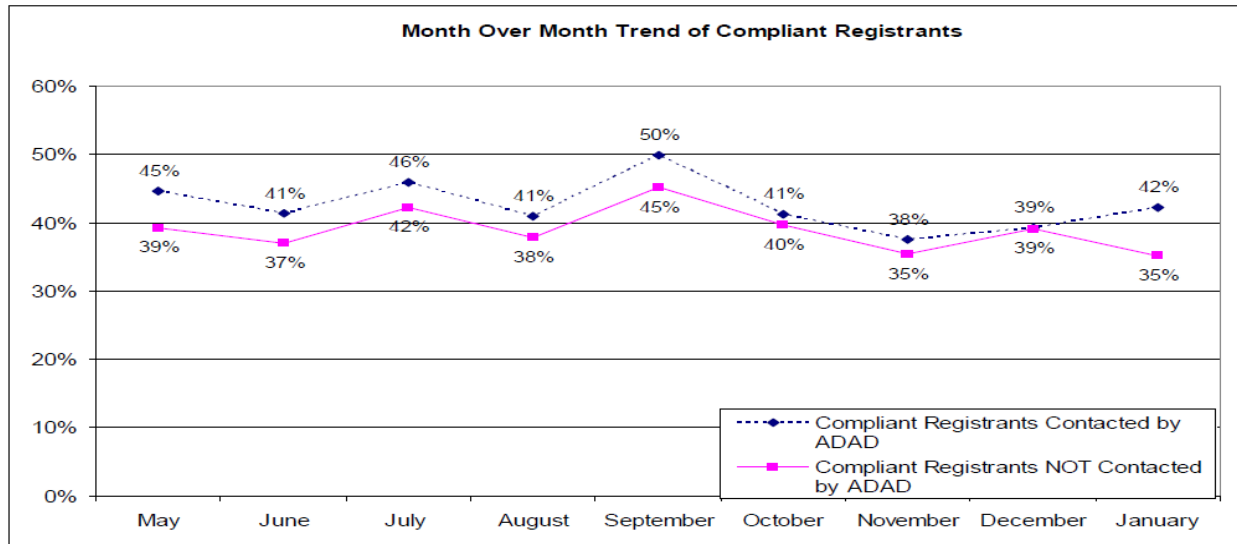
### **Filing Compliance by Payroll Registrants Contacted/Not Contacted by ADAD**

The difference in filing compliance between sample payroll registrants contacted and not contacted by ADAD, was estimated to be 4% with a margin of error of  $\pm 2\%$ . We are confident that this statistically significant result is valid 19 times out of 20 (95%).

### **Filing compliance results for the payroll campaign over nine-month period.**

<b>Overall Campaign</b>	<b>Total Compliant</b>	<b>Total Non-Compliant</b>	<b>Total Sample Registrants*</b>	<b>Proportion of Compliance</b>
Registrants Contacted by ADAD	1,854	2,502	4,356	43%
Registrants not Contacted by ADAD	1,734	2,710	4,444	39%

\* Some registrants listed to be contacted by ADAD could not be reached



## Overall GST/HST Filing Compliance

Based on the sample of all new GST/HST registrants selected for the pilot project, the overall filing compliance rate was 58%.

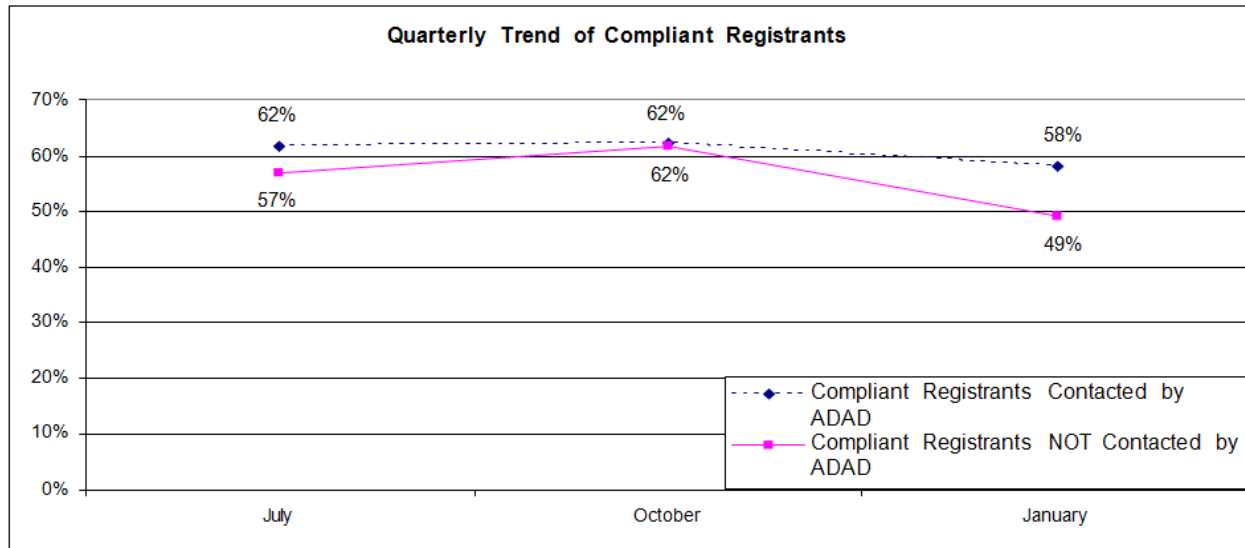
Total Compliant	Total Non-Compliant	Total Sample Registrants
1,747	1,251	2,998
58%	42%	100%

## Filing Compliance by GST/HST Registrants Contacted/Not Contacted by ADAD

The difference in filing compliance between GST/HST registrants contacted and not contacted by ADAD, was estimated to be 5%, with a margin of error of  $\pm 3\%$ . We are confident that this statistically significant result is valid 19 times out of 20 (95%).

## Filing compliance results for the payroll campaign over nine-month period

Overall Campaign	Total Compliant	Total Non-Compliant	Total Sample Registrants*	Proportion of Compliance
Registrants Contacted by ADAD	909	590	1,499	61%
Registrants not Contacted by ADAD	838	661	1,499	56%



## Phase II

### Objective

Analyze the sustained filing compliance behaviour of the registrants from Phase I.

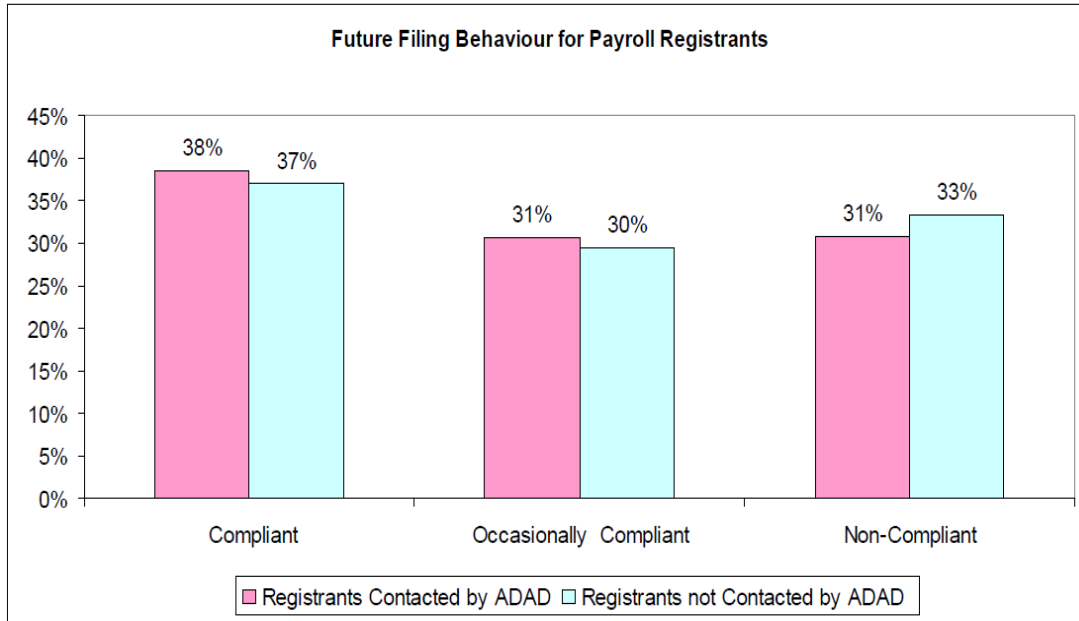
### Results

#### **Payroll Registrants**

The future filing compliance of payroll registrants was evaluated by tracking their filing behaviour in the three months following the month after registration. Filing behavior of registrants were categorized into three categories:

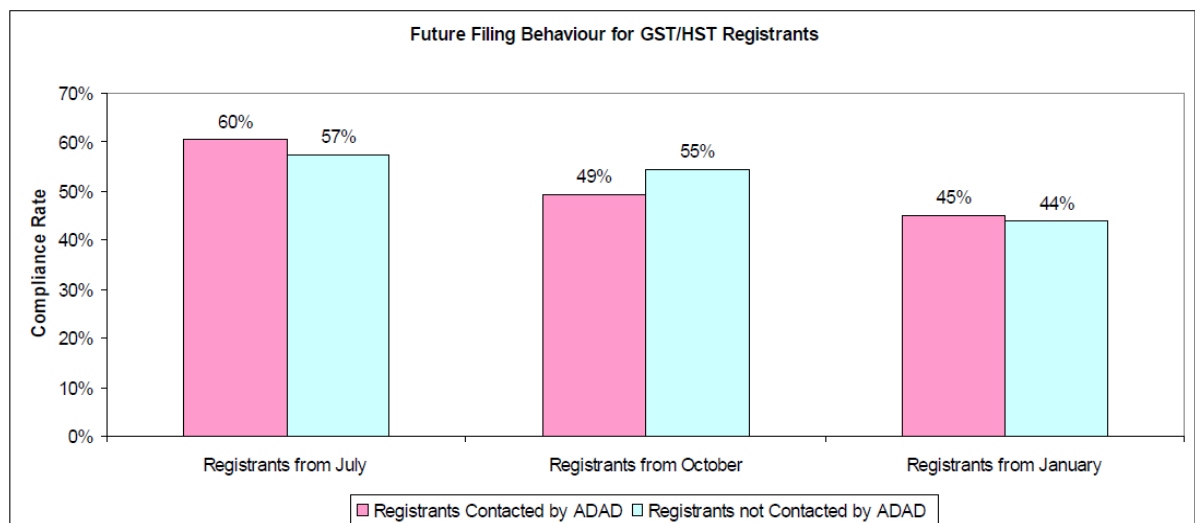
- Compliant – filed all three months by the filing date
- Occasionally Compliant – filed one or two times by the filing date
- Non-Compliant – did not file or filed after the filing deadline in all three months.

The chart below illustrates that registrants contacted by ADAD were more compliant and occasionally compliant than those registrants not contacted.



## GST/HST Registrants

For GST/HST registrants, we examined their filing behaviour for the next quarter following registration.



When sustained filing behavior was analyzed, only 41% of registrants contacted in the July campaign were filing compliant for both quarters following registration and for the

October campaign only 33% of registrants were filing compliant for both quarters following registration. It appears that, whether GST/HST registrants are contacted or not, filing compliance decreases over time.

### **Phase III**

#### Objective

Determine if **multiple** automated ADAD reminders of remitting deadlines increases filing compliance among new Payroll and GST/HST registrants.

#### Methodology

#### **Target Population**

New monthly payroll accounts activated between April and December 2012, and new quarterly GST/HST accounts activated between April and September 2012, with an available business number on record were targeted. Only GST/HST accounts with a December 31 fiscal year end were selected (unlike payroll, GST registrants can choose their fiscal year end).

#### **Sampling Design**

This phase examined three randomly selected groups for each campaign ; a control group (no ADAD contact) and two experimental groups (contacted by ADAD). Data was collected from eight monthly payroll telephone campaigns, for a period of six months, and two quarterly GST/HST campaigns for a period of 3 quarters.

The two experimental groups were randomly divided into two equal samples, after successful contact on an initial call was made :

- Treatment 1 Group was contacted once by ADAD
- Treatment 2 Group was contacted for another two remitting periods after the first completed call.

The message in the initial call was the same for both experimental groups, and stated that the message was simply a courtesy call. Those in the treatment 2 group received three messages, with the final message indicating that it was a final courtesy call. (See Appendix for full message).

## Results

### **Payroll Compliance after the Initial Call**

An increase of 4% in filing (remittance) compliance was observed between registrants contacted by ADAD and those not contacted by ADAD. We are confident that this statistically significant result is valid 19 times out of 20 (95%).

Overall Campaign	Total Filing Compliant	Total Non-Compliant	Total Sample Registrants	Proportion of Compliance
Not Contacted	11,458	16,219	27,677	41%
Contacted by ADAD	21,479	26,259	47,738	45%

### **Payroll Compliance after Three Calls and Sustained Compliance**

When both treatment groups were examined, it was determined that more frequent contact with a payroll registrant had a greater impact than a single contact.

Overall Campaign	Fully Compliant	Total Sample Registrants	Fully Compliant Rate
Control Group	13,447	26,723	50%
Treatment Group 1	12,096	23,596	51%
Treatment Group 2	11,824	22,177	53%

Overall, contact with registrants to remind them of their obligations had a positive effect on their compliance, and as the frequency of the contact increased, so did compliance, indicating that more contact influences behaviour in the short-term. However, it appeared that this training effect wore off in the months following the last ADAD contact, and the compliance rate of all ADAD accounts trended toward the compliance rate of the control group.

### **GST/HST Compliance after the Initial Call**

An increase of 6% in filing compliance was observed between registrants contacted by ADAD and those not contacted by ADAD. We are confident this statistically significant result is valid 19 times out of 20 (95%). The increase in compliance was reinforced when tracked over three quarterly periods.

Overall Campaign	Total Filing Compliant	Total Non-Compliant	Total Sample Registrants	Proportion of Compliance
Not Contacted	2,379	1,746	4,125	58%
Contacted by ADAD	4,179	2,336	6,515	64%

## **GST/HST Compliance after Three Calls and Sustained Compliance**

Similar to the results observed with payroll registrants, these results revealed that the more frequent contact made with a GST/HST registrant, the higher the compliance rate.

Overall Campaign	Fully Compliant	Total Sample Registrants	Fully Compliant Rate
Control Group	1,348	4,125	33%
Treatment 1 Group	1,259	3,575	35%
Treatment 2 Group	1,089	2,940	37%

Compliance was higher for registrants contacted in all three quarters (treatment 2 group), than for those issued one reminder (treatment 1 group). As time elapsed however, the compliance rates of both treatment groups dropped to the same levels as the control group. Sustained compliance was greater for those contacted more frequently, than those issued a reminder in only the first quarter.

However, long-term filing compliance for GST/HST appears to decrease over time, regardless of contact.

## **2. NUDGE PILOT**

### **Phase I**

#### Objective

The objective of the nudge pilot was to test the effectiveness of messages designed to nudge taxpayers, on payment compliance, among individual taxpayers with new debt owing between \$100 and \$975.

## Methodology

### Target Population

This population consisted of new intake debtors, from which a sample of nearly 25% was observed, to determine how and how much they would pay.

### Sampling Design

This project examined three testing groups that received letters and one control group.

The three testing groups were categorized by which letter they received:

1. Standard soft letter - a soft reminder letter without a nudge verse, which included the amount owed, information on penalties and interest, and methods of payment.
2. Positive nudge letter – the standard soft letter was modified to include a positive nudge verse. The verse highlights the benefit of acting quickly and calls on the taxpayer to act. The second part of the verse aims to make the taxpayer conscious of the potential consequences of inaction. The following is the positive nudge verse used: “Of individuals over the age of 18 in Canada who owe tax, 94.5% pay their taxes on time. Find out what to do when you owe taxes at [www.cra.gc.ca/collections](http://www.cra.gc.ca/collections).”
3. Negative nudge letter – the standard soft letter was modified to include a negative nudge verse. The verse educates the taxpayer about the “norm”, increasing the taxpayer’s self-reproach associated with inaction, by making the taxpayer conscious of their outlier status relative to the norm. The following is the negative nudge verse: “Of individuals over the age of 18 in Canada who owe tax, only 5.5% do not pay their taxes on time. Find out what to do when you owe taxes at [www.cra.gc.ca/collections](http://www.cra.gc.ca/collections).”

A sample of approximately 2,000 accounts from each group was randomly selected for the pilot project. The letters were mailed in September 2014. Taxpayer payment behavior was observed for 30 days after the mailing date. For the purpose of this research, "responders" refers to taxpayers who made payments or payment arrangements. The effectiveness of both nudge messages was measured against the standard soft letter, as well as the control group who did not receive any letter.

## Results

### **Proportion of Responders**

The number of responders was higher for each of the three letter (test) groups, compared to the control group. Although a minimal difference, there was no statistically significant



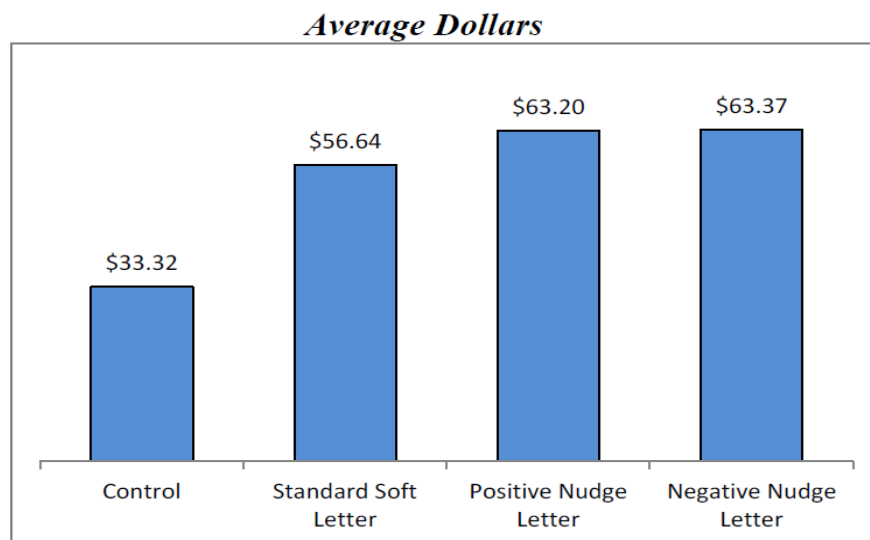
difference between the proportion of responders who received standard soft letters and those who received nudge letters. Similarly, taxpayers did not respond differently to variations in nudge verses.

### Risk and Odds Ratios for Proportion of Responders

Group		Responders	Non-Responders	Response Rate
Control		343	1,656	17%
Standard Soft Letter		550	1,417	28%
Positive Letter	Nudge	552	1,420	28%
Negative Letter	Nudge	569	1,401	29%

### Average Dollars

Statistical comparison tests confirmed that there was a significant difference in the average dollars collected from taxpayers who received any kind of letter versus those who did not receive a letter. Tests further indicated that when compared to the standard soft letter, nudge messages improved the average dollars collected. However, the difference in nudge verses did not yield a significant difference in return.



$$\text{Average Dollars} = \frac{\text{Total Dollars Collected}}{\# \text{ of Accounts in the Sample}}$$

## Total Dollars Projected

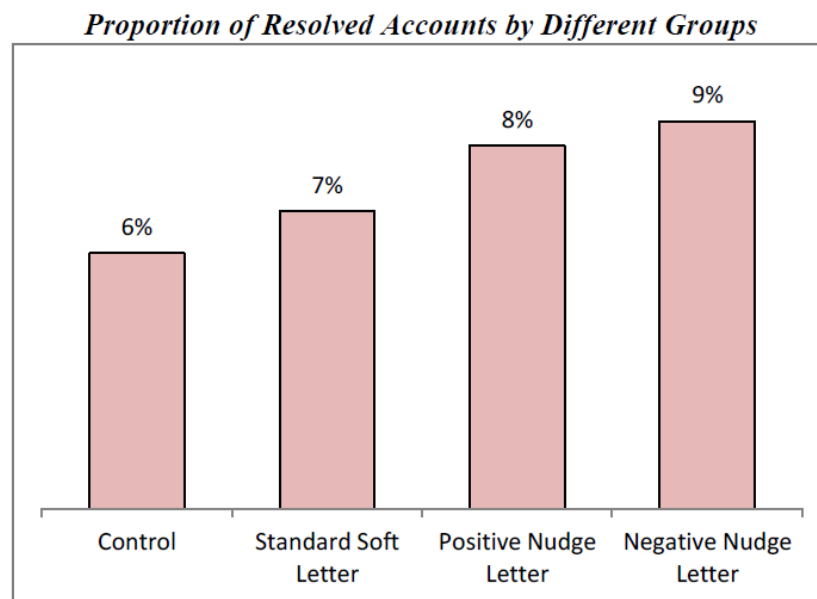
Tests further indicated that nudge letters may yield 12% more in payments than the standard soft letter in a tax year. There was little difference in total dollars collected between the positive and negative nudge test groups. Statistical inferences made from the sample indicated that total expected collections from new debtors owing between \$100 and \$975 may be increased by around \$1 million per tax year if nudge letters were sent, compared to no letter.

Group	Total Dollars Projected (\$ mill)
Control	\$1.12
Standard Soft Letter	\$1.90
Positive Nudge Letter	\$2.12
Negative Nudge Letter	\$2.12

## Total Dollars Projected by Different Groups

### Proportion of Resolved Accounts

A taxpayer resolves their account by paying all their debt and bringing the account to a nil balance. Overall, 7% percent of taxpayers selected to receive the standard soft letter resolved their accounts, 8% of the group who received the positive nudge letter resolved their accounts, and the taxpayers who received negative nudge messages had the highest proportion of resolved accounts (9%).



## **Phase II**

### Objective

The second phase of the pilot project was designed to test the effectiveness of messages designed to nudge taxpayers, on payment compliance, among individual taxpayers with new debt owing between \$1000 and \$2500.

### Methodology

#### **Sampling Design**

This phase examined two testing groups that received letters with nudge messages, and one control group who received the standard soft letter. The two testing groups were categorized by which nudge letter they received

1. Positive nudge letter – the standard soft letter was modified to include a positive nudge verse. This positive nudge verse was not the same verse that was used in Phase 1. The following is the positive nudge verse: “Pay your debt now and save money! In fact, waiting may make any financial or legal consequences more serious. Find out what to do when you owe taxes at [www.cra.gc.ca/collections](http://www.cra.gc.ca/collections).”
2. Negative nudge letter – the standard soft letter was modified to include a negative nudge verse. The same negative nudge verse was used: “Of individuals over the age of 18 who owe tax, only 5.5% do not pay their taxes on time. Find out what to do when you owe taxes at [www.cra.gc.ca/collections](http://www.cra.gc.ca/collections).”

In this phase, success from nudge letters was measured against the standard soft letter. A sample of approximately 2800 accounts was randomly assigned to each group. The letters were mailed between June 23 and August 12, 2015. Taxpayer payment behavior was observed for 60 days after the mailing date.

### Results

#### **Proportion of Responders**

The proportion of responders was higher for those taxpayers who received a positive nudge letter. Approximately 49% of taxpayers who received a positive nudge letter responded. The next closest group was the control group, with a response rate of 47%. The negative nudge letter group had a response rate of just over 45%.

There was no significant difference between the proportion of responders who received the standard soft letter and those who received nudge letters. There was however, a statistically significant difference in results between the positive and negative nudge letters.

Group	Responders	Non-Responders	Response Rates
Standard Soft Letter	1,325	1,475	47%
Positive Nudge Letter	1,318	1,376	49%
Negative Nudge Letter	1,294	1,543	45%

### Odds Ratios for Responders

#### Average Dollars

The group with the highest average dollars collected was the positive nudge letter group, followed by the standard soft letter group, then the negative nudge letter group. Statistical tests indicated that the differences in average dollars collected among the three groups were not statistically significant.

#### Proportion of Resolved Accounts

Those who received the standard soft letter had the highest proportion of resolved accounts. It was followed closely by the positive nudge letter group. The lowest proportion was observed in the negative nudge letter group. Statistical tests indicated that the proportion of resolved accounts was not significantly different among the three letter groups.

Group	Resolved Accounts	Not Resolved	Resolved Rates
Standard Soft Letter	574	2,226	21%
Positive Nudge Letter	545	2,149	20%
Negative Nudge Letter	520	2,317	18%

### Comparison of Phase I and Phase II

The results of the first phase of the pilot project showed that there was no statistically significant difference in the **response rate** for the letter types, whether they were standard soft, positive nudge or negative nudge letters. For the second phase of the pilot project, there was a marginal difference in the response rates of those receiving a positive nudge letter over those that received a negative one. In terms of **dollars**, the results of Phase I showed that nudge letters yielded more money than the soft letter. However, there was no difference in dollars collected between the two nudge-letter groups. For the second phase of the project, the results show that the positive nudge letters generated the highest amount of dollars; however, there were no statistically significant difference between all three letter groups. Both pilots revealed that sending letters improved compliance, whether a nudge message was included or no.

## **4. LESSONS LEARNED**

To date, the CRA's behavioural economics and nudge-related work has focused on increasing the rate of filing and payment compliance. As there are a variety of nudge-related tools to consider when engaging taxpayers, several projects have been undertaken and completed since 2007, all generating findings that shed light on how to engage with taxpayers and encourage compliance.

### **Key Findings**

#### **Outreach**

Generally speaking, the projects have shown that CRA interventions are usually effective at increasing compliance, at least in the short term.

Some techniques are more effective than others

Projects have demonstrated the effectiveness of different approaches to influence taxpayers' behaviour and encourage compliance. Projects have also helped to evaluate available tools, such as the use of the Automated Dialing Announcement Device.

Different groups respond better to different approaches

When evaluating the effectiveness of nudge techniques, it is important to remember that there is no "one-size-fits-all" approach. Certain techniques may work better with some groups of taxpayers than others and some taxpayers may require more contact than others, which requires a more tailored approach. This is observed by differing results in Nudge Phase I and Phase II, which may be attributed to differing amounts of tax owing. This supports the effort of multiple pilots, testing different segments of the taxpayer population and varying nudge messages.

Some groups are easier to nudge than others

While nudging can be a powerful instrument, it is important to recognize its limitations in affecting compliance behaviour among some populations. For example, it may be easier to obtain greater results when targeting taxpayers who are unaware of their obligations, versus those who are knowingly non-compliant.

### **Best practices**

Knowledge needs to be shared

Project findings have a greater effect when they are shared broadly. This means making findings accessible across other areas of the tax administration, and where appropriate, with outside stakeholders, such as academics.

## **Measurement is key**

A fundamental aspect of nudge projects is the ability to accurately assess the effect of different interventions. In this regard, experiments must be rigorously designed and executed, including the use of randomized controlled trials.

All results build the evidence base

Occasionally, projects have produced little to no impact on the targeted problem (a null finding). Such results can be viewed as a failure. However, these findings are important, and, just as with positive findings, must be well documented and shared broadly to build and refine the evidence and knowledge base.

## **5. FUTURE DIRECTIONS**

The CRA has experienced much success through the use of business intelligence to drive our automated strategies, which involve sending letters or making telephone calls. We remain committed to investing in behavioural nudge projects and enhancing our risk assessment processes through advanced technologies and by gaining access to more data sources that can be leveraged to predict behaviours. We are confident that an enhanced risk assessment model that uses data mining, predictive models and analytics will allow us to resolve more accounts through automation, ultimately reducing the number of cases our collectors must address.

The CRA will build on the lessons learned from past and ongoing nudge projects in designing and implementing future projects. Some tax agencies are currently expanding beyond individual taxpayers to businesses, in the application of behavioral economics, or nudging. The CRA will soon test nudge phrases on business (GST/HST) accounts, and will use the same methodology of testing a negative nudge and a positive nudge, against the standard soft letter.

The CRA continues to work to improve coordination, knowledge-sharing, and support for innovative projects. In this regard, the CRA officially launched a lab in January 2015, which works with program areas to coordinate the CRA's work in the behavioural economics and nudge field. This coordination of studies will further enhance our knowledge of how to better understand taxpayer behaviour. The CRA also recognizes the importance of continued engagement with external academics and experts.

## **6. CONCLUSION**

Both pilot projects revealed that compliance improvements can be achieved through minimal effort and expense, and as the ADAD and nudging activities are repeated, so are the positive results.

Given the CRA's success, other tax administrations may wish to adopt similar approaches to test the effects within their unique environments.

## **APPENDIX**

**Statistical Significance:** A result is called statistically significant if it is unlikely to have occurred by chance only.

### **Employer (Payroll and GST/HST) Accounts ADAD Messaging**

#### **Initial Message**

“This courtesy call is a reminder from the Canada Revenue Agency. Payroll deductions payments for the month of [insert month] are due by [insert month] 15th. Payments can be made using self-service options such as My Business Account and My Payment on the CRA Web site. Payments can also be made at any bank or credit union. For more information please visit [www.cra.gc.ca](http://www.cra.gc.ca), or call our Business Enquiries line at 1-xxx-xxx-xxxx or write to us at: London Tax Services Office, 451 Talbot Street, London, Ontario, N6A 5E5. Thank you. This has been a call from the Canada Revenue Agency.”

#### **Message 2**

“This second courtesy call is a reminder from the Canada Revenue Agency. Payroll deduction payments for the month of [insert month] are due by [insert month] 15th. Payments can be made using self-service options such as My Business Account and My Payment on the CRA Web site. Payments can also be made at any bank or credit union. For more information please visit [www.cra.gc.ca](http://www.cra.gc.ca), or call our Business Enquiries line at 1-xxx-xxx-xxxx or write to us at: London Tax Services Office, 451 Talbot Street, London, Ontario, N6A 5E5. Thank you. This has been a call from the Canada Revenue Agency.”

#### **Message 3**

“This final courtesy call is a reminder from the Canada Revenue Agency. Payroll deduction payments for the month of [insert month] are due by [insert month] 15th. Payments can be made using self-service options such as My Business Account and My Payment on the CRA Web site. Payments can also be made at any bank or credit union. For more information please visit [www.cra.gc.ca](http://www.cra.gc.ca), or call our Business Enquiries line at 1-xxx-xxx-xxxx or write to us at: London Tax Services Office, 451 Talbot Street, London, Ontario, N6A 5E5. Thank you. This has been a call from the Canada Revenue Agency.”



## **GST/HST Registrants ADAD Messaging**

### **Initial Message**

“This courtesy call is a reminder from the Canada Revenue Agency. GST/ HST returns for the period ending [insert month] are due by [insert month] Date. When there are no business transactions in a reporting period, a return must still be filed. Filing and payments can be made using self-service options such as My Business Account and My Payment on the CRA Web site. Payments can also be made at any bank or credit union. For more information please visit [www.cra.gc.ca](http://www.cra.gc.ca), or call our Business Enquiries line at 1-xxx-xxx-xxxx or write to us at: London Tax Services Office, 451 Talbot Street, London, Ontario, N6A 5E5. Thank you. This has been a call from the Canada Revenue Agency.”

### **Message 2**

“This second courtesy call is a reminder from the Canada Revenue Agency. GST/ HST returns for the period ending [insert month] are due by [insert month] Date. When there are no business transactions in a reporting period, a return must still be filed. Filing and payments can be made using self-service options such as My Business Account and My Payment on the CRA Web site. Payments can also be made at any bank or credit union. For more information please visit [www.cra.gc.ca](http://www.cra.gc.ca), or call our Business Enquiries line at 1-xxx-xxx-xxxx or write to us at: London Tax Services Office, 451 Talbot Street, London, Ontario, N6A 5E5. Thank you. This has been a call from the Canada Revenue Agency.”

### **Message 3**

“This final courtesy call is a reminder from the Canada Revenue Agency. GST/ HST returns for the period ending [insert month] are due by [insert month] Date. When there are no business transactions in a reporting period, a return must still be filed. Filing and payments can be made using self-service options such as My Business Account and My Payment on the CRA Web site. Payments can also be made at any bank or credit union. For more information please visit [www.cra.gc.ca](http://www.cra.gc.ca), or call our Business Enquiries line at 1-xxx-xxx-xxxx or write to us at: London Tax Services Office, 451 Talbot Street, London, Ontario, N6A 5E5. Thank you. This has been a call from the Canada Revenue Agency.”

**Inter-American Center of Tax Administrations – CIAT**

**51<sup>st</sup> GENERAL ASSEMBLY**



**“ADVANCES OF THE TAX ADMINISTRATIONS TOWARD GREATER  
TAXPAYER  
EQUITY BY IMPROVING EFFECTIVENES AND EFFICIENCY”**

**PPT**

**Asuncion, Paraguay**

**April 25 – 28, 2017**

## Tuesday April 25, 2017

**Keynote Address: Progress of the Tax Administrations toward greater tax equity**

**FMI | PPT ([ES](#))**

**Paraguay | PPT ([ES](#))**

### **Topic 1: Tools for improving the implementation of Tax Policies**

**CIAT | PPT ([ES](#))**

**BID | PPT ([ES](#))**

**Topic 1.1: Current main challenges of the Tax Administrations (globalization and digitalization of the economy, financial capacity, recruitment, education and training)**

**Canada | PPT ([ES](#)) ([EN](#))**

**USA | PPT ([EN](#))**

### **Topic 1.2: Normative anti-avoidance and anti-evasion framework**

**Italy| PPT ([ES](#)) ([EN](#))**

**Brazil | PPT ([ES](#)) ([EN](#))**

**Paraguay| PPT ([ES](#))**

## Wednesday April 26, 2017

**Topic 2: Focusing on assistance, services and transparency in management**

**Colombia | PPT ([ES](#))**

**Paraguay | PPT ([ES](#))**

**Topic 2.1: From the Taxpayer file to the current account to enforced collection**

**Noruega | PPT ([EN](#))**

**Perú | PPT ([ES](#))**

**Netherlands | PPT ([EN](#))**

**Thursday April 27, 2017**

**Topic 3: The TA's relationship with the citizens and taxpayers**

**Spain | PPT [\(ES\)](#)**

**USA | PPT [\(EN\)](#)**

**Chile | PPT [\(ES\)](#) [\(EN\)](#)**

**Topic 3.1: The strengthening of tax control processes**

**OCDE | PPT [\(EN\)](#)**

**Topic 3.2: Examination techniques and E-commerce control**

**CIAT | PPT [\(ES\)](#)**

**Topic 3.3: Programs and best practices for carrying out massive plan**

**Uruguay | PPT [\(ES\)](#)**

**Canada | PPT [\(ES\)](#) [\(EN\)](#)**