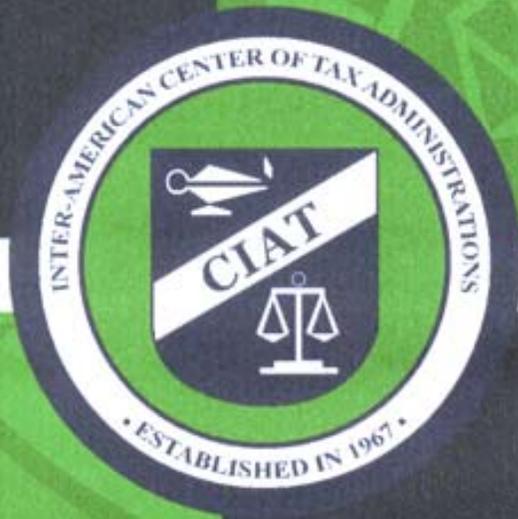




State Agency of Tax Administration

CIAT Technical Conference

An Integral Approach in Preventing
and Combating Tax Evasion



Madrid, Spain
October 23 - 26, 2006



**Inter - American Center of Tax Administrations - CIAT
State Agency of Tax Administration - AEAT**



CIAT Technical Conference



**AN INTEGRAL APPROACH IN PREVENTING
AND COMBATING TAX EVASION**

**Madrid, Spain
23-26 October 2006**

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INAUGURAL CEREMONY

**WELLCOME STATEMENT
BY MR. LUIS PEDROCHE Y ROJO
DIRECTOR GENERAL OF THE STATE AGENCY OF TAX
ADMINISTRATION
(SPAIN)**

It is a great satisfaction for me to welcome you all, representatives of tax administrations, international organizations and fiscal experts, called to the next CIAT Technical Conference, to be held in Madrid, from October 23rd to 26th.

The CIAT Technical Conferences are events of the greatest relevance for those of us who work in the tax administrations. These are genuine occasions to expound the latest breakthroughs and the goals still to be achieved; to talk about the difficulties we have overcome and the new circumstances, which are continuously being transformed into new challenges. It is a forum where we always learn about interesting experiences and where we meet participants and friends that understand us, because all of us share similar tasks and a common language.

As you know, this year's Conference will deal with "*An integral approach in preventing and combating tax evasion*", a matter that couldn't be either more up-to-date or more significant.

The first obligation of a tax administration is to serve society in every activity and to guide the relations with citizens in the easiest and most reasonable way for them. We, as tax administrators, must approach the citizens and not the other way round. This was the subject of the 2001 Technical Conference, held in Seville.

But that relation of mutual respect and collaboration with citizens cannot prosper if they see, on a daily basis, examples of tax avoidance without penalization. The fight against tax avoidance is more and more difficult each day and requires an agile and complex answer. For this reason, a substantial investment in material and, above all, human resources is compulsory.

WELLCOME STATEMENT

We know well that the growth of international trade and the abolition of the customs barriers are circumstances that favour our economies, but they favour also fraud operations. It is a true challenge to combat these without harming the economic development.

We shall be speaking about all this in the Conference. This should serve to pool our different experiences, to discuss our common problems and to advance towards effective solutions.

I would like to finish with my best wishes for a fruitful Conference and a pleasant stay in Spain to all who are visiting us.

Luis Pedroche y Rojo
Director General
State Agency of Tax Administration

INAUGURAL STATEMENT

**Statement by the CIAT Executive Secretary
Dr. Claudino Pita**



**Dr. Claudino Pita
Executive Secretary**

Mr. Carlos Ocaña y Pérez de Tudela, State Secretary of Finance and Budgets of Spain, Mr. Jorge Rachid, President of the CIAT Executive Council, Mr. Luis Pedroche, General Director of the State Agency of Tax Administration of Spain, Members of the CIAT Executive Council, Representatives of the CIAT member countries, officials comprising the delegations of the CIAT member countries, from other tax administrations and international organizations accompanying us, friends all. First of all, I would like to thank you for being here and welcome you most cordially to this

CIAT Technical Conference, whose main subject of analysis is the very current and important proposal of

**“AN INTEGRAL APPROACH FOR PREVENTING AND COMBATING
TAX EVASION”**

In particular, we would like to thank the Spanish Government authorities represented by Luis Pedroche for this new demonstration of support to CIAT, which allows us once again to hold our Technical Conference in Spain.

Spain’s identification and solidarity with CIAT, and through the latter, with all its member countries, may be understood as an expression of the vocation of cooperation and humanism that has always characterized it.

INAUGURAL STATEMENT

On the other hand, we may rightly affirm that there is no other nation outside the American continent that has such strong ties with the countries of said continent as regards their history, their culture and their people.

Many of CIAT's achievements, mainly those intended to promote cooperation among the tax administrations of its member countries, as well as many of the advances that may be perceived in the Latin American tax administrations are due to Spain's uniquely generous and great contribution.

In this respect we must point out the support received from four Spanish institutions: first, the State Agency of Tax Administration and also the General Directorate of Taxes, the Institute of Fiscal Studies and the Spanish Agency of International Cooperation.

Likewise at the individual level, regardless of admitting that many are the names that should be mentioned, there are two particularly worth highlighting because of their relationship with the countries of the Americas and their professional and human qualifications. They are José Victor Sevilla Segura, who contributed his talent and exceptional knowledge of tax issues as part of Spain's contribution to the American tax administrations and Fernando Díaz Yubero, who for many years has been a special liaison between Spain and the Americas and a decisive factor in the support given by Spain for the development of the American tax administrations.

The topics to be considered at this CIAT Technical Conference are intended to be the subject of joint reflection and exchange of experiences regarding the current challenges faced by our administrations for an effective execution of the tax law, for the prevention and struggle against evasion, by means of examination as well as recovery actions.

As the program is developed we will have the opportunity to learn about and discuss interesting and orienting experiences.

The reason for the joint analysis of these issues is because they are framed within the common challenges which the tax administrations must face within the current environment, both at the internal as well as international levels.

At the internal level, a more participative and demanding society within the context of change of paradigm we are experiencing: from that of “more market and less State”, to that of “better market and better quality State“, forces us to be more than ever concerned about achieving an adequate response to the expectations of our citizens, by strictly fulfilling our role as integral executors of tax regulations, in favor of equity and progress and by providing timely and satisfactory services.

At the international level, we must solve the new challenges arising from globalization which, on the one hand, has contributed to a greater efficiency of the economy, through the opening and subsequent greater competition it promotes, while on the other, it has implied new and renewed challenges for the tax administrations by facilitating the promotion and structuring of evasion schemes that are difficult to control. One such example is harmful tax planning which resorts to such instruments as the manipulation of transfer pricing, thin capitalization and the creation of fictitious entities supported by the use of strict confidentiality allowed by jurisdictions with little or no taxation of income or by exceptional differential regimes of jurisdictions with normal income taxation.

If common challenges are faced, then the essence of the strategy to be developed by the tax administrations should also be common. Its implementation may and should vary in accordance with the availability of resources and the achievements of each administration. Nevertheless, we believe that, in all cases, such strategy should be integrally and permanently updated to abide by changes in the environment, while being based on six fundamental elements:

1. Special emphasis on improvement of every action directly linked to improving voluntary compliance. This involves:
 - Compliance and recovery control activities, mainly through the processing of information; that is, the one available at the AT as well as that obtainable through third parties, by undertaking “crosschecks“ of that information that may allow for preventing, detecting and solving noncompliance. The promotion of these activities, in addition to having effects on those that are the subject of specific actions, will increase the perception of risk in the universe of taxpayers, while reducing propensity toward evasion.

INAUGURAL STATEMENT

- Improvement of taxpayer assistance services, which will facilitate voluntary compliance, while at the same time avoiding involuntary errors mostly generated by the complexity that characterizes tax regulations, that will allow for mainly focusing the TA's actions and resources on solving deliberate evasive behaviors.
2. Promotion of tax culture in such a way as to strengthen the "taxpayer's ethics". The intention is not only to disseminate the essential purpose of the tax administration and of taxation which is to contribute to the welfare of society, but to prevent noncompliance through the promotion of corporate responsibility, whereby business entrepreneurs may be aware of tax risks and evaluate inappropriate proposals from tax consultants, to ensure that such risks may undergo the same strict analysis and prove to be as transparent as other business risks, thereby refraining the use of abusive tax planning.
 3. Follow-up and incorporation, to the extent possible, of advances in information and communications technology which, on the one hand, will call for expanding the capacity to apply a better risk management policy to act proactively and appropriately direct control efforts in selecting and managing cases. Likewise, technological advance in the TA may result in a better and more timely rendering of taxpayer services, while allowing for keeping abreast of the requirements and possibilities that may arising when the taxpayers obtain those same advances.
 4. Reduction of evasion opportunities through a permanent analysis of tax norms (legal and regulatory) and the preparation of proposals for the reform of such norms by the pertinent authorities, in such a way as to simplify them so that they may be better accepted, complied with and managed, while eliminating ambiguities or gaps that may facilitate tax planning and law abuse, and which, above all, may abide by the lessons learned in the application of such regulations by the TA.
 5. Promotion of international administrative cooperation as an essential tool for responding to the challenges of the world environment by favoring internal legislation and international agreements that may comprise the necessary legal framework, through the establishment of the administrative structure and

adequate procedures, training of officials, with a view to effectively offering and receiving such cooperation, particularly by means of the exchange of tax information.

6. Emphasis on actions for strengthening human resources policies and management, leading to their technical-professional training, motivation, identification with the organization and its values, especially with respect to ethics, being aware that any advance in other aspects of the tax administration, as experience indicates, unavoidably requires the participation and commitment of its officials for a real implementation and sustainability of such progress.

To conclude, through its General Director, Mr. Luis Pedroche, we wish to reiterate our recognition and gratitude to the State Agency of Tax Administration for sponsoring this Conference, as well as to the staff for their warm hospitality. Likewise, our recognition and gratitude is extensive to the valuable team of officials working at the Executive Secretariat headquarters, formed by international and local officials as well as those comprising the Spanish and French missions at CIAT, for their professionalism, spirit of service and commitment to our Center, all of which, together with the support of our member countries render possible the holding and success of events such as this one, in an environment of high professionalism, harmony and sincere friendship. To all of you, thank you for your presence and for kindly responding to our invitation.



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CIAT Technical Conference
An Integral Approach in Preventing and Combating Tax Evasion

Madrid, Spain
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Topic 1

THE SPANISH TAX SYSTEM - CURRENT FRAMEWORK: TAX REFORM AND THE TAX FRAUD PREVENTION PLAN

Lecture

TOPIC 1

**THE SPANISH TAX SYSTEM -
CURRENT FRAMEWORK: TAX REFORM AND
THE TAX FRAUD PREVENTION PLAN**

Luis Pedroche y Rojo
General Director
State Agency of Tax Administration – AEAT
(Spain)

*CONTENS: I. Overview on the Need for a Tax Fraud Prevention Plan.-
II. Methodology Employed in the Prevention Plan Drafting Process.-
III. Enforcement Principles Underlying the Prevention Plan.-
IV. Features of the New Planning System.- V. Scope of the Prevention
Plan.- VI. Tax Fraud Prevention: Applicable Legislation.- Conclusion.*

The ongoing and balanced growth based on productivity stands as the guiding principle of the Spanish government's economic policy. Likewise, budgetary stability and financial adequacy principles constitute a vital requirement, which govern spending policies with an impact on productivity and are supplemented with the Individual Income Tax (IIT) and Corporate Income Tax reform.

Under this framework, the IIT reform seeks to enhance equity and growth, secure financial adequacy for Administrations overall, favor fair taxation on savings and approach, from the tax standpoint, the issues stemming from aging and dependence.

Vis-à-vis the Corporate Income Tax, the reform addresses the need to protect the competitive standing of Spanish businesses from the European Community standpoint, achieve a better tax coordination with surrounding countries, simplify its structure and attain greater neutrality in the enforcement thereof, in order to foster new business creation.

Notwithstanding, we must point out that the enhancement of equity and distribution of tax burdens according to taxpayers' paying capacity shall not be feasible on the exclusive basis of a tax reform alone.

The State Agency of Tax Administration's (AEAT, as per the Spanish acronym) efforts to prevent and counter tax fraud are deemed vital. It shall enforce the tax system in order to fulfill the Constitutional mandate enshrined in Article 31 in the Spanish Constitution, which sets forth that everyone shall make a contribution to support government expenditures on the basis of their tax paying capacity.

Therefore, the Tax Fraud Prevention Plan drafted by the Tax Agency constitutes the reference framework that has enabled to implement modern practices in the enforcement of the Spanish Tax System.

This presentation shall analyze this Tax Fraud Prevention Plan, and particularly, address the following issues:

- I.- Overview on the need for a Tax Fraud Prevention Plan.
- II.- Methodology employed in the Prevention Plan drafting process.
- III.- Enforcement principles underlying the Prevention Plan.
- IV.- Features of the new planning system.
- V.- Scope of the Prevention Plan.
- VI.- Tax fraud prevention: applicable legislation.

I. OVERVIEW ON THE NEED FOR A TAX FRAUD PREVENTION PLAN

The AEAT was created by Law¹ as a Public-Law Entity, with a legal structure different from the General Government Administration, which, without detriment to the essential principles governing every administrative office (hierarchy, decentralization and coordination),

¹ Act Nº 31/1990, December 27th, State General Budgets, 1991.

vests upon it certain autonomy vis-à-vis budgetary and staff management matters.

By Law, the AEAT has the mission of effectively enforcing the Government tax and customs system and other revenues from other Spanish Government or European Union Offices and Entities, the management of which is mandated by Law or Covenant.

In this regard, it conducts its activities on the basis of two fundamentally strategic courses of action. Firstly, it seeks to directly and immediately facilitate voluntary tax compliance for citizens, by offering information and assistance services for such purpose. Secondly, by detecting and redressing tax noncompliance based on examination efforts to guarantee the generality and equity principles in the contribution to the tax burden.

Under this framework, we may assert that although the underlying reasons for the AEAT to draft the Tax Fraud Prevention Plan are quite diverse, their common denominator is the need to improve the efficacy in the prevention of tax noncompliance.

Firstly, this Plan is the answer to citizens' claims. In the last few years, the dissemination of citizens' tax compliance assistance services and the ongoing improvement of the quality of such services has enabled the State Agency of Tax Administration to be considered as a model Administration worldwide vis-à-vis the rendering of taxpayers' services.

This assertion is grounded on the fact that pursuant to the data available before the Prevention Plan² was drafted, that is to say, in 2004, 82.8% of citizens were satisfied or very satisfied with the service rendered by the State Agency of Tax Administration.

Nevertheless, slightly over 42 % expressed their satisfaction with the effective actions of the Agency in the efforts undertaken to counter tax fraud.

Overall, the effort made and the outcomes achieved in the field of citizen assistance have failed to be reflected in the control area, which clearly evidences an under-adaptation to the economic reality and the evolution of fraud.

² CIS Survey on Public Opinion and Tax Policy 2004.

Consequently, the AEAT, pursuant to the mandates set forth in the Law that created it, has reviewed its fraud prevention and control strategy, with the resulting Tax Fraud Prevention Plan.

Secondly, tax fraud impairs Tax Administration revenues and thus conditions the quality of public services and social security, which implies that efficacy in preventing and countering tax fraud constitutes a fundamental objective.

Thirdly, we wish to avoid violations of the tax system's principle of equity. Fraudulent behaviors entail a reduction in tax revenues, which impacts the tax pressure borne by compliant taxpayers, since government expenditures would be impossible to finance otherwise.

Finally, we must point out that fraud generates distortive behaviors and detrimental economic effects on economy. Tax compliant businesses must face disloyal competition from the noncompliant ones. Therefore, the life of efficient businesses is jeopardized, which generate employment and benefits to their owners and also contribute with resources to finance government activities, but encounter difficulties to compete with businesses that avail themselves of tax noncompliance to displace them.

II. METHODOLOGY EMPLOYED IN THE PREVENTION PLAN DRAFTING PROCESS

On the basis of these assumptions, we must focus on the methodology employed in the Tax Fraud Prevention Plan drafting process.

Initial Phase

The initial phase in the Plan drafting process consisted in underlining the weaknesses and strategic, organizational or coordination issues requiring improvement in their control model. For example, the following weaknesses were detected:

- Problems that relate to information gathering and digitization of the data collected by the AEAT, which hinders the process of selecting taxpayers eligible for examination and the enforcement of control procedures themselves.

Lack of an external communication strategy that empowers the effects of control procedures and enables to achieve citizens' support, as well as businesses and entities damaged by the fraud phenomenon.

- The organizational AEAT model and external alliances have not been significantly updated since the time of its creation, which has impaired its capacity to respond to phenomena such as taxpayers who change domicile, or business operations in tax havens.
- Absence of a clear and comprehensive strategy in the face of fraud during the tax examinations' collection phase, which entails fraudster businesses that drain companies of their cash in the course of the examination period.
- Limited scope as to the examination procedures' planning in line with this Plan, the examination of a reduced number of taxpayers and the disclosure of a certain debt amount, with a discouraging effect on more complex investigation tasks.

Expert Analysis

After this diagnosis, over sixty measures or areas for improvement were identified. The Standing Committee of the State Agency of Tax Administration appointed experts to submit a report pursuant to each measure individually.

Said reports were submitted for consideration to the Agency's Departments and Services, and once ratified by the Standing Committee, they became the basis for the Fraud Prevention Plan.

Plan Draft

Once the experts' reports were received, the coordination tasks were undertaken. Over sixty reports were systematized into eleven blocks or enforcement areas, either by fraud modality, type of taxpayer involved or type of measure proposed.

TOPIC 1 (Spain)

Public Hearings

The Plan drafting process followed a methodology that introduced social participation elements unprecedented in previous plans.

The Draft Plan was subject to a two-month public hearing process in the course of which over 500 individual suggestions were received and 22 reports by professional associations, unions or professional colleges. The Agency undertook the analysis of all the information with a view to enhancing the Plan's content and to focus it on citizens' claims vis-à-vis tax fraud prevention.

Presentation of the Plan

Upon completion of the public hearing process, the final version of the Tax Fraud Prevention Plan was presented after the meeting of the Council of Ministers on February 4th, 2005. This document is organized according to four chapters.

- Chapter One addresses the Plan Introduction.
- Chapter Two includes the main courses of action.
- Chapter Three is made up by eleven enforcement areas.³
- Chapter Four refers to regulations and renders a systematized account of the regulatory proposals considered on the basis of the topics addressed in the Plan.
- An Attachment is included, which sets forth a schedule for the implementation of over three hundred measures defined in the Plan, indicating the AEAT Departments and Services in charge of enforcing them.

³ The Plan comprises the following enforcement areas:

- 1.- Information and Preventive Actions.
- 2.- Institutional Alliances.
- 3.- Organized Fraud Schemes vis-à-vis VAT and Excise Taxes in transactions within the EU.
- 4.- Real Estate Fraud.
- 5.- Customs Fraud.
- 6.- Tax Engineering and International Fraud.
- 7.- Analysis of the issues detected in the area of professional activities and Small and Medium Sized Businesses.
- 8.- Additional Measures to Counter Fraud.
- 9.- Fraud in the Revenue Collection Phase.
- 10.- Organizational and internal coordination measures and functional integration.
- 11.- Plan Enforcement Support Measures.

Suggestion Box

The disclosure of the Plan to the community, as mentioned before, is the most unprecedented aspect of the methodology employed. It has been materialized by way of a suggestion box on the Agency's Web page www.agenciatributaria.es. This suggestion box enables citizens to submit proposals and comments, which are considered on an ongoing basis by the AEAT.

III. ENFORCEMENT PRINCIPLES UNDERLYING THE PREVENTION PLAN

The Tax Fraud Prevention Plan has changed the focus of the efforts to prevent and redress tax fraud. It has defined the basic principles to plan examination and investigation actions by the AEAT and drawn the priority courses of action vis-à-vis tax control. For such purpose, it includes in excess of 300 operational, organizational and regulatory actions.

By means of the Prevention Plan, control enforcement efforts have been optimized not only to achieve a direct revenue effect, by redressing noncompliance, but also with a view to generating an induced effect: the notion that noncompliance is discovered and redressed to move taxpayers to meet their tax obligations.

In this regard, we may assert that this Plan is a turning point in the AEAT's control procedures, pursuant to the enforcement principles hereunder:

- m Firstly, it highlights the nature of the Plan: strategic, fundamentally operational and for immediate enforcement.
- m Secondly, the Plan has strengthened investigation actions as a method for early fraud detection.
- m Thirdly, debt collection, stemming from the investigation and examination processes, has evolved into a guiding principle for the AEAT's efforts.
- m Lastly, we must consider that the Plan has fostered a change in the control model, introducing the following changes:
 - Strengthening of the integration and coordination mechanisms among the different functional areas.
 - Enforcement actions applicable from the time a tax becomes payable.

- Shifting from simply reviewing data to discovering concealed income and wealth.
- Increased field work, that is to say, controls on the premises of taxpayers' businesses and offices, as opposed to controls performed at the AEAT level.

IV. FEATURES OF THE NEW PLANNING SYSTEM

From the time of its creation, the State Agency of Tax Administration has adopted the management by objectives system. It relies on a body specifically devoted to planning functions: the Organization, Planning and Institutional Relations Department.

The Tax Fraud Prevention Plan has spurred an overall review of the AEAT objectives' system. In fact, a significant review has been performed as to the planning instruments and criteria, with the purpose of empowering the foregoing enforcement principles:

- Reinforcing investigation and priority focus on the most serious and complex forms of fraud.
- Favoring collection of debts pursued by the State Agency of Tax Administration.
- Fostering coordination among the different functional areas.

The notions that underlie the new planning system are basically the following:

- Consistency with the overall Agency strategy;
- Greater involvement of the different levels of the organization in planning tasks;
- Information dissemination transparency, regarding the information aimed at the organization as well as the one meant for society.

On the basis of these notions, the AEAT shifts the focus of its plans and procedures in 2005 to meet the guidelines stemming from the Tax Fraud Prevention Plan. Therefore, the strategies, priorities and measures gathered in the Fraud Prevention Plan are made effective and implemented in the procedures' planning and scheduling process for the years 2005 and 2006.

The planning structure is based on three annual plans, which may be chiefly described as follows:

- a) The General Tax Control Plan sets forth the main courses of action to be undertaken by the AEAT departments vis-à-vis tax and customs controls, the key risk areas for the efforts to counter tax fraud and scheduling of control procedures.

The General Plan consists of a number of general guidelines, partial control plans and certain integration regulations for said partial plans.

- b) The second planning instrument, the Objectives' Plan, encompasses the outcomes that shall be attained in the fiscal year, expressed in monetary units, as well as the priority actions enforceable to meet such outcomes, in two areas: taxpayer assistance and tax control.

Regarding the tax control objectives, it highlights that the "assessed debt" may no longer be deemed a basic measurement benchmark, since it fails to adequately reflect the efforts made in the struggle against fraud, and additionally, it does not favor positive aspects, such as joint and coordinated tax enforcement efforts among different functional areas within the AEAT.

Instead, the control objective is defined in terms of actions performed in every material area of the struggle against fraud. Nevertheless, the "assessed debt" indicator is not fully discarded but it is used as a weighting factor for the outcomes achieved.

- c) Lastly, the document entitled *Central Services' Commitments* constitutes the basic annual AEAT Central Services' planning tool. It embodies the objectives in terms of projects and commitments with the different members of the organizations, other Administrations and Institutions and the citizens' themselves.

The distribution of the tasks and procedures required to meet the objectives set forth among the different AEAT departments and units is conducted according to the functional and territorial criteria that govern the Agency's organization. Of course, the latter is carried out pursuant to the principles of efficacy, hierarchy and coordination that,

as set forth in the Constitution and legislation (specifically, the Government Administration and Common Administrative Procedures' Legal System Act), shall govern the performance of Government Administration Agencies.

V. SCOPE OF THE PREVENTION PLAN

As mentioned above, Chapter Three of the Plan is made up by eleven enforcement areas that may be grouped into three sections:

- Information, preventive procedures and institutional alliances.
- Special priority areas.
- Operational and organizational measures.

Hereunder, we shall state the measures foreseen in the Prevention Plan, whose enforcement in the years 2005 and 2006 has significantly contributed to the improvement of the outcomes achieved by the AEAT.

1. Information, Preventive Procedures and Institutional Alliances

Control Information

The AEAT relies on a diversity of sources of information: statements filed by taxpayers, documentation filed by taxpayers in the course of control procedures, informative statements vis-à-vis third-party transactions, information submitted by other Administrations on the basis of cooperation agreements, data captured from individual requirements, etc. Notwithstanding, except for the management of the IIT, there has been a lack of coordinated actions' planning to gather tax relevant information. This has hurdled the development of control procedures, which inevitably require information.

In the light of the issue described, the AEAT has created a database that gathers all the tax relevant information available, which enabled to detect duplications, inconsistencies and missing data. This measure facilitates coordinated planning of the actions to gather information, vital not only to improve the selection of taxpayers to be subject to control procedures but also to enhance the efficacy of the actions undertaken in the Agency's functional areas.

Tax Education

In the area of information and preventive procedures, the interest in improving citizens' tax awareness indicates the need to undertake tax education programs and institutional communication measures to favor voluntary compliance and deter fraudulent behaviors.

In this regard, the enforcement of the Prevention Plan has entailed the consolidation of a tax education program that includes open house meetings hosted by the AEAT and the creation of a "Tax and Civic Education Portal" on the Web page www.agenciatributaria.es, in cooperation with the Institute for Tax Studies.

This portal seeks to contribute to education in values for children and youths with the purpose of developing an active and responsible citizenry. It is geared at fostering a strong tax awareness beginning at school, conveying tax responsibility values as opposed to fraudulent behaviors.

The Portal offers a section for teachers, with didactic material to facilitate their pedagogic work via the portal, and a section for children, with a cartoon adventure that takes place in different areas of a city. The portal meets the accessibility criteria for the sight and hearing impaired, and persons with motor disability.

Subscription of Memoranda of Understanding

The Prevention Plan sets forth the need to engage in subscribing Memoranda of Understanding with institutions representing economic sectors to foster social cooperation in tax fraud prevention and avoid unfair competition arising from fraudulent behaviors.

The experience of other European Union countries, like the United Kingdom, prove that such agreements are especially effective to detect phenomena such as organized fraud schemes for Value Added Tax (VAT) and the Excise Tax on Specific Transportation (IEDMT, as per the Spanish acronym).

Such agreements create a permanent and direct communication channel between the AEAT and the associations representing economic sectors, the latter promising to transfer information on suspicious transactions to the AEAT or perform according to a tax code of ethics or tax code of conduct.

TOPIC 1 (Spain)

Specifically, Memoranda of Understanding have been subscribed with the following sectors: mobile telephony, software, automotive and brand protection. Likewise, a memoranda of understanding has been subscribed with the Consumers' and Users' Organization (OCU, as per the Spanish acronym) to foster the use of invoices.

Institutional Alliances

The Tax Fraud Prevention Plan focuses on the need of implementing a policy of alliances with other departments and institutions for the effectiveness of fraud prevention.

The main purpose of external alliances, in the context of fraud prevention, is gathering tax relevant information. But there are also other motivations, such as personnel training or standardization of management and control systems.

Among the cooperation agreements subscribed by the State Agency of Tax Administration, we shall mention the Cooperation Agreement with the Justice Ministry. It is aimed at improving coordination and cooperation between the AEAT and the Office of the Attorney General by defining appropriate measures against tax fraud in the light of a suspected crime.

Likewise, it highlights the cooperation agreement with the General Council of Spanish Notaries to facilitate compliance with tax obligations for corporations and unincorporated entities who have filed for incorporation via faster communication channels.

A procedure has been put in place for the electronic submittal of the statement of entry in the Registrar of Corporations on behalf of third parties and the allocation of the temporary Tax Identification Number, and the final number thereafter, in the corporation registration procedure with the Notary's Office.

2. Special Priority Areas

The enforcement areas that constitute the cornerstone for the Tax Fraud Prevention Plan are the ones relative to organized VAT or Excise taxes fraud schemes in transactions within the EU, real estate fraud, customs, tax engineering and international fraud, and fraud in the revenue collection phase.

^M *Organized VAT and Excise taxes fraud schemes in transactions within the EU*

Transactions involving the delivery of goods among businesses from different countries within the European Union must pay VAT according to a regulation that provides that the goods delivered shall be exempt in the source country thereof, while the purchases stemming from the goods delivered shall pay taxes in the destination country.

The increasingly borderless nature of countries within the EU has brought about organized fraud schemes based on nominee corporations aimed at perpetrating fraud as to the payments of Tax installments, which have been duly offset but not paid.

This type of fraud is increasingly perpetrated in certain industries such as alcoholic beverages, second-hand vehicles, IT, mobile telephony and gold and precious metals.

Their detection involves a number of functional areas from the Tax Agency, the Public Prosecutor and the Judicial Branch. Nevertheless, the issue not only affects the Spanish Administration, but extends to all the EU Member States, in the framework of a highly harmonized tax.

The enforcement of the Prevention Plan has produced a single and centralized strategy to counter schemes, which has called for the coordination of all the Agency's areas. For such purpose, a protocol has been drafted on the applicable procedures upon detecting a scheme.

Likewise, a new database has been designed to rely on digitized information on the parties involved in schemes and to enable direct exchange of international information.

Meetings have been held with European Union member countries, with an agreement as to Spain's full participation in the EUROCANET project. The latter implies the creation of a special information exchange network among units specialized in the struggle against fraud schemes based on the information obtained by specific and systematic follow-up of a number of businesses proposed by each participating state.

Simultaneously, special investigation units have been created in all the AEAT Special Delegations, with over four hundred officials working to investigate and dismantle fraud schemes.

In addition to these measures, the access risk control criteria to the European Union Operators' Registry have been reviewed. The control of this Registry is a vital prevention tool in the struggle against schemes, since access to this Registry is one of the requirements to perform exempted transactions within the European Union. Therefore, placing controls on Corporations' access to this Registry implies preventing their participation in a scheme.

As an action specifically targeted at the IEDMT fraud schemes, the control of the declared value has been introduced as a previous requirement to registration, so that in the cases in which a value significantly below the market is filed, the registration is suspended and the requesting party shall file additional information according to the market value.

With the purpose of conducting an effective control prior to vehicle registration, in May 2005, the AEAT and the General Traffic Directorate signed an agreement. This agreement set forth a procedure to avoid registration of vehicles via nominee corporations, which file ridiculous tax bases' amounts in their self-assessments.

Likewise, it highlights a new IEDMT management system that is based on information collection to facilitate control tasks. In this regard, it is worth underscoring that since January 1st, 2006, it is mandatory to file this tax electronically, which enables to gather information on the content of tax statements immediately. Consequently, this facilitates communication with the General Traffic Directorate with a view to the potential suspension of the vehicle registration procedure when the declared value is different from the market value.

In order to facilitate the implementation of this measure, the AEAT has been signing cooperation agreements with the main automotive industry associations so that dealers may file the statements-assessments electronically on behalf of their customers.

м *Real Estate Fraud*

The Tax Fraud Prevention Plan devotes one of its enforcement areas to this sector, with a view to designing an integral plan to control compliance with obligations stemming from the ownership, use, benefit and transfer of real estate property, with a purely operational approach.

In this economic sector, a number of activities for promotion and use of real estate property are conducted, which involve a number of players. In a broad sense, we may assert that the following activities make up the real estate sector: realtors of land and property, services related to real estate property, housing, commercial property and rural property rental and construction. Additionally, we must consider the services rendered by certain professionals and real estate brokers, and the activities conducted by individuals that invest in real estate property or rent them, who also play an active role in this market.

In this context, fraudulent behaviors chiefly consist of concealing ownership of such property or the participation of the economic player in certain phases of the urban development process; filing property transfer values below the legitimate market value and concealing the exploitation of real estate property, basically referred to housing rental income.

In order to see to the specific issue posed by real estate fraud, the enforcement of the Tax Fraud Prevention Plan has generated a new control model based on the following measures.

The starting point has been the exploitation of the information available to conduct adequate control procedures' planning. For such purpose, all the information relative to real estate property has been organized according to a structure.

This is one of the most relevant and transcendental measures, which has called for the digitization of the available information into tax databases and concluded with the design and development of the "real estate query system", which enables to query on the ongoing transfer of real estate property and identify the participants in such transactions.

Likewise, a standardized system was developed to capture real estate property information with a structure and on a systematic basis. Information gathering starts at the early stages of the urban development process, an improvement regarding the previous situation focused on the final real estate property delivery phase. Consequently, this new working methodology has enabled information requirements to the Owners' Urban Development Systems (*Junta de Compensación*), Architects' Associations, etc. It is an essential procedure given the capital gains that stem from the revaluation of land.

Notwithstanding, the essential measure to face real estate fraud has been integral control procedures' planning, since urban planning projects must be followed from the early stages of the process up to the transfer of real estate property. Also, vertical inspections are being fostered in the form of coordinated and simultaneous actions affecting related business in the sector.

In order to empower control procedures, a specific unit has been created to such end in the National Fraud Investigation Office (ONIF, as per the Spanish acronym) and Real Estate Investigation Units are being created in all the Special Delegations of the State Agency of Tax Administration, devoted to information gathering and analysis.

Finally, we must point out that, for the purpose of improving real estate capital yields' control, it sets forth the obligation of reporting the identification data for the real estate property declared as regular domicile on the IIT form, by including the real estate register number and indicating whether the property is rented or used by the owner thereof.

» *Customs Fraud*

The scope of the Tax Fraud Prevention Plan relative to foreign trade transactions encompasses management and control of the customs' system, prosecution of smuggling and money laundering. Likewise, it addresses serious and recent customs fraud cases and money laundering derived from drug trafficking.

We shall take into account that customs fraud is of vital relevance since it constitutes a type of fraud with a social incidence. Citizens'

perception of fraud is restricted by the existence of activities in an underground economy. This implies that failure by the Tax Administration to undertake immediate action may produce a greater breach of tax obligations, as an induced effect.

The measures derived from the Tax Fraud Prevention Plan are geared at detecting cases of payments by remittances of drugs entered into Spain or the discovery of real estate property purchased by drug traffickers via nominee corporations, in which drug trafficking goes hand in hand with money laundering crimes. The main control mechanism is the investigation of exports to source countries for drug remittances by corporations that evidence inconsistencies between their export volume and profits. This process is supported by IT tools based on statistical information and information submitted by the *Guardia Civil* on the license numbers for suspected vehicles, especially regarding traffic with Africa. Focus is placed on the relevance of analyzing the statements from the Customs Surveillance Service and court decisions in drug trafficking cases.

The AEAT shall also play an active role in the struggle against the underground economy derived from trademark crimes and CD burning devices, by implementing specific screening procedures at the Customs level for high-risk imports relative to such transactions, and on site procedures in certain industrial areas, based on the information available on potential geographic areas where illicit economic activities are conducted.

⌘ *Tax Engineering and International Fraud*

Fraud prevention must face the evolution in the methods employed by fraudsters who, in many cases, have shifted from employing basic and unelaborated forms of fraud to increasingly sophisticated avoidance behaviors, usually defined as tax engineering or abusive tax planning.

The implementation of IT control procedures by the State Agency of Tax Administration with systematic use of the information gathered has influenced this change in fraudulent behaviors, since less complex and sophisticated violations and frauds are increasingly easier to detect and redress.

The globalization of the economy has spurred transactions involving tax havens and low-taxation jurisdictions resulting from such abusive tax planning practices. The AEAT shall face this reality with regulatory modifications as well as other of an organizational and procedural nature in line with, once again, enhanced operation and information exchange among the different States.

As to territories that qualify as tax havens, the measures approved by the Plan, such as the VAT organized fraud schemes, are geared at centralizing the coordination functions of international tax fraud prevention procedures. It is recommended to conduct a systematic control of anti-tax haven legislation enforcement with regular examination of taxpayers who conduct international business activities, as well as the execution of special inspection plans for entities domiciled in tax havens that earn revenue in Spanish jurisdiction.

Other measures to be considered may entail the enforcement of more stringent legislation to difficult the freedom of these entities in undertaking business activities, defining presumptive tax domiciles in Spain when significant assets are held in our country. Businesses shall be mandated to file for a Spanish Tax ID Number when performing transactions in our jurisdiction or we shall increase the tax burden on income earned in tax havens, with higher tax rates.

Regardless of the territories defined as tax havens, there are countries with unique tax legislation and preferential tax regimes in which actual taxation and undefined taxation are similar to those of tax havens themselves. The use of low taxation territories is increasingly frequent in the highly sophisticated international tax planning cases, in which nominee corporations or companies that transfer money from or towards other countries are normally based in said low taxation territories, employing tax havens as venues for corporate headquarters of the holdings designed for tax avoidance purposes.

The measures to counter these abusive tax planning efforts with an incidence on the revenue system in Spain are partly in line with the aforementioned ones to counter tax havens (coordination of actions by the National Fraud Investigation Office (ONIF, as per the Spanish acronym), submittal of legitimate information, adoption of stringent legislative measures for tax control and taxation). Notwithstanding, there are other specific measures geared at conducting systematic controls

to prove the proper enforcement of anti-abuse measures foreseen in the agreements subscribed with other States as well as the potential enforcement of the beneficial ownership clause as set forth in bilateral agreements.

Vis-à-vis enhancing international cooperation, which has been especially foreseen in the Tax Fraud Prevention Plan, we must consider that the challenges facing Tax Administrations are a direct consequence of the globalization of the economy and the new technologies that enable to conduct business beyond geographic restrictions.

The elimination of control systems to favor international trade has fostered new forms of tax evasion and fraud that Tax Administrations are unable to counter on their own. Therefore, cooperation and fostering subscription of information exchange agreements among Administrations is vital.

In the framework of the European Union, issues arise from the standpoint of economic players that operate in several Member States, since Tax Administrations are only competent in their own jurisdiction. The elimination of control systems to favor trade within the European Union has fostered new forms of tax evasion and fraud that Tax Administrations are unable to counter on their own. Therefore, cooperation among the Administrations of Member States is vital.

Information exchange constitutes an effective instrument that enables Tax Administrations to enforce national tax systems based on the worldwide income principle, pursuant to the taxpayer's residence. Information exchange agreements such as the one subscribed between Argentina and Spain⁴ or, more recently, between Chile and Spain⁵, shall be considered a priority in order to prevent and redress fraudulent behaviors.

As regards customs' issues, coordination is facilitated by common practices and agreements regarding international trade requirements. Nevertheless, problems remain that call for sharing relevant control information.

⁴ "Tax Information Exchange Agreement between Argentina and Spain", subscribed on May 6th, 2004.

⁵ "Administrative Agreement between Administrative Authorities from Spain and Chile vis-à-vis Information Exchange and Mutual Assistance", on April 3rd, 2004.

Vis-à-vis indirect taxes (VAT and excises), we must design and develop the appropriate mechanisms. In the framework of the European Union, the legal instruments have been adapted to enable information exchange efforts, pursuing its expansion to new fields and promoting horizontal contacts. Likewise, the legal instruments have been modified regarding collection and electronic information exchange systems have been created. Simultaneously, international cooperation agreements have been furthered to facilitate and increase contacts and joint efforts among the Administrations from the different Member States, such as the FISCALIS⁶ programs.

Vis-à-vis the OECD, the concern as to tax fraud prevention and control has been reflected by the creation of a working area in the Forum on Tax Administration whose priority is to focus on sharing experiences in such matters. Its objectives are driven by fostering transparency and information exchange among its members, as well as the adoption of measures against fraud via tax havens and harmful tax practices.

Finally, we must point out that the Tax Fraud Prevention Plan specifically considers supporting the efforts by other organizations such as the International Financial Action Task Force (FATF) or the World Customs Organization (WCO) to contribute to international fraud prevention.

m Fraud in the Revenue Collection Phase

Fraud prevention fails to be fully effective if the debt redress process does not result in the collection of the debts detected.

Therefore, the Tax Fraud Prevention Plan sets forth an objective that shall guide collection procedures, which entails completing the fraud prevention process initiated by the assessment departments by means of an appropriate management in collection of assessed debts.

In this regard, the measures foreseen in the Plan are geared at strengthening procedures in the face of specific fraud occurring in this debt collection phase, the improvement of procedures and the design of collection strategies in line with the different action plans implemented by the assessment departments in the enforcement of this Plan.

⁶ European Community Program to finance telecommunications' infrastructure for information exchange efforts and certain joint actions by the Member States.

Specifically, it highlights the increase in the number of precautionary measures adopted in the case of indications that enable to foresee attempts by taxpayers to drain their cash or any other type of behavior that may jeopardize debt collection, respecting the principle of proportionality in all cases.

In effect, the existence of delays between the initiation of procedures by the examination departments and the enforcement of the measures to collect the tax debts derived from noncompliance, proven by such procedures, may be detrimental to debt collection.

The time elapsed constitutes, per se, a need stemming from the procedures to enforce taxes and implies an essential guarantee for taxpayers, but fraudsters may take malicious advantage of it to avoid personal liability over the debts that may accrue.

It is increasingly frequent for taxpayers subject to examination to undertake actions to avoid collection of debts: cash draining, insolvent nominees or nominee corporations to hurdle the determination of liabilities, etc.

Although such behaviors are difficult to avoid, or otherwise, eliminate, anticipated procedures by the assessment departments, stemming from control actions even before the tax debt is accrued, may neutralize or at least mitigate the taxpayer's ends.

In this sense, the Tax Fraud Prevention Plan poses the need to look into new forms of organization of the assessment and collection functions as a means to enhance the efficiency in payback of the debts assessed by the Administration.

Under this framework, we must underline the creation of joint units in the examination and collection areas to conduct coordinated procedures that have resulted in improved efficiency in the payback of debts assessed by the examination departments.

These procedures are performed along the following basic lines:

- A number of coordination mechanisms are defined, based on the anticipation of the collection function, which matches the implementation of the procedures in the examination process.

- Such anticipation is aimed at detecting the cases that originate in the assessment phase with a high collection risk, with a view to applying all the mechanisms vested upon the Administration by law to ensure debt collection as it stems from the assessment process. We may note, for example, the adoption of precautionary measures on individuals or entities that shall bear the tax debt, or the initiation of the procedure to identify liable parties.
- Preventive functions as to potential asset shifting are empowered, subjecting the higher risk cases to oversight and disclosing the presence of collection officials, if applicable, in the course of the examination procedure.
- Reciprocal information exchange is intensified among the examination and collection departments, to the extent it is relevant for the development of the investigation and assessment functions as well as the collection function thereafter.
- Finally, this anticipation in the collection departments' intervention prior to the generation of the debt shall serve to foster taxpayers' assistance and consulting function regarding the methods and terms to pay the debt that may arise, and on any other circumstance that may affect the debt collection procedure.

The results achieved state that the introduction of these new working methods, which entail a change as to departments with different functions operating in a vacuum, entail significant improvements in the collection management process to face this type of taxpayers.

3. Operational and Organizational Measures

The change in the focus of the actions to control fraud prevention occurred in line with a series of organizational measures to increase the efficacy and efficiency of the AEAT's procedures.

The creation of the Central Large Taxpayers' Delegation,⁷ which started to operate on January 1st, 2006, deserves to be mentioned for its unprecedented and relevant nature.

The entities with operations' volume in excess of one hundred million Euros or more than ten thousand information records filed with the Tax Administration, are referred to the Central Large Taxpayers' Delegation. Other taxpayers may be assigned to this Central Delegation by Decision of the Director of the Department of Organization, Planning and Institutional Relations on the basis of certain circumstances (business across the national territory, relevant position in an economic sector or conducting especially complex transactions).

Both groups of entities bear a relevant revenue incidence. Their contribution to the Tax Administration has accounted for 64% of the overall tax revenue collected by the Agency in 2005, excluding revenue from custom duties and excise taxes assessed by Customs.

The Central Delegation is fully competent and performs all the functions inherent in the Tax Administration Agency as to the enforcement of the state and customs system for all taxpayers assigned thereto; it thus encompasses the management, examination and collection tasks, except for customs duties' and Excise Taxes' management.

Therefore, the goal is to improve the efficacy and fairness in the treatment of large taxpayers, by a better controls' integration from the examination and customs areas, thus strengthening the coordination between the assessment and collection areas. The creation of the Central Delegation implies that procedures from the beginning of tax examinations not only be aimed at overcoming tax noncompliance, but also at ensuring effective collection of the potential debts assessed.

We must also highlight other types of organizational measures foreseen in the Tax Fraud Prevention Plan, such as the creation of the Office for Information Analysis and Fraud Investigation of the Tax IT Department, aimed at supporting fraud prevention through the implementation of new technologies for investigation procedures.

The Prevention Plan also foresees the redefinition of the National Fraud Investigation Office, for it to play the role of a tax intelligence unit. Therefore, we are considering the possibility of turning it into a unit so that, by employing IT tools based on new technologies, it develops specialized techniques to detect and plan fraud with a view to identifying the new types of fraudulent behaviors and counter them immediately.

⁷ Order EHA/3230/2005, October 13th and Resolution of December 26th, 2005, of the AEAT Director General.

VI. TAX FRAUD PREVENTION: APPLICABLE LEGISLATION

The Tax Fraud Prevention Plan includes a chapter relative to regulatory measures. It sets forth a number of regulatory proposals considered on the basis of the Plan's scope of action.

Thereafter, the AEAT drafted a number of proposals that were included in the Tax Fraud Prevention Measures' Bill, approved by the Council of Ministers on December 30th, 2005.

After the public hearing period, on March 10th, 2006, the Council of Ministers approved the Bill that is now in Parliament.

The measures included in this Bill may be grouped into three categories: measures geared at empowering the performance of the control departments, measures to improve available information, which shall enable increase fraud detection efficiency, and measures aimed at guaranteeing effective collection of tax debts.

As to the Bill's content we must highlight measures relative to the following areas:

- VAT fraud schemes.
- Real estate sector.
- Tax havens.
- Related transactions.
- Tax collection measures.

Regarding the VAT fraud schemes, it sets forth, in line with the measures adopted by other European Union countries like The Netherlands, United Kingdom or Germany, the enforceability of subsidiary liability for unpaid VAT for businesses that purchase goods from entities involved in VAT fraud schemes.

This measure is considered for such businesses as those who should reasonably assume that they have procured goods from entities who shall fail to pay the VAT charged and therefore enjoy an extraordinary benefit derived from unpaid taxes.

This assumption has been foreseen for companies that normally trade certain goods and thus perfectly know such goods. Nevertheless, they may purchase those goods from companies involved in VAT fraud schemes, and benefit from paying notoriously anomalous prices for such type of goods.

It also foresees that, when tax crimes are suspected, the case shall be referred to the Prosecutor's Office without prior hearing requirement for the taxpayer. Thus, investigations shall be safeguarded.

Finally, it sets forth the annulment of the Tax ID Number, (NIF, as per the Spanish acronym) for fictitious or inactive corporations or entities to prevent them from filing for registration in public registries and performing banking transactions until their Tax ID Number is enabled or until they obtain a new one.

Vis-à-vis the real estate sector, in order to accurately know the data of real estate transactions and to avoid the use of laundered money in real estate transactions, it mandates the inclusion in the title deed of the means of payment used to purchase real estate property and the Tax ID Number of the parties involved to register the deed in the Real Estate Registrar.

On the other hand, in order to detect the existence of undeclared rentals and verify whether certain real estate property is occupied or vacant, it is deemed mandatory for rental and electricity supply contracts to include the Real Estate Register number.

Another item in this Act refers to tax havens. In this sense, the entities domiciled in tax havens shall be deemed to be domiciled in Spain when their business or assets and entitlements are based in Spain, thus the entities whose assets or business are based in Spain shall be subject to taxes in Spain, even when they have a registered domicile in a tax haven in order to avoid taxes.

In order to avoid undue damages, evidence to the contrary has been admitted. In other words, evidence that the entity has been chartered in a tax haven on the basis of legitimate economic grounds and actually conducts business from there.

Additionally, and along these lines, the mechanisms to secure debt collection from residents in tax havens have been improved.

Among the unprecedented features of the Bill, we shall also highlight the treatment granted to *related transactions* to adapt the Spanish regulations to the appraisal methods and reporting requirements adopted by a number of countries in line with the OECD recommendations, with a view to ensuring that the values and prices filed in related transactions are the actual market prices.

To that end, the related transactions' appraisal system has been changed (for example, transactions among companies of the same holding) to guarantee that the values filed match the actual values. Consequently, the end pursued is to avoid shifting revenue from one entity to the other in order to reduce or defer taxation, by using prices different from the regular market prices.

Finally, and vis-à-vis the measures foreseen regarding tax collection matters, it foresees that in the case of employing nominee corporations to avoid tax payments, the Administration shall directly enforce the tax liability upon the party who is effectively in control of the fraudster corporations.

With this measure, upon detecting abusive and fraudulent situations to avoid tax payments, the Tax Administration shall not resort to litigation to discover and prosecute the party who is truly behind nominee corporations. Therefore, a very effective mechanism shall be put in place to counter fraud strategies in the tax collection phase involving nominee corporations and other fraud mechanisms to avoid their responsibility before the Tax Administration.

CONCLUSIONS

The complexity in economic relations in a globalized world subject to ongoing transformations has spurred relevant fraud mechanisms. In this context, the challenges facing Tax Administrations are the following.

- Assistance and information for citizens geared at compliance with tax obligations. This is aimed at reducing the indirect costs tied to compliance. Likewise, it focuses on preventing fraudulent behaviors upon facilitating compliance for taxpayers.
- Cooperation among Tax Administrations in the framework of international cooperation. Information exchange, in all its forms, is one of the main instruments for fraud prevention and control, so that the agreements in this field constitute a vital element for mutual assistance among Tax Administrations.
- Fostering the use of new information and communications' technologies. Specifically, new technologies contribute to gather information, digitize the information available, develop selection

tools based on risk analysis and develop techniques to enable early detection of fraudulent behaviors in order to counter them immediately.

- Transparency in the results achieved and the information on the activity developed. On the one hand, offering the citizen institutional information on the purposes and results of the Administration's actions generates an induced effect: awareness that noncompliance is detected and redressed shall move taxpayers to meet their tax obligations. On the other hand, transparency enables subjecting the Tax Administration's activities to controls defined by society through their representative bodies and thus contribute to an efficient government administration.

The Tax Fraud Prevention Plan constitutes the expression of the commitment assumed by the AEAT to face the challenges described. It embodies a strategic planning document, with the purpose of preventing and countering fraud and secure the principles of generality and equity in the enforcement of the tax and customs systems.

This Plan entails a relevant investigation effort, which is especially projected onto certain sectors of economic activity and on specifically serious forms of fraud. Likewise, it consolidates citizens' information and assistance, foreseeing the use of new technologies, strengthens institutional alliances and provides for organizational modifications necessary for the effective and efficient compliance of the objectives required from the AEAT.

Case study

TOPIC 1.1

A COMPREHENSIVE STRATEGY FOR REDUCING THE TAX GAP

Deborah Nolan

Commissioner, Large and Mid-Size Division
Internal Revenue Service
(United States of America)

CONTENTS: I. The Size and Source of the Tax Gap.- II. Challenges to Reducing the Tax Gap.- III. A Comprehensive Strategy to Reduce the Tax Gap.- 1. Reduce Opportunities for Evasion.- 2. Make a Multi-Year Commitment to Research.- 3. Continue Improvement in Information Technology.- 4. Improve Compliance Activities.- 5. Enhance Taxpayer Service.- 6. Reform and Simplify the Tax Law.- 7. Coordinate with Partners and Stakeholders.- Conclusion.- Tax Gap Strategy Timeline for Fiscal Year 2007.

As tax administrators, reducing the size of the tax gap guides much of what we do on a daily basis. In recent months, there has been much attention paid to the size of the tax gap and strategies to address it in the United States. While no tax system can ever achieve 100 percent compliance, we are all committed to finding ways to increase compliance and reduce the tax gap, while minimizing the burden on the vast majority of taxpayers who pay their taxes accurately and on time. In the United States, it is important to understand, that the complexity of our current tax system is a significant reason for the tax gap and that fundamental reform and simplification of the tax law is necessary in order to achieve significant reductions. Several initiatives and actions identified deal with issues of tax policy while others are issues of tax administration.

Reducing the net tax gap, currently estimated at \$290 billion for 2001, is a top priority in the United States. Put simply, the tax gap is the difference between the amount of tax imposed on taxpayers for a given year and the amount that is paid voluntarily and timely. The tax gap represents, in dollar terms, the annual amount of noncompliance with our tax laws.

Our goal is to increase the voluntary compliance rate from the current 83.6 percent to 85 percent by 2009. To achieve that goal, we know we must attack the tax gap from both ends of the spectrum. We must help taxpayers better understand their obligations, and reduce that portion of the tax gap attributable to taxpayers being confused or uncertain about what their true obligations are. Secondly, we must improve our enforcement efforts by concentrating on those taxpayers who intentionally refuse to pay what they owe." Our guiding principle continues to be:

Service + Enforcement = Compliance

Our approach will be to attack the tax gap from both ends of the spectrum. We must help taxpayers better understand their obligations, thereby reducing a portion of the tax gap attributable to taxpayers being confused or uncertain about what their true obligations are. Secondly, we must improve our enforcement efforts going after those taxpayers who intentionally refuse to pay what they owe.

The U.S. Department of the Treasury, Office of Tax Policy recently released a document, "A Comprehensive Strategy for Reducing the Tax Gap", which includes seven components:

1. Reduce Opportunities for Evasion.
2. Make a Multi-Year Commitment to Research.
3. Continue Improvement in Information Technology.
4. Improve Compliance Activities.
5. Enhance Taxpayer Service.
6. Reform and Simplify the Tax Law.
7. Coordinate with Partners and Stakeholders.

While much of the success of the strategy will depend on IRS resources and the efficient and effective use of those resources, we continue to seek ways to deal with tax gap with existing resources as well.

Attached is a copy of the document which will be used as a basis for the discussion with CIAT participants and serve as the foundation for the presentation. Additionally, I will provide some practical applications and examples of initiatives that we have deployed at the Internal Revenue Service to deal with specific areas of noncompliance that will demonstrate a comprehensive strategy focused on a particular segment and area of risk.

As tax administrators, we strive to reduce the federal deficit by increasing tax receipts collected through taxpayer service and enforcement. We must also strive to reduce the by continuing to identify productivity improvements and efficiencies that will reduce the cost of collecting revenues.

A COMPREHENSIVE STRATEGY FOR REDUCING THE TAX GAP

**U.S. Department of the Treasury
Office of Tax Policy
September 26, 2006**

EXECUTIVE SUMMARY

In fiscal year 2005, Federal receipts totaled over \$2.2 trillion. More than 95 percent of net receipts were collected by the Internal Revenue Service (IRS) through its administration of the income, transfer and excise tax provisions of the Internal Revenue Code. The vast majority of these receipts is collected through our voluntary compliance system, under which taxpayers report and pay their taxes with no direct enforcement and minimal interaction with the government. The overall compliance rate achieved under this system is quite high. In 2001, the compliance rate was over 86 percent, after including late payments and recoveries from IRS enforcement activities. Nevertheless, an unacceptably large amount of the tax that should be paid every year is not, requiring compliant taxpayers to make up for the shortfall and giving rise to the "tax gap."

The Administration is committed to working with Congress to reduce the tax gap. This document outlines the Administration's aggressive strategy for addressing the tax gap.

The strategy builds upon the current efforts of the Treasury Department and the IRS to improve compliance. As part of the deliberations in preparing the Administration's fiscal year 2008 budget request to Congress, the Treasury Department and the IRS are working with the Office of Management and Budget to further develop this strategy to reduce the tax gap. This document is intended to provide a broad base on which to build. The more detailed elements of the tax gap strategy are, in part, contingent upon the budget process for fiscal year 2008 and beyond. Accordingly, the Treasury Department and the IRS will provide a more detailed outline of steps they will take to address the tax gap following release of the Administration's fiscal year 2008 budget request early next year.

Four key principles guided the development of this strategy:

- First, unintentional taxpayer errors and intentional taxpayer evasion should both be addressed.
- Second, sources of noncompliance should be targeted with specificity.
- Third, enforcement activities should be combined with a commitment to taxpayer service.
- Fourth, policy positions and compliance proposals should be sensitive to taxpayer rights and maintain an appropriate balance between enforcement activity and imposition of taxpayer burden.

These principles point to the need for a comprehensive, integrated, multi-year strategy to reduce the tax gap. Our practical and effective overall strategy includes the following seven components:

1. Reduce Opportunities for Evasion. The Administration's fiscal year 2007 budget includes five legislative proposals to reduce evasion opportunities and improve the efficiency of the IRS. The Treasury Department's Office of Tax Policy is working with the IRS to develop additional legislative proposals for consideration as part of the fiscal year 2008 budget process. The Treasury Department and the IRS will also continue to use the regulatory guidance process to address both procedural and substantive issues to improve compliance and reduce the tax gap.
2. Make a Multi-Year Commitment to Research. Research is essential to identify sources of noncompliance so that IRS resources can be properly targeted. Regularly updating

compliance research ensures that the IRS is aware of vulnerabilities as they emerge. New research is needed on the relationship between taxpayer burden and compliance and the impact of customer service on voluntary compliance. Research is also essential to establish accurate benchmarks and to measure the effectiveness of IRS efforts, including the effectiveness of this comprehensive strategy to reduce the tax gap.

3. Continue Improvements in Information Technology. Continued improvements to technology would provide the IRS with better tools to improve compliance through early detection, better case selection, and better case management.
4. Improve Compliance Activities. By improving document matching, examination, and collection activities, the IRS would be better able to prevent, detect, and remedy noncompliance. These activities would increase compliance not only among those directly contacted by the IRS, but also among those who would be deterred from noncompliant behavior as a consequence of a more visible IRS enforcement presence.

The IRS continues to reengineer examination and collection procedures and invest in technology, resulting in efficiency gains and better targeting of examination efforts.

These efficiency gains translate into higher audit yields, expanded examination coverage, and reduced burden on compliant taxpayers.

5. Enhance Taxpayer Service. Service is especially important to help taxpayers avoid unintentional errors. Given the increasing complexity of the tax code, providing taxpayers with assistance and clear and accurate information before they file their tax returns reduces unnecessary contacts afterwards, allowing the IRS to focus enforcement resources on taxpayers who intentionally evade their tax obligations. The statutorily mandated Taxpayer Assistance Blueprint, the next phase of which is expected to be delivered in January, will include a process for assessing the needs and preferences of taxpayers and will develop a decision model to prioritize service initiatives and funding.

The IRS is also working to provide service more efficiently and effectively through new and existing tools, such as the IRS web site.

6. Reform and Simplify the Tax Law. Simplifying the tax law would reduce unintentional errors caused by a lack of understanding. Simplification would also reduce the opportunities for intentional evasion and make it easier for the IRS to administer the tax laws. For example, the Administration's fiscal year 2007 budget includes six proposals to simplify the tax treatment of savings and families by consolidating existing programs and clarifying eligibility requirements. The Office of Tax Policy is developing other simplification proposals for consideration in the Administration's fiscal year 2008 budget request. In addition, the Treasury Department is evaluating the report of the President's Advisory Panel on Federal Tax Reform and is considering options for reform.

These initiatives will continue to be supplemented by IRS efforts to reduce taxpayer burden by simplifying forms and procedures.

7. Coordinate with Partners and Stakeholders. Closer coordination is needed between the IRS and state and foreign governments to share information and compliance strategies. Closer coordination is also needed with practitioner organizations, including bar and accounting associations, to maintain and improve mechanisms to ensure that advisors provide appropriate tax advice. Through contacts with practitioner organizations, the Treasury Department and the IRS learn about recent developments in tax practice and hear directly from practitioners about taxpayer concerns and potentially abusive practices. Similarly, contacts with taxpayers and their representatives, including small business representatives and low-income taxpayer advocates, provide the Treasury Department and the IRS with needed insight on ways to protect taxpayer rights and minimize the potential burdens of compliance strategies.

The success of this comprehensive strategy will depend, in significant part, on IRS resources and the agency's efficient and effective use of such resources. The IRS has made significant progress toward improving the efficient use of its allocated resources, especially in targeting enforcement efforts to areas

where they will have the greatest direct and indirect impact on compliance. The IRS will continue to seek ways to make its operations more efficient and thus free resources to fund new compliance initiatives. In implementing this strategy, the Treasury Department and the IRS recognize that it will be important to establish benchmarks against which progress on each element of the strategy can be measured.

I. THE SIZE AND SOURCE OF THE TAX GAP

The "gross tax gap" is the difference between the amount of tax that taxpayers should pay under the tax law and the amount they actually pay on time. In February 2006, the IRS released updated compliance estimates, showing that the gross tax gap was \$345 billion in tax year 2001. As a percentage of tax liability for tax year 2001, this represents a compliance rate of about 83.7 percent.

This estimate, however, does not take into account taxes that were paid voluntarily but paid late, or recoveries from IRS enforcement activities. Taking these factors into account, the "net tax gap" was an estimated \$290 billion in tax year 2001, which represents a net compliance rate of 86.3 percent.

There are three key characteristics of the tax gap:

- Over 70 percent of the gross tax gap is attributable to the individual income tax, which is the largest single source of Federal receipts.
- Over 80 percent of the gross tax gap is caused by underreporting of tax (i.e., by underreporting income or overstating deductions and credits), with roughly half this amount (including self-employment tax) attributable to underreporting of net business income by individuals. Eighteen percent of the gross tax gap is attributable to underpayments of taxes or failure to file tax returns.
- Noncompliance is highest among taxpayers whose income is not subject to third-party information reporting or withholding requirements.

These characteristics suggest a targeted response designed to address the most significant areas of noncompliance. The following overview discusses these characteristics in more detail.

Type of Tax

As indicated above, the IRS estimates that over 70 percent of the gross tax gap is attributable to the individual income tax. As Table 1 below shows, the remainder of the tax gap is associated with employment taxes (chiefly self-employment taxes), corporate income taxes, and estate taxes.

The estimates of underreporting of individual income and self-employment taxes were derived from analysis of the 2001 National Research Program (NRP). Most of the other estimates are projections derived from older compliance studies.

Table 1
Gross Tax Gap by Type of Tax

Type of Tax	Gross Tax Gap (\$ Billions)	Share of Gross Tax Gap (%) ¹
Individual Income	245	71
Corporate Income	32	9
Employment	59	17
Estate	8	2
Excise	Not Available	
TOTAL	345	100

¹ Totals may not add up to 100 percent due to rounding.

Type of Error

The IRS estimates that over 80 percent of the gross tax gap is caused by underreporting of tax (i.e., underreporting of income or overstating deductions and credits). Over 40 percent of the gross tax gap is attributable to underreporting of net business income by individuals (affecting both income and self-employment taxes). (See Table 2).

The remainder of the gross tax gap is split between two sources of errors:

- Roughly 10 percent of the gross tax gap is attributable to underpayments, a significant portion of which is due to employer failures to deposit withheld income and employment taxes.

- The remainder of the tax gap is due to failure to file tax returns, mostly for individual income taxes.

Table 2
Gross Tax Gap by Type of Error

Type of Error		Gross Tax Gap (\$ Billions)	Share of Gross Tax Gap (%) ¹
Undersporting ²	Individual Income Tax		
	Non-Business Income	56	16
	Business Income	109	32
	Adjustments, Deductions, Exemptions, and Credits	32	9
	Total	197	57
	Corporation Income Tax	30	9
	Employment Tax		
	FICA	14	4
	Self-Employment		
	Income Tax	39	11
	Total	54	16
	Estate Tax	4	1
	Total Underreporting	285	83
Underpayments ³	Individual Income Tax	23	7
	Employment Tax	5	1
	Other	5	3
	Total Income Tax	34	10
Nonfiling ⁴	Individual Income Tax	25	7
	Estate	2	1
	Total Nonfiling	27	8

¹ Totals may not add up to 100 percent due to rounding.

² Information regarding underreporting of excise taxes is not available.

³ Underpayments include employer failures to deposit withheld income and employment taxes.

⁴ Information regarding the nonfiling gap associated with corporate income taxes, employment taxes, or excise taxes is not available.

Level of Transparency

Tax compliance is greatest for income subject to mandatory withholding by the payer.

Only one percent of the tax due on wage income (reported by employers) was not reported to the IRS by return filers in 2001.

Noncompliance rates are higher for income that is not subject to withholding, but that is reported separately to the IRS by a third party when payments are made. The net misreporting percentage is about 4.5 percent for interest income, dividends, social security benefits, pensions, and unemployment insurance, all of which are generally subject to third-party reporting. The net misreporting percentage is somewhat higher for income items that are subject to some, but not substantial, information reporting.

For partnership and S corporation income, alimony, reportable exemptions and deductions, and capital gains, the net misreporting percentage is 8.6 percent.

Noncompliance rates are highest for income that is not subject to either withholding or third-party reporting requirements. About 54 percent of net income from proprietors (including farms), rents, and royalties is misreported. Underreporting of self-employment income also results in high noncompliance for self-employment taxes for social security and Medicare.

Intentional Versus Unintentional Errors

A common question is the extent to which the tax gap results from intentional evasion rather than unintentional errors by confused taxpayers. Determining taxpayer intent under a regular examination is very difficult. For obvious reasons, taxpayers do not concede that their erroneous reporting is intentional, and any analysis of the nature of the error by IRS examiners is inherently subjective. Some researchers have applied econometric techniques to compliance data to measure intentional evasion, but the results have been inconclusive. In all events, complexity provides those taxpayers who are predisposed to taking aggressive reporting positions the opportunity to argue that their errors are unintentional.

It is safe to conclude that both intentional and unintentional errors contribute to the tax gap and that any strategy to reduce the gap must address both intentional evasion as well as taxpayer confusion due to the complexity of the code.

II. CHALLENGES TO REDUCING THE TAX GAP

Addressing the tax gap involves improving voluntary compliance, reducing opportunities for evasion, and making it easier for the IRS to administer the tax laws. We must, however, have realistic expectations about the magnitude and timing of the impact of any reasonable strategy to reduce the tax gap, particularly if it is not accompanied by broader simplification and reform of the tax code, or significant advances in compliance technology.

Implementing a strategy to reduce the tax gap will take time. As a result, it will take time to realize the anticipated benefits. As part of this strategy, the IRS will, for example, acquire and analyze new data, improve document matching programs, refine examination selection criteria, purchase and test new technology, and train employees to handle new enforcement and customer service responsibilities.

Moreover, while it may be possible to develop a comprehensive strategy that reduces the tax gap, it is not possible to implement a policy that would come close to eliminating the tax gap without an unacceptable change in the fundamental nature of our tax compliance system.

III. A COMPREHENSIVE STRATEGY TO REDUCE THE TAX GAP

With an estimated net tax gap of \$290 billion, no single approach will be successful at substantially reducing noncompliance. A comprehensive, integrated, multi-year strategy is necessary, within the context of an annual budget process.

1. Reduce Opportunities for Evasion

Without reliable third-party data, the IRS cannot easily detect errors in the absence of expensive and intrusive audits. The IRS receives

over 1.5 billion information returns a year, reporting income from employers, financial institutions, third party payers, and state and Federal governments. However, the IRS still lacks reliable information on certain types of income, most notably income earned by the self-employed.

Penalties can deter noncompliance, but they may be set at the wrong level. Some penalties may be too low under current law to change behavior. Other penalties may be so high that examiners have been unable or unwilling to assert them, particularly when they believe that taxpayers may have made inadvertent errors.

The Administration's fiscal year 2007 budget contains five legislative proposals that would reduce evasion opportunities by focusing on employment taxes, information reporting, streamlining collection procedures, and problem return preparers. The legislative proposals in the Administration's fiscal year 2007 budget are an important step in reducing the tax gap. The Treasury Department is developing other proposals for consideration during the deliberations on the fiscal year 2008 budget, which would further reduce opportunities for evasion without unduly burdening honest taxpayers.

During these deliberations, we are exploring a number of different options including ways to:

- strengthen reporting requirements;
- expand IRS access to reliable data;
- enhance examination and collections authority;
- enable the IRS to detect and prevent multi-year noncompliance;
- and
- set penalties at more appropriate levels.

The issuance of regulations and administrative guidance by the Treasury Department and the IRS will also continue to play an important role in effectively administering the tax law and responding to the tax gap problem. Guidance clarifies ambiguous areas of the law, increasing voluntary compliance. Guidance also targets specific areas of noncompliance, and prevents abusive behavior, such as tax shelters. Each year, the Treasury Department and the IRS publish a Priority Guidance Plan. The 2006-2007 plan includes 264 guidance projects scheduled for completion between July 2006 and June 2007. Many of the 264 guidance items included in this year's

plan address potential areas of noncompliance. A representative sample of these items includes:

- guidance regarding transfer-pricing arrangements involving cost-sharing under section 482;
- guidance under section 671 regarding information reporting by widely-held fixed investment trusts (WHFITs);
- final regulations under section 860G(b) regarding withholding obligations of partnerships allocating income from real estate mortgage investment conduit (REMIC) residual interests to foreign persons; and
- final regulations under section 6655 regarding estimated tax payments by corporations.

The Treasury Department and the IRS have also successfully used the guidance process to help curb the involvement of taxpayers and practitioners in abusive tax avoidance transactions. For example, following enactment of the American Jobs Creation Act of 2004 ("AJCA"), the Treasury Department and the IRS released eleven separate guidance items to put into effect new reportable transaction disclosure and penalty rules. A major guidance project is currently underway to incorporate these rules into regulations. In addition, building on provisions in the AJCA, the Treasury Department and the IRS have taken significant steps to tighten and enforce the ethical rules that apply to tax practitioners, targeting improper tax advice as a significant contributor to noncompliance and the tax gap.

The publication of instructions and forms also contributes to increased efficiencies in tax administration. For example, the IRS and the Treasury Department developed the Schedule M-3 for large business taxpayers to disclose and reconcile book-tax differences.

The Schedule M-3 increases the transparency of book-tax differences, resulting in a material increase in the IRS's ability to detect sources of noncompliance. The Treasury Department and the IRS are expanding Schedule M-3 coverage to S corporations and partnerships.

Following release of the Administration's fiscal year 2008 budget request, the Treasury Department and the IRS will issue a more detailed outline of the steps we will take to reduce opportunities for evasion and address the tax gap. In addition, the Treasury

Department and the IRS will continue to identify guidance projects targeted to compliance and include them in regular updates to the Priority Guidance Plan.

2. Make a Multi-Year Commitment to Research

Research enables the IRS to develop strategies to combat specific areas of noncompliance, improve voluntary compliance, allocate resources more effectively, and reduce the tax gap.

The National Research Program (NRP) demonstrates the importance of comprehensive compliance data. As part of the NRP, the IRS reviewed approximately 46,000 randomly sampled individual income tax returns from tax year 2001 - the first comprehensive compliance study for individual income tax returns since 1988. Returns for which reported information could not be independently verified were audited. An NRP reporting compliance study of 5,000 S corporation tax returns filed in 2003 and 2004 is currently underway.

Data from the NRP reporting compliance study have been used to estimate the individual income tax component of the tax gap and to identify sources of noncompliance. Accurate NRP data provides a critical benchmark for determining the sources of noncompliance and for measuring changes in compliance rates over time. The IRS is also using the findings from the NRP to target examinations and other compliance activities better, thus increasing the dollar-per-case yield and reducing "no change" audits of compliant taxpayers. Innovations in audit techniques to reduce taxpayer burden, pioneered during the 2001 NRP, have been adopted in regular operational audits.

More compliance research is needed. Without new reporting compliance studies, the IRS is forced to rely on old studies, conducted over 20 years ago, to estimate compliance for areas other than individual income tax or S corporations. Moreover, with each passing year, the data from the 2001 study on individual income tax compliance becomes more outdated. Without up-to-date studies in all areas, the IRS is hampered in its ability to respond rapidly to emerging vulnerabilities in the tax system. A multi-year commitment to research would ensure that the IRS can efficiently target its resources and effectively respond to new sources of

noncompliance as they emerge. Compliant taxpayers benefit when the IRS uses the most up-to-date research to improve workload selection formulas because this reduces the burden of unnecessary taxpayer contacts. Research is also critical in helping the IRS to establish benchmarks against which to measure progress in improving compliance.

The IRS is considering new research projects in the following areas:

- *Regularly update NRP reporting compliance studies.* NRP studies (such as the 2001 reporting compliance study of individual taxpayers) must be regularly and frequently scheduled to ensure that the IRS has the most up-to-date compliance data.
- *Initiate new NRP reporting compliance studies.* To provide the IRS with more comprehensive data on the magnitude and sources of noncompliance, NRP studies could extend to partnerships, other business entities, employment taxes, exempt organizations, and government entities.
- *Supplement NRP reporting compliance studies with smaller and more targeted compliance studies.* By focusing on specific areas of noncompliance, smaller studies can yield more information about the sources of noncompliance. Targeted studies can also provide insight into the effectiveness of different types of compliance strategies.
- *Examine the linkages between taxpayer services and compliance.* Research would provide a better understanding of the relationship between taxpayer burdens and compliance and the impact of taxpayer service on voluntary compliance, two areas where there has been limited work to date. Understanding the link between taxpayer service and voluntary compliance could help the IRS better target taxpayer services as well as develop programs that would both ease taxpayer burden and improve voluntary compliance.
- *Develop new tools to uncover patterns of noncompliance.* Research must be done to understand the changing patterns of noncompliance and to develop tools to discover and address it. Improved abilities to link data sets and to recognize similarities in abusive tax reduction strategies allow the IRS to target examination resources on the most egregious cases.
- *Improve the allocation of resources.* Research could help the IRS better match enforcement and service resources with the types of noncompliance, thereby maximizing the overall impact on compliance.

3. Continue Improvements in Information Technology

Tax administration in the 21st century requires improved IRS information technology (IT). The IRS is committed to continuing to make improvements in technology, including:

- Replacing antiquated core account management systems and technology. The Customer Account Data Engine (CADE) is the technological foundation that will enable the IRS to manage its tax accounts better and provide the data for a modernized IRS. Over time, the existing data base (the Individual Master File) and retrieval system (the Integrated Data Retrieval System) will be replaced with new technologies, new data bases, and new applications.
- Expanding and enhancing compliance activities through early detection, better case selection, and better case management.
- Delivering effective customer service, including E-File systems and web services, at reduced cost.
- Investing in infrastructure necessary to perform operations more efficiently, thus freeing up resources for enforcement and taxpayer service projects.

Upon release of the Administration's fiscal year 2008 budget request, the IRS will report on specific steps that will be taken to continue to improve its information technology.

4. Improve Compliance Activities

The IRS has an annual budget of roughly \$10.5 billion for fiscal year 2006 to process roughly 140 million individual, partnership, and corporate income tax returns and 1.5 billion information returns, provide guidance to taxpayers and their preparers, enforce the tax law, and collect over \$2 trillion of taxes. The IRS can address only a small part of the tax gap each year through its enforcement activities. In 2005 taxpayer contacts by the IRS included: 3.2 million notices sent to individual taxpayers who made mathematical or clerical errors on their 2004 tax returns, 3.5 million notices sent to taxpayers who underreported income on their tax returns or did not file returns, and 1.2 million examinations of individual income tax returns.

The IRS is continuing to improve efficiency and productivity through process changes, investments in technology, and streamlined business practices. For example, to combat abusive tax avoidance transactions, the IRS is expanding its front-line enforcement activities by redirecting employees. As detailed in the following section, the IRS continues to take advantage of technological advances, such as the Internet, to improve taxpayer services. Not only do these technological advances ease taxpayer burden, but they free valuable IRS resources to be devoted to enforcement activities.

The IRS will continue to reengineer its examination and collection procedures to reduce time, increase yield, and expand coverage. As part of its regular examination program, the IRS is expanding the use of cost-efficient audit techniques first pioneered in the NRP.

By increasing its use of reliable third-party data to verify information reported by taxpayers, the IRS can better target its audit resources. The IRS is expanding its efforts to shift to agency-wide strategies, which maximize efficiency by better aligning problems (such as non-filers and other areas of noncompliance) and their solutions within the organization. The IRS is committed to improving the efficiency of its audit process, measured by audit change rates and other appropriate benchmarks.

However, efficiency gains in existing programs alone will not significantly reduce the tax gap. Some of the new steps described elsewhere in this strategy, such as providing the IRS with access to more third-party data and simplifying the tax code, would also help make compliance activities more effective.

To reduce the tax gap further, new initiatives, such as the following, are needed:

- *Expand information reporting.* If legislation were enacted to strengthen reporting requirements, the IRS could use the new information to increase and better target its enforcement activities. Voluntary compliance would also improve, freeing IRS resources to focus on more questionable returns.
- *Improve document matching program.* Increasing the number of inquiries to taxpayers when there are discrepancies between amounts reported on tax returns and third-party information returns would improve compliance.

- Refine detection programs. Refining and expanding detection programs to target enforcement efforts on noncompliant taxpayers would ensure that IRS resources are used effectively.
- Increase examinations in selected areas. Some types of noncompliance (such as the large amount of noncompliance attributable to unreported business income) can only be detected and prevented through labor-intensive, expensive examinations.

Reducing the tax gap will require more examinations in areas where they are most cost-effective in recovering amounts attributable to past noncompliance and deterring future noncompliance. As noted above, the IRS is continuing to reengineer the examination process, allowing for some increase in coverage.

Implementation of these initiatives would have both direct and indirect benefits.

Improving compliance activities would result in an increase in enforcement revenues as more noncompliant taxpayers are contacted and examined (the direct benefit). In addition, a more visible IRS enforcement presence would deter other taxpayers from evading their tax obligations, thus leading to an increase in voluntary compliance (the indirect benefit).

5. Enhance Taxpayer Service

Taxpayer service is especially important to help taxpayers avoid making unintentional errors. The IRS provides year-round assistance to millions of taxpayers through many sources, including outreach and education programs, tax forms and publications, rulings and regulations, toll-free call centers, the Internet, taxpayer assistance centers, and volunteer income tax assistance (VITA) and tax counseling for the elderly (TCE) sites.

Assisting taxpayers with their tax questions before they file their returns reduces burdensome notices and other correspondence from the IRS after returns are filed and reduces inadvertent noncompliance overall.

Since the enactment of the IRS Restructuring and Reform Act of 1998, the IRS has significantly improved customer service. For

example: (1) in the 2006 filing season, over 56 percent of all individual taxpayers filed electronically (more than double the number who filed electronically in fiscal year 1999); (2) Low-Income Taxpayer Clinics

have been established to provide free or nominal charge representation for low-income taxpayers in Federal tax disputes, and to provide tax education and outreach for taxpayers who speak English as a second language; (3) the number of hits on the IRS web site ("IRS.gov"), which enables taxpayers to more easily obtain forms, track refunds, and get answers to their questions, grew to over 135 million during 2006, up nearly 8 percent from 2005; (4) other services, including the provision of transcripts of tax returns and matching of taxpayer identification numbers for third-party payers, are now being provided on-line; and (5) a pilot Compliance Assurance Process (CAP) program, which allows large corporations to work with the IRS to determine tax return accuracy prior to filing, provides these corporations with greater accuracy on their tax returns and greater certainty about their tax liability at an earlier date.

In report language accompanying the fiscal year 2006 Appropriations bill for the Treasury Department, the Senate Committee on Appropriations requested that the IRS develop a five-year plan to improve taxpayer services. The Taxpayer Assistance Blueprint, the next phase of which will be delivered in January, will include a process for assessing taxpayer needs and preferences, develop a decision model to prioritize service initiatives and funding, recommend service improvement initiatives, create customer centric performance and outcome measures, and outline a multi-year research plan. The Taxpayer Assistance Blueprint will also provide an important tool to help establish benchmarks against which improvements in customer service can be measured.

6. Reform and Simplify the Tax Law

The current tax code is too complicated. The complexity of the tax code makes the tax law too difficult for taxpayers to understand and for the IRS to administer. Special rules and subtle distinctions in the tax law foster a sense of unfairness in our tax system, discouraging compliance and increasing the tax gap.

Taxpayers who want to comply with the tax code often make unintentional errors on their returns, as they struggle to understand complicated rules and forms. Complexity also provides opportunities for those who are willing to exploit the system. Furthermore, complexity makes it difficult for the IRS to detect noncompliance. Simplifying the tax code will reduce unintentional errors by well-meaning taxpayers and reduce opportunities for evasion. A simpler tax code will also be easier for the IRS to administer.

The complexity of the tax law also contributes to the tax gap because limited IRS resources are increasingly committed to administering a wide array of targeted tax provisions created to meet social policy goals. These targeted provisions, which themselves are growing increasingly complicated, divert IRS resources from basic compliance efforts.

The Administration's fiscal year 2007 budget contains six proposals that would simplify the tax treatment of savings and families. The Treasury Department will continue to develop additional legislative proposals to simplify the tax code in ways that will reduce the tax gap. In addition, the Treasury Department is studying the report of the President's Advisory Panel on Tax Reform and is considering options for reform. Simplification proposals aimed at reducing the tax gap would be part of a reform proposal.

Legislative initiatives will continue to be supplemented by administrative efforts to reduce taxpayer burdens. In recent years, the IRS has taken a number of steps to reduce taxpayer burden, including the establishment of the Office of Taxpayer Burden Reduction (TBR). Recent improvements in IRS forms, processes and procedures include simplifying the filing requirements for Form 944 (Employer's Annual Federal Tax Return), eliminating the need for filing Form 2688 (Application for Additional Extension of Time to File U.S. Individual Income Tax Return) by allowing the taxpayer to get an automatic six month extension to file, and the creation of the EITC Assistant, an on-line tool that helps taxpayers determine their eligibility for the earned income tax credit (EITC) and the estimated EITC amount. Additional projects to simplify tax forms and processes are currently under review by TBR.

7. Coordinate with Partners and Stakeholders

The Treasury Department and the IRS extensively coordinate with state and foreign governments, taxpayer representative groups and practitioners to increase compliance, gain efficiencies in tax administration, improve taxpayer services and minimize taxpayer burden. Increasing the level of such coordination activities will be an important part of a successful effort to reduce the tax gap.

- *International Exchange of Information.* Through tax treaties and tax information exchange agreements, the United States is able to obtain from foreign tax authorities information needed to enforce U.S. tax laws. In addition, the United States participates in information sharing regarding broader, non-taxpayer-specific information. For example, through the Joint International Tax Shelter Information Centre (JITSIC), the IRS and tax authorities in other participating countries will continue to share information regarding abusive tax avoidance transactions.
- *Federal-State Partnerships.* The IRS continues to work with state governments to develop strategies to address trends in noncompliance. For example, combined Federal-state employment tax reporting allows extensive coordination between the IRS and state governments with respect to employer noncompliance with employment tax obligations. In addition, the Treasury Department's Financial Management Service and the IRS will launch a pilot program with two states in January 2007 to enable taxpayers to pay all their Federal and certain state taxes online by means of the Treasury's Electronic Federal Tax Payment System (EFTPS).

This initiative will provide one stop for taxpayers to make their Federal and state tax payments. Additional actions to address the tax gap in the next 18 months will include:

- Exploring the use of state data-mining capabilities, designed to utilize proprietary state data, to refine further and prioritize IRS audit leads;
- Testing the use of state Department of Revenue audit reports as an efficient basis for IRS audit assessments;
- Testing the use of State Workforce Agency employment tax audit reports as an efficient basis for similar IRS audit assessments;

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- Expanding coordination with other Federal agencies with the goal of leveraging their resources and securing data pertinent to IRS compliance programs;
 - Identifying state and Federal resources and programs that can be used to communicate tax gap messages; and
 - Identifying non-traditional methods utilizing state and Federal resources to communicate the societal impact of the tax gap.
- *Practitioner Liaison and Education.* The Treasury Department and the IRS conduct liaison and education activities with practitioners in order to learn about developments in tax return preparation and to ensure that advisors provide appropriate tax advice. The IRS maintains active relationships with several national practitioner groups, small business representatives, and industry organizations to provide information related to the most current IRS positions and guidance. The creation of the Office of Professional Responsibility has helped restore credibility to enforcement of professional standards. Over the next 12 months, the IRS will enhance outreach efforts with these practitioner and industry stakeholders to engage in a discussion of key components of the tax gap including:
 - Proper reporting of gross receipts;
 - Correct computation of business deductions such as cost of goods sold, depreciation, travel and entertainment expenses, and motor vehicle expenses; and
 - Third party information reporting.
- *Taxpayer Representatives.* The Treasury Department and the IRS often communicate with taxpayer representative groups to learn about taxpayer concerns, including issues regarding taxpayer rights in administering the tax code. For example, comments received from organizations representing low-income taxpayers significantly improved new EITC procedures that are currently being tested by the IRS. Recent meetings with representatives of small businesses have focused on the importance of balancing the IRS's need for action in areas of noncompliance with taxpayer concerns about increased burdens. Ongoing interaction with these groups is an integral part of this tax gap strategy.

CONCLUSION

The Administration is committed to reducing the tax gap. In doing so, the Administration recognizes that the most effective way to reduce the tax gap is to increase compliance rates through a combination of initiatives (including targeted legislative and administrative changes, taxpayer service, and enforcement efforts) that are sensitive to taxpayer rights and minimize taxpayer burden. Simplification of the tax law is also critically important to this effort. This document provides a broad strategy for reducing the tax gap. The Administration is committed to working with Congress to further refine and implement it.

Tax Gap Strategy Timeline for Fiscal Year 2007

2006

- September o Initial tax gap strategy
- October o Stakeholder meetings to review initial tax gap strategy
- November o Development of Administration legislative proposals for inclusion in fiscal year 2008 budget request
 - o Development of Administration's budget request for the IRS for fiscal year 2008
- December o Proposal for next NRP Reporting Compliance Study

2007

- January o Taxpayer Advocate's Annual Report to Congress
 - o Update of 2006-2007 Treasury Department/IRS Priority Guidance Plan
 - o Launch of Federal/State Electronic Federal Tax Payment System (EFTPS).
 - o Deliver Taxpayer Assistance Blueprint Phase II Report to Congress
- February o Administration's fiscal year 2008 budget request, including anticipated legislative proposals for compliance initiatives, tax code simplification and IRS funding March/April
 - o Detailed outline of IRS tax gap strategy reflecting provisions in Administration's fiscal year 2008 budget request
 - o Outline steps to reduce opportunities for evasion
 - o Outline IRS research initiatives
 - o Outline IRS information technology initiatives
 - o Outline IRS compliance initiatives
 - o Outline IRS taxpayer service initiatives
 - o Outline steps to reform and simplify the tax law
- May o Stakeholder meetings to discuss Administration's fiscal year 2008 budget request
- June o Treasury Department review of practitioner compliance initiatives
- July o 2007-2008 Treasury Department/IRS Priority Guidance Plan.

Case study

TOPIC 1.1

INTEGRAL STRATEGIES FOR CONTROL AND PREVENTION

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(Chile)

CONTENTS: Introduction.- 1. Chilean Tax System.- 1.1. Chilean Tax Structure.- 2. Chilean Tax Administration.- 3. Tax Evasion in Chile.- 3.1. Evasion Measurement.- 3.2. Value Added Tax Evasion.- 3.3. Income Tax Evasion.- 4. Verification Model.- 4.1. Taxpayers' Social Behavior.- 4.2. Model Description.- 4.3. Facilitating Tax Compliance.- 5. Electronic Tax Life Cycle.- 5.1. Business Start-up and Online RUT Request.- 5.2. Electronic Invoices and Receipts for Professional Fees (Tax Documents).- 5.3 Electronic Accounting and Simplified Accounting.- 5.4. Third Party Statements.- 5.5. Tax Status Statement.- 5.6 Monthly and Annual Tax Statement and Payment.- 5.7. Correction of Statements and Tax Penalty Payments.-5.8. Taxpayer Background Changes.- 5.9. Business Closure.- 5.10 Draft Income Tax Statement.- 5.11. MIPYME Portal (Micro, Small and Medium-sized Businesses).- 5.12. Cash Register and Point of Sale Systems and Fiscal Printers' Authorization.- 6. Verification Process.- 6.1. Taxpayer Life Cycle.- 6.2. Massive Processes.- 6.3. VAT Refunds' Control.- 6.4. Selective Audit Processes - Audits.- 6.5 Tax Crime Investigation.- 6.6. SII Challenges: Tax Noncompliance Detection Project.- 7. Conclusions.

OVERVIEW

The Chilean Tax Administration has attained significant progress in reducing tax evasion through the design and application of effective control and prevention strategies. In effect, VAT evasion, which

TOPIC 1.1 (Chile)

towards the year 2000 accounted for 4 billion Dollars (21% of potential collection), dropped to 14.2% in 2004. Estimations indicate that such percentage dropped to 12% in 2005.

This reduction was based on two main factors. Firstly, as a result of the broad national consensus that enabled legal changes to increase revenue collection, bring the Chilean tax model closer to those of developed countries and strengthen the efficiency of auditing bodies. Secondly, owing to the development of numerous studies to define taxpayers' tax behavior risk areas and the application of auditing plans in line with such studies.

All of this has entailed a growing integration among the three Tax Administration institutions: the Internal Revenue Service (SII, as per the Spanish acronym), in charge of overseeing the enforcement and administrative auditing of tax obligations under the domestic taxation umbrella; the National Customs Service, in charge of overseeing duties and taxes on foreign trade transactions; and the General Treasury of the Republic, which oversees collection and management of the Government Sector's financial resources.

Currently, the SII is focused on strengthening Tax Justice, facilitating tax compliance and improving audit controls on noncompliant taxpayers. In this context, the tax obligations' compliance control model has focused on defining a set of actions to enhance taxpayers' perception of control and risk, incorporating such elements into their decision to comply. Therefore, the model is embodied in different processes to facilitate voluntary compliance and the audit thereof.

Facilitation processes have been developed and enforced to enable fast and easy taxpayers' compliance with their tax obligations.

Meanwhile, audit processes seek to control tax noncompliance. Such processes present distinctive features vis-à-vis the depth of the audit, audit cost, coverage, segmentation and special audits for taxpayers and technological support. These processes may be organized according to a pyramid, with the preventive processes at the base, with greater coverage and less audit depth; and the peak of the pyramid indicates the in-depth audits, which, in turn, feature smaller coverage since taxpayers at this level adhere to voluntary compliance.

Finally, it is vital to highlight that the design of tax evasion control and prevention strategies' must always provide for long term considerations, for their sustainability in time.

INTRODUCTION

The Chilean Internal Revenue Service (SII, as per the Spanish acronym, or the Service), is the agency in charge of the enforcement and administrative auditing of tax obligations under the domestic taxation umbrella. In the performance of the mandate vested upon it by Law, which is to ensure revenue collection in order to finance the needs of the State, it has become a relevant player in the country's economic and social activity.

Currently, the SII work is focused on strengthening Tax Justice by facilitating tax compliance and improving audit controls. Such issues have been decided by consensus in the course of recent years, enabling to define the purposes, strategies, projects and programs in the different processes under the scope of the Service.

In this context, the need arises for the Tax Administration to rely on policies that reflect the new emphasis of their actions; set forth the framework according to which it shall pursue its purposes; point out the strategic outlooks towards which the Agency shall guide its efforts and focus the attainment of their objectives under the framework of tax evasion control and prevention.

The Service has developed a working model based on a global and integrated view of its institutional purpose. The model is organized on the basis of tax compliance control, where direct actions are developed with a view to facilitating such compliance, auditing noncompliance and punish it when applicable.

On such basis, the Services course of action is grounded on an verification model that on the one hand facilitates voluntary compliance and, on the other, oversees taxpayers' noncompliance. This model is embodied by different audit processes: massive audits, ongoing audits, by sectors or selective, which entail the different review process depths, audit costs and taxpayers' coverage. This model ensures a level of control perception that promotes taxpayers' voluntary compliance.

This presentation sets forth the tax evasion prevention and control strategies applied by the Chilean Tax Administration, which integrated into their design a number of variables that are inherent in the country's economic, political and social reality.

The first section describes the Structure and the Chilean Tax Administration, which constitutes the context for the compliance control strategies adopted by the country; then, it describes the tax evasion phenomenon and finally, it deals with the verification model, its processes and forms to facilitate compliance.

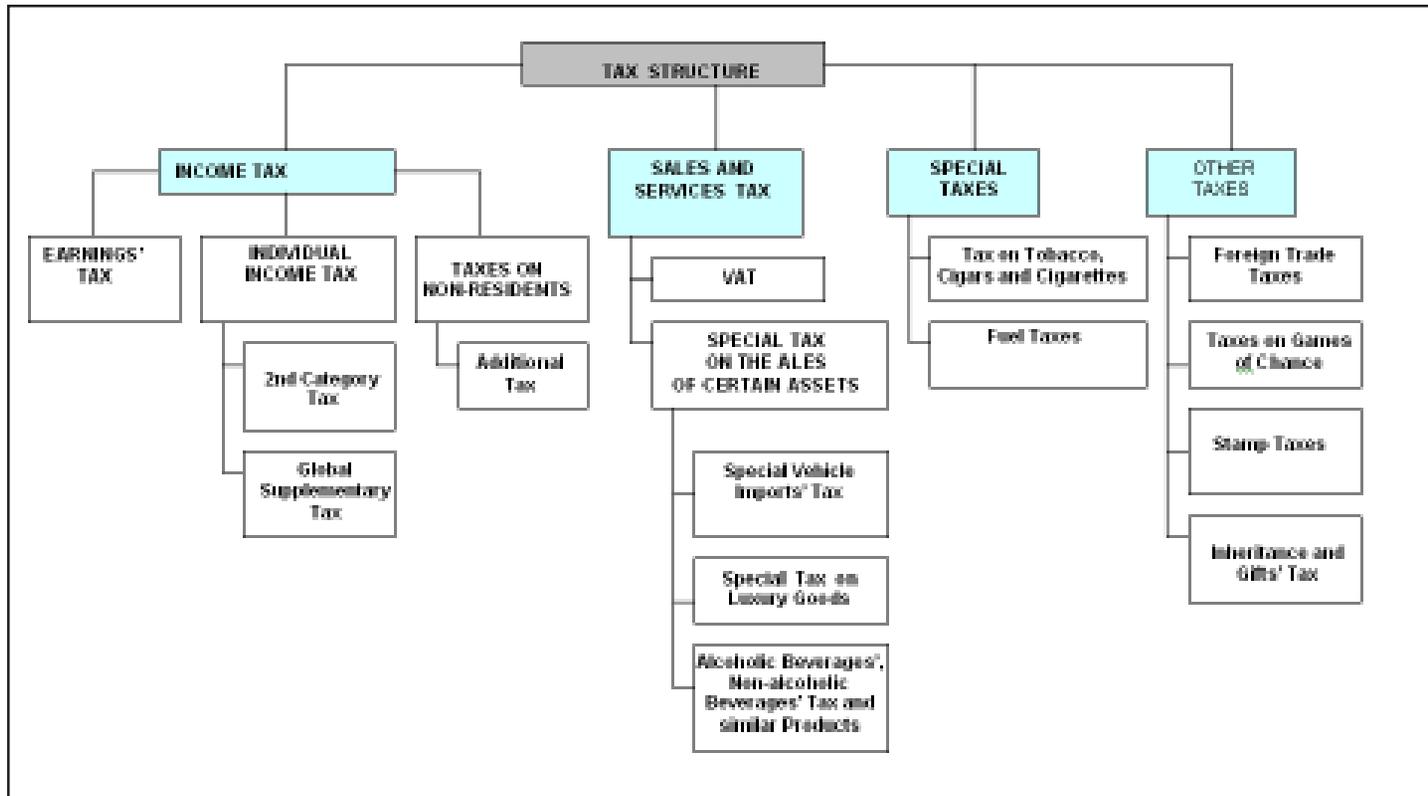
1. CHILEAN TAX SYSTEM

Chilean Tax Structure

The Chilean Tax System has been built on the basis of only a few high-yield taxes.

Existing taxes may be classified according to four types: Income Tax, Sales and Services Tax, Special Taxes and Other Taxes, as defined hereunder.

Figure N° 1 Tax Structure



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Sales and services' taxes only levy the portion of consumed income, excluding the savings' portion; they levy the sales of goods and the rendering of services as defined by the specific business definition, by commercial, industrial, mining and services' companies, among others. The most relevant tax in this category is VAT. VAT levies the end consumer, but it is generated in each stage of the good's marketing process. The tax amount payable arises from the difference between the tax debit, which is the sum of taxes added to the sales price and the services rendered within a month, and the tax credit.

Income Tax, as the name indicates, is levied on the income stemming from the exploitation of capital and work.

The design of this tax in Chile marks a difference between business owners and workers; among the latter, it distinguishes among employees and self-employed individuals.

Businesses pay an annual tax called First Category Tax, which amounts to 17% of their accrued earnings. Dividends and earnings' distribution among businesses domiciled in Chile are exempted from such tax.

Individuals domiciled in Chile pay an annual and progressive tax called Global Supplementary Tax, calculated on the basis of the income earned. In the case of dividends or business earnings' withdrawals, the first category tax paid by businesses increase the individual tax base and is deducted as a tax credit from said tax.

Individuals who only earn income as employees pay a progressive tax called Second Category Tax, which levies a shorter period spanning the salary payment, normally one month. This tax is paid via the applicable withholding by the employer.

Finally, the so-called Additional Tax levies the income from Chilean sources earned by individuals who are non-domiciled or non-residents in Chile. The general tax rate for this tax is 35%. Just like the case of the Global Supplementary Tax for the distribution of business dividends or earnings, the First Category Tax levied on such earnings is added to the tax base of the Additional Tax and is deducted as a credit against the final assessed tax thereafter.

The general rule in Chile is to file Tax Statements, which is the immediate basis to assess and pay the tax. Income Tax as well as VAT are taxes subject to Tax Statements, therefore, it is the taxpayer who must file the income earned, the amount thereof and finally, define the tax amount payable.

The Tax Administration shall only assess the tax or tax difference when, upon an audit process, it detects taxpayer's noncompliance with the Tax Statement, or that such statement is misleading or false.

Table N° 1 sets forth the tax revenue figures as of 2005, which indicate an overall revenue collection amounting to US\$ 19.996 billion, out of which 30.8% is collected from the Income Tax. VAT accounts for 46.4% of revenue collection. Taxes on specific products make up 10.0% of overall collection.

Chart N°1 2005 Tax Revenues

	Million \$	Million US\$ ⁽¹⁾	Central Gov. Overall%	% GDP
Income Tax	3,448,994	6,161	30.8	5.3
VAT	5,193,583	9,278	46.4	8.0
Special Asset Taxes ⁽²⁾	154,683	276	1.4	0.2
Special Products' Taxes	1,120,159	2,001	10.0	1.7
Foreign Trade and Others	1,275,875	2,279	11.4	2.0
Net Central Gov. Revenues	11,193,294	19,996	100.0	17.3
Municipal Taxes	926,608	1,655	8.3	1.4
Gov. Social Security Contributions	931,717	1,664	8.3	1.4
Gross General Gov. Revenues	13,051,619	23,316	116.6	20.2

Source: SII, based on Treasury and Budget Office information.

Notes:

- (1) Calculating according to the average exchange rate for the year.
- (2) Includes taxes on luxury goods, motor vehicles; alcoholic, non-alcoholic beverages and similar products.
- (3) Includes taxes on tobacco, cigars, cigarettes and fuels.
- (4) Includes taxes on foreign trade, stamp taxes, games of chance, inheritance and gifts and taxes filed in foreign currency (mostly, private mining corporations). It excludes non-tax accounts.

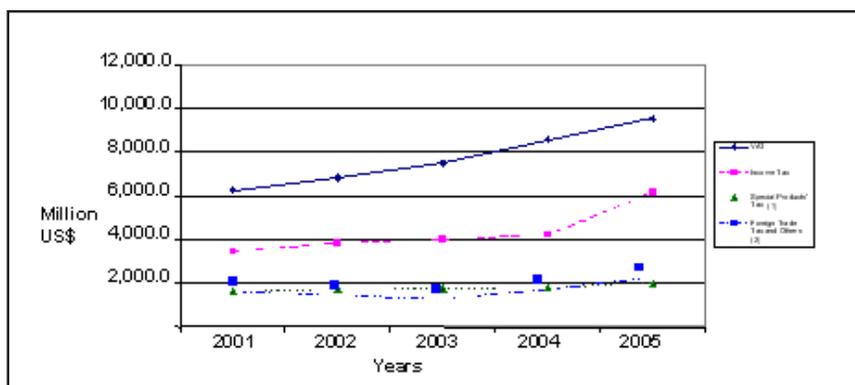
Average Exchange rate 2005: Ch \$ 559.77.

GDP 2005: US\$ 115.628 Million.

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As it may be observed, the tax structure is marked by a high concentration of excise taxes, which amount to 57.8% of the overall tax revenues, while Income Tax revenues account for approximately half that figure. In the majority of OECD countries the situation has been the contrary. That is to say, collection is mostly focused on Income Taxes¹. Chile has the typical structure of Latin American developing countries.

Chart N°2 Evolution of Tax Revenues ²
(Chart in Million Nominal US\$)



Source: SII. Drafted according to Tax Revenue Reports by the General Treasury of the Republic.

Note:

(1): Includes taxes on luxury goods, alcoholic, non-alcoholic beverages and similar products, motor vehicles, tobacco, cigars and cigarettes, fuel.

(2): Foreign Trade taxes, stamp taxes, taxes on games of chance, inheritance and gifts and taxes filed in foreign currency.

Average 2005 Exchange Rate: 559.77 \$/US\$

2. THE CHILEAN TAX ADMINISTRATION

The Chilean Tax Administration is formed by three institutions: the Internal Revenue Service, the National Customs Service and the General Treasury of the Republic.

It is worth highlighting that in addition to these institutions we rely on the Municipalities, since they also perform a tax administration function regarding certain municipal taxes (for example, vehicle licenses, or commercial permits and motor vehicle circulation permits).

¹ "Diagnóstico del Sistema Tributario Chileno", March 2000, Michael Jorratt.

² Tax Statistics, Annual Tax Revenues 1993-2005, SII Deputy Directorate of Studies.

2.1 The Internal Revenue Service

The Internal Revenue Service is a body that reports to the Ministry of Economy, whose function is to "enforce and audit all the domestic taxes currently in effect or to be made effective, of a fiscal nature or otherwise, of relevance for the Administration and the control of which has not been specifically vested by law upon a different authority". The maximum authority thereof is the National Director, designated by the President of the Republic and highly trusted by him/her.

Presently, the SII task is focused on facilitating voluntary compliance and improving audit controls, gearing its actions towards taxpayers who breach their tax obligations, fundamentally by perpetrating tax fraud and tax evasion. The Service's work is furthered under the framework of enhancing tax justice.

In order to perform its functions, the SII relies on 3,600 officials who are distributed among the National Directorate, the Large Taxpayers' Directorate, both headquartered in Santiago -the capital of Chile-, and 16 Regional Directorates, spanning the country with 68 offices.

In turn, the National Directorate is made up by nine Deputy Directorates: Audits, Studies, IT, Regulations, Administration, HR, Assessments and Internal Comptroller's Office, which are headed by the Deputy Directors, who act on behalf of the Director in the assessment and development of working programs in their respective areas and advice him on the matters in their specific fields.

2.2 National Customs Service

The National Customs Service, which also reports to the Ministry of Economy, is the Agency in Charge of overseeing and auditing the circulation of goods in the Country's coastlines, borders and airports, controlling international circulation for the purpose of collecting imports, exports and other taxes as determined by law, and generating the statistics for said circulation across the borders, without detriment to the other functions provided by law.

The maximum Customs authority is the National Director, a person highly trusted by the President of Chile.

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The institutional vision, which is the basis to determine the Chilean Customs model, has defined this Services' strategic plan, which is structured according to four lines or courses of action: Audit and Sanctions, Management IT and Process Automation; Human Resources Development and Training, and Performance Quality and Assessment Improvement.

The institution relies on 1,365 officials, which are distributed among the National Directorate, headquartered in Valparaiso, and nine Regional Directorates, seven Customs' Administrations and 42 Border Crossings. Customs is present in 90 points overall, including ports, airports and outposts.

In turn, the National Directorate is made up by six Deputy Directorates -Audits, Technical, Legal, IT, Administration and Human Resources- under the authority of the Deputy Directors who represent the Director in their functions.

2.2.1 The General Treasury of the Republic

The General Treasury of the Republic is the body in charge of collecting and managing Government Sector financial resources, and their distribution and control thereafter, according to the policies defined in the National Budget.

In order to effectively fulfill the mission that has been vested upon it, the General Treasury of the Republic performs a number of functions geared at the efficient levying and collection of government sector taxes and credits; the payment of tax obligations, and the administration of Government financial resources.

This agency also reports to the Ministry of Economy, and is made up by a General Treasury, 13 Regional Treasuries and 21 Provincial Treasuries.

The General Treasury, in turn, is organized according to departments. The Departments that constitute it are: Operations, Studies and Development, Government Finances, Collections and Bankruptcy, Legal, Administration, Internal Comptroller's Office and Human Resources.

2.2.2 Integration of the Tax Administration Institutions in the Tax Evasion Context

Tax Evasion has been a constant concern for all Tax Administrations, especially those in developing countries, since taxes constitute the main source of revenues for a nation, and the reduction thereof generates a series of setbacks and distortions in the public as well as private sphere, by fostering the enforcement of higher tax rates to overcome the collection deficit.

In Chile, this topic is subject to permanent review. Therefore, in 2001, the so-called Anti-Tax Evasion and Tax Avoidance Act was enacted, which pursued the increase in revenue collection, bringing the Chilean tax model closer to those from developed countries and strengthening and improving the efficiency of auditing agencies. This has entailed an increasing integration of the three Tax Administration institutions with the purpose of improving tax compliance control by means of actions that on the one hand foster taxpayers' voluntary compliance and on the other, combat tax fraud, by auditing noncompliant taxpayers. For such purposes, in the framework of the 2001 Anti-Tax Evasion Act, the Coordination Committee to Counter Tax Evasion, COLUCE (as per the Spanish acronym) was created. This committee is integrated by the National Directors of the three foregoing services. This year, the committee became the Tax Administration Committee with the purpose of making this institution a permanent body.

The joint action of the Tax Administration bodies has enabled to modify taxpayers' behavior, reducing tax evasion opportunities, which has improved collection by reducing tax evasion.

3. TAX EVASION IN CHILE

The Notion of Tax Evasion

Tax evasion is the overall or partial noncompliance with tax statements and payments and other legal obligations of taxpayers' with the Administration.

In 1995, the United Kingdom's Royal Commission on the Taxation of Profits and Income defined evasion as "any activity

by which an individual fails to pay the tax required by the legislation in effect." ³

The Inter-American Center of Tax Administrations, CIAT, sets forth that Tax Evasion is understood as the "illegal behaviors adopted by taxpayers to avoid, reduce or delay the payment of taxes as mandated by law."

The tax fraud phenomenon had not been formally included in the theoretical model until the unprecedented work by Allingham and Sandmo (1972). According to the original model, a representation was made of a taxpayer faced with the decision to evade or not evade the Individual Income Tax (IIT) as a risk portfolio decision. In the assumption he/she is detected, the taxpayer shall refund the tax evaded and pay a fine. In the assumption he/she is not detected, the taxpayer is fully released from the burden. Thus, the decision to evade the tax depends on the taxpayer's income, the tax rate, the fine amount and the probability that the Tax Administration surprises him/her evading taxes.

A number of other works have fostered the development of an IIT evasion theory, since risk factors go hand in hand with other variables such as the perception of tax authorities, the social acceptance of the tax system, taxpayers' tax awareness, etc.⁴

3.1 Evasion Measurement

The measurement of evasion is not an easy task. For obvious reasons, directly addressing taxpayers is the most unreliable form of observing such a behavior: it is very unlikely that the agents involved will disclose the tax amount unpaid in a given period, even when total anonymity is ensured. In this regard, the measurement methods shall follow indirect channels to obtain more reliable results, in order to quantify tax evasion and measure the impact of SII actions against this behavior.

³ Quoted by Oldam and Holland in a report submitted in the 1971 CIAT General Assembly in Brazil.

⁴ "Impuesto Personal a la Renta Comparado: Situación Actual y Perspectivas Futuras." Patricio Barra and Danae Chandía, 2004.

The general method that has been used to estimate evasion for every type of tax consists in the creation of a theoretical component in their tax base, as set forth by legislation. For this purpose, independent sources of information are employed (National Accounts, mainly) which are specific to each levy. Thereafter, an estimation of the theoretical collection is performed applying current tax rates to the theoretical base and it is compared against effective collection. This difference renders the estimated evasion amount. The specific estimation methodology for the two most relevant taxes, VAT and Income Tax, is described in the following sections.

3.2 Value Added Tax Evasion

The SII relies on an annual Value Added Tax evasion rate estimation based on the information from National Accounts.

The following table presents the estimated VAT evasion rate for the 1996-2004 period. This series has been developed on the basis of annual aggregate data on consumption, investment and product, published in March 2005 by the Central Bank.⁵

Chart N°3
Estimating VAT Evasion- Based on the Input-Product Matrix 1996
(in Million US\$, July 2006)

ITEM	1996	1997	1998	1999	2000 ¹⁾	2001 ¹⁾	2002 ¹⁾	2003 ¹⁾	2004 ¹⁾
Theoretical Collection	7,257	8,028	8,772	9,148	10,571	10,506	9,198	9,887	11,594
Effective Collection	6,108	6,435	6,714	6,338	6,383	7,203	7,639	8,111	8,122
Tax Evasion Amount	1,148	1,593	1,998	1,780	1,794	1,732	1,519	1,516	1,472
Evasion Rate	15.8%	19.8%	22.8%	19.5%	16.6%	16.4%	16.5%	15.3%	12.6%

Source: SII Deputy Directorate of Studies on the basis of Central Bank Information.

Note:

1 Preliminary Figure.

⁵ "Administración Tributable Viable, Estado Viable," CIAT Technical Conference, Cartagena, Colombia, September, 2005, SII.

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In this estimation, we observe a significant reduction in VAT noncompliance from the year 2000, when it reached 21%, up to 2004, when the indicator should account for an estimated 14%. The figures may be adjusted to the extent the national accounts for the last few years are reviewed by the Central Bank.

Another method to assess tax compliance is the VAT Productivity Index, which is calculated as a fraction between effective VAT collection, expressed as a percentage of a certain macroeconomic variable correlated with its theoretical basis, and the legal tax base in effect for the lien. In the case of VAT, a usual macroeconomic benchmark is the GDP and the Household Final Consumption Expenditure. Nevertheless, this last variable, Final Consumption, seems to be the immediate benchmark, since VAT is a levy borne by the end consumer.

The studies conducted vis-à-vis the VAT Productivity Index (as regards GDP as well as final consumption) show consistency with the tax evasion rate, with similar behaviors in time. It has been determined that as of the year 2000 -the year before the Anti-Tax Evasion Act was enacted- there was a significant reduction in VAT noncompliance, when it amounted to 21 %, until 2004, when the same indicator reached 14%. Preliminary estimations calculate VAT evasion in the year 2005 at approximately 11% to 12%.

3.3 Income Tax Evasion

The method employed to estimate First Category Income Tax noncompliance is based on the calculation of the potential collection of such tax, considering the National Accounts' Exploitation Surplus as the aggregate theoretical basis. Such surplus shall be corrected as applicable to reflect the differences between this macroeconomic concept and the tax base for the Corporate Tax.^{6 and 7}

Individual Income tax evasion has been also calculated based on the First Category Tax evasion that is transferred thereto. We consider that First Category Tax noncompliance translates directly into evasion of the Global Supplementary Tax, in the case of

⁶ The figures presented are the reviewed and updated figures obtained with this method in Jorratt and Serra [1997].

⁷ "Estimación de la Evasión Tributaria en Chile", Patricio Barra and Michael Jorratt. June 1999.

effective income earned by the ultimate owner of the corporation which is not filed as applicable. The estimation assumes that 100% of under-filed earnings are distributed.

Considering the limitations in determining individual income tax evasion, we have deemed it more appropriate to relate the result from the estimation described to the aggregate individual income taxes, since we consider that the greatest tax evasion gap occurs precisely in the Global Supplementary Tax.⁸

4. VERIFICATION MODEL

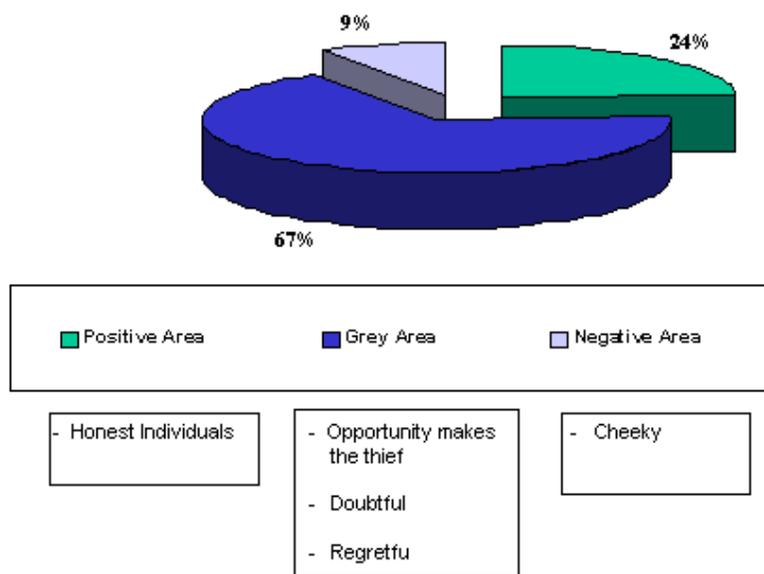
2.1 Taxpayers' Social Behavior

According to an image survey conducted in 1998 by Mori y Asociados, entitled "Measurement of Taxpayers' Perception of Tax Audits", we were able to approach taxpayers' social behavior in the light of legal obligations, specifically tax obligations.

As a result of this study, we identified three types of taxpayers. The following chart shows the three areas that represent taxpayer typologies.

⁸ The experience of the SII audit areas indicates that the Second Category Tax offers more limited tax evasion possibilities than the Global Supplementary Tax, especially since it is a tax withholding, which may be audited at the source. Regarding the Additional Tax, we have observed that foreign corporations, in general terms, do not evade First Category Taxes by under-filing them, but tax evasion practices are linked to concealing remittances in the form of expenses or payment for services.

Figure N°2 Taxpayers' Behavior



These three groups of taxpayers represent a segmentation that calls for a different control and audit treatment.

In the first group, the positive area, we find 24% of taxpayers who are compliant mainly because they invariably tend to comply. These individuals also require the procedure to be simple, low cost and not hurdle their economic activities. In this group, the Tax Administration shall offer good assistance and information services to facilitate compliance with tax obligations. On the other hand, this opinion group is influential on the perception of the Tax Administration and may be very important as to the Tax System's image vis-à-vis the acceptance thereof.

The second group, the grey area, which accounts for approximately 67% of taxpayers, features an inconsistent behavior. If they perceive that evading taxes is difficult and/or if they see that other taxpayers meet their obligations, then they shall comply. This group, which represents the great majority of individuals, is highly sensitive to the Tax Administration's control actions and to the degree of information they have on the consequences of their actions. Regarding such taxpayers, the Tax Administration shall impose

control and audit systems that motivate their compliance. In this group, the effect of the audits conducted on taxpayers of their acquaintance is very relevant, since it sets the example and motivates their compliance with tax obligations.

The third group, the negative area, made up by 9% of taxpayers, features the worst behavior and the Tax Administration approaches it differently. For this group, the audit shall be very dynamic in order to reveal the different mechanisms that evasion may adopt. It also involves taxpayers who may potentially perpetrate tax crimes. The Service's action on such taxpayers must be severe, conveying a direct message of control, since the audit's exemplifying effect is not as effective in this case.

This survey also looks into the taxpayers' perception of taxes. In this sense, 70% of interviewees estimate that VAT evasion is relatively difficult. Regarding evasion risk, 67% of interviewees estimate that evading taxes in Chile is very risky. The same survey indicates that the Internal Revenue Service is deemed a very professional institution.

According to this study, we may infer that the Service's control and audit actions are very likely to influence taxpayers' behavior. The willingness towards compliance is partly based on taxpayers' typology and partly on the perception that there is effective control of taxes.

On the other hand, it is worth highlighting that the SII actions fail to generate the same effects on taxpayers and specific actions for each segment are required, within a set of control activities that pursue the best results with the available resources.

2.2 Model Description

The Internal Revenue Service audit is based on a global and integral view of the institutional responsibilities and underlines tax compliance control. The conceptual model originates from the combination of taxpayers' social behavior (Section 4.1) and the risk areas in the behavior thereof. Thus, the tax obligations' compliance control model consists in defining a set of actions that increase the perception of tax control by the Service and taxpayer risk, incorporating such elements into their decision to comply. On

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this basis, the verification model is supported by two main courses of action, facilitating voluntary tax compliance and auditing taxpayers' noncompliance.

This model is embodied in different audit processes that shall be addressed hereunder.

The model has been designed on the basis of the interrelation among the following elements:

- Coverage balance, that is to say, in what way shall a number of taxpayers from different economic sectors be selected; and the depth, that is to say, the capacity to conduct in-depth audits on them. Therefore, we obtain high coverage and low depth audit processes and vice versa.
- Segmentation and special audits.
- Technological support.

Balance between Audit Coverage and Depth: Massive and Selective Controls

The audit shall assign equal number of resources for massive and selective control actions.

With massive actions we achieve high control coverage on the universe of taxpayers, generating a relevant indirect effect. Such activities performed on a structured basis enable the systematic improvement of taxpayers' behavior.

By means of selective actions, we seek to grant a greater in-depth auditing capacity for tax compliance. Therefore, its coverage is low and the indirect impact relatively less.

An appropriate set of massive and selective control actions fosters the perception of control in the universe of taxpayers'. In effect, with massive audits' plans, a taxpayer faces a greater detection probability if he/she fails to comply with regular tax filing obligations, as appropriate. Once said controls are exceeded, selective audits' plans enable a more in-depth examination in the face of a taxpayer with a greater compliance risk.

The difficulty in defining this balance between massive and selective actions is the limited number of officials to implement controls to the extent required. In this sense, the relevant indicator is the coverage expected from the actions performed, so that control risk is concrete and perceived by taxpayers.

The depth of the audit plans increases SII costs. An audit geared at controlling the appropriate filing of tax with many credits, deductions and special treatments requires more time, knowledge, and resources than an audit to determine the appropriate filing of a single-rate tax without exemptions.

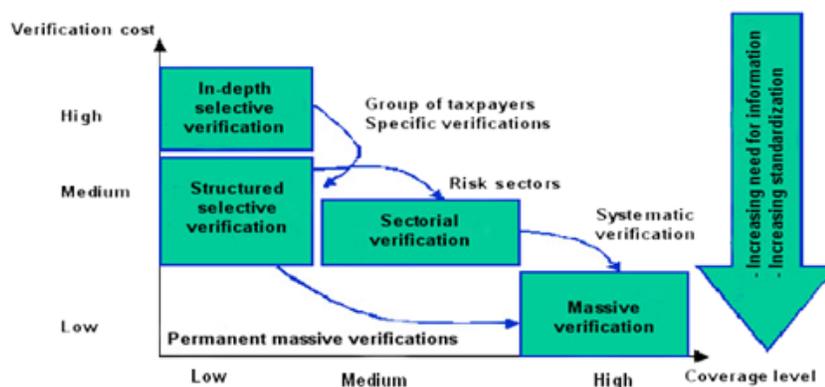
The massive audit largely relies on the use of technological tools for the development of plans, since their generation is based on IT algorithms to detect inconsistencies, and officials are focused on correcting such errors, some of which may be addressed via the taxpayer's self-service functionality.

Selective and sectors' audits are labor intensive activities for the detection of inconsistencies, with a high unit cost for the taxpayer as well as the SII, since all the information provided by the taxpayer is reviewed, determining a lengthy and complex audit.

In this regard, the massive audit plans entail economies of scale vis-à-vis the review of the information filed by taxpayers.

The balance between audit coverage, depth and cost is summarized in the following Chart:

Figure N°3 Verification Types



Control Actions' Segmentation and Special Audits

Another relevant element to achieve the efficacy in the Service's actions is to rely on the adequate segmentation of taxpayers, so as to establish audit controls for all types or groups. Thus, segmentation may be performed according to size, taxes levied upon them, type of organization or legal incorporation, etc. Each taxpayer category requires the implementation of controls to promote a better tax compliance.

On the other hand, and based on this taxpayer segmentation, special audits shall be implemented for higher tax evasion risk groups or for those in which greater evasion levels have been observed. Such activities shall allocate resources to specific groups of taxpayers and are geared at focusing the attention on the tax evasion entities to be eliminated or the effects of which are to be reduced. A clear example of such actions are the audit programs or plans for change of taxpayer, audit of individual purchases charged to businesses, among others.

Strong Technological Support in Massive as Well as Selective Actions

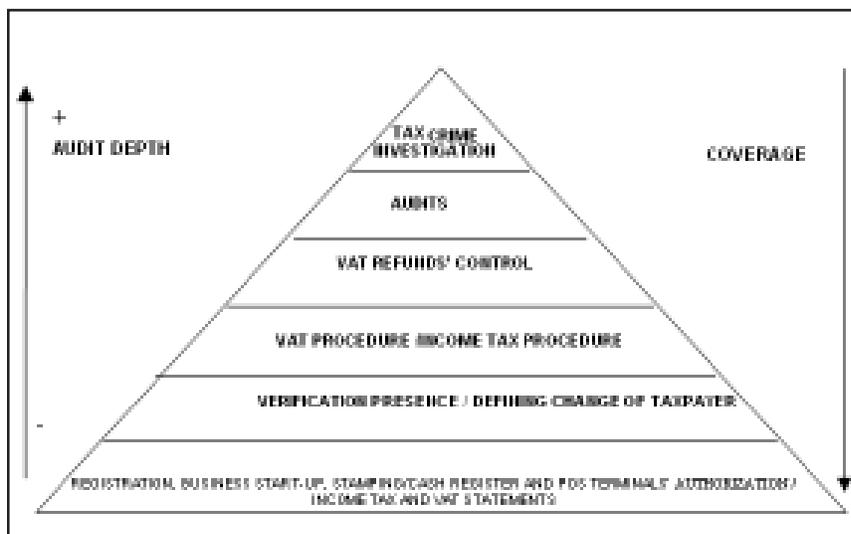
A cross-sectional audit requires strong support of Information Technologies to ensure a greater productivity and the attainment of the objectives defined.

Taxpayer communication processes, information storage and gathering, data use, support in process execution with online data and interaction, centralized information processes, etc., reduce audit costs, render it more efficient and empower the Service's performance.

The integration of the foregoing elements, coverage and depth, segmentation and special audits, as well as the IT and communications' support for audits enable to generate audit programs or plans that the SII requires for tax evasion control and prevention.

The following chart shows how it is possible to organize, in a pyramid, the audit processes performed by the Internal Revenue Service. In the base we find the preventive processes to facilitate taxpayers' compliance, with a greater coverage and less depth in the inspection process. On the top of the pyramid, the audit processes feature less coverage and greater depth.

Figure N°4 Audit Actions



4.3 Facilitating Tax Compliance

Facilitating tax compliance is among the Service's strategic objectives. This element contributes to the Tax System's acceptance and is based on the capacity it grants taxpayers to fulfill the obligations imposed thereby. This notion incorporates compliance cost, the degree of obligations' complexity and the number of procedures required. The following are the features to be included in this attribute:

Assistance Quality

Taxpayer assistance quality, in the framework of the legal and regulatory obligations, is very relevant to facilitate compliance with regulations and foster a good tax behavior. This quality improvement process legitimates control actions of a more coercive nature enforced by the Service upon noncompliant taxpayers. On the other hand, as we have seen, there is a significant group of taxpayers with a good tax standing that call for enhanced assistance standards.

The incorporation of innovations such as the maximum timeout commitments and the incorporation of more remote Internet-based assistance services are clear examples of actions that improve the quality of assistance and directly contribute to creating an image of a modern, serious and professional Service.

Simplicity of Obligations

In order for obligations to be easy to meet, we require procedures and standards to be as simple as possible, to the extent enabled by the Tax System. Such procedures shall also be duly disclosed via mass channels for taxpayers so they may obtain information and duly meet their obligations.

Compliance Cost

The design of strategies that seek to facilitate tax compliance shall take into account not to increase, and if possible, reduce taxpayers' compliance costs. To the extent this cost is successfully reduced, the Tax Administration shall move towards facilitating voluntary compliance.

Tax Administration Accessibility

Tax Administration accessibility (A.T., as per the Spanish acronym) is understood as the possibility for taxpayers to enjoy channels with the Administration that enable them to solve or clarify different tax situations. In this regard, we may underline the opening of Taxpayer Assistance Centers (CENAC, as per the Spanish acronym) in the most relevant SII Units, whose purpose is to help taxpayers with their different obligations. Also, the CENACs rely on a self-assistance module in which the taxpayer may learn about the array of existing services on the Service's Web site.

Legal Certainty

It is worth indicating that the tax authority's actions shall be in line with legal provisions. To the extent the taxpayer is certain on how to proceed, without any room for doubts, understanding the law becomes easier and, therefore, voluntary compliance is empowered.

Strengthening the Audit Process

Surveys on tax evasion levels have indicated that tax compliance is a relevant issue to be considered by the Tax Administration and calls for a significant effort in its approach.

The tax evasion issue had been approached on a number of aspects by small modifications and administrative measures. Thus, in the 90's, the country experienced an economic growth that brought about complexity in transactions and the incorporation of new technologies. The latter, hand in hand with a remarkable increase in the number of taxpayers, generated more room for tax evasion. Also, as referred to in the item on Taxpayers' Social Behavior, the studies undertaken provided references of their behavior vis-à-vis the tax obligation, determining that 76% failed to comply voluntarily in the absence of actions to promote it. All this generated the Anti-Tax Evasion Act.

Such Law was geared at punishing and hurdling the sources of tax evasion and tax avoidance by means of legal amendments with a view to reducing such behaviors, strengthening the tax audit and

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collection capacity and modernizing and fostering greater efficiency in Tax Administration offices. Among the amended laws, we may highlight the Tax Code, the Income Tax, Sales Tax and Services Tax Act, Customs Ordinance and the Internal Revenue Service (SII), Customs and Treasury Statutes.

Among the most relevant aspects defined in legislation, with the purpose of collecting a maximum equivalent to US\$ 700 in 2005, we must mention the following: greater efficiency and more equitable taxpayer treatment, new SII audit plans, strengthening the powers of the Tax Administration, tax legislation improvement (special audits, presumptive income, tax evasion and tax avoidance control for large taxpayers, etc.), institutional modernization of the Internal Revenue Service and the General Treasury of the Republic, creation of new positions and increase in the number of resources, sanctions' creation and increase.

Regarding the increase in the number of resources and the creation of new positions in the SII, approximately US\$ 20 Million were allocated and 539 new officials were progressively hired with the purpose of directly strengthening audit plans. Likewise, positions were created for audit plans' planning, support and control.

All of the foregoing enabled to generate more control actions in all the areas: (a) it strengthened tax audits on medium and large businesses; (b) it enhanced prevention and verification presence; (c) it increased the scope and effect of audits generated from VAT and Income Tax transactions' processes; (d) it enabled to improve the investigation of tax crimes and forgery of invoices, and; (e) it increased the VAT taxpayer change control.

The anti-tax evasion plan met all the goals set forth in the course of its development, increasing tax collection by US\$ 1.584 Billion between 2001 and 2005.

This section shall describe the main facilitation processes, which stem from the verification model. They have been developed and implemented to enable taxpayers' fast and expeditious compliance with their tax obligations.

5. ELECTRONIC TAX LIFE CYCLE

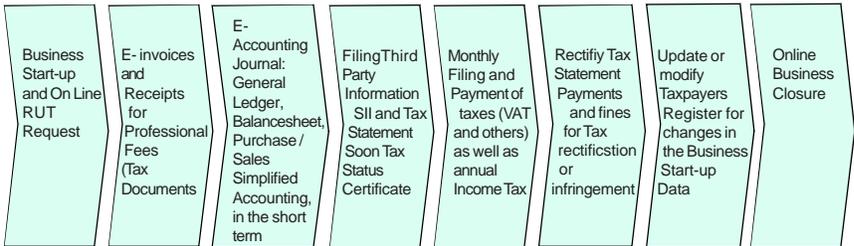
One of the greatest advances in the efforts to facilitate voluntary tax compliance is the possibility for taxpayers to complete the most relevant processes in a taxpayer's life cycle from the economic and tax procedure standpoint via the Internet. This cycle is understood as a set of procedures to be completed by the taxpayer from the time he/she starts a business (business start-up) until he/she ceases to pursue a business (business closure).

Annually, the SII processes approximately 90,000 Business Start - Up notifications' procedures for taxpayers registered in the First Category Tax, with requests predominantly from micro, small and medium sized businesses (Mipyme, as per the Spanish acronym). On the other hand, slightly over 20,000 procedures are for Business Closure requests, and both actions occur at the respective ends of taxpayers' tax compliance life cycle.

The fact that taxpayers enjoy access to a fully Internet-based Electronic Tax Life Cycle application, not only simplifies and facilitates procedures, but also provides an opportunity for all Chilean businesses to grow their productivity and enhance competitiveness. This is especially true for Mipymes, since the relative cost of duly and efficiently meeting their tax responsibilities is significantly greater than for large businesses. Therefore, the availability and access to an array of technological functionalities that span the overall tax cycle with simple, efficient and secure processes entails voluntary tax compliance cost reductions.

The following chart explains the main cycle stages:

Figure N° 5 Main Life Cycle Stages



5.1 Business Start-up and Online RUT Request

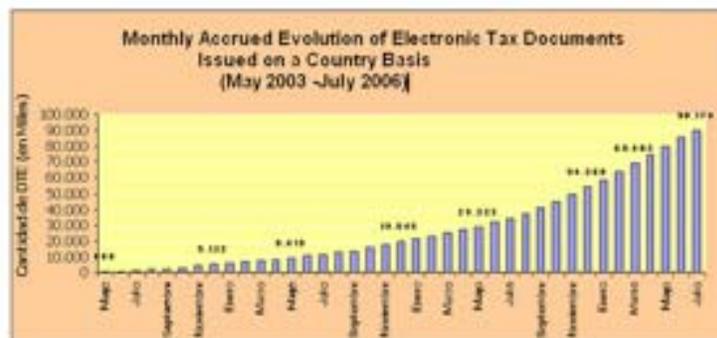
Taxpayers may file their RUT request and also report their business start-up via the Internet. Thereafter, the Internal Revenue Service shall verify this information against the business incorporation records that taxpayers themselves shall publish in the Official Gazette.

To date, almost 100 % of new individual taxpayers that start their business do so via the Internet. In the case of corporations, we are making gradual progress.

5.2 Electronic Invoices and Receipts for Professional Fees (Tax Documents)

The use of electronic tax documents has enabled taxpayers to reduce compliance costs and, moreover, to reduce commercial transactions' costs, thus increasing their business competitiveness.

Chart N°4



As regards the number of businesses incorporated into the electronic invoicing system, we may state that in January 2004 they amounted to 46, gradually increasing to 1102 business as of July 2006.

5.3 Electronic Accounting and Simplified Accounting

Electronic accounting, which enables to reduce operating costs and dispose of physical records, and simplified accounting, shall enable the great majority of taxpayers to keep the records of their purchases and sales as well as their tax assessments.

5.4 Third Party Statements

Presently, 100% of Tax Statements with third party information for Income Tax and VAT transactions are filed via the Internet, and the information to complete them may be obtained by businesses from the financial and accounting systems in order to prepare and file it with the SII thereafter.

5.5 Tax Status Statement

Via the Service's Web site (www.sii.cl), taxpayers may access the summary of their information on a Tax Status Statement (Cartola Tributaria in Spanish), which enables to detect irregular situations and verify their tax compliance, which is especially useful if the company relies on accounting auditors, whether in-house or external.

5.6 Monthly and Annual Tax Statement and Payment

Taxpayers may file their tax statements and make payments via the Internet, which, in addition to facilitating voluntary compliance, reduces the number of statements with mistakes based on information mismatch. This normally occurs when statements are filed in hard copies. It reduces information entry time and errors and generates instant follow-up information.

Following is a table summarizing the information for the years 2005, 2004 and 2003, which shows the growth experienced by monthly tax statements (Form 29) received via the Internet.

Chart N°5 Monthly Tax Statements and Payment Processes

Form 29. Statement and Payment of VAT, Withholdings and Provision	2005	2004	2003
Amount filed and paid in Million \$ (1)	7.296.019	6.286.943	5.388.607
Amount filed and paid in Million USD (2)	14.185	12.224	9.352
No. of annual forms /No. of Statements)	10.757.406	10.619.231	10.190.235
Monthly Forms' Average (No. Statements/12)	896.451	884.936	849.186
Percentage of Internet Statements	44%	36,2%	15.4%
Percentage of Amounts filed via the Internet	78%	77,7%	61,1%

Source: SII Deputy Directorate of Audits

- (1) Exchange rate updated as of December 2005. Includes Statements filed in Foreign Currency. Preliminary figures.
- (2) Dollar exchange rate as of December 2005: \$514.33

Vis-à-vis annual taxes, the SII grants taxpayers the possibility of filing annual Income Taxes via the Internet. The evolution of statements and payments is presented hereunder:

Chart N°6 Annual Tax Statement and Payment Processes

Form 29. Statement and Payment of VAT, Withholdings and Provision	2005	2004	2003
Amount filed and paid in Million \$ (1)	7.296.019	6.286.943	5.388.607
Amount filed and paid in Million USD (2)	14.185	12.224	9.352
No. of annual forms /No. of Statements)	10.757.406	10.619.231	10.190.235
Monthly Forms' Average (No. Statements/12)	896.451	884.936	849.186
Percentage of Internet Statements	44%	36,2%	15.4%
Percentage of Amounts filed via the Internet	78%	77,7%	61,1%

Source: SII Deputy Directorate of Audits

- (1) Nominal Figures. Figures for 2006 are preliminary.
- (2) Dollar exchange rate as of December 2005.

5.7 Correction of Statements and Tax Penalty Payments

Among the tools to facilitate compliance we may mention the taxpayers' statement correction functionality when they file taxes via the Internet. Likewise, if the taxpayer has been penalized, he/she may directly make the payment through the Service's Web site, benefiting from important discounts over such amounts.

5.8 Taxpayer Background Changes

Taxpayers shall inform the changes in their background information. In this scenario, the SII has enabled a feature for taxpayers to update their information on their own via the Internet. For example, change of domicile, business activity or start-up date, and opening, change, or closure of a business subsidiary.

5.9 Business Closure

Every taxpayer that ceases to pursue a business activity may file for this procedure within a period not exceeding 2 months after the business closure. Currently, this formality may be completed on the Internet by filing the Business Closure request, which enables to expedite the business closure formality and allows businesspersons to pursue new business ventures.

5.10 Draft Income Tax Statement

Among the facilitation processes, we may highlight the draft Income Tax Statement, which was developed by the SII beginning in 2002 for all individuals. It includes information relative to their salary, professional fees, dividends, withdrawals and other income paid as reported by withholding agents to the SII. In the cases in which it is unfeasible to develop a draft statement, the statement form is featured with partial completion of the codes for taxpayers to complete them with the missing information. This initiative is also relevant for the Tax Administration's transparency in showing all the taxpayer's information with the purpose of facilitating the completion of the tax statement process.

It is worth underlining that as of 2003, it is also possible to access said draft via cellular telephones with text messages.

5.11 MIPYME Portal (Micro, Small and Medium-sized Businesses)

The purpose of this facilitation project is to provide corporate taxpayers a single Web portal with all the information they require to access the E-invoice, Simplified Accounting and Tax Statement and Payment module. This goes hand in hand with a national

training plan in the second half of 2006, to show small and medium sized businesses the advantages in this portal and the fact that it requires less effort, in order to foster its use among such taxpayers.

5.12 Cash Register and Point of Sale Systems and Fiscal Printers' Authorization

The SII has enabled the use of cash registers, point of sale systems and fiscal printers that enable to issue the tickets that replace the sales and services' tickets and invoices. For such purpose, importers, dealers and/or manufacturers who wish to sell and employ new equipment releases shall request their certification and then, the taxpayers who wish to use such devices, shall request their registration and use authorization to the SII.

6. VERIFICATION PROCESS

The verification model developed by the Service is embodied in different audit processes or strategies, with different features that distinguish them as to the audit depth, cost and taxpayers' coverage, as pointed out in Section 3.

Hereunder, we present a brief description of the SII verification processes.

6.1 Taxpayer Life Cycle

The life cycle enables, on the one hand, to keep taxpayers' information updated in the course of their business and tax life in the Service's databases, and, on the other, to control the transactions conducted by agents, individuals or corporations that perform economic and/or professional activities.

In order to understand the Chilean situation in such regard, we shall indicate that the number of active taxpayers registered in the Service's database, that is to say, those who have filed the Business Start-up procedure and have not filed the Business Closure request amounts to 2,656,373 taxpayers, out of which 2,337,344 are individuals and the remaining 12% are corporations. Among active taxpayers, 30.5% account for those who conduct businesses levied with VAT.

Regarding document stamping, it is worth mentioning that this process provides an administrative authorization for the documents required to support the different taxpayers' transactions in the course of their business activities. It consists in the SII authorization of hierarchies of documents to be electronically issued and/or the stamping of each document and the copies thereof. This process also serves as a method to control taxpayers, given the fact that they frequently visit the Service's offices to stamp their documents. On such occasions, their tax behavior is reviewed and, should any observation or comment arise as to their tax behavior, they receive assistance to address the issues as applicable.

Verification Presence

The Verification Presence is the ongoing onsite audit action performed by SII officials. Its purpose is to determine taxpayers' compliance with tax obligations, especially regarding documents' registration and issue. Additionally, these type of actions seek to educate by fostering voluntary tax compliance

Hereunder we provide a table that summarizes the Verification Presence actions conducted in 2005, 2004 and 2003.

Chart N° 7 Verification presence Process

	Year	2005	2004	2003
Controls on established businesses	Number	249,850	209,944	167,970
Coverage (%) controls SII commercial businesses)	%	40%	34%	27%
Road controls:	Number	635,463	568,530	404,282
Registration and assessment controls:	Number	20,757	43,079	31,003
Auditors' hours employed	Number	411,839	415,071	342,177
Number of equivalent auditors	Number	176	178	146
Number of notified infringements	Number	23,440	27,720	25,840
Number of closures performed	Number	6,909	7,589	8,288

Source: SII Deputy Directorate of Audits

The following have been deemed the most relevant type of audits:

Controls on Established Businesses: Audits conducted by auditors in the taxpayer's commercial domicile (shops, offices, factories, etc.), with the purpose of verifying the correct issue and recording of documents.

Controls in Wholesale Markets (livestock, vegetable and fruit, lumber, etc.): Audits conducted by auditors in the wholesale markets in which raw material suppliers and purchasers do business with the purpose of verifying the appropriate transactions' issue and recording.

Mobile and Fixed Road Controls: Control performed by auditors on the supporting documentation (invoices and waybills) for the cargo carried on public roads.

Registration and Assessments: These entail the visits to taxpayers who conduct their business occasionally (arts and crafts fairs, Christmas fairs, real estate rentals in the holiday season, etc.), with the purpose of verifying taxpayers' registration in the business conducted and determining a sales estimation and profit margin for tax purposes.

All of the foregoing controls are relevant to counter taxpayers' informality. It is a preventive procedure that also seeks to educate the taxpayer.

6.2 Massive Processes

Monthly - VAT Process

It consists in the administration, processing and massive audit of taxes filed and paid on a monthly basis, chiefly VAT.

The generation of such massive plans is conducted by crossing information filed by the taxpayer and the information contained in the Service's databases, employing computer-based algorithms and structured validations.

The information rendered stemming from the information crossed enables to verify compliance with tax obligations and, in the cases in which inconsistencies are detected, taxpayers are notified to rectify or visit the SII offices in order to clarify the issue.

Another massive VAT process, which is annual and relates to the monthly VAT statement and payment, by which taxpayers who file annual credits equal to or greater than \$250 Million within a business year file the Annual Summarized Statement of the VAT on Purchases and Sales, to account for the VAT levied on purchases of goods, use of services and imports and the sales of goods and rendering of services.

This process enables a great coverage, since although it gathers information from a small group of taxpayers, the number of suppliers and customers reported is relevant and the transactions registered at the country level account for over 70%, which enables to conduct massive Value Added Tax audits.

Following is table that summarizes information for 2005 and 2004 vis-à-vis taxpayers who were notified in this process.

Chart N°8 Massive Audits' Plans

	2005	2004
Taxpayers' Notified via Massive Programs		
Non-registered (several fiscal years)	338,873	212,748
Tax Differences		
Matches (debts=credits)	5,996	12,573
Other Massive Programs (non-registered absent taxpayer)	54,922	50,034

Source: SII Deputy Directorate of Audits

Annual - Income Tax Process

It consists in the administration, processing and massive audit of taxes that levy the income earned annually by taxpayers. This process pursues voluntary taxpayers' compliance with the mechanisms that facilitate, verify and foster the appropriate statement and payment of taxes and the applicable credit rebates.

Every year in April, once the taxpayers' filing process is finished, computer data are crossed to validate the information registered and the statements with inconsistencies are challenged. In the process conducted in April 2006, approximately 200,000 statements were challenged. They are released progressively as the SII receives more information or taxpayers rectify their statements. In the remaining cases, taxpayers are notified in the course of the year and they are required to visit the SII offices to clarify, elaborate, rectify or ratify the content of their tax statements.

Following is a table with the summary of the most common inconsistencies detected in the Income Tax Process for 2004, 2005 and 2006, respectively.

Chart N°9 Most Common Inconsistencies detected in the Income Tax Process in 2006, 2005 and 2004

Most Common Inconsistencies	2006	2005	2004
Taxpayers with PUT inconsistencies	36,284	90,298	117,121
Excess Tax Credits Registered for First Category Taxes	28,889	28,601	33,312
Taxpayer with inconsistencies in the use of the training expenses allowance	2,575	14,020	106,491
Credits against the First Category Tax	12,289	11,627	8,694
Controls on Income Tax from Professional Fees pursuant to Article 42 N°2	6,649	7,228	7,706
Control on Withdrawals, Dividends distributed by Corporations and C.P.A. and Real Estate Capital	2,085	6,114	2,665
Taxpayers who excessively reduce interest paid on mortgage loans	1,263	4,994	18,364

Source: SII Deputy Directorate of Audits

6.3 VAT Refunds' Control

It entails the different procedures by virtue of which greater taxpayers' cash refunds are generated by virtue of VAT payments. Tax refunds provided for by law are exporters' VAT refunds, refunds for VAT -taxpayer change and refunds on fixed assets' investments.

Following is a summary of VAT Refunds in 2005, 2004 and 2003, respectively:

Chart N°10 VAT Refunds' Process

		Year		
		2005	2004	2003
VAT Refunds' Amounts for Exporters(1)	Million \$	2,204,240	1,027,303	1,736,443
	(2) Million USD	4,461	2,148	3,578
	Number of Refunds	14,385	14,279	13,923
	Number / 12 months	1,180	1,180	1,160
Change of Taxpayer Refunds' Amount(1)	Million \$	31,742	20,880	
	(2) Million USD	62	41	
	Number of Refunds	14,090	11,761	
	Number / 12 months	1,222	980	
Refunds' Amount for Investments in Fixed Assets (1)	Million de \$	44,108	38,620	
	(2) Million de USD	88	78	
	Number of Refunds	413	380	
	Number / 12 months	34	33	

Source: SII Deputy Directorate of Audits

(1) Nominal Figures.

(2) Dollar Exchange Rate as of December 2005: 514.33

6.4 Selective Audit Processes - Audits

It consists in the development of audit programs geared at verifying tax noncompliance for specific groups of taxpayers who meet certain selection criteria.

This process looks into new tax evasion entities and generates audit programs to be developed in the Regional Directorates of the country (operating units). Such programs, which include a small number of audits if compared to massive processes, are very labor intensive and extend in time (four to six months on average). Each program includes a guideline with the detail of the audit to be conducted and pursues the confirmation of the assumption regarding the existence of one or more tax evasion entities.

Following is a summary on the selective audits conducted in the course of 2005, 2004 and 2003, respectively.

Chart N°11 Selective Audit Process

	Year	2005	2004	2003
Audits completed	Number	12,816	11,630	13,738
Yield(1)	Million \$	515,996	233,904	206,965
(2)	Million USD	1,003	455	402
N° of Auditors	Number	300	276	276
N° of cases per Auditor	N° cases/Auditor	43	42	50
N° of Audit programs entered in the year	Number		124	42
Average number of cases per program	N° cases/Program		57	34

Source: SII Deputy Directorate of Audits

(1) Nominal Figures.

(2) Dollar Exchange Rate as of December 2005: 514.33

This process classifies the taxpayers to be audited with a view to favoring the learning process, gaining new knowledge and applying the detection of new tax evasion entities to the extent taxpayers' modify their behavior.

In addition to the classification according to type of business, the SII qualifies taxpayers according to their size. Thus, taxpayers with greater business volumes who meet certain requirements account for approximately 1500 and make up 35% of the overall national collection. Such taxpayers are audited by a special unit by the name of "Large Taxpayers' Directorate, which conducts an ongoing follow-up process on taxpayers in this category given their complexity and size.

6.5 Tax Crime Investigation

Among the audit processes, the one with the greater depth and smaller coverage is tax crime investigation. Basically, internal procedures have been established that enable the Units across in the whole country to initiate the investigation of an eventual crime upon a preliminary

analysis of the situation, by which more background information is gathered and the decision to investigate is made. In such case, an action plan is developed, the background information is verified and new data are requested from other Institutions, other Regional Directorates and of course, from taxpayers themselves.

Thereafter, a report is drafted with an account of the investigation's outcome, which includes an analysis of the facts of the crimes detected and the supporting evidence; the latter shall be organized in a folder with the procedures performed. Finally, the information is assessed and the decision is made whether to initiate criminal proceedings or refrain from doing so.

The case analysis and the potential conclusions to be defined are vital to conclusively determine the extent thereof and the exemplifying effect it generates in the market or the industry in which the business under discussion operates.

6.6 SII Challenges: Tax Noncompliance Detection Project

The Internal Revenue Service, with the purpose of improving its internal procedures and incorporate technologies, is undertaking a number of projects that enable to accommodate the audit function to present day roles, which are worth highlighting.

Knowledge Management

Knowledge Management is an emerging administration approach in expansion, to the extent organizations have become aware of the fact that their physical and financial assets lack the capacity to generate sustainable competitive advantages and discovered that intangibles are the true source of value in that sense. Such intangibles essentially account for the capacities generated in the organization when its different resources interrelate, producing organizational information, knowledge and learning.

Knowledge management takes care of these assets, pursuing the empowerment of human capital, their relations and structures.

The SII intends to implement an organizational approach based on the transformation of knowledge and better practices into an asset that it may keep and manage, which supported by information technologies shall strengthen audit processes, specifically tax audits.

Data Warehouse

Data Warehouse is, in simple terms, a data storage facility, which keeps all the organized information on a topic from internal and external sources and supports the decision-making process. This enhances data access and enables a better information processing.

This project shall then enable to strengthen Tax Intelligence tasks regarding audit processes, specifically the detection, audit and criminal prosecution of tax crimes and the analysis and study of technical tax evasion problems from specific groups of taxpayers.

7. CONCLUSIONS

The Chilean Tax Administration has attained significant achievements in the design of tax evasion control and prevention strategies. In fact, VAT evasion towards the year 2000 reached 4 billion dollars, accounting for 21 %, while in 2004 it amounted to 14.2%, with an estimated 12% for 2005.

The reduction of tax evasion has been attained on the basis of the continuous improvement of each audit strategy enhancing taxpayers' "risk perception", which has generated a change in their behavior.

The rational use of information and communications' technologies has embodied a strategic option for the SII, which entailed creating Internet-based tax compliance solutions, turning this into another communication channel with taxpayers.

An example of this development is the "Electronic Tax Life Cycle" application, which favors competitiveness, efficiency and productivity, especially for MIPYME based on the simplification, facilitation and cost reduction in tax compliance procedures. Moreover, it favors the country's productive activity by conveying and applying the tax cycle efficiency to the business cycle, enhancing the overall efficiency of the economy by aggregating taxpayer's efficiency and general transaction cost reduction in business activities.

TOPIC 1.1 (Chile)

After such relevant achievements, the SII functions have focused on strengthening Tax Justice. Among other challenges, this process entails: focusing the audit actions on noncompliant taxpayers; improving facilitation of voluntary tax compliance for compliant taxpayers; using advanced technologies for the detection of noncompliance and implementing a customer service quality within the Service.

Finally, we shall mention that the design of the tax evasion control and prevention strategies must take into account a number of assumptions for their implementation and enforcement:

- A clear political support and the leadership of economic and tax authorities, so as to materialize new policies.
- The specific situation for each country shall be always considered, its legal framework, the market's economic structure and/or the distribution of taxpayers.
- To the extent possible, the measures to be enforced against tax fraud shall be made up by a broad and diverse set of processes to enable adequate and sustainable planning in time.
- It is relevant to rely on the commitment of all the Tax Administration officials, who shall consider themselves part of the diverse strategies to be implemented.
- The follow up and measurement of the strategies implemented shall be considered.

Case study

TOPIC 1.2

CURRENT CHALLENGES IN CONTROLLING COMPLIANCE

Ans J.M. Huisman

Chair of the National Operations Intelligence Group
Dutch Tax and Customs Administration
(The Netherlands)

CONTENTS: 1. Introduction.- 2. Compliance: Self-sufficiency and Supervision.- 3. Measuring Compliance.- 4. Appropriate Services.- 5. Supervision that Matters.- 5.1. Improving investigation.- 5.2. Visible supervision.- 5.3. From administration to inspection.- 5.4. Enforcement publicity.- 6. Risk Control.- 7. Horizontal Supervision.- 8. Collaboration.- 9. Conclusion.

1. INTRODUCTION

The budget 2006 formulates one general policy objective and three operational objectives for the Netherlands Tax and Customs Administration. The operational objectives are prerequisites for attaining the main objective, i.e. the increase of compliance. The objectives are specified via effect and output indicators. Effect indicators present a picture of the effects of the policy or the implementation by the Tax and Customs Administration. Output indicators present a picture of the performance of the Tax and Customs Administration. Output indicators are used if immediate measurements of an effect are not really possible.

General policy objective

The general policy objective of the Tax and Customs Administration is formulated as follows:

Maintaining and reinforcing the willingness of the taxpayers to comply with their legal obligations to the Tax and Customs Administration (compliance).

2. COMPLIANCE: SELF-SUFFICIENCY AND SUPERVISION

The work revolves around compliance: the Tax and Customs Administration must maintain and reinforce the willingness on the part of taxpayers and supplementary benefit claimants (assumed in principle) to comply with legal obligations. People and businesses comply with such obligations if they submit the relevant facts accurately, fully and in good time and if they pay the correct amount in good time. Apart from a customer-oriented and respectful performance, the Tax and Customs Administration promotes compliance by corrective action, and as a final resort, by enforcing compliance by criminal law.

The more the tax authorities know about the taxpayers and supplementary benefit claimants, the more compliance can be promoted. Knowing means: to know what the taxpayers and supplementary benefit claimants do, what the (tax) implications are, to what (high-risk) groups similar taxpayers and supplementary benefit claimants belong, to which temptations they are exposed not to comply and what is required to ensure that they will comply.

The Tax and Customs Administration is unable to check everything. Often, this is not necessary. In its supervision the Tax and Customs Administration focuses on people and businesses that may be at risk of not complying with legal regulations or of not paying their taxes. Those risks should be covered. However, there are different risk levels. This means that the Tax and Customs Administration carries out more or less intensive checks depending on the risk level. Apart from the risk, the Tax and Customs Administration also considers whether it concerns substantial (financial) interests. Random checks are also carried out in order to avoid predictability. The Tax and Customs Administration always takes strong action upon any signs of fraud.

Groups of taxpayers and supplementary benefit claimants are not or insufficiently capable of complying with their obligations independently. The Tax and Customs Administration seeks to strengthen the self-sufficiency of taxpayers and supplementary benefit claimants wherever possible. It therefore provides services by actively providing information.

3. MEASURING COMPLIANCE

Table 1: Performance indicators general policy objective (%)
Attitude taxpayers towards tax obligations

	Realized value 2004	Realized value 2005	Figures budget 2006	Target value 2010
Tax evasion is unacceptable	88	84	88	+
Tax evasion is not really an option for me	75	71	75	+
Paying taxes means having to contribute something	58	52	60	+

Explanation

- The Tax Monitor annually measures the norms and values with regard to the payment or evasion of taxes. This is a quantitative survey which the Tax and Customs Administration annually carries out among a representative group of taxpayers (private individuals, entrepreneurs, customs clients, forwarding agents and tax consultants). Although the attitude towards tax evasion has become more lenient in the past year, there is still an ascending line if we look at the past ten years. According to increasingly more people no-one should be allowed to evade existing laws and regulations. Equality before the law is an important pillar underlying the compliance. The Tax and Customs Administration intensifies the supervision - in particular with regard to unknown and mala fide taxpayers - to ensure that the ascending line continues in the years up to 2010.

TOPIC 1.2 (The Netherlands)

- The percentage of taxpayers which indicates that tax evasion is not an option has decreased slightly. This question is both about wanting and being able to evade taxes. The Tax and Customs Administration seeks to reverse this trend and to improve its services. Working with basic registrations as a government and establishing more links with data flows of third parties, will further reduce the possibilities to evade tax by private individuals.
- People are reasonable positive about paying taxes. They believe that they contribute to society rather than that something is taken from them. The indicator shows that the majority of taxpayers believe that taxes are put to good use. The Tax and Customs Administration links up with this willingness and seeks to reinforce it. On the one hand, by providing good services and simplifying the mass process. The less errors the Tax and Customs Administration makes in its logistic process, the greater the willingness of taxpayers will be to comply with their obligations. On the other hand, by delegating more responsibility for the compliance with bona fide parties in the horizontalization process.

Table 2: Effect indicators compliance (%)

	2003	2004	2005 planning	2005 realisation
Tax return behaviour	97.5	96.9	96.8	97.3
Fill in behaviour	95.9	95.5	95.4	95.1
Payment behaviour	92.9	95.5	92.9	95.9

Explanation

- To what extent do people and businesses observe the fiscal regulations voluntarily? The effect indicators tax return behaviour, fill in behaviour, and payment behaviour illustrate this. With regard to the tax return behaviour and the payment behaviour, the Tax and Customs Administration evaluates if the taxpayers file their tax returns timely and pay their tax demands on time. The fill in behaviour expresses to what extent the Tax and Customs Administration follows the statements regarding fiscal facts, mentioned in the tax returns.

- The effect indicators are based on the non-compliant behaviour as observed en discovered by the Tax and Customs Administration. The values give an indication of the compliance. The indicators include information regarding the four most important resources: salaries tax, VAT, Corporation tax and Income tax.

4. APPROPRIATE SERVICES

Operational objective 1

Providing taxpayers, parties liable to pay wage tax and national insurance contributions and supplementary benefit claimants with appropriate services.

Table 3: Performance indicators operational objective 1

	Realized value 2004	Realized value 2005	Figures budget 2006	Target value 2010
% Telephone calls handled	67	80	80	80
Experience accessibility	60	43	70	80
Experience clear correspondence	81	82	84	85
Experience expediency completion	71	63	72	75
Performance of agreements	87	83	87	90

Explanation

- The Tax and Customs Administration measures the percentage of telephone calls it handles. After reaching a low in the spring of 2005 the Tax and Customs Administration decided to reorganize the telephone services. The telephone services were set up as a separate unit. Within this unit flexible workers are used to deal with peak pressure. The centres are geared towards specific target groups. By the end of the year the accessibility had increased to an accessibility level of 80% in 2005. This is also the norm for

2006 and the next years: 80% is a common percentage for professional call centres around the country.

- By reorganizing the telephone services the taxpayers and supplementary benefit claimants will experience the increased accessibility. Tax intermediaries (the group most dissatisfied with the accessibility) have its own telephone number and email address at its disposal per office of the Tax and Customs Administration. The Tax and Customs Administration seeks to reach the same level of experienced accessibility as the actual accessibility level (see percentage of telephone calls handled): 80%.
- In 2005 more than 80% of the taxpayers qualified the letters and tax return media (tax form, disc, and programme) as clear. The electronic tax return received the highest score, the letters the lowest score. The Tax and Customs Administration presumes that the scores will slightly increase over the next few years. On the one hand, because more taxpayers and supplementary benefit claimants use the electronic tax return, on the other hand because more attention will be drawn to the written communication. Staff members in the implementation sector receive training and have new style manuals at their disposal to improve their writing skills. The model books they already use are being modified.
- The score for the completion team has for years been fairly constant, although there was a slight decrease in 2005. Almost 70% is satisfied with the speed at which the refund is settled, tax returns are processed and queries are answered. By using the pre-populated tax return for private individuals, the score of the completion time will only increase in the next few years. The Tax and Customs Administration seeks to provide more certainty to private individuals at an earlier stage on the allowances they will receive and the debts to be collected.
- The taxpayers are positive about the way in which the Tax and Customs Administration met its promises and agreements in 2005. This score has been fairly constant for years now. By horizontalizing the supervision and the wish to involve more social parties in the supervision, the importance of proper agreements increases.

Services are being used as an instrument to promote compliant behaviour. Examples of those are:

- Taxline;
- Help desks in Tax offices;
- Aid and assistance with income tax returns;
- Internet (www.belastingdienst.nl);
- Communication (television, papers, journals).

5. SUPERVISION THAT MATTERS

Operational objective 2

Supervision and investigations stimulate taxpayers, parties liable to pay wage tax and national insurance contributions and supplementary benefit claimants to comply with their tax obligations.

By computerizing mass processes more capacity is released for supervision. Reinforcing supervision is required since people and businesses expect the Tax and Customs Administration to exercise supervision 'that matters': risk-oriented, visible, results-based and decisive where it concerns action against mala fide taxpayers. The Tax and Customs Administration will have to take more account of the social impact of its performance. This means that controls will focus less on numbers and more on content and results. Enforcement communication will be used more emphatically as an instrument to make clear what the Tax and Customs Administration is doing and which results have been attained.

The Tax and Customs Administration seeks to draw more attention to mala fide and evasive entrepreneurs (the black and grey economy). Supervision of this changeable and not always easy to trace group of entrepreneurs requires collaboration with other enforcement services.

The Tax and Customs Administration wishes to increase the number of in-depth and material controls. More attention will be drawn to investigating unknown taxpayers, both people and businesses. These controls will be conducted more often in cooperation with other services.

TOPIC 1.2 (The Netherlands)

More attention must also be drawn to strengthening the collection, the concluding activity in the supervisory process. The completion times of outstanding debts are reduced.

In order to reinforce the effect of the supervision, the different enforcement instruments must be properly compared. Given the limited capacity of the Public Prosecution Service it must be properly reviewed which cases are settled by means of criminal law and which cases by means of the administrative fine instrument. The Tax and Customs Administration in particular seeks to make the supervision more pro-active and more horizontal. Instead of checking the facts afterwards, agreements must be concluded with the suppliers of information beforehand to ensure that the data is accurate, complete and dependable. Horizontal means that the Tax and Customs Administration will avail itself more of the self-supervision which businesses and social organization may exercise.

In 2006 the Tax and Customs Administration intends to strengthen the horizontal supervision. The enforcement covenants with major companies will be extended. In the SME sector ten branches will review how the horizontal supervision may be realized. Within the vertical supervision the supervision of wage and turnover tax will increase. The Tax and Customs Administration will be lenient towards businesses which in 2006 were unable to comply with all their obligations due to the major changes in the wage tax return process.

Table 4: Performance indicators operational objective 2

	Realized value 2004	Realized value 2005	Figures budget 2006	Target value 2010
% arrears collection	3.7	3.1	3.5	2.5
% official reports leading to conviction/transaction	79	79	86	90
Chance of being caught as experienced by taxpayers (%)	66	67	70	75

Explanation

- In the event of adverse economic developments people and businesses comply less with their obligations to pay. Over the past years the tax collection arrears have therefore increased. This has resulted in an action plan, i.e. Dealing with Arrears in Tax Collection, within the Tax and Customs Administration. The organization of the collection process has been changed and from 2008 will be supported by a new collection system. The Tax and Customs Administration will sooner and more often bring an action to collect back wages and attach cars and bank credits. The Tax and Customs Administration gives priority to training and refresher courses for tax collectors and management and thereby intends to reduce the collection percentage structurally. Although the budget of 2006 still has to take account of arrears amounting to 3.5% the Tax and Customs Administration aims for 3.0%. By 2010 the arrears may not exceed 2.5% of the tax revenue.
- Fraud is effectively counteracted where as many cases as possible result in a judicial ruling. The percentage of official reports resulting in a conviction/transaction is based on the annual production of the Public Prosecution Service. This percentage has increased since 2003 when the Public Prosecution Service began to catch up. In 2006 86% of the cases should result in a transaction or summons, increasing up to 90% by 2007 and subsequent years. A maximum of 10% of the cases will then not be prosecuted.
- Within the context of the annual Tax Monitor the Tax and Customs Administration measure the chance of being caught as experienced by taxpayers in filling in incorrect data on a tax return. Since a couple of years, the chance of being caught as experienced shows a declining line. In 2002 the chance of being caught was 83, while in 2005 it had decreased to 67. Reversing this trend is a priority. By linking the government's basic registrations and expanding the data flows of third parties, the Tax and Customs Administration will reduce the opportunities to submit incorrect information. By digitalizing the tax return process, it will be easier to compare databases and to make the risk selection more sophisticated. The Tax and Customs Administration will

intensify the risk-oriented and visible controls and give more priority to investigating unknown and mala fide taxpayers. The supervision's effectiveness will increase by collaborating with other enforcement organizations and deploying specific enforcement communication.

5.1 Improving Investigation

In its supervisory role, the Netherlands Tax and Customs Administration has to check whether taxpayers are complying with tax legislation. But whenever serious fraud is suspected, supervision turns into investigation - conducted by FIOD-ECD (Fiscal Information and Investigation Service-Economic Investigation Service). And the criminal law comes into play.

In recent decades, the Tax and Customs Administration has focused on improving its logistical processes and service to taxpayers. In the next few years, it intends to focus on improving enforcement and supervision - making them tighter and more visible. Its resolution is summed up in the slogan "Supervision that makes a difference". The Administration wants to improve the quality of inspection by having tax inspection officials conduct inspections with colleagues with experience in investigation.

5.2 Visible Supervision

Taxpayers who stick to the rules can count on a Tax and Customs Administration that provides service. They get information and support, while inspections are usually conducted only at random. But taxpayers who break the rules will face a different Administration, with unorthodox and sometimes unpredictable methods. The Administration wants to make it as clear as possible that fraud is unacceptable. It is dealing with taxpayers who break the rules via its Visible Supervision strategy. In 2005, the Administration formulated several Visible Supervision campaigns.

5.3 From Administration to Inspection

The Tax and Customs Administration wants to strengthen supervision by moving from administration to inspection. In early 2005, therefore, it reviewed all its procedures and studied which ones could be conducted more efficiently and effectively. Working on the results of this review, Administration offices started centralising certain administrative tasks and some simple supervisory tasks. The exercise improved continuity, knowledge, steering, and efficiency. It also showed the benefits of dealing at a single location with inheritance tax, gift tax, registration tax, and conveyance duty. Some 2,000 employees are expected to be eventually released for supervisory support tasks.

5.4 Enforcement Publicity

Enforcement publicity is an important part of the supervision strategy. Taxpayers are more likely to fulfil their statutory obligations if the Administration publicises that fraud may be detected and attract severe penalties. Recent campaigns have targeted small, carefully selected high-risk groups of taxpayers.

In autumn 2005, various activities were launched to gain experience and give a clear signal to the target groups.

Investigation with a social impact Investigation is an integral part of enforcement at the Tax and Customs Administration and need not always be a last resort. At the Administration, FIOD-ECD is responsible for investigating tax fraud and other financial and goods-related fraud. In 2005, the emphasis in investigation shifted to quality. More attention was focused on theme-centred work, with priority for cases and operations with a possible social impact.

The Call Shop operation is a good example. In late 2004, FIOD-ECD conducted a criminal investigation of call shops. It discovered that a supplier of billing software had built in an option for call shops enabling them to cream off turnover digitally. A detection program specially developed by FIOD-

ECD made it possible to uncover the use of this option. The result was a national operation targeting the software supplier and its customers. In a single day, 217 call shops throughout the country were visited by 115 inspection teams. The teams discovered that 66 call shops were creaming off turnover.

6. RISK CONTROL

Risk control continues to be decisive for the approach to supervision. The risks are outlined beforehand, in particular by specialist knowledge groups. They carry out preliminary surveys within sectors to gain insight into the scale and interest of risks. They not only draw attention to tax risks or financial interests, but also to socially relevant risks (influencing compliance).

Annually, a set of selection rules is laid down by means of which electronic tax returns are ejected which will actually be supervised. Since businesses must file their tax returns electronically and it is easier to compare the data, the opportunities of building a high-quality parameter database increase. The objective is to eject an increasingly smaller percentage for individual processing by high-quality specialists, albeit selected in such a manner that substantial corrections are nearly always required.

Risk control is and continues to be a matter of creativity, intuition and variety. It is important to maintain a balance between the mass efficiently organized national selection process and the opportunities of regional contributions. By their very nature tax risks may be determined at central (national) level, but the selection of material risks should be made much more at regional level and subjected to present circumstances.

The Tax and Customs Administration bases its risk selection on a ration 25:50:25. This means that 25 per cent of the investigations conducted by the Tax and Customs Administration is determined at national level. This concerns mostly large, centrally coordinated actions and risks submitted by the national risk control organizations. Half of the investigations ensue from efforts at regional level, laid down in regional supervision plans.

The remaining 25 per cent is selected at random, whereby the scale of the companies and the risk of the sector are factors. This increases the unpredictability of the controls.

National actions in 2005/2006:

- The turnover accounting within the waste and recycling sector;
- The assessment of the BPM (car tax) refund at commercial registration numbers for entrepreneurs;
- Continuation of the identity fraud action with in the temporary job agency sector;
- Continuation of the construction fraud action (undeclared turnover, bribes, etc.);
- Control of the so-called 'windhappers' (natural persons with no apparent income and thus seem to live on fresh air);
- The Tax and Customs Administration will be visibly present at markets, fairs and other events, on the lookout for regular traders unknown to the Administration as business people. An on-the-spot investigation will often lead to traders paying their tax bill there and then or a Tax and Customs Administration bailiff taking possession of cars and other goods;
- In the non-profit sector the Tax and Customs Administration will exercise particular supervision of the accounting for freelance activities and incidental earnings.

7. HORIZONTAL SUPERVISION

The Tax and Customs Administration believes in horizontal supervision: to leave part of the supervision to private parties and social organizations, subject to certain preconditions. The Tax and Customs Administration is convinced that most people, businesses and institutions are able and willing to bear social responsibility. By making a clearer distinction between high-risk and less high-risk businesses and by leaving certain supervisory tasks to bona fide businesses, there is more room to deal with people who do not comply with rules within the administration's own supervision. Horizontal supervision thereby becomes an effective addition to the traditional, vertical supervision, whereby the government screens the correct compliance with regulations.

TOPIC 1.2 (The Netherlands)

In the segment of (very) large enterprises there are clear opportunities for horizontal supervision. The Tax and Customs Administration seeks to strengthen the partnership with this specific target group by intensifying the consultations. The central question in that respect is how the Tax and Customs Administration and enterprises wish to create a relationship as two professional parties. The intention is to base the relationship on transparency, understanding and trust. The idea is that both parties will have permanent insight into the actual risks and are aware of their mutual positions. Bottlenecks in the implementation and implications of new regulations are also discussed.

In 2005 a pilot with around 20, mostly listed, enterprises commenced, intended to conclude individual enforcement covenants. This action seeks to increase the legal certainty for the businesses. And by radiating trust by the Tax and Customs Administration to preclude constructions that would normally speaking be counteracted in the vertical supervision. This approach is in line with international developments in the field of financial records geared towards increasing and demanding transparency. The Tax and Customs Administration thereby seeks to make a positive contribution to the (tax) climate for the establishment of businesses. In 2006 this pilot will be extended by twenty new enterprises.

The scale of the businesses in the small- and medium-sized enterprises segment precludes an approach by means of individual covenants. The Tax and Customs Administration seeks to contact Dutch SMEs, sectorial organizations and associations to jointly represent mutual interests. Relevant issues which may be handled jointly are, for example, counteracting work in the black economy and doing odd jobs on the side, exchanging information and jointly establishing norms and ratios for supervision.

8. COLLABORATION

In exercising supervision, the Tax and Customs Administration takes account of the entire enforcement chain. The (administrative) distance between the links should be reduced and the procedures simplified.

Collaboration between supervision and investigation is improved by having tax control officers carry out forensic controls with investigating officers.

Tax fraud is usually not an isolated offence, but part of a more radical pattern in which different kinds of fraud collide. Within the context of supervision, the Tax and Customs Administration seeks to collaborate more with other supervisors, whereby the shared focus should be on determining the administrative integrity of the companies. Some malpractices, in particular where social security and taxes are intertwined, can only really be dealt with on a multi-disciplinary basis, whereby different government services act simultaneously. The Tax and Customs Administration therefore participates in intervention teams. Within the context of investigations, multi-disciplinary teams are increasingly common, whereby the FIOD-ECD cooperates closely with other investigation services such as the AIVD (Ministry of the Interior and Kingdom Relations: General Intelligence and Security Service), VROM-IOD (Ministry of Housing, Spatial Planning and the Environment-Intelligence and Investigation Service), SIOD (Ministry of Social Affairs and Employment: Social Information and Investigation Service) and the National Investigation Service.

The Tax and Customs Administration has meanwhile concluded covenants with many municipalities in which enforcement shortages occur in relation to collaboration and exchange of information relating to action against 'government refuges'. The municipalities must take the initiative in counteracting refuges. The police and the Public Prosecution Service are covenant partners.

The increasing globalization also means that collaboration with partners abroad is increasingly important and more intensive, e.g. in relation to requests for mutual assistance. Fraud does not stop at borders and cross-border collaboration is essential for effective action. The Tax and Customs Administration seeks to contribute to improving the fight against international fraud by combining know-how and exchanging data within the European Union. Collaboration and exchange of information provided by bilateral treaties is used for non-EU countries. The international assistance in collecting taxes is used in the fight against international fraud.

The collaboration with intermediaries is intensified, based on the conviction that it is better to prevent risks than to counteract them afterwards. The Tax and Customs Administration supports preventive generic supervision by discussing products which intermediaries wish to put on the market with the intermediaries beforehand. For example, on financial services with tax aspects, such as mortgages, annuities and pensions. The products which are provided within the context of the new life-course savings scheme are in particular a topic for discussion. But accountancy programmes and cash programming which should be fraud-proof are also discussed, and the provision of administrative and accountancy services. Generic products and services acceptable for tax purposes contribute to reducing repressive, individual supervision and thereby to reducing the administrative burden on entrepreneurs.

9. CONCLUSION

The more the tax authorities know about the taxpayers and supplementary benefit claimants, the more compliance can be promoted. Knowing means: to know what the taxpayers and supplementary benefit claimants do, what the (tax) implications are, to what (high-risk) groups similar taxpayers and supplementary benefit claimants belong, to which temptations they are exposed not to comply and what is required to ensure that they will comply. In this respect, services, visible supervision and horizontal supervision are equal keywords that increase the compliance of the tax payer and therefore the effectiveness of the Tax Administration.

Case study

TOPIC 1.2

CURRENT CHALLENGES IN CONTROLLING COMPLIANCE - THE ECUADORIAN EXPERIENCE

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*CONTENTS: 1. Background.- 2. The National Tax Administration
Context.- 3. SRI Efforts to Improve Tax Obligations' Compliance.-
3.1 Tax services.- 3.2 Tax control.- 4. Tax Control Actions:
Outcomes.- 5. Challenges Facing the Tax Administration.-
6. Conclusions.*

OVERVIEW

The globalization of economies is a phenomenon that fosters the movement of economic players the boundaries of States, impacting the tax sphere. In this sense, the notions of permanent establishment, agreements to avoid double taxation, tax havens, harmful tax competition and tax harmonization, among others, call for new and updated definitions, tax entities and management models, which pose new and genuine challenges for Tax Administrations.

TOPIC 1.2 (Ecuador)

On the other hand, the increasingly larger informal economies in Latin America constitute a challenge for massive tax control by regulatory agencies. Taxpayers' reluctance towards paying taxes, their social and cultural level and the complexity of economic transactions require defining appropriate strategies to apply formal fiscal policies and improve the equity and generality of the tax system.

Also relevant in countries like Ecuador, with a significant agricultural sector that produces raw material for export, are the difficulties in controlling tax compliance, given the unsophisticated production processes or the poor tax culture of the economic players. Additionally, behind small and medium sized farms, there are large trading organizations that benefit from such informal sectors and supply goods in the illegal market.

Under the current economic and fiscal scenario in Ecuador, in which the availability of greater oil resources contributes to finance the General State Budget to the detriment of tax revenues, a number of the issues described have not been approached by society with the focus they require. To the contrary, in the last few years, tax policy has been geared at creating new tax exemptions, generating greater inequity in Ecuador's tax system and more limitations for the Tax Administration's control capacity.

Therefore, Ecuador's Internal Revenue Service is faced with numerous challenges vis-à-vis such issues: a large informal sector, a limited tax culture, a legal and institutional framework that facilitates tax avoidance and a disputable system of justice with low quality government expenditure, which is a disincentive for taxpayers' voluntary compliance. In spite of these issues, citizens perceive that the Tax Administration is on the right track, implementing control programs aimed at bridging evasion gaps with actions that are strictly compliant with the principles of legality and generality.

For such purpose, the SRI has consolidated an information platform that stores the taxpayer identification information (Single Taxpayers' Register) and their economic transactions (Invoicing System). Currently underway are database information sharing programs, with different sources of information from public and private entities in the country. Progress has been made as to the enforcement of intensive audits.

Consequently, the SRI control actions have impacted society in Ecuador, since a large number of economic players became

compliant and understood the significance of tax compliance for the country's sustainable development. Notwithstanding, more efforts are required to control informal sectors and evasion and avoidance by multinational corporations or exporting companies. In this regard, the SRI is aware that there are a number of pending challenges ahead, such as defining a simplified system for an adequate approach to informality, incorporating regulations on e-commerce and implementing international tax policy programs.

1. BACKGROUND

Taxation in Ecuador has undergone a relevant change in recent years. Tax pressure from non-oil revenues of the Non-Financial Public Sector grew from 15% in 1998 to 19% in 2005. To attain such an outcome, a number of tax reforms have been implemented in Ecuador in line with a phased-in modernization process, especially for institutions that manage taxes on a national as well as local basis.

National Tax Administrations are made up by the Servicio de Rentas Internas (SRI, as per the Spanish acronym) and the *Corporación Aduanera Ecuatoriana* (Ecuadorian Customs Corporation, CAE, as per the Spanish acronym).

- The SRI is the agency in charge of the administration of Income Tax, Value Added Tax, Special Tax on the Consumption and the Motor Vehicle Tax. This entity's tax pressure went from 6.2% in 1998 to 10.8% in 2005.
- The CAE is the agency in charge of the administration of duties, with relevance against the GDP that went from 1.9% in 1998 to 1.2% in 2005.

The complex economic and tax situation and the bankruptcy of private banks in the country in 1999, entailed the examination and approval by Congress of a set of tax reforms that broadened the tax base and strengthened control powers, especially for the National Tax Administration.¹

¹ The 1999 Tax Reform, one of the most relevant in Ecuador in the last few decades, considered the elimination of a number of Income Tax shields and shifted from a short list to a long list of goods and services levied with VAT.

Since its creation by Act N° 41 in 1997, the Internal Revenue Service has geared its strategic planning at the basic purpose of maximizing taxpayers' voluntary compliance. In the context of poor tax culture and staff, infrastructure and IT systems that hurdled the performance of the former General Revenue Agency, the SRI based its management model on the renewal of human resources, investment in new infrastructure and comprehensive use of leading edge technologies in institutional processes. During the first years, this approach focused largely on taxpayers' services and the enforcement of massive tax controls, instead of the implementation of intensive controls.

Currently, SRI revenue collection accounts for over 50% of the General State Budget and has become one of the main sources of support for the sustainability of government finances in Ecuador.

2. THE NATIONAL TAX ADMINISTRATION CONTEXT

For an easier understanding of the economic, social and institutional scenario in Ecuador, a description follows on a number of variables measured in 2005, which bear an incidence on the National Tax Administrations' management capacity in the country:

- 1 Social investment: Ecuador features one of the lowest social investment rates, pursuant to ECLAC,² which points out an average US\$ 79 per inhabitant and poverty levels reaching 52%;³
- 2 Income distribution: the income structure in Ecuador is one of the most unequal in the region, the wealthiest 10% of the population concentrates approximately 40% of national income.⁴ The Gini ratio is 42.0;⁵
- 3 Informality level: the activity of the informal sectors of economy in Ecuador accounts for 30% of the GDP and underemployment, as a measure of the number of working age people that work less than 40 hours weekly, accounts for 49%;⁶

² Source: Panorama Social de América Latina 2005.

³ Source: 2006 CIA World Factbook.

⁴ Source: ENIGHU 2002 - 2003 (National Survey of Urban Household Income and Expenditure).

⁵ Source: 2006 CIA World Factbook.

⁶ Source: Central Bank of Ecuador.

- 4 Income from oil resources: in the last few years, the General State Budget has been financed with significant unforeseen income from oil resources, to the detriment of tax revenues as a relevant source of income and the Tax Administration's work in consequence.
- 5 Political instability: the Executive and Judicial branches have undergone conflicts, which have affected the Government's image and weakened the institutional quality of State regulatory agencies; and,
- 6 System of justice: the administration of justice in the country is an aspect that bears a negative impact on the control actions implemented by Tax Administrations, whether on the basis of response times or the outcomes of the litigation processes.

Such aspects affect the efficacy of the Tax Administration's actions in different manners, and therefore, restrict its capacity to counter tax evasion and tax fraud.

The tax evasion level in Ecuador prior to 1999 was directly tied to the lack of trust regarding the quality of government expenditures, the poor tax culture and a deteriorated image of the previous Tax Administration. Although the issues regarding accountability and government investment in the social sector have not been overcome yet, the new administration in the Internal Revenue Service has gradually achieved greater confidence and respect from citizens regarding compliance with their tax obligations. The figures on the following table allow us to assess the evolution of the tax evasion gaps in taxes under the IRS umbrella, between 2001 and 2005:

Tax Compliance Gaps in Ecuador

Figures in thousands

Item	2001	2005
Taxpayers pending registration in the RUC ⁽¹⁾	1,689	2,353
Taxpayers registered in the RUC	1,030	1,620
Registration gap	39%	31%
Taxpayers who must file VAT ⁽²⁾	648.5	1,020
Taxpayers who file VAT	290.4	551.9
Filing gap	55%	46%
Vehicles levied by tax	675.9	910
Invoicing noncompliance (transactions)	92%	24%
Noncompliance with waybills (documentation supporting the goods)	88%	25%
Individual Income Tax Evasion ⁽³⁾	63%	- n/a -
Corporate Tax Evasion ⁽³⁾	43%	- n/a -
VAT evasion ⁽³⁾	28%	- n/a -

Preliminary information subject to review.

Source: SRI Database

Note (1) Economically Active Population less unemployed less employees less domestic employees plus corporations.

Note (2) Taxpayers with an economic activity as determined by the Tax Administration or by an SRI process in the last two years.

Note (3) "Proyecto Salto" Survey - USAID

The gaps stated on the foregoing table enable to define the dimension of the issues and challenges facing the Internal Revenue Service. Registration in the RUC and filing taxes pose a clear challenge for control areas and reflect the levels of informality and poor culture of citizens vis-à-vis compliance with tax filing requirements. Notwithstanding, the agency has developed new mechanisms to incorporate taxpayers, by implementing systematized screening programs for the taxpayers' register and simplified tax payment programs.

3. SRI EFFORTS TO IMPROVE TAX OBLIGATIONS' COMPLIANCE

3.1 Tax Services

In order to describe the improvement process in the level of taxpayers' compliance with tax obligations in Ecuador, we must firstly refer to the broad technology and physical infrastructure investment program to render better tax services to citizens.

Nevertheless, society in Ecuador still features a poor tax culture as to tax compliance, mainly given their ignorance vis-à-vis regulations, the still limited coverage of the tax services rendered by the SRI and the complexity of procedures, and lastly, given the fact that they deliberately breach regulations.

- With reference to the fact that taxpayers ignore the regulations in place, the SRI has developed a number of training and education programs, which range from communication via mass media and tax education meetings and seminars, to the agreement with the Ministry of Education and Culture to educate children and adolescents on tax issues in schools throughout the country.
- The SRI has also invested significant resources to improve and simplify taxpayer assistance services, by appointing officials with a vocation to serve the citizen and upon opening offices in the main cities across the country and using technology-based processes that include Internet services. It is worth clarifying that citizens' Internet access is limited.
- In the light of deliberate noncompliance with tax regulations, the Tax Administration of Ecuador faces a number of issues, which especially relate to the high degree of informality and openness of the Ecuadorian economy. This hinders tax control since we lack regulations and adequately specialized officials. On the other hand, the existence of non-tax government revenues from the exploitation of oil has generated a lack of support by society of certain attempts at updating tax regulations, as proposed by the National Tax Administration.

Consequently, in the first phase of SRI actions, the improvement of tax services significantly facilitated taxpayers' voluntary compliance, increasing tax collection, consolidating the institutional image and improving relations among the Tax Administration and society. Such institutional advancements went hand in hand with the enforcement of new control systems, leveraging the experiences of other Tax Administrations, as described hereunder.

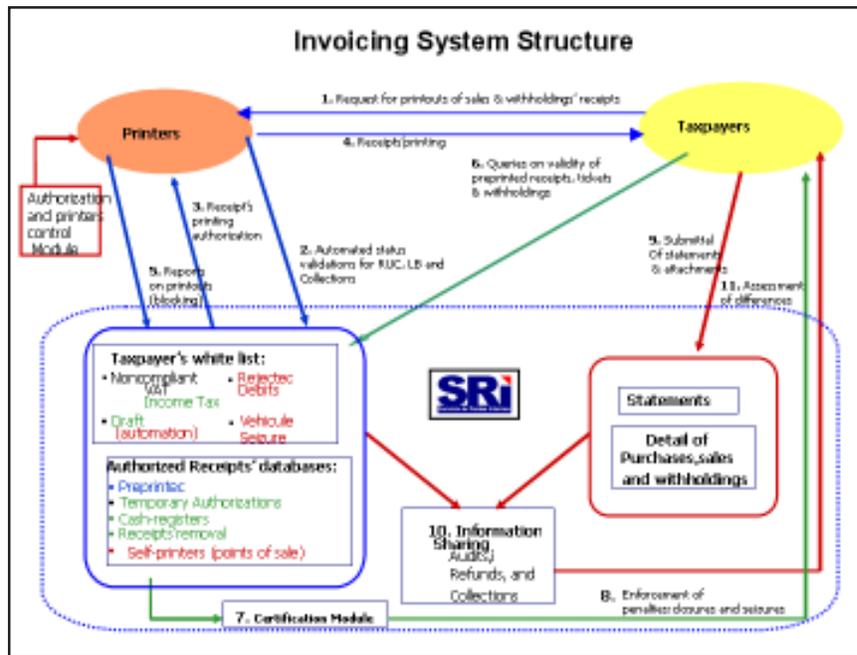
3.2 Tax Control.

In the SRI, the tax control programs were initiated upon the consolidation of the information platform to identify taxpayers and their economic transactions, a process enhanced by the implementation of an invoicing control system. This project included the development of IT systems and field programs, aimed at verifying the tax identification, issuance of sales receipts and compliance with other formal duties, according to three fundamental pillars:

- The Integrated Invoicing system, which is an Internet-based system and enables printers to issue sales receipts for taxpayers registered in the Single Taxpayers' Register (RUC, as per the Spanish acronym), for a given period, depending on whether they are listed on the White List or not.
- The White List system, which daily processes the information from the databases and produces a detail of taxpayers that have complied with the register's formal update duties, tax filing, payment of outstanding debts, among others.
- The Tax Certification program, which is based on field controls, enforces sanctions for noncompliance with tax obligations, whether by closure for failure to register or deliver sales receipts or seizures for not carrying the waybill to support the legal origin of goods in transit.

These components enabled the agency to rely on an appropriate mechanism to regularize compliance with taxpayers' reporting obligations, by means of automated systems that reduce the cost of control actions. Likewise, they have provided an information platform integrated into an institutional data warehouse with information of diverse type to enforce the subsequent tax control phases.

The following chart describes the Integrated Invoicing System, implemented in Ecuador in 2000:



As to massive tax controls, the SRI has made significant progress with the intensive use of technology, by applying database information exchange methods, geared at bridging the tax filing gap and reaching the first level of certainty. Control processes are comprehensive and automated. They exclude discretionary decisions and minimize contact between officials and taxpayers. For such purpose, the Tax Administration relies on the following sources of information:

- Tax statements: forms with detailed information on taxpayers' financial statements for the payment of Income Tax, Value Added Tax, Special Tax on the Consumption and Motor Vehicle Tax;
- Transactions' Modules: monthly detail of the transactions of registered taxpayers. It includes customer information as to local sales, exports, suppliers in local purchases and imports, beneficiaries of financial income, among others;
- Credit cards: information rendered by credit card companies detailing credit card transactions;
- Foreign trade: information from the Foreign Trade Integrated System, with a detail of the single forms for exports and imports, description of the goods traded, customs system, weight, country of origin or destination, value of the goods, among others;

TOPIC 1.2 (Ecuador)

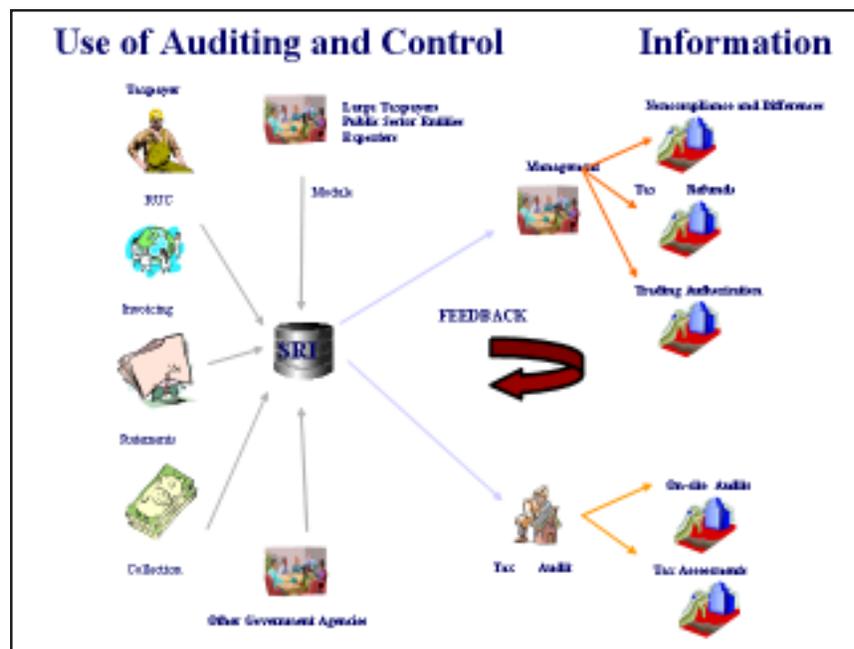
- Financial income: information from the National Financial System regarding the income and applicable Income Tax withholdings on the beneficiary;
- Credit transactions: detailed information of the credits granted by the National Financial System and the withholdings on the beneficiary;
- Risk Assessment Center: consolidated information on the credit rating issued by the Superintendence of Banks regarding National Financial System debtors;
- Donations: detailed information on the amounts allocated to different public or public entities, as an Income Tax donation item;
- Vehicle registration: detailed information on the features of motor vehicles owned by taxpayers subject to the Motor Vehicle Tax;
- Social Security: detailed information on the contributions of corporations and individuals to the Ecuadorian Social Security Institute. It enables to validate corporations' payroll expenses;
- Civil Registry Office: information on the citizens' register. It enables to update the Single Taxpayers' Register record;
- Migrations: information from the citizens' register on individuals who have left the country. It enables to update the Single Taxpayers' Register record;
- Foreign credits registered with the Central Bank of Ecuador: detailed information of the credit transactions between foreign banks or corporations and local public or private corporations;
- Superintendence of Corporations and Banks: detailed information on the registry of corporations under the control of such entities; and,
- Other Tax Administration processes: invoicing system information, white list, claims, refunds, among others.

The following massive control programs have been defined on the basis of such databases, which involve taxpayers notification and the applicable process to regulate the breaches detected:

- Unregistered taxpayers: identification of individuals or corporations with economic activities reported by third-parties, who are not registered in the RUC;
- Noncompliant taxpayers with economic activity reported by third-parties: individuals or corporations whose economic activity has been reported by third parties but have failed to file VAT or Income Tax;

- Inconsistencies: identification of statements with a mathematical or legal inconsistency. For example, allowances that exceed the regulatory threshold or show inconsistencies with other tax statements from the same taxpayer;
- Differences: identification of statements with economic transaction information inconsistent with the figures reported by private companies or government agencies; and,
- Tax refunds: examination of the tax registration status and compliance with formal duties by public sector suppliers, senior citizens, international covenants and disabled persons, in the VAT refund process.

The following chart explains the structure according to which the SRI uses information for massive controls:



As regards intensive audits, especially for large corporations, economic holdings, international tax policy and complex tax notions, such as e-commerce and compliance with covenants to avoid international double taxation, the Ecuadorian Tax Administration is faced with the greatest challenges. Nevertheless, a certain degree of progress has been made in recent years.

TOPIC 1.2 (Ecuador)

The SRI relies on a risk profile matrix for the selection of taxpayers that shall be audited, which avoids discretionary decisions and considers the following:

- Taxpayer tax and financial information;
- Taxpayer record with the SRI;
- Compliance with formal duties;
- Results from the information sharing processes from massive tax control programs;
- Information on claims and appeals for review;
- Compliance reports from auditing firms; and,
- Investigation processes and claims from regulatory agencies.

Based on the economic relevance and the data from the risk center of the Superintendencia de Bancos de Ecuador, an analysis of the taxpayer's credit record is undertaken, analyzing the taxpaying capacity and assigning priorities to cases accordingly. The following screen shows a report from the risk profile matrix used by the SRI Tax Audit units:

Matriz de Perfil de Riesgo

SECCION: Todos
 RUCs:
 PERSONA: Todos
 AÑO: 2000

RUC	Razon Social	Activos	Compras	Costos	Recechos	Financiam.	Act. Inv.	Activos Totales	Total	Nivel de Riesgo	Prioridad
0000000000	COMERCIALIZADORA AGROPECUARIA (GRAN) S.A.	8.88	2.82	8.88	8.88	7.78	1.78	8.88	41.88	1	1
0000000000	COMERCIALIZADORA AGROPECUARIA (GRAN) S.A.	8.11	1.82	4.88	14.88	8.88	8.88	8.88	41.88	1	1
0000000000	FRANCOISA LAVANDERIAS COMERCIALES S.A.	8.71	1.78	8.88	14.78	7.78	1.78	8.88	41.88	1	1
0000000000	COOPERATIVA DE PRODUCCION AVICOLA	7.84	8.88	7.78	14.88	7.78	1.41	8.88	48.88	1	1
0000000000	COMERCIALIZADORA DE CEMENTO	8.88	8.88	8.88	8.88	8.88	1.78	8.88	48.88	1	1
0000000000	COMERCIALIZADORA DE PRODUCTOS QUIMICOS	1.88	1.88	8.88	14.88	7.78	1.78	8.88	48.88	1	1
0000000000	COMERCIALIZADORA DE PRODUCTOS QUIMICOS	7.87	1.78	7.88	14.78	8.88	1.87	8.88	48.88	1	1
0000000000	CASA NACIONAL DE CONSTRUCCION S.A.	2.88	1.78	8.88	8.88	8.78	1.78	8.88	38.88	1	1
0000000000	FINANCIERA NACIONAL S.A.	8.71	1.82	8.88	12.78	7.84	1.71	8.88	38.88	1	1
0000000000	FINANCIERA NACIONAL S.A.	1.84	2.88	8.88	11.88	8.78	1.78	8.88	38.88	1	1
0000000000	FINANCIERA NACIONAL S.A.	1.71	1.84	8.88	11.88	8.78	1.71	8.88	38.88	1	1
0000000000	FINANCIERA NACIONAL S.A.	8.88	1.87	8.88	11.77	8.78	1.88	8.88	38.88	1	1
0000000000	COMERCIALIZADORA DE LA CRUZ ROJA S.A.	2.84	2.88	8.88	13.84	8.84	4.88	8.88	38.88	1	1
0000000000	COMERCIALIZADORA DE LA CRUZ ROJA S.A.	2.84	2.88	8.88	13.84	8.84	4.88	8.88	38.88	1	1
0000000000	COMERCIALIZADORA DE LA CRUZ ROJA S.A.	8.88	1.88	8.88	14.88	8.47	4.88	8.88	38.88	1	1
0000000000	COMERCIALIZADORA DE LA CRUZ ROJA S.A.	2.88	2.88	8.88	14.88	7.78	1.87	8.88	38.88	1	1
0000000000	COMERCIALIZADORA DE LA CRUZ ROJA S.A.	8.71	1.78	7.78	14.88	8.24	1.87	8.88	38.88	1	1
0000000000	COMERCIALIZADORA DE LA CRUZ ROJA S.A.	2.84	1.78	8.88	13.84	7.78	1.87	8.88	38.88	1	1
0000000000	COMERCIALIZADORA DE LA CRUZ ROJA S.A.	8.88	1.87	8.88	13.84	8.88	4.88	8.88	38.88	1	1
0000000000	COMERCIALIZADORA DE LA CRUZ ROJA S.A.	2.84	1.78	7.88	13.84	7.78	1.87	8.88	38.88	1	1

As to the auditing method, as mentioned above, in 1999 the Internal Revenue Service almost fully replaced the staff from the former General Revenue Office. Thus, the experience of such officials was lost, and they were replaced with resources that met the technical

requirements and, moreover, the principles and values necessary to enhance the technical and objective purpose of the Tax Administration of Ecuador. This staff is still undergoing a professional development and training process, with the purpose of gaining a similar experience to that of auditors and lawyers hired by private companies in the country, especially in specialized industries such as metallurgy, telecommunications' services, banking, insurance, oil industry, among others. We must highlight that the Agency has undertaken significant efforts to train officials on issues in key areas of the Ecuadorian economy, such as the oil industry, banana plantations, flower industry, fishing, liquor production, among others.

One of the priority areas in the Administration's efforts is the control of foreign trade corporations. In this regard, discussions have been held in Ecuador on several occasions as to the possibility of merging the Internal Tax Administration and the Customs Office with the purpose of having a single tax control authority that integrates control actions, regardless of the origin of transactions. Currently, the Director of the Internal Revenue Service is the Chairman of the Ecuadorian Customs Agency (CAE), but his field of action is limited and the political interference on customs management still impacts customs operations. Thus, smuggling and tax fraud continue to pose a problem.

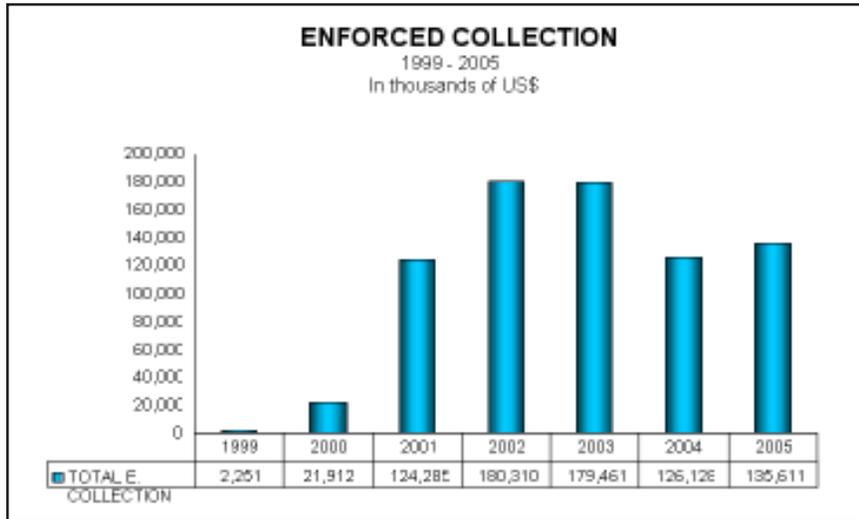
In spite of the limitations to redress the abovementioned situation, a number of coordinated control actions have been recently implemented by the SRI and the CAE on the basis of IT systems. We may mention, for example, the obligation to register with the RUC for importers and exporters in order to conduct their transactions in the customs system and the IT restriction on authorizations of imports to shell companies, that is to say, those the SRI reported as unidentified businesses.

4. TAX CONTROL ACTIONS: OUTCOMES

Massive and intensive control programs undertaken by the SRI in the last few years directly contribute with enforced collection revenues of approximately 3% of the overall revenue. Therefore, on planning and assessing the outcomes of this process, priority is attached to objectives such as reduction of tax evasion in certain segments and indirect revenue collection results, stemming from

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the risk generated for taxpayers by the SRI capacity to identify tax evasion or tax fraud thereby. The following chart states the outcomes of collection efforts directly generated by the SRI tax control units in recent years:



Intensive controls in Ecuador involve the assessment of approximately two hundred taxpayers annually and the generation of debt for an estimated US\$ 172.9 million, out of which 80% are subject to litigation in tax courts in the country. The following table presents the indirect incidence on collection, deriving from intensive SRI audits in the period 2001 - 2004:

Descriptive assessment of the Incidence of Audits on Corporate Income Tax Statements

Increase

Fiscal Years 2001 - 2004

	ratio	Tax-Income Ratio Filed		Audits Conducted	Sales of Audited Businesses (in million USD)	Overall Income (in million USD)	Audits' Coverage
		2001	2004				
ECONOMIC SECTOR							
		2.4%	3.2%	61	2,755	2,009	94.7%
		3.2%	3.6%	70	1,329	2,090	43.2%
		0.6%	1.6%	30	1,190	1,770	67.2%
		3.3%	3.2%	40	46	970	4.7%
		0.5%	0.5%	10	18	732	2.8%
		0.2%	0.3%	40	67	364	17.6%
		1.20%	4.80%	262	5,996	9,816	94.9%
INDUSTRY							
		1.4%	1.4%	152	2,217	9,061	24.5%
		0.6%	0.6%	249	5,636	19,136	31.3%
		3.2%	3.2%	81	177	2,497	7.1%
		0.4%	0.4%	40	209	2,099	12.6%
		0.90%	0.90%	528	8,286	31,751	28.1%
Reduce							
		1.6%	1.4%	51	1,209	2,009	33.8%
		0.0%	0.5%	10	47	740	6.3%
		0.0%	0.0%	14	107	366	20.2%
		0.0%	0.2%	7	29	607	4.1%
		1.40%	1.10%	91	1,492	5,611	28.2%
		0.9%	1.4%	881	15,174	47,259	32.1%

Preliminary information subject to review.
 Source: SRI Database, Tax Audit Information
 Developed by: Collection Planning and Control

Cutoff date: July 2005

The table highlights the relevant effect of the tax/income ratio from SRI audits between 2001 and 2005, in the oil sector, which in spite of the fluctuation of the international price of crude, has been subjected to significant tax adjustments based on Tax Administration reviews of the statements filed prior to 2004. Other sectors in which the incidence of tax statements' audits has been favorable are the banking and insurance sectors, power, construction, community and personal services and fishing. It is worth underscoring that such sectors, on average, recorded the largest audit coverage on the income filed.

On the other hand, we observe sectors like trade, industry, real estate and agricultural businesses with a relevant number of taxpayers, in which the coverage of SRI actions relating the income of audited businesses with the overall income for such sectors is still limited, and consequently, the tax incidence is null.

In the last segment, communication services provided by utilities, the sectors with lower tax culture such as transportation, and the exemptions in effect for numerous non-profit organizations in the social services' sector and taxpayers in the areas of health, hotels, restaurants and education, account for the shrinkage of the tax contribution per every income dollar filed.

5. CHALLENGES FACING THE TAX ADMINISTRATION

Pursuant to the foregoing issues and given the evolution of the economy in the international scenario, we may infer that the Tax Administration of Ecuador is facing numerous challenges as to the new tax evasion and tax avoidance practices, such as the creation of shell companies, creation of false tax expenditures or claims, over or undervaluation in international transactions and the lack of regulations relative to e-commerce tax policy.

Such challenges are complex for the Ecuadorian Tax Administration, to the extent the actual economic and tax scenario in Ecuador and the availability of greater oil resources that facilitate funding of the General State Budget are detrimental to tax revenues. Therefore, society has failed to consider several reforms with the relevance they deserve and, to the contrary, in recent years, tax policy has been geared at the creation of new tax exemptions, generating inequity in the Ecuadorian tax system and restrictions upon the Tax Administration's control capacity.

On the other hand, pursuant to specialized studies, in the micro-enterprise sector, which includes approximately 160 thousand business owners, craftspersons or transportation companies with annual sales amounting to US\$ 1.6 billion, 70% of participants in the survey lack the RUC and fail to comply with the invoicing system because 90% of their sales are for end consumers. In order to address the challenge of the informal economy, which generates a significant degree of tax noncompliance and unfair competition against the formal sectors of the economy, the Tax Administration determined the need to submit to the consideration of Parliament the approval of a Simplified Tax Return System for micro-enterprises, self-employed individuals, craftspersons and transportation companies. Such project provides for a monthly payment in the form of a single tax to replace the system that requires filing an Income Tax and VAT statement. The project includes the obligation that taxpayers demand invoices from their suppliers, which would facilitate the identification of large tax evaders for the SRI, corporations that avail themselves of informal practices to distribute goods of an illegal origin.

Additionally, with the purpose of reducing tax evasion gaps, the SRI tax control units are perfecting an automated system to monitor the massive control of the formal cycle, the inconsistencies and differences. This system shall facilitate SRI actions, since it allows:

- The automatic detection of breaches;
- Automatic addition of taxpayers to be subject to control;
- Automatic allocation of processes to analysts;
- Generation of the appropriate documentation, such as Preventive Notifications, Reporting Requirements, Notices of Differences, Penalty Decisions, Closure Stay Decisions, Reversal of Business Closure Orders;
- Individual and massive entry of notifications' status;
- Automated notifications' receipt, if applicable; and
- An interface with the institutional Workflow, to verify the related procedures.

The Administration has also focused its actions towards international tax policy. The first steps were taken in 2005, upon the approval of the Transfer Pricing Rules, based on the OECD models and methods. It foresees that in 2006 taxpayers shall file the transfer pricing attachment and the report on international transactions with related parties. Thereafter, in June, 2006, the Transfer Pricing Unit was created, with the purpose of defining the procedures to

undertake tax controls on international transactions, within the context of economic globalization, such as:

- designing programs to control transfer pricing,
- designing specific and automated processes to exchange information with other Tax Administrations,
- coordinating mutual assistance and cooperation among Tax Administrations,
- verifying appropriate compliance with agreements to avoid double taxation,
- defining control plans for non-residents, according to the income produced in the country and worldwide income controls, according to the residence principle.

6. CONCLUSIONS

The Internal Revenue Service, since its creation and under the scenario described herein, has achieved relevant progress vis-à-vis tax administration in Ecuador. Tax collection, lower evasion rates, the image and respect earned as a technical agency and the gradual change process observed in Ecuadorian tax culture, reflect that the administration model adopted by the agency has been fruitful in the middle term.

The grater difficulties and challenges vis-à-vis tax compliance are largely based on the high levels of informality in the country's economy, a situation that hinders the National Tax Administrations' task. The reluctance to pay taxes, the social and cultural level of taxpayers and the complexity of economic transactions at this level call for defining appropriate strategies to implement tax policies and enhance the equity and generality of the Ecuadorian tax system. In this sense, the creation of a Simplified Tax Return System embodies a vital project to counter tax evasion and tax fraud in these sectors.

There are still pending challenges in the SRI's intensive control efforts. Globalization and specifically the increasingly easier movement of international capital flows and the lack of adequately updated tax regulations regarding permanent establishments and the treatment of businesses that operate with tax havens or preferential tax regime jurisdictions, which empower tax harmonization, restricts the SRI's capacity to react in the light of tax avoidance practices.

Notwithstanding, the recently created regulations on transfer pricing treatment, set forth a new scenario for the SRI's international tax policy in future years. According to this scenario, the relatively short experience of SRI officials in conducting audits on multinationals and large economic holdings is an aspect that the organization is improving on a yearly basis with more investment in training and education in tax matters.

Finally, it is worth highlighting that in spite of such factors, the massive control processes and certain intensive auditing programs undertaken by the SRI have enabled to sustain the tax presence and generate a risk in the light of tax noncompliance, significantly contributing to voluntary compliance with tax obligations and a greater equity and generality in the payment of taxes in Ecuador.

TOPIC 2

COMBATING TAX EVASION

Lecture

TOPIC 2

COMBATING TAX EVASION

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*CONTENTS: 1. Introduction.- 2. Main Aspects Impinging on Tax Fraud.-
3. Mechanisms for Preventing, Detecting and Controlling
Tax Fraud.- 4. Conclusions.*

1. INTRODUCTION

Historically, Tax Administrations have tried to curb the levels of fiscal non compliance by means of exercising their main functions - tax levying, collection and auditing- in a traditional way, i.e. through strategies based on the application of direct operational actions geared at possible non compliers.

Thus, from the point of view of the levying and collection function, if taxpayers failed to file their corresponding tax returns or to actually pay their dues, the customary administrative processes were put in place. Within this context, these activities were quantified and statistically reported as fulfilled effectiveness measures, despite the fact that some of them had been in fact unsuccessful.

Technological advances, together with taxpayer segmentation strategies, have allowed for efficacy improvements through the

issuing of on-line notices or debt balances to the subset of taxpayers with higher fiscal significance on the basis of their historical tax payment levels.

At present, the Administration's success is measured on the basis of positive responses given by the taxpayers who have received the notice or debt balance within a given time frame. This means that the administrative process is considered successful if the non-compliant taxpayer files the corresponding tax return or pays off the fiscal debt within a short period of time after the beginning of the administrative process. If taxpayers fail to respond to said actions, the corresponding measures are taken -seizures, temporary restraining orders preventing debtors from selling property, fiscal executory proceedings, etc.-, thus ensuring that the full circle of control is closed.

On the other hand, from the point of view of the audit function, before the mentioned changes, the Tax Administration deemed it sufficient to attain a high level of audit adjustments or in some cases, it would suffice to statistically report a significant number of audit actions within a given period of time.

Both the planning of these actions and the management control of the actual activity carried out were centered on "quantifying" the tax audit activities. Thus, when the number of these activities was higher than the programmed/actually met targets of previous cycles, the new results were deemed more satisfactory than the previously attained ones.

This criterion, merely based on statistics and effects, which has prevailed for many years and which seemed very hard to change, brought about a continuous and growing degradation in the quality and effectiveness of the audit actions.

The first progress achieved by the Federal Revenue Administration (AFIP) was acknowledging this situation and deciding to change the course of the control strategies, in terms of levying, tax collection and audits, as well as adopting some new ones based on "qualitative" aspects.

This necessarily implied leaving behind the concept that if there are fewer direct control activities in place the Tax Administration will be considered to be less efficient, and taking on more developed

points of view, in terms of being more selective in the definition of the universes subjected to operational activities. It was also necessary to avoid spasmodic or disconnected activities, checking that all the processes these activities entailed were properly completed.

By all means, the adoption of this new approach at the Argentine Tax Administration has proved to be significantly more effective than the previous strategy, since the inclusion of performance indicators associated to interrelated goals and others of a qualitative nature, which allow for measuring in short time frames how full circles of control have been brought to a close, has improved the risk perception on the part of taxpayers, with the subsequent rise in their level of voluntary compliance, which is ultimately the main goal of fiscal control.

Nevertheless, the Tax Administrations which consider that by merely implementing the above changes they will be definitely solving the problems of fiscal non compliance would mean making a new mistake in their diagnosis.

In other words, planning and executing levying, collection and auditing programs which prioritize "quality" over "quantity" of actions and ensuring that said actions go through the so-called "full cycle" in each one of their functions is without any doubt better than the strategies which used to be carried out before the mentioned changes, but all of the above can barely provide by itself a consistent tool for controlling and preventing fiscal non-compliance.

Following the present trend, Tax Administrations focus their biggest efforts on activities aimed at tax fraud prevention, using for said purpose a series of various tools -legal, normative, structural, technological, etc.-, inducing all taxpayers to improve their fiscal behavior and in the event this should not be the case, granting the administrations mechanisms for quick and precise detection, so that the corresponding direct control actions towards non-compliance can be applied.

The Argentine experience in this field has not been fortuitous, rather, it has resulted from a constant interaction among the operational areas, both tax and Customs, and the key areas of planning, levying and auditing of AFIP.

As a corollary to this introduction, we may say that this paper shall focus on the tools mentioned on the above paragraph, as an improvement strategy which up until recently most Tax Administrations applied almost mechanically and whose effectiveness was somewhat doubted.

2. MAIN ASPECTS IMPINGING ON FISCAL FRAUD

As a starting point, for Tax Administrations to be ready to quickly adjust to the new manifestations of fiscal fraud, it is a must for them to be capable of immediate detection of the latter, which will allow them to carry out a diagnosis and even anticipate the impact these new manifestations may generate.

In order to fulfill that premise it is necessary to try to adopt a conceptual and overall approach, beyond the daily specific operational functions. In this sense, it is important to stress that modern Tax Administrations should strike a balance among three very concrete objectives: increasing the mean level of compliance, maximizing voluntary compliance and creating tax awareness.

The first of the above objectives is a short-term one and tends to reduce the interannual gap of general non-compliance.

In the case of the second objective, it is a medium-term one, and seeks to get taxpayers to fully comply with the fiscal regulations.

Without any doubt the creation of tax awareness is the objective which requires a bigger effort on the part of fiscal control bodies, not only because it transcends the traditional operating approach of the latter, but also because it calls for broader knowledge about the aspects which even now are -for their most part- alien to their direct responsibilities.

In this sense, we shall point out some of the most important aspects which impinge on the emergence of fiscal fraud actions.

2.1. Political and Economic Context

In recent years, Tax Administrations have started to become aware of the importance that the political, economic and social context has in the fulfillment of their functions.

The approach focusing exclusively on internal processes has given way to a change in perspective where that context acquires increasing relevance, for which the management strategy is increasingly linked to the external factors which condition the daily operation of our organizations.

Towards the end of the 90's, Argentina engaged in a downturn process which led to the 2001 crisis, which may be dubbed as the most important crisis in recent history. The logical consequences of that crisis were a significant rise in poverty levels, an increase to almost one third in the unemployment or underemployment levels of the working population, a significant GDP reduction, a sharp devaluation of the currency and the subsequent exit of the Currency Board system, a huge capital drain, the collapse of the financial system and on top of that domestic and foreign default.

It goes without saying that the above situation impacted tax collection very negatively. The collapse of the financial system and the blocking of bank deposits, added to the default situation generated on the one hand an unavailability of funds and on the other a widespread feeling of uncertainty about the future among the population and a resistance to meeting any type of fiscal obligation - municipal and provincial fees and taxes, contributions, national taxes and even fees for delivered public services.

The concrete result of the indicated conditions was a clear reduction in voluntary compliance, a situation which was aggravated by a reduction in the risk perception on the part of taxpayers.

2.2. Evolution of Tax Evasion Actions

Notwithstanding the situation indicated above and in order to provide some examples about the consequences of the experience gained by AFIP, we can describe the way tax evasion has evolved in Argentina as follows:

Until mid-90's, a very significant percentage of the adjustments originating in audits were related with evasion in the amount of sales, reduction of the tax base in connection to the Income Tax and to the Value Added Tax.

Since then and to date, the operating experience has shown that 50% of the amounts adjusted during the course of the audits still originate in omitting to report income, but the other 50% arise from the detection of false sales tickets and/or expense receipts in the accounting of the audited individuals.

In this case, it is clear that the change in tax evasion has derived from a constant improvement in the design of the billing systems deployed since 1991, which have required more formality in the drawing and later reporting of the sales tickets or invoices.

In view of the above, the taxpayer seeking to avoid correct payment of the corresponding taxes resorted to including false invoices in his or her accounting, thus reducing the tax base of the mentioned taxes.

From the point of view of audit management, this change in the way of committing fiscal fraud gave way to more thorough auditing activities, since besides focusing on checking the truthfulness of the reported income, it became necessary to include more intense auditing guidelines in order to fiscally legitimize the tickets computed as purchases and/or expenses.

The mentioned circumstance has turned audits more complex, since in order to check the mentioned legitimacy, the audits should also cover the previous links of the commercial chain -suppliers- which implicitly means opening up the spectrum of parallel inspections as part of the original inspection and to basically check not only the actual existence of the suppliers, but also their actual operating capability in connection to the amounts stated on their sales receipts.

This generation of simultaneous audits has created the need to expand the scope of original inspections and to therefore extend the duration of the latter, thus reducing the capability of having wider coverage and curbing the risk of being audited, which is directly counter to voluntary compliance on the part of taxpayers in general.

2.3. Globalization of the Economy

The phenomenon of economic globalization world-wide which we have seen for the past two decades and which has grown exponentially in recent years, is not a topic alien to tax administrations, since one of the pillars supporting said growth is fiscal planning, which used harmfully significantly damages the tax bases of the income tax in countries with regular tax rates at international level.

Although at the beginning of this period its fiscal consequences were practically disregarded at international level, over the past decade most of the Tax Administrations gave expressed interest in analyzing globalization more deeply and significant investments have been made in diagnosing and searching for mechanisms which at least mitigate the deleterious effects which this phenomenon has on tax collection.

Fiscal consequences are so important -both in terms of taxes and Customs- that some figures will help to confirm this:

- About 60% of economic transactions world-wide are carried out between related businesses.
- The average growth rate of the global economy in the past two decades was 1.4% per annum, whereas growth of tax havens was 3.3%.
- The percentage of population existing in tax havens compared to global population is 0.8%, while its gross product is close to 2.8%.
- The share of tax havens in total foreign investment results in the following percentages:
 - Over employment: 5.7%
 - Over sales: 13.4%
 - Over assets: 15.7%
 - Over net income: 30%

In fact, the last indicator shows the reduction of tax bases in the income tax suffered by those countries which are not considered tax havens, since beyond the existing employment, investment or sales levels, the incidence of the profits reported by the businesses located in said countries is without any doubt higher than that reported in any other country.

This means to say that, along the line of the ratios indicated above, there is at least 50% of over posting of profits in the countries with low or nil levying of the income tax, which directly harms their accurate reporting to all other tax administrations.

2.4. Creation of Local and International Economic Groups

Based on what we have stated in the previous point, there remains no doubt about the negative incidence of harmful tax planning carried out by economic groups of international nature.

The problem is further aggravated when harmful tax planning sets in within the local tax system. The proliferation of local economic groups forces Tax Administrations to analyze said commercial relations with the purpose of clearly setting apart the legitimate ones from those created with the only objective of avoiding the payment of the corresponding taxes.

In Argentina, AFIP has detected two ways of reallocating profits among businesses located in our country, which imply some sort of domestic harmful tax planning:

- Local economic groups which derive part of de profits to one or more legitimate businesses, existing within the mentioned group, which accrue tax losses, positive balances or enjoy specific tax advantages.
- Economic groups which derive part of the profits to one or more inexistent business, to which inexistent transactions are computed.

The first case is considered actual local "tax planning" and the Tax Administration must try to detect those businesses receiving the mentioned profits within the economic group, in order to check the authenticity of the commercial transactions carried out among them, and besides, verify that the amount of the transactions within the group matches market values.

On the other hand, in the second case, it is necessary to prove the inexistence of the business and its transactions and that its formal creation merely sought to commit fraud against the State.

3. MECHANISMS FOR PREVENTING, DETECTING AND COMBATING FRAUD

Based on all the above, Tax Administrations must include new approaches in their functions, unknown till recent times or at least unused by them directly.

Thus, the set of new political, economic and social conditions has a negative impact on the daily activities of the collection agencies and forces them to significantly expand their competencies and engage in preventive control strategies, besides the traditional activities of detection, control and the imposing of "ex post" penalty on fiscal fraud.

Below, we shall describe the main measures developed by AFIP or in the development of which AFIP has been involved as part of its new role:

3.1. Legislative Measures

Traditionally, there has always been clear differentiation between the powers inherent to the government areas responsible for creating tax policies and those areas which are in charge of the Tax Administration.

Against this background, the role of the Administration merely consisted in checking compliance on the part of taxpayers with tax norms and regulations issued by the Legislative Branch and with the relevant regulations issued by the areas of the Executive Branch which are responsible for fiscal policy.

Indeed, given the new context we have made reference to, the involvement of the collection agency in the creation of fiscal policies is of utmost importance, since the agency has acquired, as a result of daily work, rich experience which allows it to propose new norms or amendments both in terms of procedures and in terms of specific taxes it is responsible for, specially considering gaps or loopholes in the legislation in force, which allow for tax evasion or avoidance.

As a consequence of the 2001 crisis and in order to channel the economic activities through formal routes, a piece of legislation was enacted imposing a limit on cash transactions, so that all payments higher than \$ 1000, which are not carried out within the banking system -deposit, remittances or money orders, checks,

credit or debit cards-, are ineffective among the parties or vis-à-vis third parties. From the fiscal point of view, these transactions cannot be computed as deductions, fiscal credit or any other type of benefit to the taxpayer either.

Likewise, and supplementing the above measure, another piece of legislation ruled the refund of a percentage of the Value added Tax over the purchases made by credit and debit card users, which implies a direct benefit to end consumers, who are thus engaged in the fight against evasion, apart from achieving an increase in domestic consumption and in the level of economic activity. The corresponding norm also empowers the Executive Branch to grant the mentioned benefit to those making their transactions in cash or through other means of payment, all of which contributes to rendering these transactions transparent to the fiscal agency.

Another new experience in normative proposals was the regulation created by AFIP determining the reduction of VAT rates. This measure was timely sent to Congress with the purpose of applying it to certain sector of the Argentine economic activity -mostly live stocking and agricultural producers- which had high evasion rates in the commercialization of goods mainly destined to export.

In this case, the Argentine legislation provides for the refund of the VAT included in the input of the products to be exported, thus, the reduction of the general tax rate to 50% reduces the possibility of giving back to the exporter a sum higher than the tax collected in previous stages, so that the audit focus is restricted to the limited number of individuals involved in said transactions, and on the other hand, it reduces the financial cost for the exporting sector generated between the VAT fiscal credit payment at the time of purchasing the goods to be later exported and the date of actual refund of that credit by the tax administration.

Along these lines, AFIP has supported -since 2004- a series of legislative reforms known as "Anti evasion Plan I" and "Anti evasion Plan II". This intervention was not limited to proposing legislative changes deemed necessary to combat fiscal fraud, in fact, a more interesting experience has been the active involvement of AFIP in the technical commissions of the Lower and Upper Houses of Congress, explaining the rationale behind the proposed changes and providing concrete cases that substantiated the need for the latter.

Besides, once the referred norms had been passed, AFIP actively worked in combination with the other areas of the Executive Branch which are also responsible for fiscal affairs on the draft regulatory decrees which had to be issued in order to implement the discussed legislative reforms.

Another characteristic which has helped provide a comprehensive framework to the reforms is the role of Single Tax Agency played by AFIP, which has allowed for supporting amendment proposals as well as the creation of tax, social security or Customs legislation.

"Antievasion Plan I" included proposals which later on became fiscal and procedural pieces of legislation. In the case of "Antievasion Plan II" the reform included varied content such as fiscal, social security and Customs needs.

The main aspects addressed by "Antievasion Plan I" were the following:

- Fiscal law changes:
 - *Extension of the joint liability*: to the individuals who for their purchases receive false invoices or documents in the cases where the latter should check their authenticity; to the partners of irregular corporations and de facto business associations for the fiscal obligations that correspond to the business they are involved in; to the syndics in meetings of creditors and bankruptcy processes for the due taxes, if they have not taken the necessary provisions for assessing and registering the latter; to any of the members of a joint venture or business grouping, regarding the fiscal obligations of the group.
 - *Incorporation of "juris tantum" presumptions in the Tax Procedural Law*: this allows for assessing, pursuant to law, the tax base when there are differences between the stocks reported by the taxpayer and what has been surveyed through satellite imaging; or when the bank deposits of the period exceed the sales or income reported for that same period. In the case of entry of funds of any nature, coming from countries of low or nil taxation, those funds shall be considered unjustified net worth increases.

- The National Executive Branch is granted the power to condition -by way of regulations- the computation of deductions, fiscal credits and other figures in favor of the taxpayer, to the use of certain means of payment or to special ways of verifying their transactions.
- An additional criminal figure is resistance to audits. Likewise, partial compliance with the duty to provide information shall also be considered a crime, in as much as it hinders the tasks related to assessment, verification or auditing.

The most important topics included in "Antievasion Plan II" are:

- Fiscal law changes:
 - *Granting of powers to AFIP to carry out preventive deposits of assets in court and eventually rule seizures: this will be applied in the case when AFIP detects goods lacking the corresponding supporting documents accrediting their legitimate holding.*
 - *Considering electronic addresses as the fiscal domicile: thus, the electronic communication will be a valid means of notification of all acts of AFIP.*
 - *Determination of a fully valid alternative fiscal domicile for all legal purposes: this implies being able to locate and identify taxpayers who could not be found in their fiscal domicile.*
 - *Creation of the figure of "inspector with legal authority to authenticate documents": AFIP is granted power to appoint officials acting as purchasers or consumers for the purpose of verifying the control of norms ruling the issuance and delivery of sales tickets.*
 - *Implementation at national level of a system of unified registration of legal entities: the Single Code of Tax Identification (CUIT) issued by AFIP shall be the only identifier of corporations. For this purpose, the fiscal Administration participates in the implementation of the mentioned register through technical and financial assistance.*

- Changes in social security legislation:
 - *Revision of the system of domestic workers employment:* unification of the social security legislation in this field and incentives to whitewash domestic employment, allowing the employer to compute paid salaries as deductions of the income tax.
 - *Norms combating the use of legal entities destined to evade payment of social security resources:* interpretation based on the economic context; hiring of personnel through working cooperatives and other similar figures.
 - *Assessment of debt on presumptive basis when the employer does not register or report his personnel:* this allows for estimating the existence of labor relations from the last recorded contribution to the date of detection of non-compliance.
 - *Implementation of a penalty system applicable to withholding and collection agents in the area of the social security resources:* standardizing penalty systems with those previously existing under fiscal legislation.
 - *Reduction of process terms in the field of social security:* assimilation of terms to those existing in fiscal legislation.
- Changes in Customs legislation:
 - *Ban on foreign trade transactions involving falsified goods:* the goods shall be qualified as contraband, empowering the Customs service to seize the latter.
 - *Facilitation of use or sale of seized goods by Customs:* clearing the Customs service to sell the seized goods without prior judicial intervention.
 - *Redefinition of the tax base in certain transactions of foreign trade:* determination of the moment and the taxable amount at the moment when the imported goods are registered, in order to avoid maneuvers involving temporary import.

- *Limits to the term within which Customs declarations can be rectified:* AFIP has eliminated the possibility of changing Customs declarations when the agent has already learnt the selectivity channel assigned to him.
- *Optimization of coercive collection of Customs debts:* granting of coercive collection and embargo powers in the foreclosure of Customs debts, matching those existing for fiscal debts.
- *Adjustment of the figure of minor contraband and stronger penalty on judicially punishable contraband:* increase of the minimum amount as of which individuals incur in contraband, with the purpose of speeding up the processing of judicial cases deemed important by AFIP. Likewise, there is standardization between criminal definitions and economic penalties in the field of contraband and the criteria included in the Criminal Fiscal Law.
- *Power granted to AFIP for establishing collateral through electronic means:* in order to avoid falsification of required collateral, legal validity is given to the establishment, change, substitution or extension of collateral through IT or electronic means.

3.2. Organizational Measures

One of the outstanding features of the multinational businesses engaging in harmful fiscal planning is the organizational flexibility with which they operate. So much so that they constantly perform changes in their structure with the purpose of creating new components, opening branches or representations, merging or divesting in one or more countries, so that the "holding" may have the best possible fiscal positioning.

Against this backdrop, Tax Administrations also need to perform changes in their functional structure, so as to be able to create more areas specialized in the analysis and study of national and transnational economic groups with a view to be able to learn as soon and as accurately as possible about the creation of the latter and about the transactions carried out among the members of the group.

In this case, the experience gathered by AFIP as Single Tax Agency has been positive, since the concentration of knowledge in the fields of Customs, taxes and social security, combined with the consolidation, unification and/or interrelation of their respective data bases, enhances the possibility of tackling the mentioned fiscal planning.

On the other hand, the budgetary autarchy granted to the fiscal agency has allowed for the streamlining of goods and services purchase processes, needed for modernizing the agency, something which is most clearly seen in terms of IT -hardware and software- and of communications -Intranet and Internet

Also from the organizational point of view, the change in functions and profiles of the tax auditing areas, which are geographically decentralized throughout the national territory, combined with increased and permanent staff training and with the availability of integrated IT systems, have allowed said areas to count with the proper instruments for the investigation and selection of cases in order to control the higher fiscal risk taxpayers.

In this same sense, the systemic criss-crossing of information at central level, allows for feeding the auditing and verification areas with cases for punctual and office audits, without needing to have personalized intervention on the part of the investigating areas, thus freeing them up for detecting those cases of presumable fiscal interest, which will later on be referred to thorough or comprehensive auditing.

By the same token, the creation of audit areas and specific teams for the analysis of different sectors of the economic activity or high fiscal risk taxpayer segments, has allowed for allocating those specialized human resources to complex issues, which would otherwise have been included in heterogeneous control routines at regional level.

Some examples of the above are the creation of an area for the specific control of international transactions and transfer prices, as well as the creation of teams specialized in the auditing of large taxpayers belonging to different sectors such as financial, insurance, stock exchange and exporting sectors, among others.

To supplement all the mentioned measures, there is also an area with structural bearing which is charged with the analysis, investigation and auditing of different economic sectors, in order to endow the other inspecting areas with practical and new tools with fresh technical approaches, to be used in tax audits. These studies are turned into actual descriptive manuals of the activity in question, which include: the analysis of the productive process, key input used, cost structures, commercialization alternatives, possible evasion gaps and the main specific auditing strategies recommended for addressing the latter. Thus, those responsible for carrying out this type of audits do not begin by mechanically asking for general information, but they can plan them according to the different parameters established on the mentioned manuals.

As part of the previous approach and in order to check the evasion hypothesis put forth, that same area carries out "pilot" audits in order to check in fact the designed strategies and thus guarantee their later usefulness and overall applicability

In the Customs area, deep restructuring was carried out at the beginning of the current year, through the creation of a top level area within the structure, whose main functions are policymaking and the crafting of control strategies, standardizing Customs risk management, exercising the investigating function geared at ex-post auditing and linking its operational technical activities to those of Customs agencies in other countries.

Besides, and as part of the tasks this new unit is charged with, it has enhanced the interaction with the other audit areas within AFIP, thus generating positive synergy throughout the organization.

3.3. Tax Education Program

For several years now, AFIP has been developing a program on tax education, whose main goal lies in generating a true tax culture, mainly among the school population.

The multiple strategies designed within this framework aim at the creation of tax awareness which is focused on the promotion of voluntary compliance with fiscal obligations, aiming at eliminating tax evasion and pointing mainly to the field of formal education, so

that linkages can be established among the social sense of taxes, the punishment of evasion and contraband and the strengthening of citizen culture

The educational context is the privileged domain to produce this type of transformations, in view of the fact that:

- The role society assigns to school is that of distributing socially significant knowledge, that is, not only knowledge about disciplines which prepare students for future studies or for labor performance, but also about those having to do with the education of future citizens.
- The domain of formal education is the space where children and adolescents assimilate the changes in their representations, acquired from the first learning matrices generated during the course of their relationship with their parents and during their exchanges with peers and teachers.

Fostering the culture of voluntary payment of taxes from school age is a way to educate children and adolescents about the importance of taxes as a way to sustain public development policies for the community, based on fundamental concepts and values such as solidarity, cooperation, social responsibility and ethics.

These contents are treated from a cross-section perspective in terms of curricula -its approach is proposed from different disciplinary areas, institutionally -committing all the players in the school community, socially- outside school, with the physical presence of AFIP booths in entertainment spaces for children, in trade shows, fairs or other events attended by large audiences.

3.4. Structural Measures

Another aspect worth stressing is linked to the analysis, design, development and implementation of structural mechanisms and measures, which do not call for the application of direct auditing resources.

These measures, defined with the purpose of establishing favorable conditions for carrying out control activities and attaining the set strategic objectives, consist of issuing regulatory norms and

implementing systematic control tools, seeking to hinder or discourage evasive maneuvers, acting preventively as a way of extending and supplementing the auditing process.

In the same vein, they help in fostering voluntary compliance on the part of taxpayers and provide information which is used by AFIP for orienting the direct auditing actions towards non compliants. Definitively, they allow for assessing the risk situation of each individual vis-à-vis the group he is part of, and thus for applying this concept in differing circumstances.

Although we mentioned that the structural decisions do not require direct auditing resources, certain criteria are actually used as rationale behind the measures implemented in each case, some of them applied in a widespread manner to all taxpayers and others to a more limited segment, according to the characteristics of the latter. These criteria are basically the following:

- *Taxpayer identification*: counting with the necessary tools for adequately identifying taxpayers is an indispensable aspect in the process of improving the control processes of fiscal compliance. Therefore, imposing greater requirements for obtaining certain tax benefits, or for legitimizing the generation of fiscal credit for the VAT or for computing expenses in income tax assessments, are considered highly positive, since they reduce the possibility of creating false taxpayers or "ghost" businesses.
- *Differentiation of taxpayers*: this criterion, as a supplement to the previous point, is used for granting different fiscal treatment to those taxpayers who properly comply with their tax obligations than to those who do not. For the latter cases, AFIP establishes more rigorous requirements and controls for the processing of certain processes or applications for benefits originated by the taxpayers, or in other cases, there is direct establishment of higher withholding or collection percentages. As a corollary to this, to AFIP a reliable taxpayer is one with good fiscal behavior, and this concept is based on:
 - Compliance in due time and form with all the formal fiscal obligations - filing tax returns of the different taxes and social security.

- The consistency of a series of technical indicators related to the economic sector to which they belong - fiscal debit/credit relation; gross income/sales relation, net profits/sales, etc.
- Reporting the correct fiscal domicile: this requirement is more than a mere formality, since it facilitates the early detection of "ghost" businesses.

3.4.1. Risk analysis

In this sense, sectorial fiscal registers were created, including those individuals who respond to certain requirements of fiscal compliance; as well as differentiated systems of withholding and collection pursuant with the fiscal behavior of the taxpayers, on the basis of which, withholdings and/or collections are increased when individuals are perceived to have higher risks.

On top of this, information systems were created -many of which were implemented over the Internet- for the control of transactions falling under the norms referred to transfer pricing, to the financial and stock exchange sectors, to the tax exempted liquid fuel operators, to the grain sector and to the sale and purchase of second-hand vehicles, among other activities in the Argentine economy.

On the other hand, specific requirements were set for the newly-registered taxpayers whereby they are assigned special invoicing methods in accordance with their degree of reliability.

Automatic control systems were also implemented for the authorization of printed sales tickets -invoices- and supporting documents for the transfer of goods -delivery notes-, for the authorization to grant exclusions or reductions in the withholding and/or collection systems, for verifying the correct incorporation of the individuals included in sectorial fiscal registers, among other control mechanisms of similar characteristics.

Finally, it is worth to mention an instrument implemented by AFIP named "SIPER" -Risk Profile System-, which departs from a concept based on the theory of the discriminating factor, whereby the cases which are an exception to the general rule are identified.

The mentioned system is based on running computer processes comparing the fiscal behavior of individuals in homogeneous universes. Among them, a few are characterized by behavior which is better than the standard and others by behavior which is worse than the standard. In turn, there is a trend whereby the majority of individuals may be classified as part of a range close to the standard as predefined for the sector under analysis.

From the fiscal point of view, the above theory proves highly useful due to the very low proportion of human resources and materials available for audits, as compared to the large universe of taxpayers that all Tax Administrations must manage.

Following this concept, identifying subsets of individuals whose behavior is below standard, allows AFIP to pay closer attention to the individuals included in said subsets. In the medium run, this tends to generate a shift of each subset with that same qualification towards a higher qualification when there is some improvement in the behavior indicators, thus generating, period after period, an overall positive change throughout the sector, since improving the behavior of the "worst" pushes the standard value up and the mean comparison level rises for all the participants in the universe.

For the methodology to be more effective, it must be sufficiently publicized so that those individuals who have been audited as a result of its application become aware of the risk of moving away from the standard and also because as taxpayers learn about the tool the Administration counts with, they will progressively change their behavior towards the standard and thus reduce the likelihood of being audited.

The main goals of SIPER are:

- Categorizing the taxpayers -taxpayers and foreign trade operators- through the analysis of their fiscal behavior -including taxes, social security and Customs-.
- Using the categories under "SIPER" as indication in the preselection of cases to be audited. Presently, all the areas of AFIP involved in the investigation and selection of cases have access to this system.

- Implementing confidential consultations over the Internet so that each taxpayer can know the risk profile AFIP assigned to him with regards to his fiscal behavior and thus infer the possibility of being audited for said reason. This functionality is operative, in this stage, for approximately 230,000 taxpayers registered for the VAT.

3.4.2. Trade Transparency Units (TTU)

Global experience in the field of Customs has proved that the best way to analyze and investigate suspicious commercial activities is counting with systems which may monitor specific imports and exports towards and from certain countries.

In fact, the US Customs service was a pioneer of this approach upon creation of a computerized system which uses international commercial information, examines possible anomalies and suspicious transactions and identifies probable targets for investigation.

This type of investigation is seriously limited if information on only one country is available, for which, in order to maximize its effectiveness, comparisons must be made between the commercial information of each country and that of the rest of countries.

Although the countries gather commercial information related to imports and exports, and they have Customs services and in general impose tariffs and fees with collection purposes, there is yet no existence of a systemic mechanism based on the exchange of mutual information, which would allow the intervening Customs officials to compare and examine commercial transactions in the search of Customs fraud or other related crimes.

Under this concept AFIP analyzed the feasibility of establishing TTU prototypes gathering and analyzing suspicious commercial data, through the use of an investigation tool for combating Customs fraud.

At present, this initiative is being incorporated in the risk analysis of several countries, and recently AFIP signed its incorporation into the Commercial Transparency program with the US Government, thus initiating the exchange of information between the Customs services in both nations.

As indicated above, this software tool investigates and combats over and under billing in the area of Customs, through the crossed comparison of data existing in both Customs services, in order to verify their coincidence.

The mentioned intelligent exchange of information with the US shall allow AFIP to:

- Guide the investigation, control and external procedures activities for combating Customs fraud, from a comprehensive approach through the detection of anomalies in the logistic circuits of foreign trade.
- Incorporating to the AFIP data bases the information coming from the exchange system under analysis so that the areas of risk analysis and investigation may gain access to the latter.
- Strengthening the prevention of fraud, detecting risky transactions before these take place.
- Early detect irregular or non habitual transactions, used for hiding the true economic nature of the transactions, which will enable the creation of operator risk profiles.
- Tightening control after the analysis concludes, orienting the investigation towards greater integration into the audit function of all the operational areas of AFIP by relating the foreign trade transactions made by the taxpayers with those made in the domestic market.

3.4.3. Container Security Initiative

AFIP has decided to intensify controls with the purpose of combating contraband and the crimes related to foreign trade transactions.

In this regard, it is worth to mention two initiatives related to the physical control of the goods which enter and leave to or from Argentine territory, supported by state-of-the-art technology in the field: security electronic devices - SED - and non intrusive inspection systems -scanners-.

SEDs allow for monitoring container movements and thus preventing possible crimes. This system which controls the transfers of goods allows for tracking their entry into national territory until they get to their final destination, be that exiting the country or temporary warehousing for import.

In turn, the incorporation of scanners significantly improves the selective physical control of the goods, without needing to inspect the means of transport. The application of this procedure optimizes control timing and supplements the intelligent analysis process, thus achieving greater efficacy and efficiency in the process of verifying goods, luggage, means of transport, containers, vehicles, etc.

These high technology systems are a strategic tool for solving some of the major Customs crimes such as drug trafficking, and trafficking of weapons, explosives, radioactive material and non declared goods.

This method of control is quite widespread in several countries round the globe with significant volumes of international trade and provides a balanced response to the need of increasing the level of control without extending the timing of Customs inspections, considering that roughly 90% of the global cargo is made in containers. Based on the above, this method also meets the requirement of easing and simplifying trade, through a significant reduction in the timing and costs for the operators of international trade.

The joint use of both mechanisms favors the increase in Customs collection of duties, since it minimizes fraud derived of goods which have been falsely typified, which have not been declared or which have been hidden in equipment of difficult access. Besides, it provides greater verification capability, improving risk management in the application of intelligent red channels and increasing the capability of verifying cargo without needing to open it up.

Finally, it is worth mentioning that the image of the inspected cargo under this model is stored together with the Customs declaration, thus allowing for integration of this information to the mechanisms of selectivity and risk management, and increasing the capability of detecting future fraud, efficiently focusing "ex-post" control outside the primary area.

3.4.4. Systems of withholding, collection and down payments

Argentina's experience in the adoption of regulatory measures such as down payments, withholdings and receipts is already renowned. At present, these obligations have become institutionalized and therefore the specific figure of the withholding and/or receipt agent is used for the purpose of granting greater transparency and equality to the players within the same sector of economic activity, while it provides useful information for the control of the transactions which relate them. Besides, it pursues the additional goal of inducing taxpayers to report minimum income in proportion to the result of extrapolating the withholding or receipt suffered.

3.5. Information Exchange Measures

3.5.1. Synergy with Tax Administrations in other countries

The processes of economic integration and globalization have generated the need to have tax and Customs harmonization among the countries. This responds to the fact that the traditional taxpayer has become a global taxpayer seeking to optimize his profits, with which it has become necessary to increase control of all international transactions.

The different countries have gradually lost effective taxing power, and this gave way to cooperation or mutual assistance among tax and Customs agencies as a strategy for mitigating this situation.

This cooperation has materialized through various mechanisms such as agreements to avoid double international taxation, administrative cooperation agreements and mutual assistance treaties in the judicial arena.

In general, this type of covenant seeks mutual assistance for preventing evasion, avoidance, fraud and any other tax or Customs crime, and for improving the application of their tax systems.

Argentina has signed several agreements seeking to avoid double taxation, which include, besides, user-friendly methods for interpreting the different norms, as well as clauses relative to the exchange of fiscal information. The country has signed agreements of this nature- in force to date -with Australia, Austria, Belgium,

Bolivia, Brazil, Canada, Chile, Denmark, Germany, Finland, France, Italy, Norway, The Netherlands, Spain, Sweden, Switzerland and United Kingdom.

Notwithstanding the existence of this type of instruments, AFIP has recently signed information exchange agreements with other Tax Administrations in order to establish a direct link with them, rendering it unnecessary to involve other government areas, which do need to be involved in the case of signing the agreements referred to on the paragraph above, that is, Ministry of Foreign Affairs, Ministry of Economy, etc.-

Within this framework, agreements have been signed with Spain, Brazil and Peru and at present conversations are ongoing with other tax administrations on the implementation of additional agreements.

Their main characteristics are the following:

- Mutual assistance to prevent evasion, avoidance and all other tax or Customs crimes.
- Improvement in the application of their tax systems.
- Taxes included in the agreement: income tax, taxes on consumption, net worth tax and Customs duties.

The information exchange methods set forth are:

- Habitual methods with agreed regularity.
- Spontaneous method, when a tax agency detects information which may be useful to some other agency.
- Upon request of an agency concerning specific cases.

The agreed methods of auditing are:

- *Simultaneous auditing*: where each one of the administrations -upon previous agreement- selects the taxpayer whom both agencies are interested in auditing, determines the period and the purpose of the audit.
- *Joint audits*: when agents of both administrations partake in audits in one or both countries. In this case it would also be necessary to previously agree on what taxpayer to inspect, as well as the period and purpose of the intervention.

3.5.2. Synergy with provincial and municipal Tax Administrations

Deemed a priority activity by AFIP, the agency has encouraged signing agreements with tax agencies at different government levels in order to harmonize the relationship with the latter; and to accompany their streamlining; while searching for the following goals: strengthening of the tax agencies, progressing in the fight against evasion and trying to curb the costs of tax collection.

In the pursuit of said goals, the agreements basically include clauses relative to the exchange of information, incorporation of the CUIT (Single Tax Identification Number) to real estate and property registers, simultaneous auditing operations, exchange of systems developed by both parties and -in particular- the widespread implementation of the collection system used by AFIP.

The topic of information exchange has particular importance for the provincial tax agencies, given the possibility they have of gaining access to AFIP's taxpayer register, thus being able to obtain data from the VAT, income tax and social security tax returns in their respective jurisdictions. This possibility of online exchange is based on an IT solution hinging on web service standards and requires the establishment of a communication channel which meets strict security parameters.

On the other hand, in order to shore up the relationship and integration with provincial or municipal collecting agencies, AFIP issued a provision aimed at enforcing the funding of programs carried out jointly and which are directly connected to fiscal aspects and to border control. This criterion is equally applicable to the funding of system streamlining or adjustment programs at different national agencies, as long as they give way to improvements -direct or indirect- in the collection or auditing of the national taxes.

3.5.3. Synergy with other national and international agencies

At international scale, the active presence and involvement of AFIP at meetings, conferences, seminars and workshops organized by different international agencies -CIAT, OECD, WCO, etc. - have allowed not only for learning about good practices applied by the

different attending countries but also for presenting experiences and strategies successfully implemented in Argentina.

Thus, the gathered experiences prepare the attending countries to face evasion and avoidance maneuvers which are oftentimes masked as fiscal planning strategies carried out by large international economic groups.

Domestically, it is recommendable to sign agreements with sectorial or specific control and supervision agencies, which bolster the capabilities to detect crimes and to eventually penalize them, since in many cases these agencies have penalizing powers which are more effective and faster than those of the fiscal administration itself.

AFIP usually interrelates with other state agencies such as:

- The Central Bank of Argentina (BCRA) and the Superintendence of Financial Entities: from which the Tax Administration obtains information related to significant financial movements and learns about the "modus operandi" of the sector in particular.
- National Superintendence of Insurance: from which the Tax Administration obtains information about the behavior of the insurance sector, as well as valuations of certain registered assets and income of the insurance brokers and advisors.
- National Register of Vehicles and Credits secured by Pledges: from which the Tax Administration obtains information related to the purchase and sale of new and second-hand vehicles, farming and road machinery.
- National Register of Air Navigation: from which the Tax Administration obtains information related to the purchase and sale of aircrafts.
- National Register of Vessels: from which the Tax Administration obtains information related to the purchase and sale of ships.
- General inspection of Justice: from which the Tax Administration obtains information relative to the establishment and ownership of corporations.

- National Office of Agriculture and Livestock Commercial Control (ONCCA) reporting to the Secretariat of Agriculture, Fisheries and Foodstuffs: from which the Tax Administration obtains information regarding the control of the farming, live stocking, meatpacking, grain mill sectors, etc.

3.6. Aspects Related to the Application of IT and the Internet

IT is no longer considered a simple tool for supporting tax administration management, so much so, that we all recognize the need nowadays to permanently upgrade technology as the only way to meet the objectives inherent to tax administrations.

But upgrading does not only imply purchasing new equipment, it also means incorporating technological advances based on an IT strategy designed for that purpose.

For said purpose, the following aspects should be taken into account:

- *information to store*: all the data reported by the taxpayers, supplied by third parties in compliance with information systems and obtained from other public and private agencies upon request of the tax administration.
- *data integration*: the present trend is the centralization of information with the purpose of facilitating its administration and mining.
- *implementation of IT applications*: they facilitate both the tasks of the administration agents and the relationship with taxpayers -basic information for complying with their obligations, answers to frequently asked questions, way of submitting claims, guidelines for filing tax returns, etc. -.

To meet these goals, greater emphasis is increasingly put on the comprehensive leveraging of the services and benefits which are enabled by web technology developments.

In this sense, AFIP has managed to attain very significant usage levels of different applications over the Internet, regarding the entry

of information through tax returns and through all types of reporting through this means, as well as payments through electronic transfers.

To provide an example of the degree in which the agency uses these applications, it suffices to say that presently over 70% of tax return filing takes place over the Web -approximately 25 million per year- and about 80% of fiscal revenues is produced through electronic fund transfers.

3.6.1. Equipment

AFIP has recently inaugurated a modern and sophisticated computing centre with significant investments in servers and state-of-the-art equipment, placed in a vault room which meets all the security requirements.

This achievement is the result of a policy of permanent investment in this area, which has been specially enhanced in recent years and has been a fundamental condition for applying a strategy based on the use of information as main support for the collection and audit functions in the organization.

3.6.2. Data bases

Several of the elements mentioned above (Internet, new hardware, vault room, etc.) are not an end in themselves, but a means allowing for the reception, storage and processing of the information within a data base environment.

In view of this, the change developed by AFIP in the past years in terms of auditing has been possible thanks to the widespread leveraging of the information residing on data bases through a tool called "e-tax agency". The latter contains all the information coming from the tax returns filed by the taxpayers, data coming from the different information agents appointed by AFIP and from the processing of information coming from external sources and accessed by the agency.

A special case in point is AFIP's access to all the financial information -opening and closing of accounts, bank accreditations, debit card

transactions, remittances to and from foreign countries, purchase and sale of foreign currencies, etc.- and stock exchange - purchase and sale of government and private bonds.

Thanks to the use of the mentioned tool, the central criss-crossing of information generates data which is sent to over 140 decentralized departments, with roughly 80,000 annual office audits -inspections- ; likewise, around 120,000 systemic cross comparisons of information at central level generate data which is sent to the investigation areas -also decentralized- and is used as input for the later generation by these areas of preventive external, modular and thorough audits.

Besides, a new tool of decentralized use has been recently made available -in the regional sphere- named "e-bafis", which allows the investigating areas to select, within their jurisdiction, potential taxpayer segments to audit on the basis of predetermined criss-crossing of information, or else determine punctual cases through the generation of specific data interrelating any of the indicators and filters existing in the tool, which presently exceed 150 items.

This tool also provides decentralized consultation of the "jurisdictional map", which allows not only for knowing the profile of all of the taxpayers to be managed within a certain geographical jurisdiction, but also facilitates the sorting out of taxpayers on the basis of their economic activity, amount of sales, sums paid for their different fiscal obligations, etc., thus facilitating the tasks of investigation and selection of taxpayers to be audited in an absolutely objective and systemic manner.

This tool may also be used centrally, at national level, facilitating taxpayer segmentation on the basis of geographical criteria, economic scale, activity and/or fiscal sector and it is used in the Annual Audit Plan of AFIP as a strategic instrument for the definition of universes with risk profiles to later investigate and select individuals who will be subjected to potential control activities.

3.6.3. Interaction with taxpayers

A series of features have recently been implemented over the Internet in order to allow taxpayers to gain access to certain information AFIP has about them, and which helps rendering this information more transparent and generating controls through the contrast of different consulting individuals.

The mechanism is based on the widespread use of web technology and on the implementation of a "fiscal key" as a valid instrument for preserving the confidentiality of the access to this sensitive information.

To date over 4,000,000 "fiscal keys" have been delivered, enabling that same number of taxpayers to access the applications listed below by way of example:

- *"My contributions"*: this system allows employees to check their personal situation vis-à-vis the social security system. The most important aspect to consult about is whether the employee has been declared or not by his or her employer, or if he or she has been correctly declared. Besides, the employee will be able to find information concerning the tax return filed by his or her employer regarding the respective contributions, the agencies to which the contributions are derived -Pension Fund Administrators, National Administration of Health Insurance, Union-run Social Welfare Funds, Workers Compensation Administrators, Trade Unions, etc. -.
- *"My simplification"*: is a program which entails radical change in terms of labor registers, since with a brief errand employers may electronically register their employees at different agencies of social security, to avoid reporting repeated information. This simplification of registers, which will entail a higher concentration of employer and employee data, will allow for enhancements in the fiscal intelligence tasks, inducing to the whitewashing of labor relationships and on the other hand will be the basis for making presumptions concerning social security infringements. As a supplementary service, in the short term we are planning to implement a pre-populated tax return, making available the monthly summary of social contributions made by employers to all employees over the Web, which may be validated and then submitted.
- *"My Customs transactions"*: through this service, Customs service users may access different data from any computer connected to the Internet, with on-line information related to their Customs transactions. Thus, importers, exporters and Customs agents shall be able to monitor the status of a

process, so that they may on that basis organize their logistic and administrative activities, basically when they are dealing with the commercialization of perishable goods. On the other hand, reductions in the distribution and storage costs are attained.

- *"Self-employed"*: through this section of the AFIP portal we have achieved the new registration of over a million small contributors, a threefold increase in compliance with obligations for this taxpayer segment. The section includes several tools for the self-employed to channel all types of tasks, ranging from quarterly recategorization to the verification of their fiscal account status. This allows them to assess and print the forms needed for the payment of the periods omitted with their corresponding compensating interests.
- *Systematization of the claims made by the taxpayers*: AFIP has developed a strategy geared at systematizing all of the taxpayers claims and requests, from their beginning -the application- to the final resolution of the procedure, including a follow-up on the internal development of the performance of all the intervening agents - employers, inspectors, heads of areas, etc. These tools developed under the process flow framework not only ensure the integrity of the information included in the claim or request, but also provide greater transparency to the internal performance of the administration, since the system records the performance of each agent involved during the processing of the requests and the dates of beginning and conclusion of their activities, as well as the reasons behind possible delays. The most significant example is the application of this method to the refund of VAT fiscal credit for export transactions, through the tool named "SIRIVA".

This IT tool enables the total systematization of the mentioned procedure, which is the most complex one given the number of cases involved and the refund sums to manage. In this case, the application form is submitted by the taxpayer over the Internet, attaching the files with the invoices whose VAT is to be refunded and ends -in case the systematic controls have satisfactorily cleared the process-, with the order to electronically transfer funds to a

bank account previously reported by the applicant. This procedure guarantees the absolute objectivity of the control actions carried out, as well as the time frames assigned for carrying out each one of the steps that the electronic payment requires, within 20 days of submitting the corresponding application.

- *Electronic invoice:* in the present year AFIP has issued norms and has implemented a new procedure whereby the fiscal validity of the receipts issued electronically supporting commercial transactions is recognized. The chosen methodology starts at the application -over the Internet- on the part of the taxpayer to be accepted into the system; then the answer is issued - by that same means- by the Administration and later on for each receipt or batch of receipts, accordingly, the corresponding electronic communication is sent to AFIP before sending the latter to the customers and the message of full or partial approval or rejection is sent back, accordingly, all through the "electronic counter".
- *Consulting the status of audits:* soon AFIP will be implementing a method of consulting over the internet which will allow audited taxpayers to learn about the status of audits which have exceeded a certain period of time from their beginning. The tool provides information by the inspector, supervisor and the heads of the audit area, who draw a monthly report on the reasons for the delay in the completion of the inspection, as of the time frame considered standard for completing said audit. Additionally and automatically, monthly management reports shall be issued for higher-ranking officials to monitor the delays of audits and the reasons given for them.

4. CONCLUSIONS

The present paper has outlined a series of external conditioning factors which have significantly impinged on the way the Tax Administrations should face maneuvers of fiscal avoidance, evasion and fraud.

These factors stem from the growing globalization of the world economy and the proliferation of national and international holdings which, through harmful tax planning, erode the tax bases of the main taxes which support most of the tax systems -income tax and taxes on consumption-.

In this sense, the application of traditional auditing methods based only on routine inspections is not enough to maintain, and much less to increase, the subjective risk which helps improve voluntary and widespread compliance with fiscal obligations.

Based on this diagnosis, this paper has described a set of measures of different nature, in which AFIP has been actively involved, whose common goal is improving the position of the tax collection agency within the described context.

The planned strategy is focused on fostering and then applying legislative, organizational, tax educational, structural, information exchange and IT and technology use measures as instruments tending to increase the fiscal risk as perceived by taxpayers.

This type of instruments, besides attaining wider coverage than traditional methods of fiscal control, tend to be more objective, rendering the relationship between the Tax Administration and the taxpayers more transparent, without hindering the facilitation of business as economic engine.

The application of measures such as those described on this paper, help in using strategies based on risk analysis for all taxpayers, which seeks in the first place to prevent situations of non compliance and fiscal fraud, and in the event of this happening, detect the involved individuals, audit them and penalize them in a way that deters the rest of taxpayers from committing said infringements.

Case study

TOPIC 2.1

THE USE OF INFORMATION IN COMBATING EVASION

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SUMMARY

This paper discusses the use of information in combating tax evasion based on the experience of the Secretaria da Receita Federal (Federal Revenue Secretariat) in Brazil. It addresses the need to ensure the availability of information, be it information provided by taxpayers themselves in the returns required by law, or received from third parties through different means, like conventions, international agreements, integrated information systems, among others. Quality and security of information are discussed as

essential requirements which call for constant investment on the part of the Tax Administration. Several successful projects and initiatives used by the Receita Federal are presented, including IT tools developed specifically for the purpose of combating tax evasion. By way of conclusion, in addition to showing some results obtained, the paper refers to good management and the intelligent use of information as two key pillars for not only the fight against evasion but also for the very efficiency and effectiveness of tax administrations.

1. INTRODUCTION

Information is admittedly one of the most valuable assets of our time. For tax administrations, in particular, it is an essential "raw material". Knowing how to use information to achieve organizational objectives requires much more than investment in technology, since you need talent and creativity to identify opportunities, and persistence to reap the benefits. Combating evasion is one of the main objectives of any tax administration; therefore, using information for this purpose is of paramount importance.

This paper discusses the use of information in combating tax evasion based on the experience of the Secretaria da Receita Federal. No technical considerations are presented about technological platforms or the legal instruments available for the Receita Federal for the use of information. We seek to focus on the measures recently taken by the Receita Federal and which have had a significant impact on the fight against evasion.

The paper is organized as follows: after this introduction, Section 2 provides a context with general information about the current situation in Brazil and the Receita Federal, describing the strategic conditions that limit the management of information, especially as it refers to combating evasion. Section 3 describes some aspects of information management in the Receita Federal aimed at combating evasion, such as sources of information, information quality and security, the tools used to combat evasion and the new technologies that will supposedly bring about radical changes in business practices, both of tax administrations and taxpayers, be they individuals or legal entities. Finally, Section 4 presents some final comments about this topic.

2. CONTEXT OF ACTION OF THE RECEITA FEDERAL

Brazil is the fifth largest country in the world, with an area of more than 8 million square kilometers, and also one of the most populated, with 180 million people. It is a Federative Republic made up of a Federal Union, 26 States and a Federal District. It has around 5,500 municipalities. Surveillance over this extremely large territory requires big investments, since it has a long coastline and borders with all the countries of South America, except for Chile and Ecuador. Net Domestic Product amounted to US\$ 795.8 billion in 2005, which has earned the country the 11th position in the ranking of the largest economies in the world.¹ Inflation is under control and foreign trade volume is expected to amount to approximately US\$ 190 billion in 2006.

The Receita Federal, which reports directly to the Minister of Finance, is responsible for the joint administration of domestic and customs taxes at the federal level. It therefore has to combat tax evasion in foreign trade transactions as well as in the whole range of different commercial and financial transactions. It is responsible for almost 48% of tax revenue in Brazil, which amounts to 17% of the Net Domestic Product, and manages the transactions made by thousands of legal persons and millions of individuals -residents and non-residents.

To perform its mission, the Receita Federal is structured around central units (based in the capital city, Brasilia) and decentralized units. The former conduct regulatory, supervisory and planning activities, while the latter have execution and operational functions. There are 566 decentralized units all over the country, which employ around 15 thousand officials.

The data presented above are a clear indication of the big challenge that the Receita Federal faces. To be effective, the Tax Authority needs to make significant investments in information technology as part of its strategy to combat evasion.

¹ Rating by Austing Rating, based on data about 155 countries published by the IMF.

3. MANAGING INFORMATION AND COMBATING EVASION

General

Information is a key concept in this paper. Yet, it is not easy to define. In an article published in the magazine *Informatique et Gestion*, in 1978, Le Moigne defines information as "an object formatted and artificially created by man with the purpose of representing a type of event that can be identified in the real world". Stair (1998)² defines information as "a set of events organized in such a way that they acquire a value in addition to the value of the event in itself". It is interesting to note, in this definition, the reference to the "value of information", which becomes essential for the tax administration. Information allows the Tax Authority to know the external environment from where it gets the resources used to fund the State. It also allows the Tax Authority to act upon that environment to ensure compliance with the law. Without information, tax administrations would be unable to meet their role in society.

The term information technology (IT) refers to all the activities and solutions provided by computer resources. Information being an asset that adds value to a company or an individual, it is necessary to use IT resources in an adequate manner, which means that it is necessary to use tools, systems or other means that make a difference in terms of information; hence the importance of information management for tax administrations. Information management comprises collection, treatment and use of the data needed for the good performance of the organization, as well as the definition of contents, storage systems and access to information. In the following sections we shall address some aspects of information management in the Receita Federal, aimed at gathering and using information to combat evasion.

3.1 Sources of Information

How can one obtain the information needed for the success of the tax administration? For this purpose, the Receita Federal resorts to several means. The first and most usual method is requiring taxpayers to file their returns. If taxpayers refuse to do so, they fail to comply with the law and are therefore subject to penalties. Thus,

¹ Stair, R. "Princípios de Sistemas de Informação - Uma Abordagem Gerencial" - LTC Editora, second edition, Rio de Janeiro, 1998.

the obligation to file returns not only provides access to information about compliant taxpayers, which would otherwise be unknown to the Tax Authority, but it also imposes a cost on defaulting taxpayers, who have to face the risk of disobedience.

Although vital, the information provided by taxpayers is not sufficient for the tax administration. The Tax Authority needs to resort to third parties to improve the quality of the information it receives. Thus, the Receita Federal has sought to execute information exchange agreements with national and international entities, in addition to using other sources of information, like those listed below.

3.1.1 Tax Return

Some of the major returns filed by taxpayers are:

- DIRPF - Personal Income Tax Return, filed by natural persons subject to personal income tax;
- DIRF - Return of Income Tax Withheld at Source, filed by companies and institutions under the obligation to withhold income tax. Crossing data from the DIRF and DIRPF is essential to detect indications of Personal Income Tax fraud;
- DIPJ - Economic and Fiscal Information Return, filed by legal persons in general, comprising information relative to different taxes in addition to economic and accounting information.

Other countries most probably have similar returns, so they shall not be discussed at length here. Below we mention the most recent returns, which were devised to deter evasion or improve data crossing.

Returns Aimed at Combating Evasion in the Real Estate Market

Indications of high evasion in the real estate market led to the creation of two statements: the Real Estate Transactions Statement (DOI) and the Real Estate Activity Information Statement (DIMOB).

The DOI is a statement to be filed by court officials and officials responsible for registration offices, registration of real estate, title deeds and documents. They are required to report the documents drawn up, signed and registered in their offices for the acquisition or disposal of real estate by individuals or legal entities regardless

of the amounts involved. In addition, the parties shall report the amount of the real estate transaction or, in absence thereof, the amount that served as the basis for the calculation of the tax on the transfer of ownership of real estate (ITBI), which is a tax levied by the federated states.

The Real Estate Activity Information Statement (DIMOB), created in 2003, is a statement required to be filed by construction companies or companies that sell real estate on their own account, and agents and managers that provide brokerage services for the purchase, sale or leasing of real estate. Basically, the DIMOB informs, for a given transaction, the contracting parties, the piece of property, the date of the transaction and the amounts involved.

By crossing the information contained in the DOI and the DIMOB with other sources, the Receita Federal can identify events of non-payment of taxes on the income derived from the leasing of real estate, which are subject to a high risk of evasion. Transactions relative to the disposal of real estate very often fail to be reported on account of the fact that they are made with funds for which taxes are not paid, and the corresponding title deed is drawn up after expiration.

Statement of Fiscal Benefits (DBF)

Implemented in 2003, this statement contains information about donations made to the Funds for the Rights of Children and Adolescents, investments in audiovisual pieces and donations and sponsoring of cultural projects, provided for under the law. The parties required to submit this information are public entities like the Municipal and State Councils or the National Council for the Rights of Children and Adolescents, the Ministry of Culture and the Brazilian Securities Commission (CVM). The main objective of this obligation is to compare the amounts declared with those that were deducted from personal and corporate income taxes.

Statement of Credit Card Transactions (DECRED)

The Statement of Credit Card Transactions (DECRED), which is required to be filed by credit card managers every six months, was implemented in July 2003. Information is provided about the monthly

payments made by credit card users and the amounts transferred by the credit card managers to the merchants. The DECRET provides access to information about credit card transactions, which are experiencing a significant increase in the country. Comparing this information with the economic and fiscal data available internally provides the Tax Authority with a powerful instrument to unveil tax offenses.

Credit card managers may be exempted from reporting credit card transactions when the total monthly payments and transfers amount to less than R\$ 5,000.00, in the case of individuals, and R\$ 10,000.00, in the case of legal persons.

Special Statements for the Control of the Cigarette and Beverage Markets

The cigarette and beverage markets have always been difficult to control and have therefore deserved special treatment. The Special Statement of Fiscal Information on Cigarette Taxation (DIF-Cigarros) was created in 1999. It is filed monthly by cigarette manufacturers and contains information relative to the purchase of raw material, production, use of stamps, sales, brands and prices, as well as returns and taxes due.

Similar to the DIF-Cigarros, the Special Statement of Fiscal Information on Beverage Taxation (DIF-Bebidas) was created in 2003. It is required to be filed monthly by beverage bottling companies, with information about the purchase of raw material, production, use of stamps -when applicable-, sales, brands, as well as returns and taxes due.

In addition to the two statements described above, the Receita Federal uses the Demonstrativo de Notas Fiscales (DNF), which was devised as a useful and necessary instrument to audit the cigarette and beverage sectors. This can be done when the products declared in the DNF (in outbound transactions) are mandatorily used as raw material in the beverage and cigarette industries (in inbound transactions). Auditing based on the collection of information about raw material can be done in two complementary ways:

- a) Crossing information, by note or by product, checking the recipients reported in the DNF against the suppliers reported in the DIF's Bebidas and Cigarros;

- b) Auditing production at beverage bottling facilities and cigarette manufacturers, considering that it is possible to compare the production declared against the information contained in the balance statement of materials effectively used in the productive process.

The DNF is being adapted for the control of manufacturers of solvents and resins, which is a market that has been showing signs of high evasion.

3.1.2 National Entities

Unless otherwise provided for in the legislation, the Tax Authority may require public and private entities to submit relevant information for the execution of fiscal procedures. Secrecy and other types of restrictions may be overcome by means of information exchange agreements. The Receita Federal has been extending the list of entities with which such agreements have been signed, among them, the Brazilian Securities Commission, the Brazilian Institute for the Environment and Renewable Natural Resources (Ibama), the Central Bank, the Public Ministry of the Union, the Federal Police Department, several municipalities, natural and legal person registration agencies, the Federal Judiciary and the tax administrations of the states.

Information exchange agreements executed with the Judiciary provide the Tax Authority with access to information about court cases involving large sums of money. The Receita Federal can identify, in a big court case, who the parties are, who received money and if the money received was duly reported in the income tax return. It is also possible to check whether the attorneys reported the income derived from the fees charged.

In addition to exchanging information, in some cases, the Receita Federal has formed partnerships. For example, the partnership agreements signed with the Attorney General's Office, the Federal Police Department and the Social Security Revenue Secretariat have resulted in the success of different joint actions to combat evasion. This would not have been possible without exchanging information. Some examples are mentioned in Section 4 of this paper.

The agreements signed with the tax administrations of the states deserve special attention. Those administrations gather important information about taxpayers' businesses since they audit and collect taxes under the jurisdiction of the states; therefore, it is of the interest of the Receita Federal to have access to their databases. Countless events of fiscal non-compliance were detected over the years by checking the data of the Receita Federal against those in the states' databases. Until not long ago, comparing information was a complex and cumbersome task on account of the fact that there are differences in definitions and policy for the treatment of information between the Receita Federal and the tax administrations of the states. For example, a single taxpayer may have one registration number in the Receita Federal and a different one at the state level, which makes it difficult to link the systems. Recently, upon a constitutional mandate, the Receita Federal and the tax administrations of the states have been jointly developing several integration projects with a view to automating information sharing. Among those projects are the Synchronized Register Project and the Public Digital Reporting System (SPED), both of which are discussed later in this paper.

3.1.3 International Agreements and Conventions

At an international level, relevant information is obtained through the use of several channels, like information exchange agreements and double taxation conventions.

Some of the information exchange agreements worth noting are those signed to control foreign trade: the Multilateral Convention for Cooperation and Mutual Assistance between the Customs of Latin America, Spain and Portugal, and the Convention for Cooperation and Mutual Assistance between the Customs Administrations of MERCOSUR, to prevent and combat customs offenses (Common Market Council Decision - CMC - No. 01/97). Signatories to the former are Argentina, Bolivia, Brazil, Colombia, Costa Rica, Cuba, Chile, Dominican Republic, Ecuador, El Salvador, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Portugal, Spain, Uruguay and Venezuela. Signatories to the latter are the MERCOSUR countries and Chile.

In addition to those mentioned above, customs information exchange agreements have been executed with France, the United States and The Netherlands; while there are others that are being

discussed in Congress or under negotiation. Also, a Tax and Customs Information Exchange Agreement was signed with Argentina on the occasion of the CIAT General Assembly held in Buenos Aires in 2005. This agreement covers information about not only customs taxes but also domestic taxes.

Double taxation conventions, in general, include a provision for the exchange of information, which makes them important sources of information, mainly regarding transactions of non-residents and residents that do business overseas.

3.1.4 Other Sources of Information

There are several other sources of information. We shall refer to the tax attachés, intelligence networks and tax withholding at the source.

Tax Attachés are career officials that are stationed abroad. Brazil currently has Tax Attachés in the United States, Argentina and Paraguay, who are responsible, among other things, for promoting the exchange of information and technical data, news and experiences relative to tax and customs administration.

Intelligence networks operate as an extensive information exchange web. One example is the RILO Project, designed within the framework of the World Customs Organization (WCO) and consisting of an international intelligence and information exchange network with centers in several countries. Its main purpose is to combat customs offenses, among them, evasion and fraud. It is worth noting, however, that the information exchanged is unofficial.

The Receita Federal has several fiscal intelligence centers throughout the country, making up a network. Those centers play a key role in gathering information to combat fraud. Several fiscal proceedings were initiated and conducted successfully based on information provided by the intelligence centers. The Receita Federal now has a center specialized in combating smuggling.

Tax withholding at the source may also be used as an instrument to gather information. For example, in 2005, withholding of the tax on the income derived from stock exchange transactions was

implemented with a 0.0005% rate. The mismatch between the information about the stock exchange transaction volume and the amount of tax collected made it necessary to implement withholding at the source in order to obtain information about this market. By crossing that information with the database of the Receita Federal, decisions can be made about the initiation of fiscal proceedings.

3.2 Quality and Security of Information

Good information should be accurate, complete, economical, flexible, reliable, relevant, simple, and it should be possible to audit it. All of those characteristics have to do with the quality of information. The Receita Federal seeks to have secure and high quality information, which requires investment and effort. Today, we can say that the Receita Federal has the best and most reliable registers of natural and legal persons in Brazil. The register of natural persons, for example, has been undergoing a clean-up process for several years, with the obligation to annually validate the persons registered. There used to be a large number of "ghosts" in the register, which was an obstacle for auditing tasks. Today, the register of the Receita Federal enjoys so much respect that all public and private institutions in Brazil require the registration of citizens as a pre-condition for any transaction.³

However, the concern about the quality and security of information goes beyond the initiatives relative to registers. Without quality information there is no way in which to define good strategies and policies to combat evasion. The Tax Authority needs to know the risk level of each taxpayer in order to decide what action to take or how to respond, without being ineffective or wasting resources. On the other hand, the confidential nature of the information that the Tax Authority has makes it essential that the information be secure, in order to ensure the respect for the rights of taxpayers and to prevent the damage that a leakage of information could cause to the Tax Authority itself.

³ In Brazil, the identification document of natural persons is issued by the Secretariats of Public Security of the States, in addition to other identification bodies. The diversity of identification registers, with different numbering systems, is considered to be a cost-increasing factor for companies and institutions. The Receita Federal's register is one for the entire country and it is quite reliable. Therefore, it is being increasingly used for general identification purposes.

The increasing use of IT presents new challenges. A natural user of large amounts of information, the Tax Authority can not be out of line with the new technologies, endangering the security and/or quality of information. On the contrary, to be efficient and effective, tax administrations need to be at the fore front, making investments and innovations with a view to maximizing the use of information.

The two projects mentioned below serve to illustrate the efforts made by the Receita Federal to make the best use of technological innovation to improve the quality and security of information.

3.2.1 Digital Certificates

The Receita Federal has had an Internet page to provide taxpayer services for the last ten years. Its electronic portal has received several national and international awards. However, the limitations imposed by fiscal secrecy restrict the capacity for virtual exchanges with taxpayers. To ensure greater security and integrity of the information exchanged by virtual means, it is necessary to use an electronic signature to authenticate taxpayers and ensure their privacy, and also for the purposes of legal validation of electronic documents. As a result of all that, the digital certificate project was designed.

The digital certificate project of the Receita Federal provides for the certification of individuals (e-CPF project) and legal persons (e-CNPJ project). Both projects will provide for the use of electronic signature cards by a significant portion of the population, using the Brazilian public key infrastructure (ICP-Brazil). The e-CPF project, under which a unique digital certificate will be offered to each citizen that has a checking account, resulted from an agreement between the Receita Federal and the Febraban (Brazilian Banking Federation). The partnership with banks, whose interest in linking a digital certificate with the e-CPF lies in the economy of scale that the project offers, helped reduce the cost of technology. The security of information and of the identity of clients is one of the issues that worry financial institutions, which face risks of fraud and theft of keys.

The project will bring benefits for the population and the public administration as a whole, since the government will have the

means to provide secret data services electronically, avoiding queues, with the certainty that they are operating with the right person. Citizens can now be free of most keys, which are not always secure or easy to remember, in addition to having a certificate accepted and recognized nationwide by the government, enterprises and banking institutions.

Currently, the Receita Federal officials are already using the e-CPF cards to access their workstations. Some companies are also already using the e-CNPJ to access services available on the web site of the Receita Federal. In the next stage of the project, cards will be distributed among income tax payers since the filing of returns will be validated via digital certificates. Subsequently, all who have a bank checking account will have to use the cards.

3.2.2 Synchronized Register

The Synchronized Register Project aims at simplifying and standardizing accessory obligations deriving from registration acts at the three levels of government, and expediting registration and register changes, based on the following premises:

- a) adoption of the Federal Tax Authority identification number for legal persons (CNPJ) as the single identifier for the three levels of government;
- b) single data entry;
- c) more synchronized view of the taxpayer at the three levels of government.

With these premises, efforts have been made to provide greater integrity to the register data at the three levels of government, by means of an integrated monitoring of taxpayers by the various tax authorities. This will prevent taxpayers from having a different status in the various registers of the three levels of government, like being in business for the Federal Tax Authority and inactive for the tax authority of one of the states. With the use of the unique CNPJ number and the single data entry, those mismatches will no longer occur. Thus, taxpayers will go to a single place for their registration with the CNPJ, and they will no longer need to go to the state or the municipal tax authority for registration. The purpose is to simplify and rationalize registration procedures.

Thus, the benefit of the development of this project for society will be speed and simplicity for taxpayers, which implies stimulating formality in business due to the lower cost of registration and compliance with accessory obligations. Register integration is an important step towards a government with a single interface with citizens, who will no longer see a segmented government or multiplied bureaucracy.

For tax administration bodies, integration will lower costs in the long run, since duplication of tasks will be eliminated, multiple controls will no longer be needed, and it will not be necessary to maintain different systems which are not compatible one with the other. This will enable a more effective exchange of information among tax authorities, joint and coordinated action and a stronger fight against tax avoidance and evasion.

The Synchronized Register has so far been implemented in the States of Bahia and São Paulo, only within the scope of the States' Finance Secretariats, but it will gradually be extended to the other agencies involved in the registration of companies throughout the country.

3.3. Specific Tools to Combat Evasion

Below is a description of some of the measures taken and instruments devised by the Receita Federal in the last few years in order to combat evasion more effectively based on optimizing the use of information.

a) SIGA DW - Unified Selection of Taxpayers

In the last few years, with the SIGA DW project, the Receita Federal has unified the various data crossing tools to select taxpayers to be audited, by making use of the data warehouse technology. This project makes it possible to use the more than 80 sources of information available in the Receita Federal to measure risk and define fiscal interest based on the identification of signs of fiscal irregularities. Thus, today, the tool used to select taxpayers for audits is the most advanced tool available, making it possible to deal with a large volume of data in a flexible manner.

b) Integrated File System - Support to Prepare Fiscal Procedures

On account of the increasing need to obtain quality information based on the data available in dozens of databases in the Receita Federal while meeting the security requirements in terms of fiscal secrecy, a unified tool has been developed for the generation of digital reports with taxpayer information for auditing purposes -the Integrated File.

This system makes it possible to obtain relevant information about taxpayers based on their own returns or third-party information, integrating it to the applications used to support and optimize audits.

c) Inconsistent Financial Movement Information (MFI)

In 2001, the Receita Federal created an operation to check the consistency between financial movements and the returns filed by taxpayers, especially in the case of taxpayers that appeared to be tax exempt, inactive (with no financial movements), immune (tax exempt upon a constitutional decision) or who had failed to file their returns. This resulted in a tax credit for an amount of 8 billion reais (US\$ 3.5 billion), raised in approximately five thousand audit procedures. On account of the good results obtained, the Receita Federal will now include financial movement information in the systems used to select taxpayers for audits and to provide support for the preparation of fiscal procedures.

d) Data Extractors - Corporate Data Warehouse (DW)

The Receita Federal has powerful data extractors in its Corporate Data Warehouse (DW). The DW offers the following views: administration, customs, collection and auditing. The tool makes it possible to cross information in a variety of ways. In the customs view, for example, the integrated use with the RADAR system (Registration and Follow-up of Actions of Parties Involved in the Customs Process - corporate system) is making it possible -as a result of the production of quality information- to change the focus of Customs, revolutionizing the way in which customs controls are seen and formulated. Thus, as controls are focused on the clearance operation, international trade is facilitated, with the adoption of preventive measures and audits after clearance, shifting

the focus from controlling goods to controlling taxpayers. This is one more example of how risk management is added to the processes of the Receita Federal, combating evasion in a more intelligent manner and making the best use of information technology resources.

e) Computerized Foreign Trade Information Exchange: the INDIRA System

In MERCOSUR, the INDIRA system comprises data from four foreign trade systems: SISCOEX (Brazil), MARIA (Argentina), LUZIA (Uruguay) and SOFIA (Paraguay). The INDIRA system, which was put into operation in March 2004, enables the exchange of data among the four countries via the Internet. It aims, among other things, at allowing the automatic exchange of foreign trade information among the customs of the Mercosur member countries and helping combat customs offenses.

3.4. Recent Developments

In addition to the tools just referred to, it is worth mentioning three other important projects that are currently being implemented.

3.4.1 Flow Metering System (SMV)

The Flow Metering System, which was made mandatory in 2002, aims at providing the Tax Administration with real time information about the production of beverages as required by the relevant regulations.

The system is made up of flow meters, conductometers, and devices for control, registration, recording and remote transmission of readings to the Receita Federal. It continuously monitors the production of beverages at the industrial facilities where it is installed, performing the following functions:

- Metering (volume by time unit) the fluid fed into the filling machines;
- Metering the electrical conductivity and temperature of the fluid fed into the filling machines;

- Recording the flow, conductivity and temperature readings and making that information available to the Secretariat of the Receita Federal;
- Remotely communicating with the systems of the Receita Federal for the transmission of the information recorded.

The electrical conductivity and temperature readings will make it possible, under certain conditions, to tell the different fluids that are fed into a filling machine. The flow meter readings provided by the system will make it possible to estimate the volume of beverage produced by a plant in a given period of time.

The Receita Federal may consult the Flow Metering System remotely at any point in time to obtain information about the production of beverages at a given plant, and it may provide such information - under the relevant agreements- to the tax administrations of the states where the plants are located.

3.4.2 Harpia Project

The purpose of the Harpia Project is to promote the integration and standardization of the fiscal selection process based on the application of artificial intelligence techniques for risk analysis and evaluation of results.

In fact, it is a project that aims at giving continuity to the RADAR system (Registration and Follow-up of Actions of Parties Involved in the Customs Process - corporate system), which, in turn, integrates information on foreign trade transactions with economic and fiscal data for risk analysis purposes.

Initially devised for the customs area, the Harpia system could be extended, in the future, to cover domestic taxes.

3.4.3 Public Digital Reporting System (SPED)

The SPED project aims at replacing accounting and fiscal documents and books issued in paper form with electronic documents with digital certification, ensuring authorship, integrity and legal validity.

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The program is being developed jointly with the tax administrations of the states. Corporate accounting, including cash flow statements, financial statements and balance sheets, will be made in digital format. The electronic documents will be standardized for all tax administrations and sent to a single data bank -the Public Reporting System, to which federal, state and municipal tax administrations will have access.

Within the context of the effort to improve relations between tax authorities and taxpayers, the SPED system is intended to promote the reduction of compliance costs for taxpayers, with the following basic premises: simplification and rationalization of accessory obligations, avoiding duplication of documents required to be submitted to more than one institution with the same information; reduction of costs entailed in the issuance and maintenance of documents in paper form; standardization and improvement of the quality of information; increased auditing activity; use of digital certificates; greater availability of services over the Internet, among others.

The project is subdivided into 3 (three) different, yet integrated, subprojects: (a) Digital Accounting - ECD/Sped; (b) Digital Fiscal Reporting - EFD/Sped; (c) Electronic Fiscal Note - NF-e. The SPED will initially prioritize strategic sectors and large enterprises, which are participating in the joint development effort and in pilot projects, and it will then be gradually extended to other taxpayers until the final objective is reached.

The first valid electronic fiscal note was issued on September 15, 2006. In the near future, most companies will be expected to cease using paper when reporting accounting and fiscal information to the Receita Federal and the tax administrations of the states and municipalities. Another interesting point is that, with the electronic note, the goods moved from one location to another do not need to stop at the various fiscal posts, thus reducing costs for the taxpayer and the administration, while preventing fraud.

4. FINAL COMMENT

In the last few years, the Receita Federal (SRF) has been intensifying the fight against big tax evaders by investing in information technology. Numbers attest to the result of this effort: in 2004, there were 50% more proceedings than in previous years, and they remained at approximately the same level in 2005. There was a more than 100% increase in the revenue derived from penalties and interests, which shows that the counter-evasion effort goes all the way up to the recovery of the tax credit. The industry, services and trade were the sectors in which most of the evasion was detected and where most proceedings were conducted.

The increase in the volume of proceedings does not mean that tax avoidance in the country is increasing, but rather that auditing efforts are more efficient. Auditing work is based on two pillars: modern methods and new intelligence techniques. The goal of the Auditing Department of the Receita Federal is to cover all the sectors that show deviations in tax conduct, like beverages, cigarettes, some branches of industry, construction and the financial sector.

The use of IT has resulted in improved performance of the auditing work in the brewery industry, with the installation of flow metering equipment. In the next few months, the cigarette industry will be provided with equipment to track production and distribution, which will also ensure greater control by the Tax Authority. Results can also be illustrated with the approximately 50 actions that the Receita Federal undertook jointly with the Federal Police and the Attorney General's Office, with the support of other bodies, like those exemplified below.

TOPIC 2.1 (Brazil)

Operation	Description
Narciso	This operation had repercussion nationwide. 33 search and arrest warrants were executed, plus 4 imprisonment orders in 4 states. The objective was to put an end to tax avoidance by certain businesses. Investigations started in the Receita Federal, based on information captured by the institution. Three people were taken into custody.
Lion Tech	A gang that committed fraud to obtain undue income tax reimbursements was dismantled. The fraud is estimated to have amounted to 2 million reais.
Monte Edén	An operation conducted with the support of the authorities of Uruguay. Members of a money laundering and tax avoidance and evasion scheme were taken into custody. Actions were taken in 7 states.
Cebada	70 people were taken into custody for participating in criminal gangs, tax avoidance and fraud in the beverage distribution market.
Diluvio	118 imprisonment orders and 220 search and arrest orders were executed in 8 states. The investigation was conducted jointly with the Internal Revenue Service of the United States. The individuals involved were suspected of fraud in foreign trade, tax avoidance, and other crimes. Under the scheme devised, electronic appliances, IT and telecommunications equipment, tires, orthopedic equipment and surgical gloves, among others, had been imported by fraudulent means.

In summary, good information management is key for the success of any tax administration, both in terms of the services provided to taxpayers and in connection with control and auditing efforts. In the case of the Receita Federal -and keeping our focus on actions to combat evasion-, the strategy for good information management is based, necessarily, on constant investment in technological innovation, as required by the continental dimensions of our country, by the trends in tax evasion resulting from globalization and the increasing sophistication of offenders.

In addition, it is necessary to ensure other sources of information. Information provided by taxpayers is necessary though not sufficient. It is necessary to resort to third parties, ranging from domestic private entities to tax administrations of other countries. In turn, having more sources of information requires better conditions for the treatment of such information, which makes technology a fundamental strategic element.

In addition to all the efforts made and initiatives implemented, the Receita Federal continues to prepare for the future. The projects developed for digital certificates, synchronized register and public digital reporting system attest to that commitment.

Continuous improvement in quality and security of information, together with the trend towards integration of government bodies, including those from other countries, is at the core of the current strategy for the use of information to combat tax evasion.

Case study

TOPIC 2.1

THE USE OF INFORMATION IN COMBATING EVASION

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South African Revenue Service - SARS
(South Africa)

CONTENTS: 1. Introduction.- 2. The South African Context.- 2.1. SARS Mandate.- 2.2. The South African Reality.- 3. Environment.- 4. External Environment.- 4.1. Background.- 4.2. E-commerce and tax compliance.- 4.3. Use of tax havens.- 4.4. Money laundering.- 4.5. Tax Professionals.- 4.6. Amnesty.- 4.7. Sources of information within South Africa.- 5. Internal Environment.- 5.1. Background.- 5.2. Processes.- 5.3. Technology.- 6. Utilisation of Information.- 7. Challenges faced in the 21st century.- 8. What do we intend to do.- 9. Expected Benefits.- 10. Conclusion.

EXECUTIVE SUMMARY

The purpose of this paper is to analyse the use of information in combating tax evasion by the South African Revenue Service (SARS). The analysis takes cognisance of both the internal and external environmental factors and in doing so fine tune the strategy. The strategy must support the vision, mission and higher purpose of the organisation within the legislative framework imposed upon SARS.

The point of departure is an understanding of the current situation faced by SARS. The history of taxpayers' behaviour is depicted by taking the turbulent political situation of the past. This is further expounded upon in more detail in the external and internal environmental analysis with specific emphasis being placed on the sources and use of information in combating tax evasion. This analysis reveals that the industry is very attractive, with globalisation having a major impact on SARS.

It is evident that both internal and external sources of information should be utilised optimally in order to effectively combat tax evasion. Various initiatives have been undertaken to obtain information, understand the environment and to combat tax evasion. This includes, inter alia, offering a tax amnesty to small business and building relationships with various bodies. Crucial in doing so are the development of relationships with governmental and non-governmental agencies both locally and internationally. By adopting this approach, historical factors affecting compliance levels will be addressed.

Information technology tools can be used to assimilate the data, develop trends and identify specific risks. This can assist with targeted campaigns in order to combat tax evasion. These campaigns may include taxpayer education initiatives to hardcore criminal investigations. It may be industry-specific or based on a specific hypothesis of non-compliance. It is thus imperative that the correct tools are available to optimise the use of this information. Various opportunities for improvement are highlighted in the following analysis.

The changing environment creates challenges and opportunities to curb tax evasion. In order to reach the organisation's strategic intent, management is required to address certain critical issues, such as expanded electronic services; customised approach to compliance; strengthening partnerships and co-operation; transparency, clarity and simplification and workforce development.

The strategy deployed by SARS is aimed at making major in-roads in striving towards its vision and higher purpose. It is essential that the factors impacting on SARS be reviewed continually in order to ascertain the impact that it has on the environment. This will allow SARS to fine tune its strategy to any environmental changes.

1. INTRODUCTION

The point of departure is an understanding of the current situation faced by SARS. The history of taxpayers' behaviour is depicted by South Africa's turbulent political situation of the past. This is further expounded upon in more detail in the external and internal environmental analysis with specific emphasis being placed on the sources and use of information in combating tax evasion.

It is evident that both internal and external sources of information should be utilised optimally in order to effectively combat tax evasion. Various initiatives have been undertaken to obtain information, understand the environment and to combat tax evasion. This includes, inter alia, offering tax amnesty to small business and building relationships with various bodies. Crucial to doing so are the development of relationships with governmental and non-governmental agencies both locally and internationally. By adopting this approach historical factors affecting compliance levels will be addressed.

The changing environment creates challenges and opportunities to curb tax evasion. In order to reach the organisation's strategic intent, management must address certain issues. These issues include expanded electronic services; a customised approach to compliance; strengthening partnerships and co-operation; transparency, clarity and simplification and workforce development.

In the Information Age, 'knowing your client' is a maxim that affects government agencies as vitally as it does their private enterprise counterparts.

2. SOUTH AFRICAN CONTEXT

2.1. SARS Mandate

The South African Revenue Service Act No. 34 of 1997 gives the entity the mandate to perform the following tasks:

- collect all revenues that are due;
- ensure maximum compliance with the legislation; and
- provide a customs service that will maximize revenue collection, protect the borders as well as facilitate trade.

The money raised by SARS through the imposition of taxes, duties and levies account for the bulk of the funds required by government. The funds are used by government to provide basic services such as education, health, welfare, maintaining national security and ensuring law and order. In addition, government invests in the infrastructure of the country for sustainable development e.g. roads, railways and telecommunications. If SARS is unable to fund government spending, basic service delivery to South Africans may be compromised. SARS therefore plays a pivotal role in developing the country and the economy and exists to improve the quality of life for all South Africans through the taxes raised and trade facilitated. The effectiveness of SARS is dependent on a variety of external factors such as the state of the economy, public support for the priorities of the government and the willingness of taxpayers to comply with tax rules.

2.2. The South African Reality

Since the inception of a new democratic government in 1994, South Africa has undergone enormous change on all levels of society and the economy. South Africa's political past has played a significant role in the country's history of non-compliance with tax laws. Since the start of change in 1994, as more previously disadvantaged people became economically active and eligible for tax, no incentive existed to attract them into the tax base. Many eligible taxpayers also are uneducated and/or ignorant when it comes to tax obligations and the importance and value of all paying tax.

The following factors also contribute to the general climate of non-compliance in South Africa:

Historical factors

- Tax and duty evasion is not generally considered as serious a crime as the more conventional types of crimes where victims are affected directly;
- Certain "facilitators of revenue-related crimes" (e.g. lawyers, accountants, financial advisors, and consultants) have managed to create a base for their services to non-compliant taxpayers whereby they assist them to evade taxes or duties;
- Since 1994, criminals have increasingly abused the birth of democracy and increased opportunities resulting from an increase in trade, relaxed exchange controls and non-restrictive

movement across borders. Criminals tend not to declare their income derived from illicit activities;

- Within the informal economy, which is substantial in South Africa, an element of criminal opportunism will always be found; and
- Sanctions imposed on South Africa pre-1994 resulted in the circumvention of customs-controls to facilitate sanction-busting. Over time, the existence of weak customs-controls provided opportunities to defraud Customs which led to the expansion of irregular trends and habits in different sectors of the economy, and the strengthening of criminal elements.

Other factors

- The opportunities provided by globalization as well as rising unemployment have contributed to an increase in the informal sector and cash economy. This has directly influenced the South African compliance landscape in that the country is characterized by a dual economy; that is, a sophisticated industrialized economy operating alongside an undeveloped informal economy that also includes elements of a cash economy and shadow economy of crime syndicates.

Global trends affecting SARS include:

- a) Advanced passenger and cargo information;
- b) Automated data collection – e.g. Smartcards;
- c) Legislation to address privacy concerns;
- d) Extending the borders and implementation of a secure supply chain;
- e) Innovative sourcing of support and non-essential functions;
- f) Global terrorism threat; and
- g) Money laundering activities.

Specific regional trends that need to be addressed include:

- a) Political and economic developments in the Southern African Development Community (SADC), Southern African Customs Union (SACU) and African Union (AU) regional co-operation; and
- b) Meeting objectives as set out in the New Partnership for Africa's Development (NEPAD).

- The efforts of government and the changing environment also impact on the compliance climate in the country in the following ways:
 - a) The shift of focus and change in general in the State has weakened its ability to function optimally. This is further compounded by the change in the legislative environment;
 - b) Opportunism and expectations of entitlement by some citizens in general;
 - c) While the State is able to define those aspects that are not considered favourable for growth and development and similarly what is envisioned as desirable for the future, the road to the developed state is still wrought with obstacles;
 - d) The risk of the State being “captured” in particular scenarios by different market forces or stakeholders has diminished. Previously the State and business were very closely aligned – as SARS changes/adapts, increasing resistance by business is experienced; and
 - e) Black empowerment presents unique challenges to SARS, when considering the intention of empowerment and weighing that against accountability and governance.
 - In 1998 just over 5.8m taxpayers were liable for income tax. Those with taxable incomes of less than R40 000 constituted 50 percent of the number and contributed to 8% of the total taxes paid. Taxpayers with taxable incomes of R100 001 and higher represented approximately 10% of the total number of individuals but contributed 46% of the total taxes paid. Estimates for corporate income tax revealed that the overall effective rate may have been as low as 9% compared to a statutory rate in excess of 30 %;
 - Substantial opportunities for evasion and tax abuse are linked to corporates and high net worth individuals because of the potential for tax arbitrage and the fact that high net worth individuals have access to significant resources to engage in aggressive tax planning and non-disclosure of off-shore investments. Consequently there are huge disparities between the statutory and effective tax rates of these groups;

- The more regulated industries boast higher compliance levels. A sector that assumed prominence in recent years is that of the financial services, the growth of which was accelerated by globalisation and the information age. The introduction of new financial instruments coupled with the difficulty of tracking these transactions offer significant opportunities for tax evasion; and
- With regard to customs, compliance levels are negatively impacted by the existence of a complex tariff regime and unwieldy, manually-driven procedures. Further, the system is vulnerable to fraud and collusion due to the necessarily close and frequent interaction between traders and customs officials coupled with the staggering amounts involved and their impact on business operations. For a customs official earning a nominal salary, this poses a high risk for corruption of varying degrees.

3. ENVIRONMENT

Ideally information should filter into the risk model from both external and internal sources. External environmental scanning should identify those factors which could prevent the organisation from achieving its objectives. This information should be consolidated and centralised in a database. A similar process should be adopted with internal risks identified through the internal environmental analysis. By applying intelligence to the risk assessment, non-compliance risks can be highlighted. A mechanism should be adopted (framework, processes and systems) that will produce risk ratings and prioritisation that will inform interventions for specific transactions / trends. These risks can be communicated so that relevant parts in the organisation can define appropriate measures to mitigate risk and implement the most appropriate risk response. Risk monitoring is not a once-off process. Changes in the environment need to be regularly. This will provide the organisation with the knowledge to improve business processes, responsiveness to their customers and adapt to changing economic conditions.

It is essential that targeted risk knowledge identifies and informs the organisation of risks at a strategic, tactical and operational level in order to achieve its objectives. The supply of strategic intelligence

brings the appropriate focus, detail, attention and understanding of the key environmental risks to the organisation as a whole. The risk capability provides tactical and operational intelligence that, in turn, provides the relevant risk-related analysis for the prioritisation and increased effectiveness of compliance activities.

4. EXTERNAL ENVIRONMENT

4.1. Background

Factors in the external environment that impact on an industry are defined in Thomson and Strickland (2001 : 93) as the driving forces, i.e. the major underlying causes of changing industry and competitive conditions. They argue that, whilst there may be many forces influencing an industry, there are usually only three or four which are likely to be the "... major determinants of how the industry evolves and operates" Thomson and Strickland (2001 : 99). It is therefore essential to identify those driving forces that are likely to dynamically influence the future trends of the industry.

Taxpayers and Government have a mutual interest in maintaining the integrity of the tax system, thereby ensuring that:

- it is convenient for taxpayers to comply with their obligations and secure their entitlements;
- compliance costs are kept to the minimum compatible with effective tax administration; and
- tax evasion is addressed so that (those) compliant taxpayers are not disadvantaged and public services can be adequately funded.

There will inevitably be those who will regard globalisation as an opportunity to evade taxes. For example, electronic trading provides opportunities for fraud similar to those that exist with cash. It, however, also has the potential to amplify significantly some existing areas of risk. Techniques for detecting and deterring those attempting to evade taxes must therefore keep pace with the development of technology.

Thus, in addition to being mindful of specific threats, law enforcement and revenue agencies should aim to gain an understanding of the specific characteristics of the emerging environment that, individually or in combination, may generate new types of crime. Countermeasures can then focus on these general characteristics, as well as specific identified known threats.

Had it not been for concurrent revolutions in globalization, deregulation of trade and related technologies such as telecom, computer networking, computing power and satellite systems, the impact of the internet might have been far less.

Figure 5.1: The trio of forces in the 'new economy'



Source: Downes and Mui, 2000.

These concurrent revolutions, according to Downes and Mui (2002), created a trio of new forces with digitization spurring on deregulation of industries and globalisation of markets. Global competitors are created where only local players previously mattered. These give power to customers, suppliers and new entrants, upsetting the previous careful cultivation of competitive advantages that were based on now-obsolete technology. The new technology undermines customer relationships, distribution networks, competitor behaviour and economies of size and scale.

With digitisation, information is being moved to computer systems and public networks where it can multiply in value. The more global the economy becomes, the more local regulations tend to restrain the industries they were enacted to protect, increasing the velocity of deregulation. Deregulation opens previously closed markets to competition, exposing chronic underinvestment in technology. And so the cycle continues.

These developments spurred the shaping of the 'new economy' in the following ways:

- Computing devices: Freeing people from mundane tasks and increased rate of work-flow. Increases in computer power and a reduction in size continue;
- Networks: one PC alone is a powerful tool, but two PC's are able to share information and resources and are clearly more powerful. As more computing devices are added, the network increases in power;
- Telecommunications: the growth in global telecommunications infrastructure continues. Today, fibre optics, satellites, mobile phones and other related devices drive this growth;
- Globalisation: in the past, the motor car and aeroplane played the most important role in bringing people from different nations or regions together. Today, television and telecommunications play a vital part in opening a window to other countries and cultures and to exploring new business opportunities;
- Internet: the internet supplies information and resources available through millions of connected networks around the world. It is a vast store of information, knowledge and ideas; and
- E-Business: E-Business is a holistic look at how the organisation can benefit from these new technologies. Companies need to progress towards being more flexible and agile to cope with the increased rate of change. The higher the degree of automation, the higher the ability to adapt to the environment.

These developments culminated in a shift in the world's economy from an industrial to an information base in just over a quarter of a century. It becomes ever more difficult to control tax evasion if there is no information available on economic events that have fully or partially taken place abroad, on individuals domiciled in other countries and on properties located abroad. Issues such as transfer pricing, tax havens, treaty shopping, under-capitalization, electronic commerce, among

others, are recurring concerns in tax administrations throughout the world. Without mutual assistance among these administrations that may afford them the possibility of counting on reliable and timely information from abroad, their commitment to exercising control becomes a very difficult task.

4.2 E-commerce and Tax Compliance

Government is encouraging and assisting taxpayers to comply with their tax obligations. This applies to those taxpayers engaged in e-commerce as it does to those trading by more traditional means. Taxpayers are more likely to comply if:

- they understand and have confidence in the laws they have to observe;
- it is easy to comply; and
- compliance is a positive move giving certainty and reflecting good citizenship.

Encouraging and improving compliance is achieved by respecting taxpayers' rights and helping them recognise their obligations under the law. Publicity, taxpayer education and support are all essential to achieving these goals.

Government is rewriting tax law to make them more transparent and simple to apply. E-commerce provides an opportunity for Government to interact with business in a direct way. It has the potential to provide access to structured information on demand as well as interactive services.

To assist in this process, the Government should:

- adapt the design of income and corporation tax returns to incorporate a request for a business to give its web site and e-mail address. This could, in the future, bring the advantages of speedier communication and enable SARS to target sector-related information or guidance;
- examine how developments in technology might be used to reduce compliance costs on business during the audit of electronic data, books and records, within acceptable risk parameters;
- encourage taxpayers to use e-filing;

- consider, in particular, what guidance small- and medium-sized enterprises (SMEs) that are starting to trade over the internet and, perhaps, internationally for the first time, need to help them comply with their obligations; and
- use the opportunities offered by technology to assist taxpayers to comply with the law and to help keep compliance costs for business down.

Information is the key to addressing the risks and maintaining the effective administration of both direct and indirect taxes. It should be accessible to SARS to the same extent as the case with more conventional means of commerce. Consultation with business is required to ensure that any measures considered necessary to deter, uncover or rectify non-compliance should have proper regard to the costs they may impose.

Confirming the integrity and authenticity of data provides a challenge in the electronic environment both for business and tax administrations. They have traditionally relied on paper-based audit trails - with its inherent look, feel and authenticity. Data held in electronic form does not at first glance provide these comforts. It can be corrupted unintentionally or otherwise manipulated before presentation.

Electronic audit methods are being developed to address these problems and to deliver the level of assurance that businesses and tax administrations need. Business will inevitably lead the way in developing secure systems. It is in their interest to maximise performance through reliable information systems whilst, at the same time, minimise the risk of fraud. Government will need to discuss its requirements with business and conclude on the adequacy of assurance for tax compliance purposes.

E-commerce is essentially a new means of trading. SARS needs to understand how it performs, the type of trade attracted to it and the ambit of activity. While the reasons for non-compliance will not be new, there will however be lessons to be learnt on the specific methodologies in use.

4.3 Use of Tax Havens

Government is adopting legislation to prevent companies from avoiding tax by diverting profits to controlled foreign companies (CFCs). A CFC is a company that is resident in a low-tax territory and controlled from South Africa.

There are substantial similarities between the techniques used to commit tax crimes and those used to launder the proceeds of other crimes. The use of artificial arrangements and offshore financial centres is common to both money laundering and tax evasion, and various regulatory systems have been designed to facilitate the flow of information between tax and anti-money laundering authorities at the national level.

The most widely disseminated form of information exchange used in the past was through clauses included in the broad treaties to avoid international double taxation. At a very early stage, the agreements and model agreements on the subject included specific clauses regarding the exchange of information, initially for the exclusive application of the agreement itself and, progressively, expanding such purpose to also consider the struggle against tax evasion.

The international exchange of tax information is a key factor, acquiring ever greater importance so that the tax administration may effectively control compliance with tax obligations and, accordingly, ensure an equitable application of taxes in an international scenario.

Information exchange at the international level may take place informally, that is, without there being any conventional commitment and, merely as a result of an attitude of courtesy or solidarity among countries. However, no matter how useful it may be, this form of exchange faces such inconveniences as insufficient juridical support, the fact that it is sporadic, inarticulate and subject to all internal legal limitations of the informing country and its willingness as regards timeliness, extension and the way the information will be provided. In view of such circumstances, currently it is recognised that there is a need to enter into international agreements that would allow the contracting States access to information that could otherwise not be obtained through means and sources available internally. At present, South Africa has 57 fully ratified treaties, 9 comprehensive treaties and 3 sea and air treaties in place. Negotiations are currently underway to expand the number of treaties by a further 22.

A Large Business Centre (LBC) was launched in September 2004 as part of the overall strategy to become more taxpayer- and trader-oriented. The LBC was designed to provide a one-stop facility to meet the needs of an important group of taxpayers. Large business is a distinct community with sophisticated and wide-ranging tax issues, and the complexities of these issues are increasing with the advent of new

technologies and globalisation. This has created the need for tax technical integrity, industrial specialisation and relationship building.

4.4 Money Laundering

Money laundering is the movement of criminally-derived funds for the purpose of concealing the true source, ownership, or use of the funds. Laundering is a necessity for any profit-generating criminal activity. Without the ability to launder their illicit proceeds, criminals fail because money sustains them, motivates them, and gives them power. Narcotics traffickers, perpetrators of financial fraud, organized crime groups and others invest considerable effort into laundering their illicit proceeds. Weak financial regulatory systems, lax enforcement, and corruption are key factors that make certain jurisdictions particularly attractive for laundering illicit proceeds by international drug trafficking and other criminal organizations, by terrorist groups financing their activities, and even by states undertaking financial transactions to evade international sanctions to acquire various technologies and components.

The global nature of the money laundering problem is clear. The world's financial markets are becoming increasingly intertwined, and free trade agreements and customs unions are increasing the movement of goods and people while blurring traditional borders. These new global systems, fuelled by technology, also allow criminals and their money to move easily from one jurisdiction to another, as they seek less regulated areas to hide.

The international community is responding: trans-governmental groups composed of financial, regulatory and judiciary specialists are working in a variety of ways to share information and expertise to fight money laundering and other crimes. Although they act internationally, they do so in their own national interest to improve enforcement of domestic laws and regulations, and to protect their financial systems from criminal abuse. Formidable challenges are posed by bank secrecy havens, alternative remittance systems, the development of new payment technologies, and the continuing evolution of the financial services industry. All nations must join the international community, working together to insure the stability and integrity of our financial systems, our economies and our governments.

South Africa has also adopted money laundering laws to help it comply with its international obligations to fight organised crime and terrorism. The latest and most comprehensive legislation detailing money

laundering controls is the Financial Intelligence Centre Act (FICA), the focus of which is on control requirements.

FICA creates money laundering control obligations for banks and other institutions and professionals, such as estate agents, brokers, attorneys and insurance companies.

Customer identification is therefore a crucial element of any effective money laundering control system. Reasonable measures have been implemented to identify the customers and to prevent criminals from using false or stolen identities to gain access to services.

4.5 Tax Professionals

The professional integrity and expertise of tax professionals and advisors also impact upon the compliance climate in South Africa. Rocked by the recent global scandals relating to accounting misrepresentation and fraud, the accounting profession needs urgent intervention to enhance its credibility. As many tax professionals come from this environment, this also impacts on the level and willingness to voluntarily comply with tax and customs legislation. Furthermore, because of the complexity of the tax environment and degree of literacy required, the opportunities for increased business make this a prime area for the proliferation of 'quasi' professionals who are not regulated. These factors create a tax-paying environment that is rife with aggressive tax planning schemes and outright evasion (underreporting of income and overstatement of deductions). "Facilitators of revenue-related crimes" (e.g. lawyers, accountants, financial advisors, and consultants) have managed to create a base for their service to non-compliant taxpayers whereby they assist them to actually evade taxes or duties.

SARS uses intelligence from compliance activities to ensure that a particular tax practitioner is not encouraging or facilitating taxpayer non-compliance. Tax practitioners are monitored for compliance with their own tax obligations, including filing of tax returns and payment of tax debts. Where there is evidence that tax practitioners are encouraging or facilitating non-compliance or have poor performance in their own tax compliance, they are investigated and, where appropriate, the matter referred to the relevant professional society or the practitioner is prosecuted.

4.6 Amnesty

Exchange control and tax amnesty

According to the Minister of Finance in his National Budget Speech of 15th February 2006, a total of 42 672 applications for amnesty have been dealt with, and a total of R68,6 billion in foreign assets have been disclosed. The regularisation of the foreign asset holdings and tax obligations of the vast majority of applicants means that they can now manage their financial affairs without fear of criminal or civil prosecution. It also raises the declared income tax base by some R1,4 billion, and contributes to the statistical records of the Revenue Service and the Reserve Bank. The R2,9 billion in revenue raised through amnesty levies will be assigned to joint public-private partnership investments in community infrastructure and business development in low-income neighbourhoods.

Small Business Amnesty

Small businesses play a vital role in stimulating economic activity, job creation, poverty alleviation and the general upliftment of living standards. Many small businesses operated informally, were historically marginalized and were excluded from the economic mainstream, thus remaining outside of the tax system. These small businesses are now keen to regularize their tax affairs but their past non-compliance and the resultant potential tax liabilities, penalties and interest remains an obstacle. Recently, the exchange control and tax amnesty catered for the regularization of the more sophisticated and affluent taxpayer. There has been criticism that no similar opportunity has been made available for small businesses.

SARS efforts to broaden the tax-base and “walkabouts” in informal business areas have shown that numerous small businesses, though not registered, would like the opportunity for regularization without fear of tax liabilities arising from past non-compliance. Bringing people into the tax net is not always about immediate gains – it is also about future contributions and general improvement in the culture of compliance. This amnesty therefore enables both compliance and regularization. As businesses grow, they are able to see the benefits of moving into the formal economy. One part of this growth is about positively changing their relationship with government, as well as SARS as a revenue

administration. It will also eliminate any uncertainties in respect of taxation that may exist among partially-compliant small businesses.

4.7 Sources of information within South Africa

In order for SARS to effectively and efficiently carry out its mandate to the South African nation it is essential that relationships are developed in order to obtain and share information that supports its mandate to maximize its return on investment. To do this effectively, information sharing is crucial to the whole process. Working together and sharing information with other agencies and reliance on third-party co-operation will all assist in realising the mandate of SARS.

The following few examples will show how the above operates in practice:

- information gathered from Government Departments, for example the Department of Environmental Affairs and Tourism can assist SARS in evaluating and verifying whether total income or turnover of a particular taxpayer has been disclosed. Crucial information such as fishing quotas can be independently used in support of our case;
- independent opinions expressed by Public Accountants & Auditors also assist SARS in evaluating the risk of non-compliance by Taxpayers. Usually, a negative report will indicate that a risk may exist that a certain taxpayer is not complying. Relying on these professional reports and opinions is assisting SARS in its efforts to improve voluntary tax compliance. Accreditation of accountants for e-filing is another example of this type of relationship;
- relationships and information sharing with Trade Organisations, Local Authorities etc. assist SARS in obtaining information that may be generic to a large group of individuals or businesses and this can lead to a further broadening of the Tax base in registering those people for Vat, Income Tax and other taxes. This also may bring on board role players in the informal sector of the economy in the long run;
- government Agencies sharing information with SARS may result in additional revenue collections as income earned from an illegal source is still subject to Income Tax. Information to assist with anti - drug and smuggling campaigns can be shared with SARS by Law Enforcement Agencies;

- in order to complete the circle of compliance from the time an assessment has been raised until such time the book debt has been finally paid there can be various role players involved. The process of raising additional revenue for the state is only complete once the debt so created has been fully paid;
- in order to facilitate the effective collection of such debt, the Master of the Supreme Court, the Deeds Office, Executors of deceased Estates and Liquidators of Corporations and Companies all play an important role. The Credit Bureau is another source of information as to the creditworthiness of taxpayers. The Department of Home Affairs can also assist with the follow up of taxpayers especially where they are leaving or have left the RSA;
- Public Corporations, where major groups of individuals have assets, can be approach to support SARS in the collection process indirectly. An example is the Demutualization of Long Term Insurance Companies;
- Professional and Industrial Bodies can be a reliable source of information as certain professional occupations are subject to registration by law. Tax base broadening, compliance of members of such associations as well as the collections process can be enhanced by these sources; and
- information sharing within SARS between the Customs and Revenue arms can lead to increased compliance and improved revenue collections. Items of particular interest are Vat and the value of trading stock from an Income Tax perspective.

The above outlines but a few examples of reliable and accurate sources of information that can play a pivotal role in combating tax evasion. The dynamics of an integrated information network is the ideal in order to maximise revenue collection and combat tax evasion.

5. INTERNAL ENVIRONMENT

5.1 Background

According to Thomson and Strickland (2001: 129), an organisation's value chain identifies the primary activities that create value for customers. Disaggregating an organisation's operations into strategically relevant activities and business processes exposes the major elements of the company's cost structure and determines its competitive advantage.

An organisation's value chain and the manner in which it performs each activity reflects that evolution of its own particular business and internal operations, its strategy, the approaches it is used to execute that strategy, and the underlying economics of the activities themselves.

5.2 Processes

It is imperative to first analyse the value chain in order to determine how the organisation can become more effective and efficient. It is essential that SARS perform its value chain activities in ways that give the administration the capability to outmatch its rivals. This will lead to a competitive advantage for SARS.

Multiple tax types and product silos that do not communicate well with each other: in one way or another tax types are interlinked and can show up other areas of non-compliance. It is essential that the processes are interlinked where there are interdependencies between these silos. An example of this is a taxpayer that is registered for VAT but not for Income tax. This should not (and will not) continue if an integrated system is used.

Duplicated and disconnected business processes and IT systems: the core operational processes should be simplified by utilising the appropriate technology. SARS is developing a systems integration plan to ensure stability and provide the necessary infrastructure that will create a more effective and efficient operation.

Benefits of an integrated approach include the following:

- the customer-centric approach ensures an integrated service delivered with regard to all revenue products i.e. a "total business-solution";
- customer services of high quality form an integral part of the entire revenue product package and processes are holistically seen i.e. a "single view of SARS by the customer";
- due to the fact that the entire process is integrated, quality controls at all stages of the process will of necessity take place and are included in the manner in which the processes flow;
- performance of SARS officials, during all stages of the process, will be measurable;

- the processes will not be time-bound, as the performance thereof will not be bound to office hours and information can be received via various mediums and from various sources;
- the option/possibility of outsourcing certain parts of the processes can be investigated and/or considered;
- the processes relating to the various revenue products will be integrated, and compatible formats can/should be developed to ensure uniformity throughout; and
- quality control, service and engagement become inherent parts of each specific process and measurable in terms of each output and product for each process.

If SARS truly wants to aspire towards its strategic intent, it is essential that the value chain be analysed in terms of efficiency and effectiveness gains with the view of the taxpayer in mind. There are many areas of overlap between these value chain activities which lead to potential synergies being created once re-designed.

5.3 Technology

Systems do not permit a single view of the taxpayer across tax types: as the various tax systems are not integrated, it is currently not possible to have a single view of the taxpayer. The Income Tax, VAT, Customs, Pay As You Earn (PAYE) and other systems are stand alone systems and are not integrated in any manner. This has huge disadvantages as the service provided to the taxpayer suffers. The taxpayer has more than one registration number and has to contact different offices to direct queries relating to the various tax types.

Outdated information technology systems that do not compliment each other: synergies between the systems are absent. An example could be someone who is being paid a VAT refund might actually owe SARS money for an Income Tax assessment. The money will be paid out in any event as the systems do not speak to each other.

The use of Information Technology has brought about a revolution in the manner in which business operations are carried out throughout the world. More and more operations are being carried out 'on-line', reducing the time taken and taking the world towards 'paperless' operations. Thus the use of 'Electronic Data Interchange'(EDI) has come to be accepted widely as the means of interface between business partners as also Government agencies.

Encourage the automation of all processing activities: a substantial percentage of human resources are also dedicated to this task that could probably be more productively used in compliance and taxpayer services initiatives. Most of this processing is formulaic and amenable to automation. Add sufficient value, give the system a user-friendly aspect, provide plenty of hyperlinked online help, make kiosks available for taxpayers who don't have network access, and establish an intelligent well designed front-end for taxpayer data entry, feedback and interactivity and much of the processing workload will disappear.

Encourage real-time rather than batched information processing: customer service will be regarded as a more user-friendly process if taxpayer information can be checked and validated against other sources and assessments or bills are received in real time. Real time correlation between taxpayer information, and information provided by employers, other traders and enterprises up and down the transaction trail should also be possible.

Integrate information technology systems: the next generation Business to Business (B2B), Business to Government (B2G), Government to Government (G2G), Business to Client (B2C) and Government to Client (G2C) interactions will require that SARS systems are connected in real time, and can exchange and process information from each other relatively seamlessly before a third party is brought into the equation. The ideal would be to integrate all of the above under a single automated real-time infrastructure.

Design SARS client systems and business processes effectively for the new environment: at present, systems mirror their non-electronic counterparts, rather than capitalise on the advantage of the new environment. Electronic forms reflect their paper counterparts item for item and clients are requested to provide the same information in any number of different forms that may be required. If the systems are integrated, this should not occur. New business models, forms, customer relationship management techniques and client interaction models need to evolve if networks are used to their full potential.

Tailor the electronic form to the taxpayer client: most electronic forms are mirrors of their generic paper counterparts. The majority of advantages of electronic forms are overlooked. It should be possible for the taxpayer to log onto the related SARS system, enter the file number or other identifier, and have a return or e-form constructed immediately-that is, a form which is consistent with the entity being

lodged, the industry, the location it falls under, the income sources and deductions disclosed, and any other circumstances that are pertinent to that entity. This benefits both the taxpayer and SARS and results in relevant and timely information.

Build client relationship management systems that can automatically deal with the majority of taxpayer enquiries and contact: as much experience is available in various technical areas, thus it should be possible to build very sophisticated network-enabled databases from previous client contacts. Most of these databases, if properly assembled and indexed for search purposes, would forestall the need for many taxpayers to contact SARS in person on routine enquiries and contacts.

Encourage creative information validation and data matching: time and resources are mainly spent on collecting and processing dated information supplied by taxpayers in paper-based returns. A small proportion of information received is validated in audits against taxpayer records and records from a few third parties such as financial institutions, while a large part of the data is in need of 'cleansing'. There are a vast number of third party sources for return validation data that could be used much more effectively than by current methods. These methods rely on intrusive 'hit or miss' audit methodologies which owe their existence to 1950's accounting techniques.

Use real-time Business Intelligence systems, for risk management that continuously acquires and analyses information from a wide variety of sources: in the IT industry, these techniques are called 'data-warehousing', 'data-mining', 'customer relationship management', 'online analytical processing' and, in the networked age, are allied with 'search engines', 'bots' and 'agents' to continuously update the information. The main criticism is that of being reactive and procrastinating. Systems and information are relied upon and are constantly actioning business transactions and tax affairs and matters that occurred years before. However, SARS operations require different financial, market and industry indicators in real-time rather than relying on a database of returns that captured events long ago. There is no shortage of networked, publicly available information and data sources that can do this.

Use open rather than proprietary standards for networked client interactions: ever-growing client contact via the internet should be pursued as clients will be using of different platforms, networked devices and technologies that SARS will have no control over. Developing

solutions using open standards ensures that all of these clients will be SARS-enabled, and that SARS does not have to replicate expensive system development for each new technology and device that appears over time.

Establish network access between revenue collection agencies in different countries: previously trans-national operations were the exclusive purvey of large corporations, but in the new environment SMEs can participate in huge numbers. As has become obvious from several forums, we share many of the same strategies, problems and opportunities, and information-sharing and consultation has proved very useful.

'Big systems development is out, manageable fast incremental development is in': previously big mainframe-based processing systems were developed over a period of three or four years. In the new environment, neither the luxury of time nor money is available to do so. The client-server and peer-networked world of the internet mandates that systems be developed quickly in small incremental chunks, with added services and functionality being added in each new iteration.

Add value to clients: this is probably the most important facet of all when developing IT and particularly Web systems. Unless the IT system adds value for the client when compared with traditional ways of conducting transactions, it won't be marketable. It must be easier, faster, cheaper, more convenient, and more accessible than any other alternative.

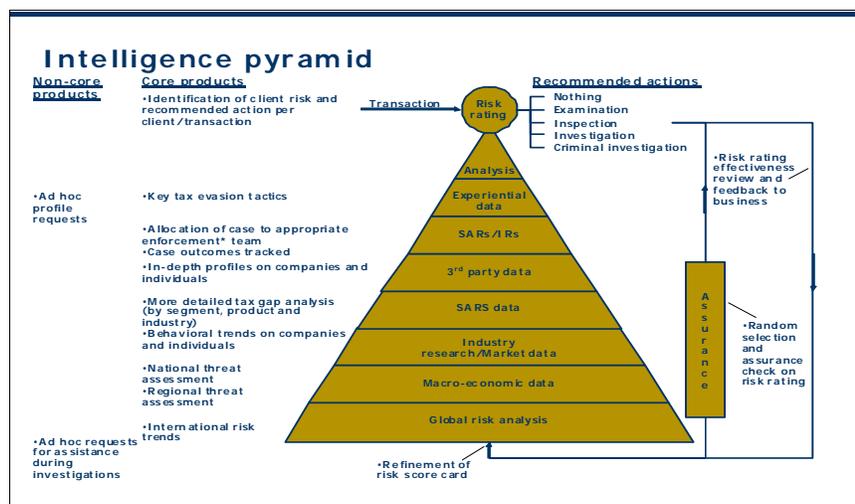
6. UTILISATION OF INFORMATION

It is essential that targeted risk knowledge is used that identifies and informs the organisation of risks at a strategic, tactical and operational level in order to achieve its objectives. The supply of strategic intelligence brings the right focus, detail, attention and understanding of the key environmental risks to the organisation as a whole. The risk capability provides tactical and operational intelligence, which informs relevant risk-related analyses for the prioritisation and increased effectiveness of compliance activities.

It is imperative that clients are evaluated holistically through an improvement of overall levels of compliance while reducing the costs of compliance to business. SARS should place an emphasis on critical

processes where the customer meets the revenue service, such as registration, receipt of payments, filing and assessing of returns. Good service and quality within these initial processes must balance stringent enforcement actions.

Figure 6.1: Risk Model



Source: SARS Intranet

This implies that Risk provides a supply of intelligence through the analysis of data and relevant information according to the requirements of the internal customers. The information processing capability will sort, analyse and refine raw data to prevent loss of valuable core activity time that currently is used to perform this function. It will provide timely and relevant knowledge to specific entities of the organisation. The intelligence will highlight external risks to SARS and trigger specific actions to mitigate non-compliance. It will provide an analysis of the taxpayer archetype in order to identify behavioural and market related trends that may increase the risk of non-compliance. In consultation with the other elements to continuously monitor changes in the environment that may pose a threat to the organisation and hinder the efforts of achieving SARS' strategic objectives. It monitors the environment to provide the organisation with the knowledge it needs to improve business processes, to be responsive to the needs of the other capabilities. Research products will enhance the understanding of the different risks, provide an in collaboration with Risk Control,

Co-ordination and Framework & Internal Audit, to have developed and implemented a mechanism (framework, processes and systems) which will produce risk ratings that will inform interventions for specific transactions/trends.

The compliance model promotes the use of tailored responses to different taxpayer groups based upon their behaviour, compliance risk levels and history. A key theme continues to be the improvement of overall levels of compliance while reducing the actual costs of compliance to business. The model is intrinsic to the policy, legislative and administrative processes of the tax system and the manner in which SARS interacts with its customers. Good service and quality within these initial processes must balance stringent enforcement actions.

Taxation compliance behaviour is influenced by many factors - business, industry, sociological, economic and psychological - all of which influence whether an individual chooses to meet their obligations or not. The model shows a continuum of taxpayer attitudes towards compliance. At the base of the continuum, taxpayers have the desired attitude of actually being committed to compliance. At the other extreme, taxpayers have decided to engage in evasion.

The model also summarises the different sorts of support and interventions that may be needed to provide to collect the required revenue. The model suggests that SARS has the ability to influence taxpayer behaviour through timely response and interaction.

At one end of this continuum, they foster voluntary compliance through the timely provision of useful information and efficient, client-centred services. At the other end, they undertake responsible enforcement action to deter wilful non-compliance and promote the fairness and integrity of their border control, benefits payment, and tax systems. The right mix of services and enforcement across the entire continuum allows them to maximise compliance while minimising intervention and the burden on clients to fulfil their obligations.

Enforcement actions are reliant on the optimal functioning of these critical processes and draws on a broad suite of compliance tools compared to the compliance products upon which the organisation has relied in the past.

The strategy takes cognisance of the continuum between total compliance and total non-compliance. Taxpayers should be disincentivised from moving towards total non-compliance on the continuum, and encouraged moving further on the continuum towards total compliance. Compliance functions are part of all actions performed throughout SARS, and the strategy aims to address the different stages in the “life cycle” of a taxpayer.

Case selection is predominantly risk based, but is tempered with a degree of randomness, in order to cater for the requirements. However, where dictated by business-rules and legislative requirements, there will be a full coverage of compliance actions including maintenance actions. When customers de-register for particular products or in instances where credit balances inform refunds across the revenue-types, SARS will perform quality control in every instance. Risk profiling will recommend the ideal action based on the profile.

Information technology tools can be used to assimilate the data, develop trends and identify specific risks. This can assist with targeted campaigns in order to combat tax evasion. These campaigns may vary from taxpayer education initiatives through to hardcore criminal investigations. It may be industry specific or based on a specific hypothesis of non-compliance. It is thus imperative that the correct tools are available to optimise the use of this information.

7. CHALLENGES FACED IN THE 21ST CENTURY

In many ways tax administrations in the year 2000 are doing exactly what they did in the year 1970. Only the means and medium of doing so have changed. Tax laws that are administered trail social and scientific developments by a long margin and are often nightmarish in their complexity. A tremendous portion of our resources are devoted to processing information received from taxpayers in the form of tax returns. The taxpayer provides the data in a paper return, the information is re-transcribed onto various information systems, and this information is processed in batch mode, and that generates further paper that is sent to the taxpayer.

There is a reliance on information from the taxpaying clientele which is outdated and often unreliable. A significant portion of the

resources are utilised to provide personal and person-to-person services to the taxpaying clientele. Work is concentrated at centralized offices and locations. Heavy reliance is placed on increasingly outdated accounting conventions and often-artificial geographical and jurisdictional limitations. Natural resources for example attract no value on the conventional company balance sheet, but most governments are attempting to conserve same. Most income taxes reward expenditure and discourage frugality and saving. Our tax regimes encourage personal, corporate and national debt, whilst our Treasuries bemoan the lack of national savings and funds. We encourage the artifice of trans-national corporate entities, and yet fail to associate those entities with actual productive, economic and trading activities in their supposed countries (often tax havens) of domicile. We are still coming to grips with phenomena like the multi-national corporation, profit shifting, corporate tax minimisation, tax competition and tax havens. And what had previously been the sole purvey of large corporations is now well within the capabilities of small to medium enterprises thanks to computers and the Internet. Many entities are allowed to hide behind legal and professional privilege.

We are redefining ourselves not solely as revenue collectors, but also as financial transaction monitors, economic observers and stock and financial market speculators. The major compliance problems that face us are still, broadly speaking, identity, evidence and jurisdiction although we are coming to grips with these questions in a multitude of different ways.

The information technology revolution is redefining our traditional focuses and boundaries and offering an increasing number of opportunities to expand our client services and increase our effectiveness as revenue collectors. It also offers a number of new threats to the revenue that we collect. At present we seem to be applying old business models, forms and methods to the new environment, but this will no doubt change as we refine our appreciation of electronic commerce, enterprise application integration and real-time automation, and integrate our IT systems better. Our personnel should be better educated, and far more conscious of the complexities of social, economic, technological and geo-political interactions than they have ever been. Broadly speaking they should be evolving into the valuable 'knowledge workers' we will need in the future.

We work in the context of a dynamic and changing world. Aside from the technological revolution, we also have social revolutions occurring, some due to environmental, some due to political and cultural, and others due to economic and geographical factors. With all this in mind, we must prepare ourselves for new demands and focuses in the next ten years. These will be generated by political, market, financial and economic, technological and environmental factors over which we have little control.

The next ten years offer a wealth of opportunities, in addition to the revenue threats that more often raise their head at an international level. 'Master Plans' or 'Organisational Strategies' in times of great flux such as now are probably not the most desirable alternative. More often than not such plans seem to waste away due to the exigencies of time and dynamic change which characterises the modern world. Rather, we should be making plans to become more responsive to that world and our clients. But, as a rule, bureaucracies are not good at this. We should be structuring our cultures, systems and business processes so that they are responsive and adaptable to change. We should not regard procedure, systems, law and regulation as something 'written in stone'. We should not expect our client groups to adapt to us, we should be thinking about adapting to them. We should be value adding to our clients' interactions and experiences with us.

The outstanding revenue agencies of 2010 will be those that have profited from the change. Those whose corporate culture and leadership have embraced change and the dynamics of the modern networked world.

8. WHAT DO WE INTEND TO DO

Responses to the various environmental changes will differ but a number of strategies will be useful in generating cost effective resource utilisation, more effective client service, and the reduction of compliance costs. To effectively contribute to Government's goals SARS will leverage its internal resources to instil a culture of compliance and enhancing citizen confidence in the tax and customs system. To sustain its performance while reaching higher thresholds SARS will focus on the following strategies:

- Creating a customer service culture which puts the needs of taxpayers, traders and the public first;
- A new business philosophy that defines a holistic and integrated approach to the management of people, processes, technology and organisational culture;
- Establishing an Enterprise Architecture that integrates revenue and customs where appropriate, and creates synergy between the core operating and support divisions at all levels of the organisation;
- Implementing a coherent approach to service, education and enforcement that is based on a segmentation model that assesses risk and responds to different needs and behaviour patterns among citizens;
- Integrated border management;
- Leveraging technology for electronic transactions, inspections and enforcement. Establish Accredited Client scheme to facilitate faster turn around in the Import and Export clearance process; and
- Develop Customs Transit Acquittal process to allow for greater control of goods being removed in transit and in bond.

These paradigm shifts require that SARS develops a sharper vision, a sophisticated and modern approach to work and the following portfolio of organisational capabilities that will enable us to achieve our goals. SARS will transform its culture and build organisational capabilities to:

- balance continuity (meeting targets through superior operational performance) with profound change (transformation);
- quantify the tax gap, profile and segment the tax base, and accurately predict future revenue streams;
- gather and analyse segment specific information to inform enforcement, service and education programmes;
- create a learning organisation that is equipped with knowledge management tools that create, archive and share knowledge across the organisation;
- investigate and audit to detect, measure, deter and correct areas of high risk;
- create and use meaningful information to guide executive decision making;

- develop a structured and systematic change management programme; and
- establish a strong base of people across the organisations that are passionate and enthused about serving taxpayers and stakeholders.

It is essential that SARS develops its strategies by taking the above factors into account. Should the proposed strategy be deployed, SARS will make major in-road striving towards its vision and higher purpose. It is essential that the factors impacting on SARS be analysed continually in order to ascertain the impact that they have on the current strategy. This will allow SARS to fine tune its strategy to these environmental changes.

The above risks are essentially common to the administration of tax systems throughout the world. Government recognises that a number of risks can best be addressed in co-operation with other countries. Where tax administrations have developed expertise, the aim should be to share best practice for application both domestically and internationally.

9. EXPECTED BENEFITS

SARS will be leveraging compliance and collections better by intelligently allying new technology with better administrative arrangements for collection. This will allow SARS to effectively reduce the cost of compliance dramatically. The information technology revolution will redefine traditional focuses and boundaries and offer an increasing number of opportunities to expand client services and increase effectiveness as revenue collectors. It also offers a number of new threats to the revenue collected. Personnel will be better educated, and far more conscious of the complexities of social, economic, technological and geo-political interactions than they have ever been.

The taxpayers will benefit as focus shifts from processing to compliance monitoring. This environment will be identified by improved taxpayer service that is professional and efficient and higher processing speeds that are accurate.

Resources and employees will be freed up to take a proactive role in revenue collection. They can regularly visit taxpayers and corporate clients to research their respective industries and enable early identification of new tax issues, compliance threats and opportunities for leveraging and timely client service. Servers and search engines can be used to monitor and gather data thereby regularly updating the Business Intelligence databases. Regularly meetings can be convened and forums held with different industries and taxpayer groups, to determine how best to resolve any outstanding issues. A real-time picture will develop of the economy and business environment, rather than dealing with an outdated view of it as was the case in the past.

Timely detection of a particular compliance threat and widely publicising it can become a compliance strategy that works in its own right. It also has the side effect of discouraging the migration of those compliance threats into the 'widespread tax scheme' arena. Public discussion with professional associations and other interested parties is encouraged with respect to these matters.

SARS can be a signatory to many OECD sponsored treaties and double tax agreements, and be diligent in extending agency cooperation with revenue agencies in other countries. Negotiations with various third parties, financial institutions, banks and electronic transaction facilitators will take place to ensure a high degree of cooperation and liaison between government and these sectors. These parties are efficiently and effectively used to leverage compliance freeing a large proportion of the tax base from any compliance obligations with respect to many taxes. The South African supply chains will be safe guarded which will also assist in safe guarding trade and investment potential. Emphasis will thus be placed on facilitating regional trade and economic development. Each new business process, each new IT system, each new procedure or initiative, should be subject to stringent benchmarking against the current indices, and if it fails to improve on them is abandoned in favour of other alternatives. SARS will be a "Learning Organisation". Encourage employees to train and educate themselves in an ongoing manner, to garner a wide range of experience, to do useful and creative research using the myriad of resources available to them, to investigate and report on various matters of ongoing concern. The ability to react quickly and responsively to their external environment should not be compromised

The networked age will be recognised, in which geographic boundaries have become even more intangible, they must bow to the inevitability of some multinational services being provided by others. SARS will be conscious that business competition is much more ferocious in the new environment, and that its actions, or failure to react, in given situations can often make or break a local business deal, a business, an industry sector or even an entire industry. For this reason it seeks to be a lot closer and more responsive to its client base than may have been considered proper or appropriate 10 years beforehand. In the Information Age, 'know your client' is a maxim that affects government agencies as vitally as it does their private enterprise counterparts.

10. CONCLUSION

SARS struggles with the legacy of an organisation, systems and culture that, like many South African organisations, is weak on service delivery and efficiency. In order to optimise the use of information to combat tax evasion it is essential that there is a detailed understanding of both the internal and external environment. It is evident that both internal and external sources of information should be utilised optimally in order to effectively combat tax evasion. Various initiatives have been undertaken to obtain information, understand the environment and to combat tax evasion. This includes offering tax amnesty to small business and building relationships with various bodies. Crucial to doing so are development of relationships with governmental and non-governmental agencies both locally and internationally. By adopting this approach historical factors affecting compliance levels will be addressed.

Information technology tools can be used to assimilate the data, develop trends and identify specific risks. This can assist with targeted campaigns in order to combat tax evasion. These campaigns may vary from taxpayer education initiatives through to hardcore criminal investigations. It may be industry specific or based on a specific hypothesis of non-compliance. It is thus imperative that the correct tools are available to optimise the use of this information.

The core business processes are inefficient as significant duplication exists between tax types and many of the processes are performed at sub-scale locations. The processes are not standardised across branches and as such efficiencies vary significantly between branches.

The processes are fragmented, contain too many hand-offs and too many steps. There is also no prioritisation of work, resulting in a sub-optimal allocation of time and effort to high impact areas such as audit and collections.

The changing environment creates challenges and opportunities to curb tax evasion. In order to reach the organisation's strategic intent, management has addressed these critical issues. These issues include expanded electronic services; customised approach to compliance; strengthen partnerships and co-operation; transparency, clarity and simplification and workforce development.

The strategy deployed by SARS will make major in-roads in striving towards its vision and higher purpose. It is essential that the factors impacting on SARS be reviewed continually in order to ascertain the impact that it has on the environment. This will allow SARS to fine tune its strategy to any environmental changes.

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Case study

TOPIC 2.2

ORGANIZATIONAL STRUCTURE REQUIRED IN COMBATING TAX EVASION

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CONTENTS: 1. Introduction.- 2. Role of Organizational Structure.- 2.1. Need for balance and integration..- 2.2. Need for flexibility.- 3. Organizational Structures in Tax Administrations.- 3.1. Type of tax.- 3.2. Functions.- 3.3. Type of taxpayer.- 4. Designing an Effective Organizational Structure.- 4.1. Pitfalls to be avoided.- 4.2. Suggested features for consideration.- A. An Enforcement Unit in Collections Section.- B. A Strong Audit Section.- C. A Criminal Tax Investigation Unit (CTIU).- D. Internal Audit and Internal Inspection Units.- E. The Case for Autonomy.- Conclusion.

1. INTRODUCTION

Volumes that can fill libraries have been written on the topic of Organizational Structure and Management but there is very little in the literature that focuses on the unique Organisation of the Tax Administration. In an attempt to fill this void, CIAT published an excellent

handbook in July 2000 entitled “Organisational Structure and Management of Tax Administrations.” Written by two Dutch Tax Administration officials and based on extensive research done by two international working groups, the book explores in great detail the Tax Administrations’ challenge of effectively organising its resources to meet its objective. Since time does not allow for a detailed background study of Organisational Structures, I take the liberty of highly recommending CIAT’s Handbook as priority reading for all Tax Administrators, particularly those engaged in any reform exercise.

The purpose then, of this paper is to promote an awareness of the critical role played by the Organizational Structure of the Tax Administration in fostering an integrated approach in combating tax evasion and also the need to continuously assess and adapt the structure to meet the challenges of an increasingly volatile environment.

A brief look will be taken of the role of Organisational Structure and the most common types used by Tax Administrations. This would set the framework for an appreciation of the experiences of the Trinidad and Tobago Inland Revenue Division (IRD) in making adjustments to its own internal structure in its efforts to combat Tax evasion. This will be the main focus of the paper highlighting both successes achieved and pitfalls to be avoided.

By way of conclusion we shall consider some of the desirable features of the organisational structure of a Tax Administration in the modern world that would promote an integrated approach to combating evasion.

2. ROLE OF ORGANIZATIONAL STRUCTURE

Organizational Structure is the framework established by Management within which tasks and resources can be allocated, performed and co-ordinated for the sole purpose of achieving the Organization’s core purpose. It involves:

- (a) allocating the tasks required to fulfil the objective of the organization to suitable individuals or groups;
- (b) giving each individual or group the authority and resources to perform the allocated tasks, while controlling their behaviour and use of resources in the interest of the organization as a whole;

- (c) linking individuals in an established network of relationships so that authority, responsibility and communications can be controlled;
- (d) co-ordinating the objectives and activities of the separate units so that overall aims are achieved without gaps or overlaps in the flow of work;
- (e) facilitating the flow of work, and information through the organization.

In a normal commercial enterprise all this is done to deliver a good or service in exchange for a monetary return. The Tax Administration is in the unenviable position of having to take money from citizens without directly delivering a good or service. This can be met with much resistance and administrators must perform a balancing act of encouraging citizens to meet their obligations voluntarily and forcing them to do so when that fails.

2.1. Need for Balance and Integration

Jean Baptiste Colbert, a respected figure in French Public Finance, likened the art of taxation to the art of skinning a goose; in both cases one tries to obtain the maximum amount of feathers with the least amount of yelling and cackling possible.

Designing an Organizational Structure to achieve this goal is a hard, long, tedious process involving much trial and error and requiring great skill and patience. The frustrations may well tempt us to just let the geese make as much noise as they want – this may in fact be an effective method in dissuading would-be evaders. But we are cautioned against such an approach by Fernando Sainz de Bujanda who opined that in our times we “... must endeavour to find a point of equilibrium between the tax sovereignty of the State and the sacred rights of the human being ...” A proper balance must be struck between preventative and coercive aspects of promoting compliance and resources must be appropriately allocated as circumstances dictate.

As societies have developed, a marked move from a purely enforcement approach to a more cultured Voluntary Compliance approach is noticeable among Tax Administrations. Many resources are being allocated towards this effort of promoting compliance; in fact voluntary compliance has become the mantra of Tax Administrations. However, as desirable and effective as Voluntary Compliance may be, resources must also be allocated to detection and effective punishment

of non-compliance, as there would always be an element of taxpayers who would seek to evade meeting their fair share of the tax burden.

This is essential, both in the interest of equity and also because any perception by compliant taxpayers of inequity in the system could negatively impact on any gains that might have been made through the promotion of voluntary compliance. Mr. Salvador Ruiz Gallad of the Spanish State Agency of Tax Administration in his paper on “Actions to Promote the acceptance of taxes in a Democratic Society” said that “... the traditional task of the Tax Administration is the detection and pursuit of non-compliance and evasion ... if adequate tools are not available for the pursuit and punishment of fraud and evasion, it will be useless to bet on voluntary compliance due the economic incentive to evasion, as well as the demoralising effect and unfairness which complying taxpayers will feel when they find that they must bear the consequences of the lack of solidarity of other citizens and must pay for what others do not.” The law provides the coercive measures that may be used to enforce compliance but the organizational structure provides the infrastructure to apply these measures.

A well organized Structure must also provide for an integrated approach to the entire process of the Organization. Through an integrated approach each function in the process is supported or weakened by the other functions. For example, selection of taxpayers for audit or collection activity can be adversely affected by deficiencies in the Registration process such as issuing of duplicate or multiple identification numbers.

2.2 Need for Flexibility

With the rapid strides made by economic and technological developments, the world has become a global village and the methods of doing business have changed drastically. Organizations must adapt themselves to meet these changes or face the risk of becoming ineffective or even obsolete. There is need to move away from the classical approach of Maslow and Taylor that may promote more stable but bureaucratic and rigid structures to the modern approaches that favour flatter and more flexible structures to meet the challenges of an increasingly volatile environment. The experience of many Reform programs, certainly the experience of the IRD, has been that effective change could not be implemented without changes to the internal structure.

New procedures cannot be successfully implemented in structures rooted in history and bureaucracy and that have evolved on a piecemeal patchwork basis. There must be a holistic approach to designing the structure. This requires first an understanding of the existing structure, a clear vision of the administration's objectives, identification of the obstacles preventing achievement of the objectives, determination of the organizational changes needed, and proper planning for a seamless transition.

Let us now briefly look at the structures in most common use by Tax Administrations and consider their advantages and disadvantages. This would help us reflect upon the structures within which we each presently operate and also serve to set the framework for an appreciation of the experiences of the IRD in adjusting its structure to combat evasion.

3. ORGANIZATIONAL STRUCTURES IN TAX ADMINISTRATIONS

There are a variety of approaches a Tax Administration can take to organize its resources to best achieve its core purpose – which is, the correct assessment and collection of all taxes under its jurisdiction legally due to the State by taxpayers on a timely basis -. Basically there are three forms of Organisational Structures commonly used by Tax Administrations and they are based on: *Type of Tax*; *Functions*; and *Type of Taxpayer*.

Most administrations follow one or some combination of these three models.

3.1 Type of Tax

Since the advent of Taxation this is one of the most common organizational structures used by Tax Administrations. Basically, each type of Tax (Income, Corporation, VAT ...) is administered by a separate department with each department performing basically all the functions required to administer the Tax for which it is responsible. Many modern Administrations have their genesis in this type of model. An example of this is the IRD which was so structured prior to the 1970's, when it was changed to the functional model following the example of the U.S.A, which itself changed from the type of Tax to the Functional Model in the early 1950's.

In a broader sense many countries administer their taxes on a Type of Tax Organizational Structure where the Inland Revenue Department is responsible for direct taxes and the Customs and Excise Department responsible for indirect taxes. These two departments, Customs and Inland Revenue, operate independently of each other with each having its own management structure, staff and offices to administer the tax under its jurisdiction – each carrying out the full range of administrative functions (assess, collect, audit etc.). Good examples of this are the United Kingdom and Trinidad and Tobago.

The main advantage of this system is that there is clear accountability and control for each tax. The head of each tax department is answerable for the administration of the tax under his control and has authority over a complete administrative office which allows for quick responses to any problems or change in circumstances that may arise.

However, the administrative costs of operating such a system are very high since there is a duplication of administrative function in each tax department. Each department has its own computer system, own collections and processing unit, own audit units etc. Such a system is also not amenable to joint compliance programs such as simultaneous audits of Income and VAT returns. There are also separate tax offices in each location which adds to the cost of operations with duplications in real estate and machinery as well as personnel.

The cost of compliance to the taxpayer is also high since the taxpayer with multiple tax liabilities must of necessity deal with more than one tax department - each with its own offices and administration.

The disadvantages of the tax based organizational structure far outweigh its advantages and many countries have opted for one of the two more common alternatives – the Functional Type organisation and the Taxpayer Type organization.

3.2. Function

The key characteristic of this type of structure is that staff is grouped around the organizations essential functions or work processes. So a separate section is established to perform each major function – processing of returns and payments, auditing, objections, collections etc. –. Each functional section is headed by a manager who is in a direct line of authority to the Administrations Head. Many Tax Administrations are organized along this line.

A major benefit of the Functional Organisational Structure is that it facilitates Taxpayers' compliance by establishing one department to address and be accountable for each major form of non-compliance for all taxes. So Audit addresses under-reporting, Collections addresses arrears of payments and Processing addresses stop-filers for all types of tax. Each manager is responsible for managing a specific administrative function for all taxes rather than manage all functions for a single type of tax.

Under this structure the Administration can then easily conduct comprehensive compliance programs such as joint audits of Income Tax and VAT and collection of all types of tax arrears by one Collection Section.

Another advantage is that it reduces administrative costs since administrative functions are not duplicated as under a Tax Type based organizational structure – e.g. all tax returns and payments are processed in a single section rather than by multiple tax type departments; all collections are done by one Collection Section in the department and by one officer collecting arrears for all taxes as opposed to one collecting VAT and another collecting Income Tax. It also allows the Tax Administration to economise on skilled managers and staff – e.g. one IT manager can head the organization's Computer Systems Section rather than a separate one for each Tax Type.

Yet another benefit of the functional Organizational Structure is that it reduces the scope for collusion between taxpayers and tax officials thereby enhancing the integrity of the system – the auditor raising an assessment is separate and distinct from the collector. The model also provides for an element of self-checking whereby the work performed by one function serves as a control on that of another function thereby reducing the opportunities for collusion or at least increasing the risk of detection. The model also provides for an independent Internal Audit Section that monitors all the functional sections thereby having the ability to follow the audit trail from start to finish and cover all taxes simultaneously.

The main weakness of the functional organization is that it provides poor service to the taxpayers. This arises as each functional section focuses on their aspect of the Taxpayers' affairs often in isolation from activities carried out by other functional sections. The problem is compounded by a tendency for the functional sections to operate disintegrated computer systems which complicates exchange of

information. Thus, the Administration performs poorly in dealing with issues that cut across functional boundaries. For example, Data Processing may be more geared towards processing returns and neglect the updating of payments to taxpayers' accounts thereby affecting the efficiency of the Collection Section.

Most Administrations of developed countries operate on the functional model with a move in recent times to combine it with the Type of Taxpayer model e.g. a Large Case Unit.

3.3 Type of Taxpayer

A third type of Organization Structure is the Type of Taxpayer or 'client based' model where staff are assigned to units that focus on specific groups of taxpayers usually based on taxpayers' scale of operations (large Taxpayers), form of ownership (partnerships) or economic sector (petroleum). This model primarily serves to ensure tight monitoring of those taxpayers who account for the largest proportion of tax collection, providing them with more efficient personalized services and ensuring collection of the large Tax Liabilities.

One advantage of this Organizational Structure is that it strengthens the responsibility and accountability for achieving organizational outcomes. Under a functional organizational structure, management cannot easily assign responsibility for achieving the Administrations ultimate objective because the objective cuts across the boundaries of several functional departments. A Type of Taxpayer based organizational structure however, establishes a direct link between each section and its assigned set of taxpayers. This makes it easier to assess the performance of each section in achieving the objectives of the organization.

Another advantage is that resources can be better allocated to meet the risks posed to tax collection by different groups of taxpayers. Consequently, client based organizational structures commonly include a "large taxpayer" section to closely monitor the relatively small number of taxpayers who collectively account for the largest proportion of a country's tax collection.

Like the other models, the Type of Taxpayer or client based organizational structure also has disadvantages. It may lead to an increase in Administrative costs by duplicating common functions across sections to process tax returns or pursue arrears.

Another disadvantage is that the client based Organizational Structure depends largely on the availability of skilled managers and technical staff to redesign the administrations enforcement and educational programs so that they are better tailored to the circumstances of each group of taxpayers. High calibre staff is frequently one of the scarcest resources to many tax administrations. Without sufficient numbers of highly skilled managers, the introduction of a client based structure, in itself, may not lead to any significant improvement in the compliance of Taxpayers and may even result in a decline in compliance as the small numbers of skilled staff become too thinly stretched across the organization.

The structure may also lead to an inconsistent application of the tax laws across different groups of Taxpayers or may make the organization vulnerable to corruption as the internal self-checking under a functional structure is not there. For example, a large Taxpayer unit may be responsible for raising assessments and hearing objections to these very objections. This may undermine Taxpayers confidence in the fairness of the tax system and lead to lower levels of tax compliance.

The Taxpayer Type of Organisation is an appropriate model where sectors of the economy play a critical role in contributing to the revenue of the Government. With proper planning it can be successfully implemented in conjunction with the functional model. Many countries now are opting for this type of arrangement.

4. DESIGNING AN EFFECTIVE ORGANIZATIONAL STRUCTURE

Which of these structures or combination of them would be the most effective in promoting compliance/combating evasion? Contingency theory suggests that there is no universally best organizational structure but that the best structure for a given organization will depend on contingent factors in the environment in which it operates. Structures must be tailored to the culture of the society and must take into account the economic, social, cultural, political, geographic and demographic state of the country. The worse mistake an administration can make is to take the structure and features of another country and apply it wholesale to their own country. Based on the experiences of the IRD I wish to now highlight some pitfalls to be avoided and some suggested features for consideration in designing an Organisational Structure.

4.1 Pitfalls to Be Avoided

Since the early 1970's the IRD moved from a Tax Type Organizational Structure to a Functional Structure with separate and distinct sections responsible for Processing, Audit, Objections, Collections. Since then the economy has grown tremendously manifesting itself in increased volume of work and the introduction of many new taxes. The Tax Administration's response to this was piece-meal and disjointed, resulting in breaches to the established functional structure, inadequate staffing and redundancy in operations.

(a) Joining as Opposed to Integrating Two Structural Models – The VAT Experience

In 1990 with the introduction of a new tax -VAT- there was a breach of this model with the imposition of a semi autonomous VAT Administration within and running side by side with the mainstream functional model. This crude combination of the Functional and Tax Type Models led to inefficiencies in the cost of operations and did not foster the sharing of information through integration to combat evasion. Whereas there were separate Commissioners responsible for the management of Processing and Collections, Audit and Objections of all taxes, with the introduction of VAT an additional Commissioner was introduced with responsibility for all the functions of that tax – only the Personnel and Accounting aspects of the organisation were common to both administrations. The VAT Commissioner was responsible for the Processing of Returns and Payments of only VAT with its own Computer System; VAT had its own staff of collectors to collect only VAT while there were other collectors collecting all other taxes; its own audit staff to audit only VAT returns, its own Objections Unit, Registration Unit and even its own Cashiers Unit to collect only VAT payments side by side with the mainstream organisation's cashiers collecting all other taxes.

This was a duplication of functions that already existed within the Functional Structure of the IRD administering Income, Corporation; Petroleum and other taxes. Apart from the increased administrative costs to the government, the arrangement was also more costly and burdensome to the Taxpayers who had to interact with two different administrations at different locations to register for Income Tax and VAT; to pay their VAT and other taxes; appeal against assessments; (and in the case of VAT, appeal to the very commissioner who raised

the assessment) and were subjected to multiple visits by both audit and collections officers each dealing with different taxes. Also the structure did not contribute to combating evasion effectively, since two separate non-integrated Administrations did not facilitate the sharing of information to obtain a total picture of a Taxpayers compliance record.

In 2001 the IRD established a Reform Unit to improve efficiency and effectiveness of operations and one of the first projects undertaken was to restructure the organization to integrate the VAT operations with the mainstream Organization along functional lines. The main objectives were to reduce costs of operations, offer a better service to the taxpaying public and be more effective in identifying and combating evasion. An Integrated Processing and Management Information System (ITPS) is now being implemented that would facilitate the monitoring of all the tax activities of a Taxpayer. Integration with the Audit function would facilitate joint total audits (i.e. for all taxes) by one auditor or team of auditors. Integration with the Collections and Processing Section would provide the Tax Collector with a total picture of the Taxpayer with respect to his filing and payments compliance in respect of **ALL** taxes.

Progress of the Project has been slow with one of the main hurdles being resistance to change. But this is a critical area of restructuring and must be handled delicately. Care also has to be taken to ensure that in the integration there is no overlapping of duties and more importantly that no tasks are left out.

I have gone to great lengths on this experience to sensitise you to the danger of changing the organizational structure (in this case to administer a new tax) without proper integration. It could lead to greater inefficiencies and the process of repair is long, tedious and frustrating. At times we have been tempted to drop the project and just let the goose be.

(b) Addition to the Organisation without Adequate Staffing – Large Case Unit

With the turn of the century and an increase in oil and gas prices and production, the economy of Trinidad and Tobago began to grow at a tremendous pace. With the greater proportion of taxes coming from a small sector of the economy (petroleum and manufacturing) and the increasing difficulty in controlling compliance in such hard to tax areas like Transfer Pricing within Multi National Corporations and local

conglomerates, the need for a Special Unit to monitor the taxpayers in this sector was recognized. Such a Unit would not only offer a better personalized service to these 'prized clients' but also exercise stricter control over them ensuring total compliance in terms of timely filing of returns and payments and auditing for under-reporting of taxable income.

This was another major project of the Reform Unit and again involved the restructuring of the internal organization. With the lessons learned from the VAT experience, we were able to design, build and implement the Petroleum and Large Taxpayers Business Unit (PLTBU) in 2003 as part of the established Audit Section and fully integrated into the existing functional model. Though structured on the lines of the Taxpayer Type Model the unit was successfully adapted to work within and as part of the established Functional Model, thereby enjoying the benefits of both Structural Types.

The main focus of this Unit is on the audit of approximately three hundred large companies, (including all petroleum producing companies, commercial banks, and insurance companies) verifying the taxable income declared. There have been significant increases in adjustments to tax liabilities and collections over the period 2002 to 2005. An International Tax Group within the Unit was also enhanced in 2004 to monitor the Withholding tax payments requirements. This has proven to be very successful with assessments in this area increasing by over 50% in 2005 over 2004 and a continuing trend in 2006 to date. The reallocation of resources through the structural adjustment has proven to be very successful in terms of promoting compliance both through voluntary and coercive means.

The filing of Returns and payments aspect of Compliance remained under the Processing and Collections Functional Areas of the Administrations Organizational Structure. However, the PLTBU also plays a close monitoring role over these areas quickly bringing any discrepancies to the attention of the taxpayer to voluntarily correct and alerting the Processing and Collections functional areas for compliance action where the taxpayer is non-responsive. Close collaboration between the functional areas of operations (which would be further enhanced with the implementation of the ITPS) ensures there is no duplication of efforts. There was a 23% reduction in stop filers in 2004 and a further 14% reduction in 2005. Objections to assessments are also to be under the Objections Functional arm of the Organization – this is in progress of being implemented.

The entire process of implementing this Taxpayer Type model into the Functional Model has been fairly smooth and successful. Yet there was one major oversight which adversely affected the rest of the Organization. Drawing persons from existing Sections to staff the PLTBU, reduced the effectiveness of those sections, particularly VAT. Both Income/Corporation Tax (individuals and small businesses) and VAT audit activity have been severely strained over the last few years and the IRD is now in the process of recruiting additional staff to address this situation.

I point out the staffing error made so that administrations would be aware that it is a key element to consider in any reorganization exercise. The tendency is to think that restructuring leads to greater efficiencies which automatically translate into reducing or at least maintaining present staff levels. This is not necessarily true and proper planning is essential in determining the cost/benefit ratio to the organisation in its totality and not just in respect of one section.

(c) Introduction of a Unit that Duplicates & Cuts across all other Functional Line

In an effort to improve compliance, the IRD introduced a Tax Surveillance Unit in the late 1990's. This was intended to be an enhancement to the existing structure to boost compliance by non-filers, stop-filers and delinquent Taxpayers. Following the strict Functional Model Type of Organizational Structure, the information gathered by this Unit should have been simply channelled through the relevant Functional sections of the organization namely Processing or Collections triggering the necessary compliance activities.

However, the Unit quickly evolved into an additional separate Compliance Unit performing all the functions of processing, auditing and collecting –a duplication of functions already performed by the Administration–. Like the VAT experience this led to inefficiencies in cost of operations by cutting across and intruding on already existing functional lines of operations. Administrators should guard against adding new units to the Organization when simple enhancement of existing Units may be all that is required.

4.2 Suggested Features for Consideration

In pursuit of its core purpose, the IRD has opted to maintain a basic Functional model with a combination of the Type of Taxpayer model for large cases. The IRD is responsible for the collection of 75+% of the National budget; it is of paramount importance therefore, that the Administration be efficient and effective in its operations to ensure government has the necessary financial resources to carry out its social programs. The Administration must ensure that all citizens meet their fair share of the tax burden. Though much attention is given to promoting voluntary compliance through improved customer service activities, it is recognized that resources must also be dedicated to the detection, controlling and punishment of evasion. In this regard the IRD has allocated resources to the following units to combat evasion:

A. An Enforcement Unit in Collections Section

In pursuit of arrears the structure provides for Taxpayers to settle their liabilities amicably with least cost to both Taxpayer and Administration. Delinquent Taxpayers (in arrears) are first contacted by the Office Collections Unit to make good on their arrears. Failure to comply results in a visit by the Field Collections Unit; failure to comply with this unit results in the case being forwarded to the Enforcement Unit which then takes more forceful actions to collect, such as Garnishing the sources of income to the Taxpayer (e.g. banks, debtors, contracts) and seizure and sale of property.

These actions are heavily publicized to send a clear message to would-be evaders of the strength of the IRD to enforce collections. An average of 175 garnishee orders have been issued over the last three years and the budgeted collections by this Unit has always been exceeded, over the last three years.

B. A Strong Audit Section

Studies have indicated that there is a positive relationship between the probability of being audited and Taxpayers compliance. Even with efficient registration and detection of stop-filers and delinquent payers, the overall effectiveness of the compliance effort of the Administration will be low if auditing (intelligence and investigation) is not effective in discouraging evasion.

The resources assigned to the Audit function affect the ability to enforce compliance with respect to underreporting. Unfortunately, it appears that in many countries auditing has decreased in importance relative to the other functions. This is reflected in the reduction of auditing staff and audits conducted. On average auditors account for 10-15% of the Administration's staff in most countries when it should be in the vicinity of 25%. The IRD places a heavy emphasis on auditing and in the new organizational structure to which we are moving, two Commissioners will be assigned to the Audit function. Presently the audit function, particularly for VAT, is severely hampered by a shortage of technical officers most of whom were absorbed by the Large Case Unit. Efforts are being made to have this rectified but the process is slow under the bureaucratic Public Service.

In addition to the PLTBU, the Reform program also instituted a Data Procurement Unit to compile third party information in support of the intelligence of the Audit Section. Information is gathered from other government departments and the private sector such as Motor Vehicle Licensing, Land Registry, contracts etc. Unfortunately, employees were again drawn from other sections contributing to the present staffing problems.

C. A Criminal Tax Investigation Unit (CTIU)

Out of a need assessment conducted in 1998 was a proposal for improving and strengthening of strategies to combat evasion through the establishment of a capability to deal adequately with the investigation and prosecution of criminal tax violations.

Through its Reform Program the IRD established a Criminal Tax Investigation Unit (CTIU) in 2003 modeled after a similar program to the IRS in the U.S.A. The establishment of this Unit within the IRD has provided the concomitant administrative capacity to deal with all tax violations, clearly signalling to the national community that the IRD now possessed the ability to swiftly and effectively prosecute. Through the promotion of fairness and equity in the system, public confidence in the Administration will be enhanced producing increased voluntary compliance.

Like the PLTBU this Unit is a strengthening of the investigative arm of the I.RD and works within the established functional structure. Cases are sourced from different sections of the IRD and from 3rd party

information on Non-Filers. The Legal Section of the Administration provides legal services to the Unit.

In the long-term it is envisaged that the Unit will be part of the wider law enforcement community by working in partnership with other law enforcement agencies in the prevention and detection of organized crimes, many of which manifest themselves in financial transactions which come under the purview of the Tax Administration. The Unit has enjoyed a number of successful prosecutions to date which were heavily publicized with the desired effect.

D. Internal Audit and Internal Inspection Units

These functions sometimes come under one Internal Affairs Unit in some Tax Administrations. The IRD places great emphasis on a strong Internal Audit Unit with the head of the section reporting directly to the Chairman. The Unit is being enhanced to efficiently monitor adherence to Financial Regulations and processes and procedures established by the Board.

Yet another allocation of resources to boost compliance is the introduction under the Reform Program of an Inspection Unit to foster integrity in the conduct of Tax officials. The aim is to build public confidence in the integrity of the system and to deter efforts at collusion between officials and taxpayers to defraud the Treasury of collectible taxes.

This project is still in progress but one foreseeable hurdle will be the staffing of the Unit, as there are no such positions in the current Public Service. Creation and establishment of new posts under the Public Service is a long drawn out process. Creation of the post under contract is also untenable since a contract officer cannot investigate an officer appointed under the Public Service Regulations. This, together with the many other deficiencies of a bureaucratic Public Service, hinder efficient productive service and are raising thoughts of the introduction of a Revenue Authority that would allow for more autonomy – which would be the last point for a brief reflection.

E. The Case for Autonomy

The more autonomy the organization has from the civil service bureaucracies the more flexibility it will have to make major organizational and procedural changes that are needed to modernize the tax administration. Ability to make its own decisions regarding the appropriate organization structure, staffing, salary levels, procurement, real estate, system of rewards/punishment, promotion etc, with the necessary safeguards against abuse, would certainly lend itself to a more efficient organization. Many countries have introduced a Revenue Authority for the administration of its taxes and experience has shown that making changes in administration is easier under a relatively autonomous organization.

Under a Revenue Authority, the Structure would facilitate quick adaptation of the organization to challenges as they arise, whether they come from new forms of tax evasion or introduction of new taxes. This flexibility would allow for better integration, not only within the Inland Revenue organization but also with other tax collecting organizations such as Customs and Excise which presently has its own administration, offices etc, with all the disadvantages of a Type of Tax Structure as previously discussed. However, the establishment of a Revenue Authority and its relationship with the Minister of Finance is a topic that requires careful study and is mentioned here only as food for thought. Trinidad and Tobago is presently giving serious consideration to this structural adjustment.

CONCLUSION

I trust that I have succeeded in heightening the awareness of the important role played by the Organisational Structure of a Tax Administration in promoting a balanced approach to encouraging voluntary compliance and combating evasion. Hopefully participants would reflect upon their own current position and ponder upon the need to adapt their internal structures as they confront the challenges of the new emerging societies – societies characterized by an increasingly global economy, technological advancements in communications, difficult to tax sectors and transactions and a more informed and demanding public. With these advancements economies grow but they also bring increased opportunities for tax evasion and new challenges for the Tax Administrator.

Case study

TOPIC 2.2

ORGANIZATIONAL STRUCTURE REQUIRED IN COMBATING EVASION – THE MEXICAN CASE

José María Zubiría Maqueo*
Head
Tax Administration Service - SAT
(Mexico)

*CONTENTS: I. Integral Anti-Tax Evasion Program (PICE).- II. Integral Tax
Administration Solution.- III. Conclusion.*

*Organization. An association of individuals governed by a
set of norms in furtherance of specific ends.*

*Organize. To create or reform something to achieve an end,
coordinating the appropriate individuals and means.*

Royal Spanish Academy Dictionary

Prior to presenting the case of Mexico, please allow me to address this
topic on an abstract and conceptual level.

* Mr. Zubiría Maqueo, for reasons of major force he could not appear in Madrid,
nevertheless already he had prepared his paper, which we publish.

The Spanish *Real Academy* Dictionary defines “organization” as the association of individuals governed by a set of norms in furtherance of specific ends, in our case, combating tax evasion. This dictionary also defines the term “organize” as to create or reform something to achieve an end, coordinating the appropriate individuals and means.

The former clearly identifies three key elements: individuals, norms and ends. Upon reading the definition, we perceive the idea of an action that is developed upon the integration of the three elements, but it lacks the light shed by the verb “to organize”. In the latter definition, we observe the need to rely on the catalysts that enable things to occur.

We have all witnessed organizations that simply do not function. They are created as structures that intend to attain goals and fail from the outset. Thus, let me include as a vital organization element in this presentation the means that enable it to achieve its *raison d’être*.

Therefore, in an act of heresy with the Spanish *Real Academy*, let us understand by organization the association of individuals governed by a set of norms, which availing itself of the appropriate means, succeeds in its objectives.

The organization’s effectiveness, efficiency and productivity shall arise from the quality, quantity and integration of the different parts or elements (individuals, norms, means and ends).

- Ends

An organization’s *raison d’être*, its objectives and goals are the starting point for a vital process of definitions. Their clarity enables deciding on strategies, creating initiatives, sizing efforts, identifying hurdles and measuring results.

- Norms

The set of rules that determines the degree of flexibility and defines the interaction alternatives. The simplicity and transparency thereof are tied to the degree of certainty that shall underlie the strategies to be implemented, the resources required to meet them and the objectivity according to which the most complex decisions shall be made.

- Means

The available resources to perform the necessary activities that impact the possibility of meeting the *raison d'être* and compliance cost/time. The quality and quantity thereof directly influence the result.

- Individuals

The association of capabilities, skills, attitudes and behaviors that make up individuals and which, undoubtedly, embody the element of greatest incidence on the organization's results.

The foregoing elements, appropriately aligned, balanced and integrated produce enormous synergies that bear a favorable impact on the organization's results.

We may thus infer that there is not a model organization but a set of basic principles that, adapted to specific circumstances, create an organization that optimizes the end result. It is also clear that since the elements that constitute the organization are dynamic, it acquires a different dimension, as a living entity. The organization's success is thus closely tied to the capacity of its leaders to develop the elements so that, when adapted to specific circumstances, they obtain the greatest value overall.

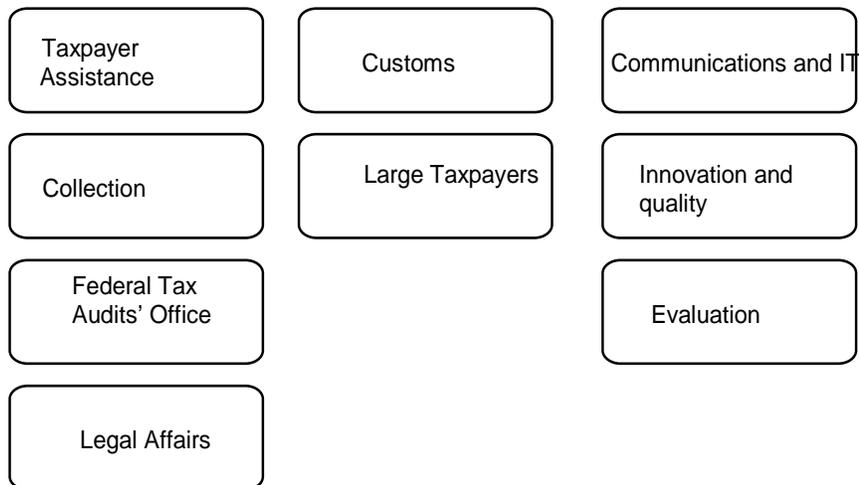
In the field of taxes, the diversity of experiences enables us to identify practices that have produced extraordinary outcomes. Their study enables to understand the determining elements of their success and it shall be of no surprise to us that in the end, they stem from the foregoing principles.

THE MEXICAN CASE

In order to introduce the case, we shall present the current organizational structure of the Tax Administration Service (SAT, as per the Spanish acronym), to combat tax evasion as well as the actions we are undertaking.

The SAT is undergoing a transition. Today, its basic structure is geared at the specialization by functions based on the tax cycle. It is fundamentally made up by nine general administrations: four belong to clearly defined segments within the tax cycle; an additional two serve specific groups of taxpayers; and the other three offer support services to the organization overall. Additionally, it relies on a planning staff area and the internal Comptroller's office.

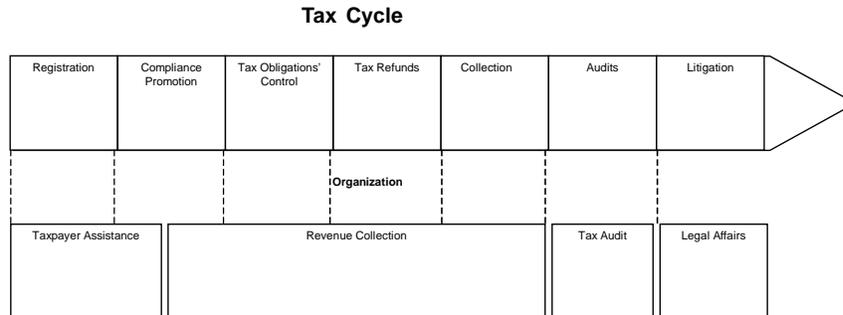
Chart N° 1: General SAT Structure



With the purpose of serving taxpayers nationwide, there are 66 local administrations that replicate the structure of the four administrations in the tax cycle. Each one has been assigned an exclusive jurisdiction in a geographic region.

Additionally, we rely on 49 Customs checkpoints in the country through which goods from other countries are entered: borders, maritime ports and airports.

The structure is supplemented with four large taxpayers' assistance offices and the delegation onto Federal Agencies of the small taxpayers' administration functions and certain taxes (tax on first-hand motor vehicles and ownership and use of motor vehicles' tax).

Chart N° 2: SAT Tax Cycle and Operating Structure

Currently, in an effort to reduce the partial vision originated in a functional organization, we are working on a deep transformation process, which entails numerous initiatives that support and impact the four general objectives that guide the Institutional Strategic Plan:

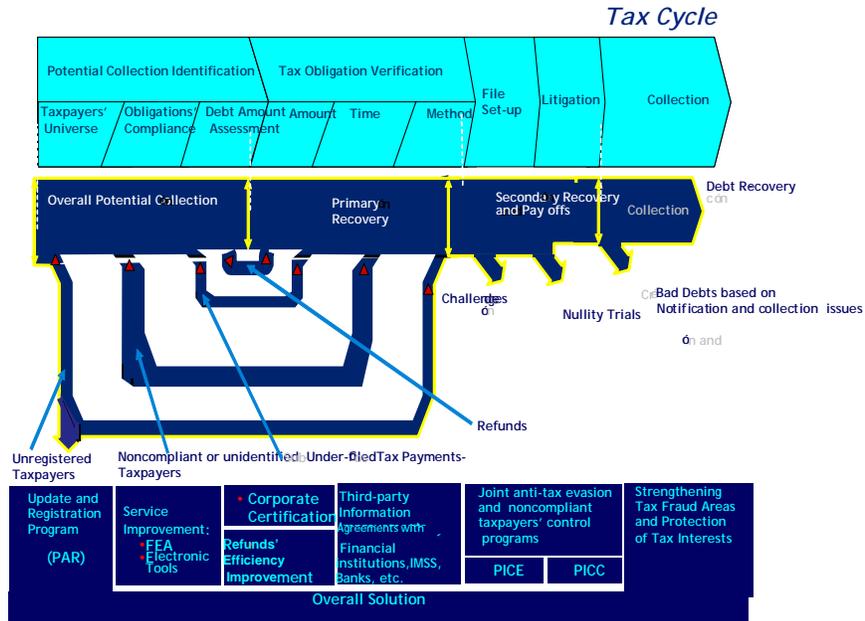
- I. Facilitate procedures and promote voluntary compliance.
- II. Combat tax evasion, contraband and informality.
- III. Enhance tax administration efficiency.
- IV. Rely on an integrated organization renowned by its capacity, ethics and commitment.

The organization intends to answer affirmatively to the tax cycle, but with a different outlook, of assistance and follow-up of complete processes (from end to end). This not only enables a greater efficacy of the administration's different actions, but also, a greater efficiency in the results and resource allocation via the appropriate indicators (see Chart 3).

Specifically, as regards Objective II, a number of initiatives have been developed which are aimed at:

- ✓ Strengthening the audit elements in service organizations and vice versa.
- ✓ Developing administration techniques to enable the improvement of the administration's enforcement capacity in the detection of tax noncompliance.
- ✓ Integrating the information from diverse areas into the taxpayer's risk analysis.
- ✓ Developing a cooperation environment to address the different noncompliance scenarios.

Chart Nº 3: Tax Cycle



In the struggle against tax evasion, the SAT has worked on different risk management models encompassed in the Integral Anti-Tax Evasion Program (PICE, as per the Spanish acronym). This program, which started as a coordination instance of all the SAT areas in order to increase the effectiveness of control and audit actions —by translating them into revenue collection—, has become the key component of the strategy to punish noncompliance and promote compliance.

At the same time, the SAT is working on an Integral Solution for the Tax Administration, with the support of a technological platform, which spans the overall tax cycle, including a fundamental audits' support component.

In order to provide a general overview of the efforts focused on tax audits, we shall firstly explain some of the most relevant PICE aspects, and the Integral Solution's tax administration support thereafter.

I. INTEGRAL ANTI-TAX EVASION PROGRAM (PICE)

The PICE is an initiative that integrates several (and different) efforts by the organization to consolidate risk analysis as a vital element for the Tax Administration and for the current transformation process. By the creation of the Single Risk Number, we intend to lay the groundwork for the policies and programs that generate a greater efficacy in audit tasks, optimizing the available resources and increasing taxpayers' risk perception as regards noncompliance. Specifically, we expect:

- ✓ To increase the revenue collection levels in a context of equity.
- ✓ To rely on a structured and integral strategic planning information base.
- ✓ To contribute in a strong assessment of the program based on evidence.
- ✓ To enable external scrutiny of the scope thereof.
- ✓ To do away with discretionary strategies defined in processes within the tax cycle.
- ✓ To differentiate the service and control strategies pursuant to the taxpayer's risk profile.
- ✓ To interact successfully with the taxpayer by relying on the supporting tax cycle compliance information.
- ✓ To optimize the organization's scarce resources by adopting the principles of risk administration.
- ✓ To achieve institutional performance transparency by providing solid evidence for assessment.

In order to determine the components in this number, a series of risk models have been established, which span from taxpayers' behavior in terms of domestic taxes or foreign trade activities to the specific follow-up of tax-cycle related agents (such as external auditors, Certified Public Accountants (CPAs) and law firms) and the specific tax cycle segments (refunds and collection).

The aim is to identify the more vulnerable aspects and gradually build a perfectly integrated system that impact significantly on the risk perceived by noncompliant taxpayers. Among the most relevant models, for their significance in terms of their impact on revenue collection, their coverage and degree of development, we may mention the following:

(a) Domestic Taxes' Risk Model

The Domestic Taxes' risk model, based on massive IT processes, identifies the taxpayers with inconsistencies as to tax obligations' compliance or who conduct business in a risk environment. The General Federal Tax Administration (AGAFF) is spearheading this effort by incorporating information from tax decisions issued by third parties, information provided by banks, customers and suppliers' list, etc.

The model is basically based on systematized processes aimed at verifying annual statements, installments and final payments, clients and suppliers' informative statements, informative statements on payments and withholdings' statements filed by taxpayers.

Based on the processing of large volumes of information, the main outcome of the model is the selection of taxpayers to be audited, considering the individual risk profiles and the impact on a global, sectorial and regional basis.

(b) Large Taxpayers' Risk Model

Large taxpayers resident in Mexico are economic groups strongly linked to the growing internationalization of business in the global economy—with transnational corporations engaged in international trade—and to the globalization of the financial system—which entails new and innovative products and/or financial tools in investment and financing transactions.

Clearly, the problem faced by Administration in this group of taxpayers (which as of December 2005 accounted for approximately 0.1% of taxpayers overall and 75% of overall revenue collection) is very different to that of the vast majority of taxpayers and thus requires a special and targeted treatment.

The aims of this model are:

- ✓ To create taxpayers' behavior profiles, as well as sectors and segments, based on an integral approach in the focus of specific control programs.

- ✓ To rely on a list of priorities to define measures geared at correcting the issues detected, generating automated alarm signals in the IT systems and applications.
- ✓ To develop a systematized formula for the creation of norms to enforce control measures.
- ✓ To conduct relevant measurements of the tax compliance process and Large Taxpayers' risk management results.

The main feature of the methodology to build the risk management model structure is the use of OLAP technology (On-line Analytical Processing), useful to view information from the different databases in multidimensional cubes. Dimensional cubes deploy the risk identification results, their causes or possible factors and their classification. When combined, they enable to integrate the risk assessment criteria into three main areas:

- ✓ To control tax collection from the 500 largest taxpayers.
- ✓ To qualify the admissibility or inadmissibility of tax refunds.
- ✓ To define selection criteria for taxpayers to be audited.

In this taxpayers' segment, in addition to the model, we created a think tank in which specialists from different fields share the practices they deem aggressive and, based on their analysis, are incorporated into the selection criteria.

(c) Foreign Trade Risk Model

The Foreign Trade Risk Management System (SARCE, as per the Spanish acronym) determines the risk according to taxpayers' background individually, from their registration with the Federal Taxpayers' Registry (RFC, as per the Spanish acronym) up to the last foreign trade transaction performed by the taxpayer.

TOPIC 2.2 (Mexico)

The international trade policies and dynamics require countries to implement mechanisms that facilitate the entry, exit and transit of goods, mostly in the cases linked with free trade systems, such as ours. Such circumstances force States to implement measures that without detriment to process facilitation, analyze, control, and mitigate the risks that may arise from the entry, permanence and exit of goods.

The system offers numerous benefits, among which we may mention:

- ✓ It reduces time and increases the accuracy for the selection of taxpayers to be audited.
- ✓ By duly identifying irregularities via this tool, we obtain the leads and elements that will underlie the decision to conduct an audit.
- ✓ It enables the automation, enhanced efficiency and simplified programming of audit actions.
- ✓ It consolidates the information included in the institutional systems and databases (single information systems).
- ✓ It saves material and human resources.
- ✓ It reduces the discretionary selection procedures for taxpayers to be audited.

The SARCE is fundamentally relies on the information registered with the AGAFF, the General Revenue Collection Administration and the General Customs Administration, that is to say, the information crossed relative to the foreign trade transactions conducted by taxpayers with the institutional database information.

(d) VAT Refunds' Risk Model

The purpose of this model is to process taxpayer information so that it enables to identify, process and complete refunds' requests that represent a risk for the interests of the federal administration. At the same time, identifying those that do not pose a significant risk level shall facilitate resource allocation and increase productivity and the quality of decisions.

Previously, the information necessary to decide on the requests' for refunds was located in different databases. With this tool, the information is integrated into a single database that enables to improve the decision-making process efficiency, since it reduces processing and payment time and provides further grounds for analysis in the doubtful or complex cases.

The model chiefly considers the following elements:

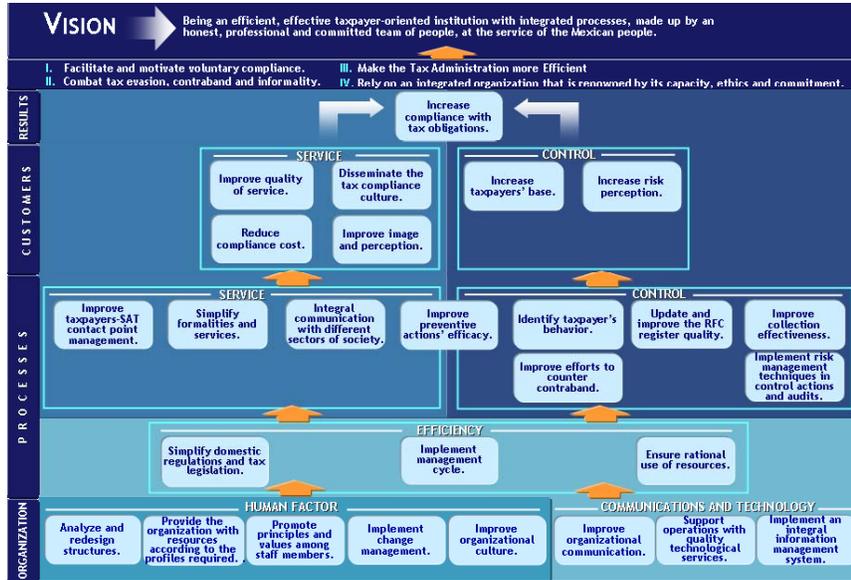
- ✓ The requesting party's tax domicile as well as the tax domicile of his/her suppliers.
- ✓ The taxpayer behavior as perceived by the Tax Administration based on the taxpayer's net revenue collection, as well as that of suppliers and service providers.
- ✓ The potential relations among the requesting parties and their suppliers and service providers.
- ✓ Certain special events regarding the participation of individuals in the refund process in other requests that have been deemed to entail a risk.

II. INTEGRAL TAX ADMINISTRATION SOLUTION

Naturally, as mentioned above, the organization exists in a scenario of permanent change. Two years ago, the SAT initiated the review and examination of their operations, in the context of an integral analysis model aimed at improving taxpayers' quality of service, reducing tax evasion and increasing productivity.

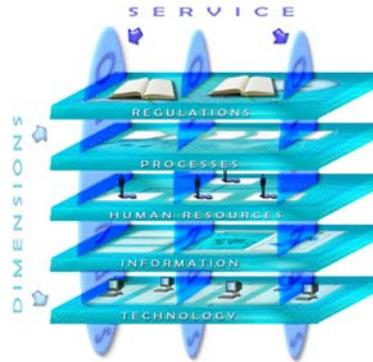
This effort provides for the different areas of the organization. The Strategic Map (Chart 4) was the conceptual guide and consolidates the Institutional Mission and Vision with the different strategic objectives, in the context of the four general objectives (service, control, efficiency, communication and technology and the human factor), as well as the different levels where they stand (results, clients, processes and organization).

Chart 4: Strategic Map



Behind each strategic objective we find indicators and goals that enable to assess and follow-up the strategy, in addition to programs, projects and different actions that support the objectives' validity and feasibility. Within the numerous initiatives that constitute the Strategic Plan implementation, there is a small group that, based on the magnitude, impact and relevance has been called

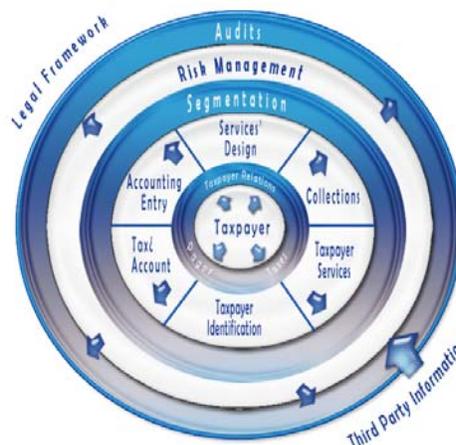
Transformation Projects. Among them, the Integral Solution constituted the backbone of the change process experienced by the SAT¹.



Although the Integral Solution does not exhaust change, it shapes it to a great extent, since it provides for the use of the available technologies in line with the incorporation of new definitions vis-à-vis processes, organization, people and information models. The solution is based on the Institutional Architecture principle and seeks to grant consistency and harmony to every SAT component or service as a gear in an interdependent system.

¹ To learn more about the project scope, visit www.sat.gob.mx

Therefore, this process of change entails the fundamental transformation in our practices as well as in the way we work. The latter evolves upon the review of our current work to redesign it according to the best practices that enable to sustain a systemic continuous improvement vision.



Naturally the transformation process requires defining a collaborative culture where each individual's work entails a meaning and a fundamental value to the extent it forms part of a chain of actions, an end to end process, in which different areas participate at different times and interact within a same flow to obtain a clear and transparent outcome for all.

The audit areas tasks have been the focus of the SAT efforts in the last few years to increase voluntary compliance with tax obligations. The efficiency and efficacy in the performance of such tasks is fundamental for the country's tax administration in order to meet the planned objectives towards the future.

Specifically, the Integral Solution provides the tools as well as the methods to optimize the selection of taxpayers to be audited. The automation of different phases of the process enables to exercise the auditing powers according to the different methods set forth in the Mexican Tax Code. The selection of proposals to undertake audits offers auditors a technical support and control tool for the auditing procedures applicable, as well as the follow-up of the deadlines set forth for the completion of each one of them, guaranteeing the integrity of the information generated in the process and greater trust to assess the outcomes of the audit procedures.

TOPIC 2.2 (Mexico)

Therefore, the Tax Intelligence Service (based on risk management), supplements PICE's work by broadening the information management scope, empowering it and facilitating the definition of rules and criteria to select taxpayers or groups of taxpayers to be audited, in addition to the assessment of the revenue collection impact.

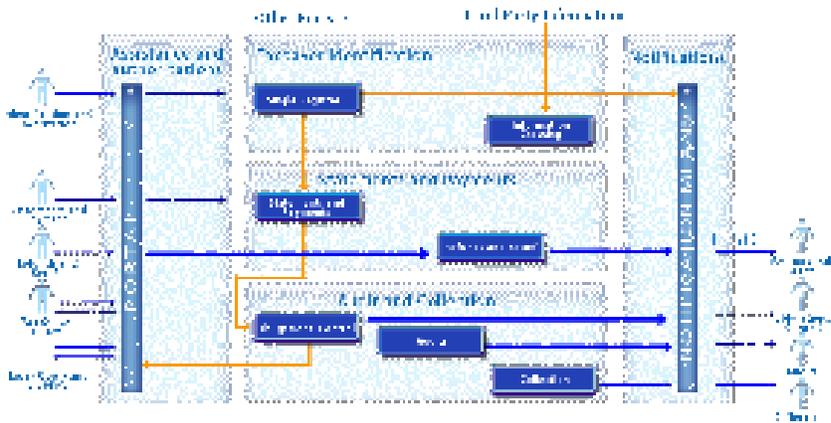
On the other hand, the functionality to be provided by the Audit Service to the daily operations of the auditing areas shall enable the automation of the current administrative tasks to a large extent; assertive information shall be generated in each one of the process phases for a timely decision making, the vital element to enhance the technical quality of tax audits. This shall undoubtedly reduce execution time and contribute with elements to increase taxpayer's risk perception, to the benefit of secondary revenue collection, firstly, and primary collection indirectly.

The Audit Service focuses on the improvement in the execution of audit actions set forth in the Mexican Tax Code, with the purpose of verifying the appropriate taxpayers' compliance with tax and customs obligations. In terms of the general SAT objectives, this service is mostly tied to the second objective (combating tax evasion, contraband and informality), although it somehow impacts the other three (See Chart 5).

The advantages of Audits' Support:

- ✓ It avoids discretionary selection of taxpayers' to be audited.
- ✓ It increases the technical quality of audits, guaranteeing that the controls performed meet the current tax regulations.
- ✓ Audit execution time is reduced.
- ✓ It optimizes the audit process, as a result of more effective procedures as well as the improved selection of taxpayers to be audited.
- ✓ It increases taxpayers' sense of risk.

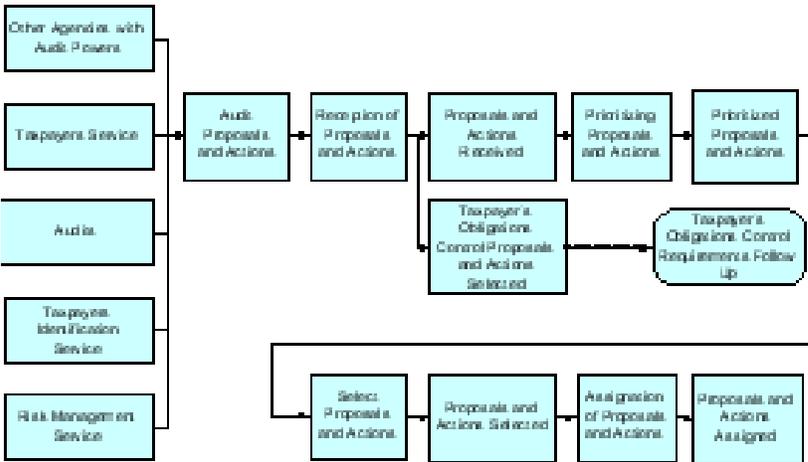
Chart 5: Contact instances with Taxpayers



The structure is based on three sub-services: selection and audit proposal allocation; execution of audit actions; and assessment and feedback.

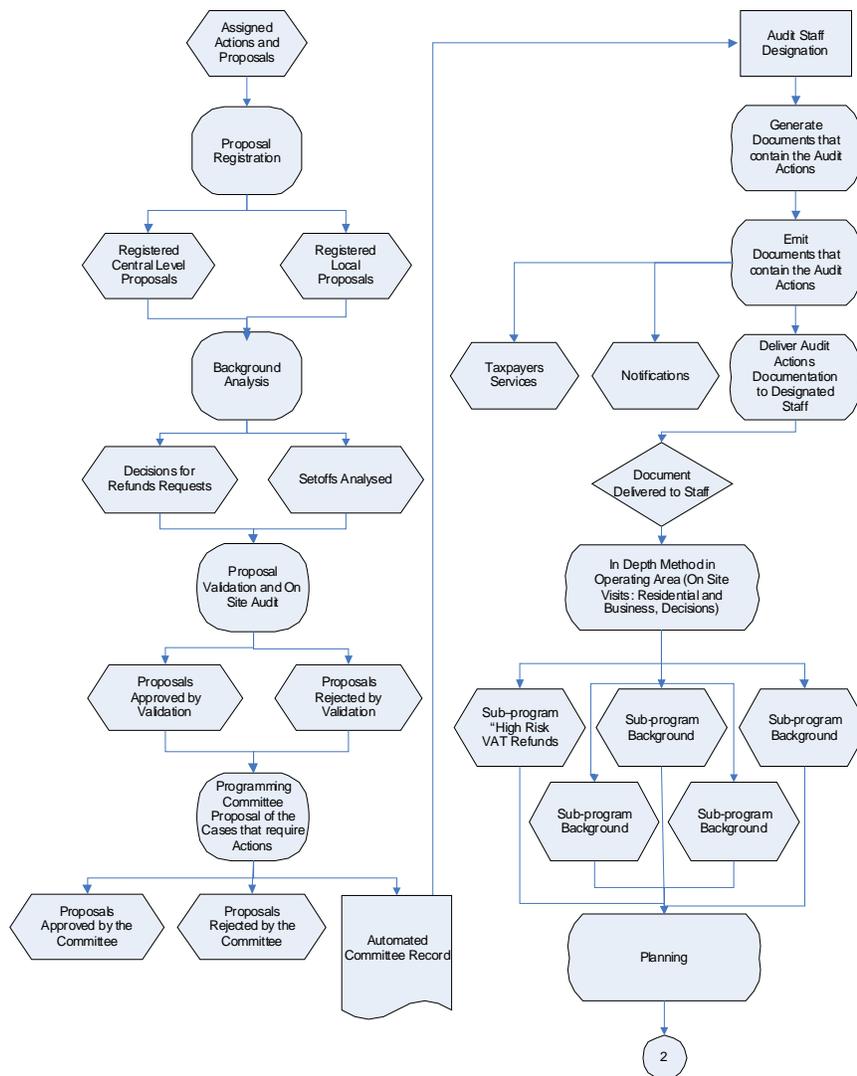
1. Selection and audit proposal allocation: based on the reception of audit proposals, it prioritizes, selects and allocates them (Refer to Chart 6).

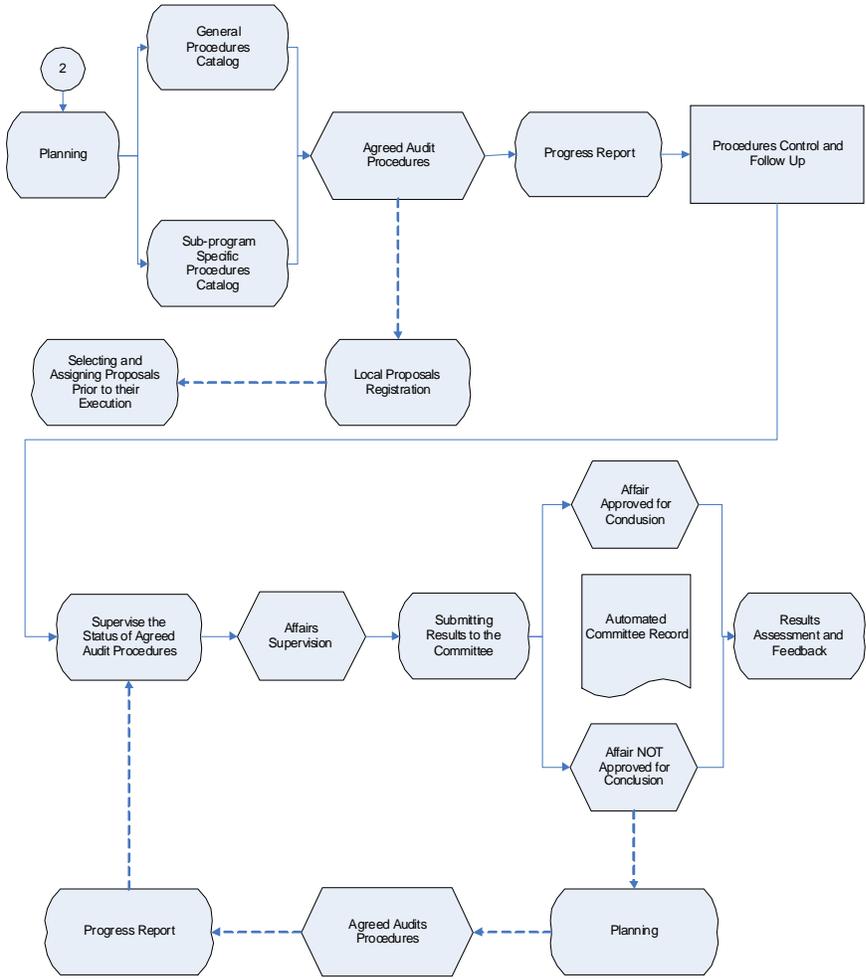
Chart 6: Selection and Audit Proposal Allocation



2. **Audit Execution:** includes the registration of proposals originated Centrally or Locally; proposal analysis and validation; issuance of supporting documentation for audit actions; planning for the execution of audit actions; and transferring proposals to the execution units.

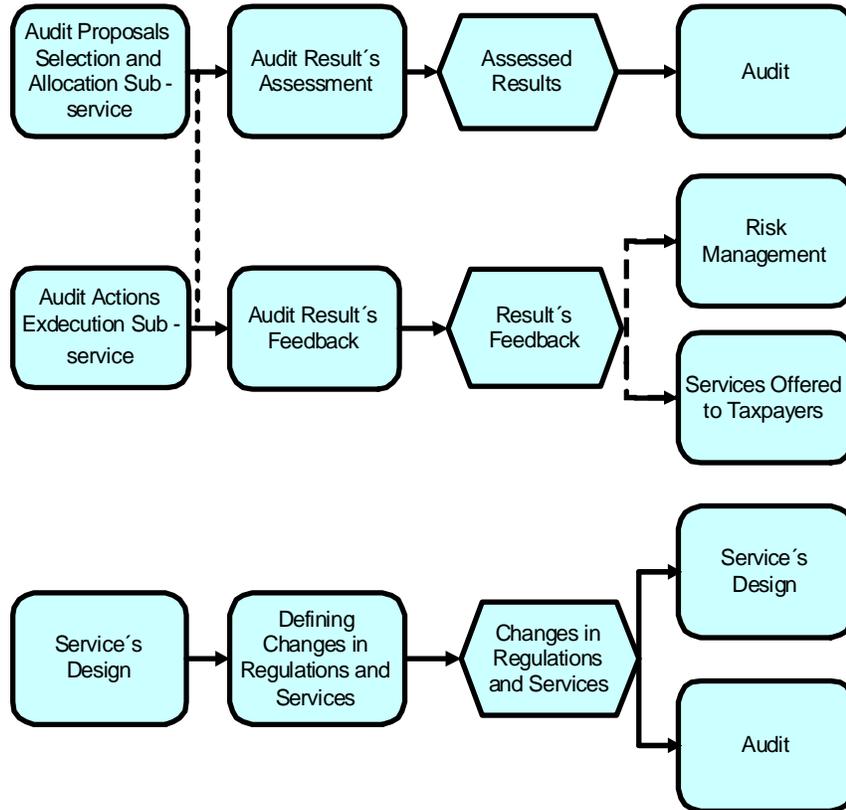
Chart 7: Audit Actions' Execution





3. Assessment and Feedback: in order to close the circle, this sub-service encompasses the assessment and feedback of audit results; and, if applicable, the subsequent implementation of changes in Regulations and Services.

Chart 8: Assessment and Feedback



Overall, Audit Support is aimed at offering a solution to the operating areas to meet the need of automating the audit process: the selection of the proposals for taxpayers to be audited -also providing a tool to facilitate the issuance, control and follow-up of audit actions- and the appropriate expediting of the auditing procedures, integrating the information generated in the process into the same IT solution that guarantees the integrity and reliability thereof for its use in the decision-making process.

III. CONCLUSIONS

In addition to SAT's efforts in terms of facilitating compliance with tax obligations, which reduces tax evasion attempts and, therefore, the pressure on audit areas, the advances regarding efforts to combat tax evasion are supported by two initiatives: the PICE and the Integral Solution.

On the one hand, the PICE lays the groundwork for coordinated actions among the different areas in the short term for enhanced Tax Administration risk management in the different services or fields of action. On the other, the Integral Solution — which, in addition to offering tools to increase productivity and quality in auditing efforts, broadens the strategy's potential by enabling the transformation of data into taxpayer knowledge. By incorporating risk management techniques, it enables to redesign audit actions, optimizing results and allowing a more efficient use of resources.

Pursuant to the elements that define an organization, the purposes have been clearly defined in the Mission, Vision, objectives and goals that stem from the Strategic Plan. The role of combating tax evasion within the strategy overall is vital, with a clearly outlined direction and target.

Norms constitute the legal framework of reference but, in turn, they set forth the scope of action to design policies to facilitate and grant clarity and certainty in compliance and, at the same time, generate the perception of uncertainty and effective risk in noncompliance. On a dynamic basis, norms, understood as the set of rules (legal and procedural), shall adapt to the existing conditions and the institutional strategy.

The SAT now relies on a greater number and variety of resources to see to its social responsibility. The effort has been considerable and many of the alternatives provided for in legislation that had been unfeasible in practice are now feasible, to the benefit of taxpayers who wish to meet their tax obligations, as well as the Tax Administration as regards promoting and fostering voluntary compliance.

In addition to availing itself of the institutional knowledge that stems from experience, the transformation process has called for an additional effort in training, education and consolidation of values. The new

TOPIC 2.2 (Mexico)

working model requires institutional and personal competencies to consolidate the advantages derived from the incorporation of state of the art technology, methods based on best practices and different innovative tools.

The SAT transformation process is not over. In fact, as mentioned in the beginning, it is not about a model organization but of basic principles that must adapt to circumstances. Therefore, the organization shall include ongoing audits among its capacities, and specifically, vis-à-vis combating tax evasion, being a risk management play between noncompliant taxpayers and the Tax Administration, which calls for continuous change.

Along the endless road towards improvement, we envision new directions. The changes implemented require supplementing by deep adjustments in the organization with a view to align it with the services, the strengthening of human capital, the creation of incentives that promote continuous performance improvement, the implementation of fair mechanisms that enable to correct without punishing, the ingenious design of solutions in the light of the aggressive attitude of many taxpayers, the Tax Administration's consistency in combating new tax evasion schemes, etc.

If we develop the capacity to use the basic elements common to all our organizations, as many taxpayers do, with the flexibility to adapt them to local reality, we shall succeed in devoting our limited resources, not to repeat efforts, but to innovate and increase the effectiveness in the performance of our functions.

Case study

TOPIC 2.3

TECHNICAL COOPERATION PROCESSES AMONG INSTITUTIONS: THE PERUVIAN EXPERIENCE

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Superintendent

National Superintendence of Tax Administration – SUNAT
(Peru)

CONTENTS: Introduction.- 1. Conceptual Framework.- 1.1. The new complex scenario.- 1.2. The new cross-sectorial scenario and the network state.- 2. Cooperation Process: Legal Framework.- 2.1. The tax administration's powers to directly request information.- 2.2. Information as a public asset.- 2.3. Information exchange limitations.- 3. SUNAT Cooperation Model with other Entities.- 3.1. Cooperation Model Phases promoted by the SUNAT to prevent and combat tax evasion.- 3.2. Strategy.- 4. Main Cooperation Initiatives with other Entities to Prevent and Combat Tax Evasion.- 4.1. Ministry of Labor and Promotion of Employment (MTPE).- 4.2. Production Ministry (PRODUCE).- 4.3. Energy Investment Oversight Agency (OSINERG).- 4.4. The National Public Registers' Superintendence (SUNARP).- 4.5. The Public Prosecutor's Office.- Conclusions.

INTRODUCTION

SUNAT's mission is to increase and sustain tax and customs' revenue collection, combating tax evasion and contraband, by effective risk generation and quality services for taxpayers and users who conduct

foreign trade transactions, as well as promoting compliance with their tax obligations to enhance the economic and social wellbeing of the Peruvian people.

A few years ago, in the complex scenario faced by Government agencies in the efforts to meet their purpose, the SUNAT undertook coordination initiatives with numerous entities that would enable its access to valuable information to prevent and combat tax evasion.

Originally, information sharing served specific information objectives. Therefore, the data structure, the frequency and means of transfer had no relevance. Notwithstanding, with the success in the detection of tax evasion practices, such information sharing efforts became increasingly significant.

Thus, the first initiatives appear: subscribing cooperation and information exchange agreements among institutions to ensure the data quality, transmission frequency, the standard transfer modality and the arrival of information in the organization via the same channel.

To date, in the context of the implementation of e-Government and integration processes, the SUNAT relies on specific procedures to subscribe agreements and cooperation processes not only regarding information exchange matters, but also vis-à-vis mutual training programs, logistic support and IT developments in other fields.

1. CONCEPTUAL FRAMEWORK

1.1. The New Complex Scenario

Currently, the world is experiencing times of greater complexity constituted by a larger number of increasingly interactive elements, stemming from the ever-evolving technological developments and the political, economic and social changes in the last 50 years.

This is evidenced by the sudden demographic growth, the outburst of communications and the accelerated trend towards globalization. The latter, which implies the growing influence of worldwide economic, social and cultural processes on the national or regional ones, is in turn the symbol of the dramatic changes spurred by the communications and IT revolution, to which technological development has granted new dimensions.

Given this greater complexity of reality, the theory of organization and administrative practice has undergone significant changes. The information rendered by administration and behavioral sciences has been enhanced –among others- by the advancements in IT Theories, under the focus of which the structural complexity is acknowledged according to two levels:

- vertical complexity, which refers to the hierarchical organization of control or management structures; and
- horizontal complexity, which occurs in the same spatial dimension and refers to interrelated organizations or structures under the control of a decision-making power of a higher order.

Government Administration is one of the main areas where this complexity occurs, owing to its great dimension, the number of systems it manages –political, social, legal, economic, among others-, its high level of influence and its permanent vulnerability to scenario changes.

For a long time, attempts have been made at managing vertical complexity through the decentralization of work and generation of divisional structures, such as the creation of autonomous government agencies.

Horizontal complexity, on the other hand, has gained greater relevance in the last few decades, given the increasing difficulty posed by problems to be solved by organizations and the enhanced interoperability spurred by the development of information and communications' technologies (ICTs).

1.2. The New Cross-Sectorial scenario and the Network State

One of the methodological strategies that arises in order to manage the horizontal complexity level is the so-called cross-sectorial approach or specifically, of relational management. The cross-sectorial approach is an organizational concept and instrument with the function of providing performance capacity to organizations regarding a number of issues that the classic organization is unfit to serve.

Therefore, from the point of view of the State, Castells¹ has set forth the Theory of Social Networks in what he calls the “Network State”, in the context of the effects that the multidimensional globalization has on the National State’s intervention capacity. The Network State defined as such is marked by sharing authority, that is to say, the institutional capacity of imposing a decision upon a network of institutions.

Largely, the State is evolving towards more flexible forms of organization, enabled by the development of information and communications’ technologies that allow for the day to day articulation of a network of institutions and organizations whose complexity would be impossible to manage without such IT interactivity features. In that regard, we must consider that government and administrative offices massively store and process personal data of millions of citizens. Thus, massive information flows among individuals and government offices, and among government offices themselves constitute an ineluctable reality.

In the area of Tax and Customs Administrations, which must always tend to meet the purposes of enhancing tax collection, facilitating taxpayers’ services and being efficient in the tax fraud prevention control, we may state that there have been large developments as to cooperation among institutions, which have occurred hand in hand with the interoperability factors among systems and organizations.

¹ Castells, Manuel (1996).

The development of the “e-Government” initiative is one of the greatest challenges for administrations’ modernization policies in the majority of countries. In fact, Tax Administrations play a relevant role in the interoperability developments, especially in the aspects linked to citizens’ services that enable to reduce transaction and compliance costs.

Although one of the key factors for Tax Administrations is risk generation, the greatest advancements in such field have generally consisted in the supply of information to citizens and the possibility of performing online administrative formalities, either fully or partially.

In spite of this, it is worth underscoring that even in less developed countries where resources are scarce and interoperability is slow, cooperation among institutions continues to be very significant, moreover as to risk generation, since the sole possibility of exchanging information makes citizens perceive a greater risk level (subjective risk). Likewise, part of the cooperation in the tax fraud control efforts is not only linked to information exchange, so it is worth focusing on such aspects.

2. COOPERATION PROCESS: LEGAL FRAMEWORK

2.1. The Tax Administration’s Powers to Directly Request Information

One of the main purposes of every Tax Administration is controlling taxpayers’ compliance with obligations by means of auditing their behavior with the aim of detecting potential tax evasion.

With a view to meeting their purposes and functions, the National Tax Administration Superintendence (SUNAT, as per the Spanish acronym) requires information not only provided by taxpayers but also by other Government agencies.

a. The Right of Access to Information

Peru's Political Constitution embodies the right of access to information as a fundamental right, as a guiding principle of the legal system in general and the tax system in particular. It sets forth that every person is entitled to request and receive information, without stating any grounds, from any government agency, in the legal term provided for and according to the cost entailed by such request.

On the other hand, the Transparency and Access to Public Information Act regulates said fundamental right of access to information and sets forth that all the activities and provisions from the entities governed by such Act are subject to the principle of publicity, and consequently, any information held by the State is assumed to be public, except as otherwise expressly stated in said Act. That is to say, the Government Administration agencies are mandated to deliver the requested information, provided it has been created or obtained thereby or is under its possession or control.

b. The Access to Information Mechanism

The General Administrative Procedure Act sets forth that relations among entities are governed by the cooperation criterion, without this implying a waiver of individual jurisdiction as provided for by law.

This opportunity of implementing cooperation initiatives is an invaluable tool for the Administration to attain its purposes. It contributes to the effectiveness and efficacy of tax administration activities. Collaboration or cooperation entails an active involvement by government agencies to facilitate the work of other entities or undertake joint and voluntary actions to meet their shared goals; it is an implicit and inherent principle in the State.

Theory is clear when it sets forth that the administrative cooperation activity does not require express legal authorization; notwithstanding, there are regulations in

place that define a number of parameters to be followed in cooperation activities.

In this regard, the foregoing Act sets forth that, on the basis of the cooperation criterion, entities shall directly deliver the data and information in their power, whatever their legal nature or institutional status, through any means. For such end, electronic information processing devices or other similar means shall be interconnected. Active cooperation and assistance shall be provided in the inherent jurisdiction required by other entities in order to perform their own functions, unless this entails incurring high costs or jeopardizes the performance of their own functions. The elements of evidence available to an entity shall be facilitated to other entities.

A one-time requirement shall be satisfied upon request. But, should the need be sustained, the IT systems shall be interconnected on a permanent basis.

Therefore, it is a general duty for all entities with respect to the others to facilitate information for the appropriate performance of their functions. Likewise, the information held by a government entity is not meant for the exclusive exploitation thereof, and not even for its sector, but forms part of the overall services that all the other entities must render on an equal footing.

In the case of the Tax Administration, the Tax Code sets forth that no person or entity, whether public or private, may refuse to supply the Administration with the information it may request to determine the economic or financial standing of tax debtors.

For such purpose, it may request public or private entities to report or provide evidence of compliance with tax obligations for taxpayers under their jurisdiction or with whom they conduct business. The former are mandated to submit the information requested according to the format, dates and conditions set forth by the SUNAT. The information gathered by the Tax Administration shall not be disclosed to third parties, under the responsibility of the official in charge.

c. Other Forms of Cooperation

Another form of cooperation is the administrative assistance or aid, which also constitutes a general duty, with the same consequences and the same limitations for the duty to facilitate information as those mentioned before. Such assistance may be purely legal (for example, to enforce the acts of an Administration that must be performed outside its jurisdiction), or may consist in technical assistance (for example, by recommending staff members, exchanging technical tools from one entity to the other, etc.).

Therefore, Peruvian regulations foresee the duty of cooperation among institutions, which purpose is to achieve an extended benefit for society overall.

d. Means for Cooperation among Institutions

The General Administrative Procedure Act enumerates certain means for cooperation among institutions, by which government agencies may put in place stable or continuous forms of performing the duty of cooperation among entities. Notwithstanding, such means are not vital to exercise the duty of cooperation among entities, since cooperation is embodied directly in our legislation.

The Law provides for two mechanisms, pursuant to the most widespread international theory and law: conferences among related entities and cooperation agreements, without detriment to other means that may be leveraged and are legally acceptable. For example: associations of entities or ad hoc working groups.

- Conferences among related entities enable entities facing the same administrative issues to meet in order to exchange solution mechanisms, foster institutional cooperation in specific common aspects and define bilateral cooperation opportunities. Agreements among them shall be subscribed by the authorized representatives, as applicable.

- Entities, by means of cooperation agreements, subscribe agreements through their authorized representatives, as set forth by law in the area of their respective jurisdiction, which are binding for the parties and include a provision on free acceptance and termination of agreement.
 - On the basis of such agreements, two or more entities agree to sustain reciprocal cooperation, accepting the techniques to be employed and the content thereof.
 - The general content usually identifies the entities subscribing the agreement, the jurisdiction of each entity, financing, the actions agreed, the need to establish an ad hoc organization to oversee the agreement, or not, or the executive representatives thereof, and the life of the agreement.

In that regard, the SUNAT Rules of Organization and Functions foresees as powers thereof, to subscribe agreements and covenants for technical and administrative cooperation in matters under its jurisdiction and promote, coordinate and conduct technical cooperation activities, pursue research, training and education in tax and customs matters in the country or abroad, among others.

For such purpose, the SUNAT has determined an internal procedure to request, assess, negotiate, subscribe and follow-up cooperation agreements among institutions.

2.2. Information as a Public Asset

We must differentiate between those assets on which the State holds an actual property right, with all the attributes it entails, from those over which the State only exercises a regulation, protection, administration or other power, but are actually meant for the public use.

The former are called “State assets” and the latter “public ownership assets or public assets”. Public ownership is not attributable to the State but to the people.

Therefore, according to current regulations, all the information held by the State becomes a public asset, that is to say, neither the State nor any authority may claim the exclusive property thereof, given its nature of community asset.

Thus, regardless of the requesting party or its motives, Government entities are mandated to provide the information to the requesting party, in compliance with applicable regulations, which set forth certain access to information restrictions. We shall address the latter in further detail.

This definition applies to all the information that an individual or corporation, public or private, may hold, since the right to information is a right that spans not only the power to request information, but also that of providing it.

2.3. Information Exchange Limitations

We may broadly assert that under the principle of the Rule of Law there is no room for a sovereign power that departs the norms or rules in place. Consequently, the Tax Administration's power to gather or render information shall be exercised in strict compliance with the laws that protect the rights of individuals and guaranteeing the tax confidentiality thereof. In this sense, the limitations on information requests in effect are chiefly tied to the protection of the privacy of individuals.

a. The Right to Privacy

In general terms, the word privacy is employed to refer to the set of actions, situations or circumstances that given their extremely personal nature, are not normally exposed in public.

The right to privacy is granting citizens' the protection that the private spectrum of their personality shall not be approached by third parties, including the Tax Administration.

In that sense, the Transparency and Access to Public Information Act sets forth that the information on personal data, the dissemination of which is an invasion of personal

and family privacy, is classified as confidential information and is not governed by the right of access to information. In this case, only a court of law may order the dissemination thereof without detriment to the rights stated in the Political Constitution of Peru.

Nevertheless, we must highlight that the restriction or extension of such right to privacy is not specifically provided for by law. Constitutional rights as well as the principles of theory and case law have not concurred on an unequivocal definition of what is to be understood by privacy, as well as the notion of private life. Therefore, in certain cases this right may be abused to restrict the right of access to information to a greater extent than the one provided for by law.

b. Tax Confidentiality

Pursuant to the Peruvian Tax Code, the information held by the Tax Administration, obtained by any means, regarding the amount and source of income or data relative thereto, is protected by tax confidentiality and shall only be used for inherent Tax Administration purposes.

The tax confidentiality entity legally stems from the Peruvian Political Constitution, which sets forth certain cases in which the entities shall not deliver the information requested, on the basis that it would be detrimental to such rights as personal privacy, national security or in cases specifically provided for by law, such as tax confidentiality.

Tax confidentiality protects the secrecy of the information gathered by the Administration to fulfill its purposes, ensuring it will not be used by third parties who might jeopardize taxpayers' integrity and that of related individuals, or hinder commercial transactions by performing actions that may border with unfair competition.

Given the secret nature of the confidential information, the protection thereof extends to the prohibition of disseminating such data among the Tax Administration's officials themselves, who may only access them according to the scope of their competencies.

This limitation is also provided for in the Transparency and Access to Public Information Act, upon determining that the right of access to public information shall not govern the information protected by tax confidentiality, among other cases.

Notwithstanding, the Political Constitution sets forth that tax confidentiality may be waived upon request of a court of law, the Attorney General or an Investigation Committee of Parliament by legal mandate and provided that the information refers to the case under investigation. Likewise, the transparency rule indicates that Parliament, the Judicial Branch, the General Accountant of the Republic and the Ombudsman may also access confidential information, in furtherance of their duties.

c. Banking Secrecy

Banking secrecy constitutes a limited system on the framework of relations between banking institutions and their clients, which is marked by the bank's obligation to keep the confidentiality of the information rendered by their clients.

The General Financial System and Insurance System Act and the Banking and Insurance Sector Superintendence Statute set forth that financial system businesses as well as their managers and employees are banned from supplying any information on their transactions with clients, unless expressly authorized thereby or according to the assumptions defined by the law itself.

From the Tax Administration's standpoint, banking secrecy is a barrier to access to information required to define the income level of certain taxpayers.

d. Other Limitations

In addition to the foregoing limitations, the Peruvian Political Constitution defines other restrictions on access to information stemming from the constitutional rights embodied and protected thereby. Among them, we may

mention the right that information services, whether based on IT or not, public or private, shall not provide information that affects the personal and family privacy, the right to honor and a good reputation, as well as the right to one's own voice and image; and the right to the secrecy and privacy of their private communications and documents.

3. SUNAT COOPERATION MODEL WITH OTHER ENTITIES

Our cooperation model with different government and private sector entities, international agencies and customs of the world has reflected our e-Government development phases. Thus, we have started from a Presence phase, then moved on to the Application-based Interaction phase and the current Transactions' Development phase. Finally, we are moving towards the full transformation of our processes.

For the SUNAT, e-Government is the continuous improvement of its processes and services, transforming internal and external relations towards their integration with the rational and automated use of information.

Although presently most of our control processes are in the transactions' development phase, for the purpose of clarity, we shall individually address each one of the phases in our cooperation model.

3.1. Cooperation Model Phases promoted by the SUNAT to Prevent and Combat Tax Evasion

a. Presence

In this phase, information is gathered chiefly by the exchange of physical documentation. We must mention that presently this modality is being discontinued, mostly in the cases in which the cooperating institution relies on very poor technological infrastructure or in cases of specific and unstructured information.

b. Application-based Interaction

In this phase, cooperation is fundamentally seen in mechanisms to gather or exchange basic information among institutions.

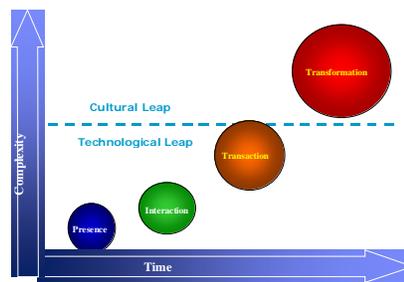
Currently, it is one of SUNAT's most broadly used cooperation methods. The spectrum of information exchange has ranged from forwarding basic information asynchronously to accessing the cooperating institution's databases.

It is worth pointing out that one of the main uses given to the information obtained under these mechanisms is crossing taxpayers' information on a massive basis and applying business intelligence to select taxpayers to be audited, always abiding by the principles of efficiency and transparency in the audit process.

c. Transactions' Development

In this phase, the information from external institutions is transmitted online for the immediate execution of processes' activities.

Thus, this has called for the automation and integration of our internal processes, fundamentally generating a technological leap, still not entailing changes in the organizational or functional structure. Nevertheless, in this stage the need arises to generate synergies with other public and private entities with a view to rendering increasingly complete services and more effective risk management services, which shall in turn generate a cultural change as a condition to continue with the development process. Precisely at this time greater momentum is given to the implementation of information exchange agreements, which shall be later modified by addenda to the processes' integration agreements.



In this phase, the processes undertaken by other institutions enable the reduction of the Tax Administration's vulnerability to tax evasion, which is addressed hereunder.

In Peru, the SUNAT issues the Single Taxpayers' Register (RUC, as per the Spanish acronym) for individuals or corporations that undertake business activities. In order to do so, evidence is required as to the existence of the individual or corporation that shall be granted the taxpayer status.

In the case of Individuals, since 1998 the RUC generation process performs an online validation of the individual against the National Identification and Marital Status Register (RENIEC, as per the Spanish acronym). This enables, in addition to verifying the validation of the existence of an individual, to access other relevant data such as the individual's photograph, which avoids generating RUCs for inexistent individuals.

d. Transformation

In this fourth phase, which we are approaching, the cultural leap is already a fact and on such basis, the SUNAT services and operations are redefined by means of integration with a number of public and private institutions at their different levels, and the private sector, NGOs and citizens, enabling increasingly customized services, available via a single window.

In this phase the service and information networks available know no institutional or business borders. Internal automated tax evasion control processes are supported by a high degree of internal and external integration.

In the modality of this phase we have included our corporation control project. Such project will be implemented in the pilot phase in December this year. It foresees the integration of control processes' for incorporations by Notaries' Public, the National Superintendence of Public Registers and the SUNAT. Based on this system, the incorporation of a business with a Notary Public shall be

recorded minutes later in the Public Registers, which in turn shall forward the information on the new corporation or business to the SUNAT for it to issue the RUC. Once the RUC has been assigned, the information shall be updated in the Public Registers' databases and forwarded to the Notary's Office for delivery to the taxpayer thereafter.

Although this integration project may be deemed a service to the citizen, it shall be also considered to avoid supporting the RUC application process with forged documentation.

3.2. Strategy

In order to achieve the level of cooperation that enables the transformation and integration of our processes and information systems with those from Government entities, the strategy we follow is that of participating in the National e-Government Initiative and implementing information integration solutions with public administration offices, in a context of global efficiency. For such purpose, among the main projects we are undertaking, the following may be highlighted:

a. Cooperation in the Pilot Project for the National e Government Initiative

Peru has undertaken the development of the e-Government initiative as a national project that requires the cooperation of all Government entities. The Tax Administration attaches special priority to this project given its national scope, the impact on society and the technological feasibility.

Therefore, in 2003 we actively participated in the Multi-sector Committee for the Integration of Government IT Systems and Technological Platforms (COISIP, as per the Spanish acronym). The essential purpose was defining the guidelines for IT systems' integration and technological platforms from the different Government Administration entities.

In this scenario the Single Window Project for the Incorporation of Businesses is being furthered. It originates as a taxpayer service, but in turn, it directly impacts the use of the RUC as a single ID code with the Government and the reduction of possibilities to employ forged documentation in the registration process.

This integration process not only provides for integration with public sector entities, such as Public Registers, but also with the private sector, since the Notary Offices have been included as the process starting point.

b. Institutional and Government processes' Mapping Analysis and Defining Critical Processes across Institutions.

i. Mapping Institutional Processes

In 2004, the analysis of the SUNAT institutional macro-processes was performed in line with the mapping of institutional processes. This enabled to attain a global vision of all the institutional activities from a systemic perspective and identify in what way each institutional process interrelated with the rest.

The chief benefit of such effort was the identification of critical institutional processes and gaining a systemic vision thereof, clearly identifying the relations with other internal as well as external institutional processes. Consequently, we were able to ensure that any process improvement would not be focused on the optimization on a local basis, but on achieving an overall improvement, avoiding the risk of improving one process to the detriment of another related one.

ii. Information Plan

Upon completion of the institutional processes' mapping effort, a relevant project arises, named the "SUNAT Information Plan" with the short term purpose of obtaining vital information from other institutions for our critical processes, while processes' integration requires a greater development from each cooperating agency.

Pursuant to this plan, the information required from each SUNAT external institution is defined by the organic units in charge of the use thereof. The latter, in coordination with the National Information Systems' Office, selects the appropriate mechanisms and tools to exploit information .

The phases for information gathering and organized use thereof are the following:

- **External Source Information Request**

It entails the identification of SUNAT information requirements from external sources and their detail, which shall facilitate compliance with the purposes of the institutional operating plans.

- **Assessment and Definition of Priority External Sources**

Prior to massive information reception, we assess the data quality, the frequency, volume and means of transfer, since all these aspects impact their use thereafter. The first factor is the identification of the code or variable that enables to connect to the databases –in our case, it is the RUC- and this is the variable that provides information with consistency, integrity and unicity.

Upon completion of this pre-qualification stage, the information is ready for the Offices involved to determine the information that shall be included in the external sources' plan.

- **Execution of the Annual External Sources' Plan**

Once the plan is approved we develop the external sources' information requirements, the data quality report is issued, and we address the query tool development requirements and incorporation into business intelligence tools to detect tax fraud.

Once the information gathering process has been stabilized in terms of data structure, delivery

frequency and technological transmission method, it is embodied in formal agreements that shall create commitment among institutions.

In this respect, we must not overlook the fact that this mechanism, described as a one-way information flow herein for its implementation thereafter, may be applied in agreements with a two-way information flow.

c. Integration with the Most Relevant Public Entities

Given the degree of development of our e-Government initiative, the SUNAT, based on its 2004 – 2006 Strategic Institutional Plan, has defined among its priorities the use of information to strengthen auditing processes.

In our 2005 presentation we mentioned one of the greatest difficulties to forge alliances with external agents: the lack of technical tools to share information on a large scale. This is especially the case with public sector entities, which for a long time have employed different criteria to record their information.

Therefore, a number of processes' integration projects have been initiated. On the one hand, an interconnection was created with the National Identification and Marital Status Register (RENIEC, as per the Spanish acronym) for online validation of individuals' ID card upon registration with the SUNAT.

On the other, since Government entities do not apply the concept of single ID, the SUNAT is promoting they use the Single Taxpayers' Register (RUC) of the SUNAT as a required field for their subjects (corporations). Thus, it provides the information of the RUC Record on a regular basis to the requesting entities according to the technical feasibility thereof.

Additionally, we have been focusing on the Single Window Business Incorporation solution, by which the Notary Offices, the National Public Registers' Superintendence

and the SUNAT are interconnected. This initiative covers approximately 50% of the taxpayers that file for registration with the Public Registers. In the section on description of initiatives we address some of our most relevant experiences in this regard.

d. Training Cooperation

In the course of our integration process with different institutions we have identified different hurdles that may stall or delay the transformation of our processes across institutions.

Constant change and the context of complexity mentioned before make tax evasion mechanisms evolve with technological improvements as well. Therefore, the cooperation efforts among Government entities shall not only focus on information exchange, but also on mutual training in the enhancements of intrinsic processes for economic sectors, as well as the new tax evasion modalities that may arise therein.

In this regard, training cooperation may be classified into three types:

- i. Telecommunications training and applications' development to support an effective integration process, since certain government entities fail to use technologies. For example, several municipal administrations are only beginning to digitize their information, which makes it unfeasible to exchange it.
- ii. Training on specific notions of productive or business sectors that bear an incidence on tax assessment. Such training enables to identify new tax evasion modalities.
- iii. Training on procedural issues to file tax crimes' claims. This training enables to adapt the evidence gathering process to contribute to accelerate the legal claim process with the Judicial Branch.

e. Cooperation with External Processes that Influence Preventing or Combating Tax Evasion.

Another strategy adopted by the SUNAT is the coordination with public sector entities that somehow conduct activities linked to the struggle against tax evasion. In doing so, achieving the efficacy and efficiency of internal processes in such institutions devoted to controlling tax evasion becomes an institutional objective.

In this regard, the following courses of action for this form of cooperation have been decided:

- Combating tax evasion is strengthened to the extent that fraud is effectively punished, and therefore, the promptness in the process to prove fraud is crucial.
- The efforts to combat tax evasion shall be frustrated should any of the phases of the process be stalled in any instance thereof. One of the forms of delaying the tax evasion detection process and the collection of the tax liability is by the claims and appeals' process. Therefore, we have promoted cooperation with the Tax Court as the last stage of the administrative process.

4. MAIN COOPERATION INITIATIVES WITH OTHER ENTITIES TO PREVENT AND COMBAT TAX EVASION

This analysis has been broken down according to tax evasion compliance gaps.

4.1. Ministry of Labor and Promotion of Employment (MTPE, as per the Spanish acronym)

Since 1999, the SUNAT has been in charge of the administration of social security contributions and payments, which entailed broadening its competencies to the labor field. Such contributions are directly tied to the existence of a labor relation and the employees' payroll assessment.

TOPIC 2.3 (Peru)

Payroll taxes and contributions amount to an estimated 20% of the annual revenues. Therefore, creating a strategic cooperation alliance with the Labor Ministry is vital.

a. Commitments

- Coordinate actions to construe labor and social security laws in order to guarantee the fair enforcement of legislation.
- Conduct joint oversight and/or auditing actions as to compliance with labor and social security obligations.
- Develop labor-tax IT systems to enable the incorporation of technological innovations in the registration systems, spreadsheets, payment tickets and others linked to compliance with labor, tax and social security obligations.
- Implement and execute joint training programs.
- Exchange information as applicable.

b. The Cooperation Process

The Labor Ministry provides information on temporary employment agencies, modal contracts, annual labor statistics' statement and companies that perform risk activities.

Regarding process integration, the creation of the Workers and Service Providers' Register has been approved, which as of 2007 shall be filed by taxpayers on magnetic tape instead of the current Record Book. This shall allow us to assess tax liabilities as well as social security contributions and payments and achieve an estimated 10% reduction in the time required for the auditor to examine labor taxes.

This new register reduces the duplication of efforts stemming from the requirement to file the Record Book with the Labor Ministry and the Employer's Payroll Statement with the SUNAT, making it a single process.

Vis-à-vis training cooperation, we have received training support on labor issues for 60 Tax Administration officials. Likewise, a number of Tax Administration officials have been participating in the multi-sector committees that analyze labor legislation in effect or underway.

c. Outcomes

The information and technical support received on the basis of this Agreement have been very useful since they have enabled the development of auditing strategies for payroll taxes, with actions that seek to bridge the main tax evasion gaps, such as:

- Regarding the registration gap, the Labor Ministry information helps us identify businesses that hire employees and determine their compliance with the statements and payment of social security contributions and payments, as well as other payroll taxes. Likewise, upon request of the Social Health Insurance (ESSALUD, as per the Spanish acronym), it helps us avoid fraudulent registration, by removing from the workers' register the individuals registered without a legitimate right in order to unduly enjoy health services or low-cost medical assistance.
- The information rendered by the Labor Ministry has enabled to increase labor tax audits in 2005 by 300% after subscribing an agreement with said entity in 2004.
- The annual revenue increase based on payroll taxes accounts for 7%. As of June 2006, revenues from this item amount to US\$ 678 million.

4.2. Production Ministry (PRODUCE, as per the Spanish acronym)

The Production Ministry oversees national policies applicable to extraction, production and transformation activities in the industry and fishery sectors.

a. Commitments

- Joint actions to define the principles that enable the progressive integration of information processes and systems.
- Provide the technical-regulatory areas with any information required for the tasks of both entities.
- Creation of working groups among institutions.
- Support during control operations.
- Staff training.

b. Cooperation Process

The Production Ministry has been rendering the following information to the SUNAT:

- Authorizations, permits and entitlements granted for extraction activities and industrial processing of hydro biological resources.
- Information on the assessment and payment of fishing rights.
- Information on the program for oversight and control of fishing and landing in the maritime areas.

c. Outcomes

The information and technical support of the Production Ministry has been successfully used in the oversight strategy for the Fishing Sector, which has enhanced tax control actions with the following outcomes:

- Registration gap reduction, by identifying the holders of fishing permits that have been involved in extraction activities and were not registered in the Single Taxpayer's Register. A total 23 thousand new taxpayers have registered in this sector between January and June 2006.
- Filing, payment and data accuracy gap reduction. We have implemented a System of Tax Advances on sales of hydro biological resources, fishing vessels and fish meal and oil, which has achieved significant progress in the

sector's tax compliance and an increase in revenues there from. Therefore, it is worth underscoring that deposits in the tax advances' accounts from taxpayers' in the fishing sector in the period from January to June 2006 has increased to US\$ 47 million.

Additionally, in this cooperation process with the Production Ministry, joint actions have been undertaken geared at the progressive integration of information processes and systems, as well as training of auditors and professionals in specific sector issues.

4.3. Energy Investment Oversight Agency (OSINERG, as per the Spanish acronym)

The Hydrocarbons Sector in Peru accounts for almost 14% of annual revenues, therefore, this sector's analysis and control acquires special relevance in the struggle against tax evasion.

a. Commitments

- To exchange information.
- To perform joint operations to control fuel transportation and sales.
- To provide mutual technical support in oversight and audit tasks.
- To draft and develop training programs for officials in both institutions.

b. Cooperation Process

OSINERG has been providing the SUNAT with the following information:

- Identification of the agents that participate in the fuel market: producers, distributors, wholesalers and retailers, gas stations, end consumers and provisioning facilities' operators and carriers.

TOPIC 2.3 (Peru)

- Detail of the sales volumes for each stage in the process, that is to say, from producers to wholesale distributors, from wholesale distributors to gas stations and end consumers, as well as from retail distributors to end consumers.
- Wholesale distributors' initial and final inventories.
- Gas stations' storage capacity.
- Destination of jet fuel purchases.

Likewise, as provided for by the agreement, the OSINERG has provided training to the SUNAT, mainly regarding the following issues:

- Operation of the fuel sales' market.
- Tax evasion modalities, chiefly adulteration and blending.
- The OSINERG system to control purchase orders.

Vis-à-vis systems' integration, the use of the URC as a common code enables information sharing between the SUNAT and the OSINERG. On the other hand, the incorporation of the SCOP code, by which the OSINERG identifies the fuel orders on the payment receipts for the fuel sales transactions, is an additional step towards the integration of our processes for the improvement of the use of information.

c. Outcomes

The information and technical support received on the basis of this agreement has been extremely useful since it enabled the furtherance of an auditing strategy for the fuel sales sector, according to the following procedures:

- Creation of the receipts' system for oil-byproduct liquid fuels levied with the General Sales Tax (IGV, as per the Spanish acronym) with a 1% receipt rate. The purpose of this system is to broaden the tax base by formalizing the sector's players and guaranteeing due tax compliance.

This system may be described as follows: the party that sells the goods subject to a receipt rate shall

charge its customers an additional amount over the sales price base, payable to the Tax Administration thereafter. The receipt amount is an advance IGV payment for the sale of the purchased products in the future.

Receipt agents are liquid fuel wholesalers designated by the General Hydrocarbons' Office and appointed by the SUNAT; the parties who shall be subject to receipts are outlets and gas stations (purchasers).

This system has been implemented thanks to the OSINERG's support in the knowledge of the fuel market, which has enabled to determine that the Receipts' System is the best system for the control thereof.

- Audit processes that seek to eliminate the main tax evasion modalities:
 - Regarding the registration gap, the SUNAT assigned the RUC to those taxpayers who lacked such code in the OSINERG records. Since then, the SUNAT has been referring to the OSINERG taxpayers who file for registration with the ISIC for fuel sales, with the aim of verifying whether they have obtained the respective business authorizations.
 - As to the data accuracy gap, thanks to the information exchange activities with the OSINERG systems, we rely on the fuel volumes that wholesale and retail distributors buy from producers and sell to each outlet and end consumers. Upon determining its value, they are compared against sales and purchases filed on the monthly General Sales Tax statement. Additionally, with this information, we may establish inventory differences concealed mainly in under-valued sales.

Prior to the cooperation process with the OSINERG, approximately 30% of transactions' amounts were not reported by fuel purchasers and thus, the product sales could not be subjected to audits. To date, 100%

of transactions are attributable to purchasers and it is possible to audit the value added chain as well. This information has allowed the number of interventions to grow from 643 in 2002 to 2,303 in 2005.

- Improper use of tax-free fuel. The SUNAT requested the OSINERG to incorporate the control of jet fuel that is exempted from the Excise Tax into its systems, thus developing an additional module in their systems, which enables to know the final destination of this type of fuel. This system has allowed to reduce the use of tax-free fuel from 3.67 to 0.51 thousand barrels daily, which leads us to assume that 3.16 thousand barrels were unduly used.
- Fuel Contraband. The implementation of the use of molecular markers is being coordinated with the OSINERG to enable to differentiate local fuel from fuel that is smuggled into the country mainly through the borders with Ecuador and Bolivia. This system shall be also applied in the differentiation of the fuel from tax-free areas in the country, which shall not be sold outside such areas.

4.4. The National Public Registers' Superintendence (SUNARP, as per the Spanish acronym)

a. Commitments

The agreement subscribed with the SUNARP sets forth the technical cooperation and information exchange commitments, with the sole purpose of using them in furtherance of their ends and the institutional objectives:

- Implementing the RUC registration process for Corporations from the Public Registers' offices via an interconnected system involving the Notary Offices, Public Registers and the SUNAT.

- Implementing RUC data update processes for Corporations from the Public Registers' offices via the interconnected system mentioned above, with the purpose of updating information on individuals involved in the business (legal representatives, partners, agents).
- Providing additional technical cooperation, in the time and manner defined in specific agreements.

b. Cooperation Process

Based on such Agreement, the SUNAT has been receiving basic information on the records entered in the following Public Registers: Real Estate Property, Vessels, Airplanes, Mining Duties, Public Services Concessions, Motor Vehicle Ownership, Pledges, Term Sales, Hydrocarbons, Corporations, Intestate Inheritances, Business Owners and Brokers.

c. Outcomes

The information received by virtue of the Agreement has been useful because it enables us to conduct the following actions in order to bridge the most relevant tax evasion gaps:

- As regards the payment gap, the information provided by the SUNARP is exploited via an application to perform individual and massive queries of the transactions recorded in the Public Registers, with the purpose of guiding the attachment and collection efforts. The SUNARP has provided over two million records, which are updated on a monthly basis and made available to the collection units. This has generated a 25% growth in the number of attachments in the period between January and June 2006 against the same period in the previous year.

Likewise, vis-à-vis the improvement in the attachment measures' registration process, coordinated actions is conducted to implement an application to electronically issue attachment notifications to the SUNARP.

For such end, we are working with the SUNARP to open a window and appoint a Public Register official to see to the attachment measures records filed by the SUNAT Enforcement Officials with the Real Estate Property Register and Motor Vehicle Register of Lima.

- As to the filing gaps, we shall use the information from the Public Registers to build indicators to select taxpayers to be audited when the information from the present records indicates an Unjustified Wealth Increase.
- Finally, as regards the reduction of the data accuracy gap, the individual and massive query application referred to above shall serve as a support element in the course of the audits conducted, enabling auditors to rely on a query tool for the background of the transactions performed by the audited taxpayers, facilitating the detection of taxable events and the tax liability assessment for the official.

4.5. The Public Prosecutor's Office

In the cases in which the audit process indicates a possibility of a tax crime, the Tax Administration shall only enforce administrative penalties and collection of the tax liabilities. In other words, the impact is strictly of an economic nature and on the business or corporation.

Nevertheless, the perpetrators of tax crimes must be punished by a court of law, under the scope of the Judicial Branch.

Therefore, and according to the premise that the struggle against tax evasion is strengthened to the extent fraud is effectively punished, an agreement has been subscribed with the Public Prosecutor's Office, which is the authority in charge of formally filing the criminal claim for tax crimes with a court of law.

a. Commitments

- Creation by the Public Prosecutor's Office of the Tax Fraud Prosecution Unit with two prosecutors assigned for such end.
- SUNAT support as to logistics, technical and legal staff and infrastructure for the venue of the Tax Fraud Prosecution Unit.
- Information and dissemination vis-à-vis the new strategy to counter tax evasion, to the benefit of the Government's economic interest.

b. Cooperation Process

The Public Prosecutor's Office created the Tax Fraud Prosecution Unit in 2002 and the SUNAT assigned the applicable resources for its implementation as agreed.

c. Outcomes

This cooperation process directly impacts the data accuracy gap.

Prior to the cooperation work with the Public Prosecutor's Office, the assumptions of tax crime filed by the SUNAT to the Public Prosecutor's Office were processed together with the claims for ordinary crimes processed by the Public Prosecutor's Office. That is to say, the claims could be forwarded to any of the 60 Public Prosecution Units in the Public Prosecutor's Office, without any kind of priority or specialization in tax matters.

Therefore, every tax crime assumption filed by the Administration was referred to the Judiciary in an average term between 12 and 16 months.

Upon the creation of the Tax Fraud Prosecution Units the process has been centralized and accelerated. Now, the tax crime assumptions filed by the SUNAT are referred to the Judiciary within a term not exceeding 30 days. To date, 579 cases are being heard by the courts.

CONCLUSIONS

The current complex context and the speed of IT development force the Tax Administrations to promote cooperation processes beyond simple information exchange.

In the Peruvian case, the legal framework according to which the SUNAT undertakes such cooperation process enables it to provide and receive information, training and logistic support among others, with the purpose of effectively preventing and combating tax evasion. Notwithstanding, it shall take into consideration the right to privacy, tax confidentiality and banking secrecy to achieve its purposes.

Technological advancements and the e-Government strategy guide the cooperation initiative towards the overall transformation of processes, integrating them with those of other entities. This mutual cooperation process, asserts and strengthens the State as the regulatory agency and the promoter of services, and empowers the Tax Administration in its effort to combat tax evasion.

TOPIC 3

**TAX COLLECTION IN FRANCE. LEGAL AND ADMINISTRATIVE
FRAMEWORK – ENFORCED COLLECTION POLICY**

Lecture

TOPIC 3

TAX COLLECTION IN FRANCE. LEGAL AND ADMINISTRATIVE FRAMEWORK – ENFORCED COLLECTION POLICY

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*CONTENTS: The Legal and Administrative Framework of Collection.-
I. The collection organization.- II. The legal framework of collection
in the DGI.- III. Collection management and control.- The Collection
Policy.- I. Increased responsiveness vis-à-vis returns non-compliance
and delinquency.- II. Strengthening the tax control quality chain.*

Before describing the organization and the specific working methods used in tax collection in France, it is worthwhile providing a brief description of the legal and administrative framework where said collection takes place.

THE LEGAL AND ADMINISTRATIVE FRAMEWORK OF COLLECTION

I. The Collection Organization

Peculiarity of the French system: 3 collection networks

Tax collection is performed by 3 different networks:

- The accounting network of the **General Directorate of Taxes** (DGI as per the acronym in French);

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- The accounting network of the General Directorate of **Public Accounting** (DGCP as per the acronym in French) ;
- The accounting network of the General Directorate of **Customs and Indirect Taxes** (DGDDI as per the acronym in French).

The **DGI** is in charge of collecting major professional taxes: VAT, corporate tax, payroll tax, stamp tax, solidarity tax on wealth.

The **DGCP** collects income tax and local taxes (land tax, property tax, trade income tax).

The General Directorate of **Customs** collects excise taxes (alcohol, tobacco), import duties, the tax on petroleum and its byproducts and VAT on imports.

The recent shift (2003-2004) of the responsibility for collecting payroll tax and corporate tax from the DGCP to the DGI reflects the willingness to adjust the procedures linked to professional users.

As a result, from now on corporations have a single tax interlocutor within the DGI – the **Corporate Tax Service** – which is responsible for managing and collecting professional taxes.

Large corporations (bottom-line before taxes > 400 million Euros) have had a single interlocutor since 1 January 2002, namely the Large Corporation Directorate.

In 2005, the joint collection by the 3 networks was **549, 900** million €, broken down as follows:

Customs:	11%
DGCP:	40%
DGI:	49%

These figures include both fiscal and non-fiscal collection (proceeds from the sale of goods and services by the government and local administrations, such as the water supply service).

The DGI's Accounting Network

The tax collection carried out by the DGI is supported by a rather large network made up of 791 corporate tax services.

Public Accountants

The heads of these accounting locations have the status of public accountants, which means they are liable with their own equity in the framework of the collection service where they perform their function. For this reason, they may be personally sued in case of negligence or embezzlement.

Accountants are held liable mainly in the event cash or assets are proven missing, or if a credit becomes unenforceable by prescription owing to inaction by the collection agent.

II. The Legal Framework of Collection in the DGI

Spontaneous Payments

In principle, the payment of taxes to an accountant should be accompanied by a tax return filed before the service in the corporation's jurisdiction.

Payments are deemed "Spontaneous" when they are made without any reminder from the service within the legal framework applicable for returns submission. These payments are also called "payments by due date".

Means of Payment

The services accept numerous means of payment, including:

- cash,
- banking card,
- check .

There are two payment modalities which have the advantage of not requiring the involvement of an accountant, thus speeding up and simplifying collection in addition to avoiding the issues of security associated with the handling of funds:

- **wire transfers**: since 1992, payment by direct wire transfers to the *Banque de France* is required when the annual tax paid is above a certain threshold (760,000 • for VAT);

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- **electronic payment:** VAT, corporate tax, payroll tax and local taxes may also be paid over the Internet. This means of payment is required in the case of VAT for businesses whose bottom-line exceeded 1,500,000 • the previous year (760,000 • effective 1 January 2007). When this means of payment is selected, the local service is not involved in the payment of taxes by the due date.

Accounting of the Means of Payment

Collection services have an IT system for the accounting of means of payment called “MEDOC “. This system encompasses accounting tasks (preparation of financial statements) as well as management tasks (follow-up lists, drafting of reminders). The heaviest printing tasks (warnings, enforcement writs) are entrusted to IT service centers. The use of IT has resulted in improved productivity.

The Enforced Collection Procedure

In the event of failure to file the return and pay by the due dates foreseen, the service makes an ex-officio assessment of the return and the accounting system calculates the applicable amount including penalties.

Should the delinquency not be redressed after the invitation to make the tax payment, an enforcement writ is issued. This is an executory instrument which enables the filing of legal claims upon issuance of a payment warning, without prior intervention by a judge.

Means of Intervention: the Enforced Collection Procedure

A significant portion of the work carried out by corporate tax services consists of obtaining payment for the amounts outstanding by the due date.

The services have a variety of tools available to make enforced collection:

1°) Legal

- Preference of the Treasury over the debtor’s personal property: preference whereby the Treasury’s credits prevail over those of other debtors;

- Enforcement: judicial writ to third-party owners, seizure and sale of the debtor's property, overall sale of goodwill, personal liability of corporate officers;
- The right to receive communication, whereby the debtor is compelled to provide the list of its own debtors so that the latter may be summoned in their capacity as third-party owners.

2°) IT

The IT application (MIRIAM) deals with enforcement procedures. Its function is to help the services follow up on delinquent taxpayers and produce the necessary documents.

The DGI manages an IT application (FICOBA) which keeps a record of the references of all bank accounts declared by French banks.

III. Collection Management and Control

An Essential Player: the Head of the Accounting Service

In addition to corporate tax services, each Department has a service whose mission is collecting taxes but also consolidating the accounts of the remaining services in the Department. The main function of the head of this service is to manage the accounting network in his/her Department.

Their function is to ensure:

- immediate accounting for the means of payment;
- efficient tax management and enforced collection proceedings.

Every two years, each tax service director submits to the General Tax Director a balance sheet of the management of the completed years which includes the collection function. The diagnosis of said mission, assessed by management indicators, gives rise to an action plan aimed at correcting the weaknesses detected.

The head of the consolidating accounting service is involved in preparing the diagnosis and the action plan. Likewise, in his/her capacity as responsible for collection in the Department, he/she ensures the implementation of said plan.

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The actions undertaken have the following general aims:

- improving the collection rate,
- reducing the number of debtors of outstanding balances,
- curbing or reducing the amount of outstanding balances,
- increasing the quantity and quality of judicial proceedings.

Finally, the DGI is currently creating collection centers which centralize at the level of the consolidating accounting service the enforced collection of complex cases across the Department.

Checks by the National Audit Office

The National Audit Office checks accountants' performance, mainly in connection with the regularity of transactions vis-à-vis tax rules (jurisdictional control) and the timeliness of said proceedings.

The first check performed by the Audit Office consists in examining accountants' accounts and assessing the adequacy of the proceedings undertaken in view of the justifications provided. Should this adequacy not be confirmed, accountants may be held both personally and financially liable in the framework of the institute of accountant's liability.

This liability may also originate in a regular check performed by accountants from the main inspection corps at the central administration.

An accountant having incurred accountant's liability may request voluntary reimbursement of said debit balance (usually accepted if there are specific circumstances which explain the irregularity detected). Finally, accountants are personally insured against the risks that might render them liable.

THE COLLECTION POLICY

The collection policy is part of an overall initiative of improving the efficacy of the administration's actions. This initiative has been the subject of covenants between the General Secretariat of the Ministry and the DGI in the framework of their performance agreement.

Thus, the 2003-2005 agreement foresaw a series of priority actions in connection with quantitative objectives: consolidating and continuing tax awareness promotion efforts, increasing responsiveness vis-à-vis returns non-compliance and delinquency, improving the efficacy of the tax control quality chain.

The 2006/2008 agreement extends these priority actions, undertaking to:

1. increase responsiveness vis-à-vis returns non-compliance and delinquency;
2. strengthen the “tax control quality chain”.

I. Increased Responsiveness vis-à-vis Returns Non-compliance and Delinquency

The DGI’s commitment in the area of tax awareness among professionals, the core of its performance agreement, translates into a two-fold effort aimed both at returns irregularities and delinquency.

Regarding **returns awareness**, very satisfactory results were obtained in the two more recent agreements, which resulted in increased responsiveness vis-à-vis non-compliance.

Working Methods

The first step consisted in providing credibility to the “retorsion” measures applicable in the event of non-compliance, by implementing a gradual sanctioning mechanism:

- firstly, invitations to regularize the payment situation, either by telephone or by mail, with the purpose of favoring a dialog with the user;
- secondly, in the event of late regularization, strict enforcement of delinquency penalties;
- finally, should non-compliance persist, an ex officio regularization by the service by applying a more forceful tax procedure (an ex officio assessment).

The objective is to collect the full amount of taxes evaded as well as the penalties applicable. These actions should unfold very quickly in order to facilitate adhesion of the most recalcitrant taxpayers.

Organizational Steps

With a view to facilitating compliance with returns and payment obligations, the DGI created a single window for professionals – the **Corporate Tax Service**, which takes care of all management tasks

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(assessment, collection, contentious proceedings). In parallel, **remote transactions were actively promoted** with the purpose of creating a multi-service access to the tax administration.

Regarding the raising of **payment awareness**, in addition to applying penalties, DGI accountants carry out enforcement procedures – friendly at first, and then coercive – which might, should the case so warrant, lead to the file being followed up by a structure specializing in the management of complex cases, namely the **collection center**.

The collection center is a working team created at the departmental level and part of the consolidating corporate tax service, which specializes in difficult or complex collection cases: files referred as a result of tax checks and any other files relative to which the director of tax services has decided to speed up the collection procedure.

The ruling principles for the work of this service are responsiveness and paced action, since timing is a priority factor.

All files sent on to the center are difficult by definition, since they pertain to taxpayers with whom the proximity service – the corporate tax service – has not been able to agree on a payment plan using customary means (payment warnings, judicial writs to third-party owners addressed to banks, visiting right).

Furthermore, these cumbersome and complex procedures must no doubt be carried out ensuring all necessary efficacy.

These centers are being extended throughout France at the national level. The first performance evaluations have yielded very positive results, with the emergence of a “center effect”, since the mere passage of a file to a specialized center seems to have a coercive effect on taxpayers.

In view of the tax implications at stake, follow-up instruments have been implemented for each monthly due date. The main tax awareness indicators show a progression which has resulted from this strategy.

Indicators	2003	2004	2005
Compliance with VAT tax returns	84.2%	88.5%	89.2 %
Payment of professional taxes by due dates.	98.2 %	98.5 %	98.8 %
Delinquency for annual corporate profit (loss) returns	1.5 %	1.1 %	0.8 %
Net coercive collection rate	55.9 %	54.2 %	54.3 %

Note: the net coercive collection rate is impacted by the shift of collection responsibility from the IS to the DGI in 2004.

II. Strengthening the Tax Control Quality Chain

Maintaining a high collection level by implementing tax controls is one of the DGI's priority focuses.

This focus translates into a series of specific steps to be implemented by the services.

It is part of an overall framework characterized by the willingness to ensure citizens' equality vis-à-vis taxes.

Improving collection of amounts owed is an essential link in the Tax Control Quality Chain

The concern regarding collection of amounts owed as resulting from tax control led to the creation (in 1998) of a specific follow-up mechanism for enforced collection procedures relative to significant claims, which focused on the highest financial amounts.¹

Effective back in 2001, a more global initiative was implemented to enhance the quality of tax control, based on the notion of linked operations, which claims that the quality of tax control builds on the inherent quality of every individual operation performed. These operations encompass all processes, from targeting businesses for control purposes to collection *per se*. Thus, quality naturally includes the concern of collection, which is an integral part of the fiscal objective of tax control.

¹ Claims rights+ penalties > 150MF, which threshold was brought down to 10MF in 2001.

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This strategic focus was stated in the first DGI agreement on objectives and means (2001-2002) which included an indicator on debt collection referred from tax control, and continued to be stated in the performance agreements for 2003-2005 and 2006-2008. The latter has a chapter on the promotion of a tax control quality chain whereby the DGI and the DGCP (given that the DGCP has jurisdiction to collect some direct taxes) undertake to raise the collection levels of evaded taxes.

This feature is measured by the Tax Debt Collection Rate indicator (TRCF as per the acronym in French).

The TRCF indicator is used both by the DGI and DGCP networks in their respective performance agreements.

In the 2003-2005 performance agreement, this rate measured semi-net debt collection (i.e. all debt except the portion pertaining to businesses under bankruptcy procedures or in receivership) resulting from tax control, considered as in year N-2.

In the present agreement (2006-2008), the TRCF indicator measures gross debt (i.e. all tax debt without exceptions) with the purpose of better reflecting the reality of post-control collection as well as the quality of the latter.

This indicator was built as a cross-cutting indicator, since it assumes that debts will not be questioned (which fact depends upon the quality of the work performed by the inspecting service) and that they are effectively collected (which fact depends upon the action taken by collection services).

In building this indicator, strong cooperation is required between the control and collection services, mostly in connection with passing on to accountants data and elements held by tax control, and implementing specific follow-up.

The target for this joint indicator was set at 43% for 2008. It is also reflected at the departmental level by the setting of a single joint target.

An exchange of information mechanism between the two networks regarding the level achieved in the departmental sphere was implemented by a DGI/CP joint working group.

Raising the collection rate of CFE owed amounts calls for action by all players involved

The services have been instructed to include collection as one of their main concerns as from the control phase.

Thus, a strategic objective was determined – “conveying the right data at the right time”. To achieve this, a solvency sheet was drafted by the inspection services aimed at collection services, whose content and issuance term may vary depending on the potential collection risk as assessed in a **risk analysis grid**.²

The presence of risks which can potentially jeopardize debt collection may lead inspectors to send the solvency sheet from the very beginning of the control phase to prompt **precautionary steps** to be taken by the accountants.

In exchange, the accountant communicates his/her remarks on the taxpayer’s position.

Tax documents shall be determined promptly so that they can be immediately considered by collection services.

The time elapsed from the ending of the inspection procedure to the effective assessment of the applicable taxes is measured by a specific application which follows up tax control³ activities and is subject to targets defined by the agreements at the service level.

Cooperation has consolidated between the assessment services and the two accounting networks.

Joint work by the two networks in charge of collection in pursuit of the same target is the logical counterpart to having a single indicator.

For this reason, TRCF local follow-up cells were created. All the players in the control chain are part of these cells: the division director in charge of tax control, the DGCP’s responsible for the collection center, the

² Implemented in certain services and later extended to all others.

³ ALPAGE

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DGI's responsible for the collection center or the representative of the corporate tax consolidating service and, should the case so warrant, control corps heads or inspectors. The purpose is to strengthen exchange of information between the two networks in order to trigger alert procedures and create synergies of means.

These cells focus on the most sensitive cases, either because of the high amounts at stake or the prospect of a potentially difficult collection.

In addition to the work performed by these cells, exchanges were intensified within the inspection and collection services of the DGI. Thus, the involvement of the head of the consolidating accounting service at the local programming committees and meetings of the inspection corps enables the services to receive feedback and become more aware about collection-related issues.

Collection services were urged to use all the tools they have available

Exercising the communication right, even during the control phase, usually leads to favoring collection inasmuch as it resorts to judicial writs to third-party owners.

Likewise, taking precautionary measures contributes toward anticipating potential collection risks, especially in the case of organized insolvency. In effect, the accountant may submit to the judge a grounded claim and point out the risks that might jeopardize its collection in order to obtain an authorization to issue a precautionary measure. As mentioned above, the alert signal is mostly up to the control service, since this is the only party in a position to detect this type of risk.

Precautionary measures are even used in the framework of tax searches, which enables the attachment of assets found during the procedure with the purpose of securing the payment of potential new tax assessments that might be applicable.

Improving tax control quality is one of the main commitments of the DGI. Action by all players involved and the use of the whole array of technical and organizational tools available are the reason for its successful operations.

Case study

TOPIC 3.1

COMPETENCE AND ORGANIZATION OF THE TAX ADMINISTRATION VIS-À-VIS COLLECTION

Mike Snaauw

Director, Accounts Receivables Division
Canada Revenue Agency

CONTENTS: Introduction.- Entities Responsible for Taxation.- Tax Collection Today.- Enforcement Remedies.- Third Party Liability.- Crown Priority.- Deemed Trust.- Prescribed Security Interest.- Enhanced Garnishment.- Deemed Security.- Bankruptcy and Insolvency Law.- Challenges.- Conclusion.

INTRODUCTION

The Canada Revenue Agency (CRA) is the principal revenue collector for the federal government. Annually, the CRA collects over \$300 billion in taxes and other revenue and distributes close to \$12.5 billion in benefit payments to millions of families and individuals on behalf of the federal, provincial and territorial governments, as well as First Nations. The taxpayer base includes approximately 24.4 million individual income tax filers; about 1.5 million employer accounts; about 1.6 million corporate income tax filers and 2.4 million GST registrants.

The Agency's mandate and strategic direction focus on promoting compliance with the legislation it administers. It pursues this mandate while ensuring that the tax benefits administration system functions in the best interest of Canadians at the lowest possible cost.

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This technical paper describes, primarily from an enforcement angle, the present state of affairs regarding the competence with which the Canada Revenue Agency, functions as Canada's tax collector. In discussing the competence of Canada's tax administration, we include the successes and frustrations that CRA experiences today.

The paper details the priorities afforded the Crown in the deemed trust provision, the enhanced garnishment legislation, the deemed security interest provision, third party liability and priority as a judgment creditor. It will also discuss the challenges of being unable to convince the court to pierce the corporate veil, as well as the practice of tax debtors to make themselves judgment proof. At times, priority is not awarded to the Crown and other remedies are used. These remedies will be discussed. Further, the paper provides examples of provincial legislation where the provinces have legislated provisions to counter successor corporations.

Issues concerning bankruptcy and insolvency are discussed throughout the paper. As well, the paper outlines the Agency's position on proposals and the bankruptcy system as it pertains to collections.

Even with all of the collection remedies and tools at the disposal of CRA not all collection cases are met without challenges. CRA aims to remain focused on the challenges ahead and continues to move in a direction, which promotes compliance and the competence of our tax system.

ENTITIES RESPONSIBLE FOR TAXATION

Taxation in Canada at the federal level involves the Department of Finance, the Department of Justice, the Treasury Board, and the Canada Revenue Agency.

The Department of Finance

The Department of Finance is responsible for tax policy. It formulates amendments to the tax statutes, which the Minister of Finance normally introduces into Parliament in the budget or in a technical bill. A technical bill would deal with deficiencies in the statutes, areas of

abuse, and case law. At times, a press release would announce changes to the statutes, when a single area is targeted, and when there is a need for immediate action.¹ Sometimes, the technical changes are significant changes to policy; however, for the most part, they deal with particular fact situations and a small number of taxpayers. Usually it is the budget though, that is the source of major policy initiatives and substantive changes to the tax statutes.²

The Department of Justice

The Department of Justice is responsible for providing legal advice to other departments of the government and for conducting litigation on behalf of the government. The Attorney General of Canada represents the Crown as the top-prosecuting officer in Canada.

The Treasury Board

The Treasury Board controls the Treasury Board Secretariat and the Office of the Comptroller General. Both ensure that sound administrative principles are followed in government activities and that proper controls are in effect concerning government assets such as accounts receivable (tax debts), and adequate safeguards are in place with regard to spending.

The Canada Revenue Agency

Evolution

The CRA - originally the Department of National Revenue, or Revenue Canada, Customs, Excise and Taxation - is responsible for the administration and enforcement of the tax statutes. With the passing of the *Canada Customs and Revenue Agency Act* on November 1, 1999 the Canada Customs and Revenue Agency ("CCRA") replaced the Department of National Revenue.

¹ A case in point is the adverse decision in *Royal Bank of Canada v. Sparrow Electric Corp.*, 97 D.T.C. 5089 (S.C.C.), decided in February 1997. Six weeks later (April 7, 1997), the Minister announced a proposed amendment to section 227 of the *Income Tax Act*.

² Hogg, Peter W., Magee, Joanne E., Cook, Ted *Principles of Canadian Income Tax Law* (Carswell, 3rd ed., 1999) Pg. 10

In 2003 with the creation of the Canada Border Services Agency (“CBSA”), the Minister of Public Safety and Emergency Preparedness became responsible for the CBSA and the non-collections portion of the *Customs Act*. In 2005, the CCRA became the Canada Revenue Agency (“the Agency”).

Collections

The Agency’s collection functions are multi-faceted. It collects taxes for the federal government, and income taxes for almost all provincial governments and the territories through the system of returns, assessments, audits, collection and prosecution. It delivers benefit programs through the tax system and collects program related debts. CRA has the authority to enter into new partnerships with the provinces, territories and other government bodies in order to administer non-harmonised taxes and other services.³

Program Delivery

CRA delivers its programs through a number of branches at the Headquarters level and field offices. The program delivery branches consist of Appeals, Compliance Programs, Assessment and Benefit Services and Taxpayer Services and Debt Management (TSDMB). These branches set policy and provide oversight to field operations. Field offices such as Tax Services Offices and other specialty workload sites deliver the Agency’s programs.

TSDMB administers the collection programs. It provides information and services to taxpayers and benefit recipients and collects outstanding taxes, other levies, duties and non-tax debts.

Ministerial Responsibilities

The statutes describe the administrator as “the Minister”, defined as the Minister of National Revenue. In reality, though, officials of CRA perform nearly all of the Minister’s functions through the delegation of authority provisions of the statutes.

³ *Ibid.*, section 5

The Minister is accountable to Parliament for all of the activities of the Agency, and is responsible for administering all or part of:

- (I) the Air Travellers Security Charge Act,
- (II) the Canada Pension Plan,
- (III) the Customs Act (“CA”),
- (IV) the Employment Insurance Act,
- (V) the Excise Act,
- (VI) the Excise Act, 2001,
- (VII) the Excise Tax Act, and
- (VIII) the Income Tax Act.

The Board of Management

A board of management (“the Board”) oversees the Agency. The Board consists of 15 members, who include the Chair, the Commissioner of the Agency, and 1 director nominated by each province as well as one director nominated by the territories.⁴ The Governor in Council appoints the Board. The members of the Board must be permanent residents of Canada, and cannot be a sitting member of the Senate, House of Commons, or of a provincial Legislature.⁵ The Commissioner is the only full-time public servant. The Board has no say in the administration and enforcement of fiscal legislation and will not be privy to any taxpayer information.⁶

TAX COLLECTION TODAY

The Process

The Canadian tax system is based on self-assessment and voluntary compliance. The statutes require every person, who is liable to pay tax, or who collects tax as an agent of the Crown, to file a return periodically. The primary task of collecting and remitting taxes rests with employers, sellers of goods and services as well as importers. These amounts collected by the agents belong to the Crown and, when not remitted, are held in trust, since the entities that have collected the funds are not entitled to retain them.

⁴ Section 14, *Canada Customs and Revenue Agency Act*.

⁵ *Ibid.*, section 16

⁶ *Ibid.*, sections 34 & 35

For the tax collector at the Agency, tax collection generally starts with an assessment. CRA takes a firm but fair approach to tax collection. Payment of taxes is due on filing a return or on assessment. Where a taxpayer is unable to pay the debt immediately, the Agency's preference would be to conclude an arrangement to resolve the amount outstanding in the shortest time possible. Failing to conclude an arrangement when the tax debtor has the capacity to do so, CRA will enforce collection.

CRA collects taxes through quality service and responsible enforcement.

Quality Service

CRA facilitates payment of taxes through quality service. To that effect, it offers taxpayers a wide range of services through a variety of channels. These channels include Internet, telephone service, written correspondence and personal service. A taxpayer can now complete a form, obtain information guides, view his account, change his address, amend his return and make payment arrangements and payments online.

Responsible Enforcement

Responsible enforcement entails early detection of non-compliance, and directing the taxpayer to file outstanding returns or amend returns where information is found to be inaccurate. With respect to the collection of outstanding debt CRA takes reasonable enforcement action, based on the ability to pay principle, to collect debts. Risk assessment techniques and case management tools facilitate CRA in taking appropriate enforcement measures.

The standard method of operation used to call for the computer system to collect accounts, is through a series of letters mailed at predetermined times. Accounts not collected in this manner would be redirected to a Tax Services Office for enforcement action. Reasoning is that a personal call is more effective and efficient than a series of letters; the Agency complemented this program with a Collections Call Centre. Agents there adopt a soft approach when contacting taxpayers, with emphasis on persuasion with regard to filing and paying, in an attempt to promote compliance. It is important that CRA contact a tax debtor early to collect the amount,

thereby pre-empting, to the extent possible, any efforts on the tax debtor's part at judgment proofing, or becoming insolvent.

When the Call Centre is unsuccessful at collecting, instead of referring the account immediately to a Tax Services Office for enforcement, CRA places it in the National Inventory System. The National Inventory System has offices situated across the country and accounts are assigned without geographical considerations. The collection of an account at this stage involves routine enforcement; typically issuing a Requirement to Pay and the collection officer does not have any face-to-face contact with the tax debtors.

The third stage would be the referral to the Tax Services Office for strategic enforcement action. Accounts are referred at this stage to the Tax Services Office with the closest geographic proximity to the tax debtor. Tax recovery by the Tax Services Office can become quite complex, in the sense that there may be other creditors' claims in competition with the Crown's, and CRA may have to rely on the priorities afforded the Crown to collect the debt.

ENFORCEMENT REMEDIES

CRA collects most debts through an arrangement with the tax debtor, avoiding the need to apply statutory collection remedies. Ability to pay is the cornerstone of tax collection. In the case of an individual, CRA takes into consideration household income, basic living expenses, net worth and the ability to borrow. In the case of a corporation, cash flow, operational expenses and the ability to borrow are the key factors.

If a tax debtor can demonstrate that he does not have the financial capacity to pay, CRA will not pursue collection. If this inability to pay is temporary, CRA will defer collection action until that person's financial circumstances improve. If there is no financial capacity to pay, CRA will write off the account.

CRA will also write off an account when the limitation period for collection ends. Some of the statutes contain a provision to that effect.⁷ Else, the *Crown Liability and Proceedings Act* will prevail in those statutes that do not have a collection limitations provision.⁸

⁷ S.72, *Air Travellers Security Charge Act*, s. 284, *Excise Act 2001*, s. 313, *Excise Tax Act*. S. 82(1), *Excise Act*, s. 222 *Income Tax Act*.

⁸ This will apply to the *Customs Act*, the *Canada Pension Plan*, and the *Employment Insurance Act*.

As mentioned, reluctance by the tax debtor to pay could cause CRA to enforce collection of the debt by invoking the provisions of the statutes. In this respect, the statutory remedies for tax recovery are wide ranging, and include:

- administrative garnishment,
- seizure and sale of a tax debtor's property,
- acquiring a tax debtor's property,
- asserting the Crown's priority,
- holding third parties liable, and
- proceedings under bankruptcy and insolvency law.

Administrative Garnishment

Administrative garnishment is the most widely used remedy. It is cheap and efficient to apply. It requires no pre-judicial sanction, and a tax debtor cannot dispute its application. CRA always ensures that administrative garnishment is based on the tax debtor's ability to pay.

When CRA knows, or suspects, that a third party is liable to make a payment to a tax debtor it may intercept monies owed or payable by a third party to the tax debtor. All CRA has to do is serve a letter known as a *Requirement to Pay*, in person, or by first class mail on the third party. The *Requirement to Pay* may also be used to intercept monies about to be advanced to the tax debtor or to seize money from a bank account. If the amount is payable immediately, the third party has to remit likewise. If the amount is payable at a later date but within a year, the third party has to remit the funds when they become payable. The third party receiving the *Requirement to Pay* does not have to be involved in a debtor/creditor relationship with the tax debtor.⁹

Acquisition of Debtor's Property

CRA may acquire and dispose of any interest in a tax debtor's property, and apply the available equity to the arrears, when such property is the subject of foreclosure or other similar proceedings.

⁹ National Trust v. The Queen.

THIRD PARTY LIABILITY

The statutes hold third parties jointly and severally, or personally, liable for an amount owing by a tax debtor. A liability of this nature presents CRA with an alternative source for collecting an account. It is effective, in that it encourages the third party to make the tax debtor pay. It is efficient, in that it induces the third party to take measures to enforce payment.

The liability against a third party is joint, as each third party is liable on the same set of facts. The liability is several, for this liability is separate and apart from the tax debtor's liability, it has a life of its own.

The third party liability has other attributes. It is a derivative assessment, as a debt must exist before CRA can assess the third party, which, CRA can do concurrently with an assessment raised against the tax debtor. It is vicarious, for a third party can owe no more than what the tax debtor owes.

Further, a tax debtor's insolvency or bankruptcy does not inhibit CRA from holding the third party liable for a debt of the bankrupt or insolvent tax debtor.¹⁰ Bankruptcy and insolvency legislation provides that a person, who is jointly bound with a debtor, is not discharged from any liability for which the debtor was liable.¹¹ Therefore, if a tax debtor is bankrupt, or has obtained a discharge from the bankruptcy, CRA can assess a third party for the difference between the amount of tax debtor's liability and the amount which he is paying in the proposal. Or, if the tax debtor is bankrupt, CRA may recover the amount owing by the bankrupt from the third party.

When CRA assesses a third party to collect the debt of the tax debtor, that third party is vulnerable to the same collection measures available to collect the amount directly from the tax debtor.

Examples of the third party liability provisions follow.

Distribution of Property

A responsible representative, such as an executor, who distributes a tax debtor's property without first obtaining a clearance certificate,

¹⁰ *Heaveyside v. Canada*, [1997] 2 C.T.C 1 (F.C.A)

¹¹ S.179, *Bankruptcy and Insolvency Act*.

is personally liable for the tax debtor's debt.¹² Even if a responsible representative has obtained such a certificate, CRA may collect the amount owing from the tax debtor, or from a third party who benefited from the distribution of the property.¹³

Transfer of Property

A person (a transferee) to whom a tax debtor (a transferor) while, indebted under the statutes, transfers property at less than fair market value, is jointly and severally liable for the transferor's debt. For the liability to apply, the transferee must have been the transferor's legal or common law spouse, or a person with whom the transferor was dealing at arms length, or was under 18 years of age.¹⁴

Directors' Liability

The directors of a corporation are jointly and severally liable with the corporation, for the corporation's failure to remit payroll deductions, GST, the air travellers security charge, or the excise tax.¹⁵ The liability is conditional. CRA must demonstrate that it was unable to collect the amount from the company. It cannot recover such amount from a director more than two years after ceasing to be a director, and the directors are not liable if they took steps to prevent the failure by the corporation to remit the amounts.

Specified Person

A person, such as an accountant, who has any direct or indirect influence over the disbursements, property, business or estate of the payor of wages, is deemed to be the person who failed to make the payment, and is jointly and severally liable, with that payor, for failure to remit or pay payroll deductions.

¹² S. 159(2) *Income Tax Act*, s. 81(2), s. 270(3) *Excise Tax Act*, s. 97.39(3) *Customs Act*, s. 212(4) *Excise Act 2001*.

¹³ *Boger v. M.N.R.*, 89 D.T.C. 15 (T.C.C); *Bougie v. The Queen*, 90 D.T.C. 6529 (F.C.T.-D).

¹⁴ S. 160 *Income Tax Act*, s. 325 *Excise Tax Act*, s. 97.44 *Customs Act*, s. 297 *Excise Act, 2001*.

¹⁵ s. 227.1 *Income Tax Act*, s.323 *Excise Tax Act*, s. 295 *Excise Act 2001*, s. 81(1) *Air Travellers Security Charge Act*.

Shareholders' Liability

A shareholder of a corporation may have third party liability in several cases such as;

- where a shareholder has used the assets of the corporation to his own benefit he is deemed to have received a dividend;
- where a shareholder is deemed to have received a dividend on the winding-up, discontinuance, or reorganisation of the business; or
- where a shareholder has received dividends as a result of excessive elections for capital dividends and capital gains.

In each of these situations, a shareholder is jointly and severally liable, with the corporation, to pay a portion of the corporation's liability.

Non-Compliance with Garnishment

A person, who has failed to comply with a Requirement to Pay or an Enhanced Requirement to Pay, is personally liable to pay the amount equal to the amount that that person was required to pay.¹⁶

CROWN PRIORITY

General

A tax debt could be regarded as an unsecured claim, a secured claim, or as property. The ability of CRA to claim priority ahead of other creditors in insolvencies, bankruptcies, or otherwise, would depend on the nature of the claim. While it has a limited ability to assert priority for a personal or corporate income tax debt, or a debt for customs or excise duties, the Agency's powers with respect to source deductions, GST, and the air travellers security charge, are significant.

¹⁶ S. 224(4) and (4.1) *Income Tax Act*, s. 317(7), (8), 84(4)(a) and 84(4)(b) *Excise Tax Act*, s. 97.28(5) and (6) *Customs Act*, s. 289(5) and (6) *Excise Act, 2001*, s. 75(6) and (7) *Air Travellers Security Charge Act*.

At common law and by statute, the Crown has always enjoyed a privilege or an advantage over private creditors. This privilege provides that where a debt or a claim due to the Crown competes with a debt or claim due to a private creditor, and both claims are alike; the Crown's claim prevails.¹⁷ Basically, the privilege protects the rights of the community against the rights of the individual.

The privilege does not serve to elevate Crown claims beyond the status of an unsecured creditor. To achieve greater protection for some types of Crown claims, Parliament has deemed certain amounts owing to be held in trust, or to be subject to a security interest. The effect of such legislation serves to remove such amounts owing by a tax debtor from that debtor's property. Cases in point are the deemed trust, enhanced garnishment, and the deemed security interest.

Priority as a Judgment Creditor

Absent a bankruptcy or insolvency the Crown privilege is recognised when CRA is a judgment creditor. So where CRA assesses a tax debtor and the amount remains unpaid on the expiry of any collection enforcement restrictions, CRA can obtain a certificate for the unpaid amount from the Federal Court. The *Income Tax Act* provides that the certificate has the same force and effect as a judgement of the Court.¹⁸ A judgment of the Federal Court may be enforced as if it were a judgment from a provincial court.¹⁹

As a result of these provisions, the Agency's most common status regarding unpaid personal or corporate income tax, or customs and excise duties and taxes is as a judgment creditor.²⁰ However, if the tax debtor became bankrupt, CRA would lose this status and its attendant privilege.

¹⁷ *Household Realty Corporation Ltd., v. A.G. Canada; MacCulloch & Co. Ltd. v. A.G. Canada*, [1980] 1 S.C.R. 423 (S.C.C).

¹⁸ See also s. 316 *Excise Tax Act*, s. 97.24 *Customs Act*, s. 288 *Excise Act, 2001*, and s. 74 *Air Travellers Security Charge Act*.

¹⁹ *Ibid.*

²⁰ *Ibid.*

Priority Flips

Secured creditors frequently cite the loss of Crown privilege as a persuasive reason for seeking the bankruptcy of a tax debtor.²¹ Where a secured creditor's security is at risk on account of the amount of the GST claim – which has a higher priority than that of a secured creditor in an insolvency – it is not unusual for the receiver to advise the tax debtor to file an assignment in bankruptcy. The result of this filing relegates the status of the GST from a property claim to an unsecured claim.²²

The courts have ruled that it is acceptable for secured creditors to invoke the Bankruptcy and Insolvency Act (BIA) and as a result have created a priority flip.²³

CRA has developed a policy that would minimise or nullify priority flips. If a taxpayer is indebted for source deductions, GST, corporate income tax, as well as customs and excise duties, and has a limited amount of funds that cannot retire in full all of the debt, CRA will apply the funds first to the GST debt.

DEEMED TRUST

General

The *Income Tax Act* obliges persons, in most cases employers, making various kinds of payments, to withhold taxes from the payments, and remit the taxes to the Crown.²⁴ Any person paying a wage has to deduct and withhold,²⁵ and a payment of such can be made in cash or in kind.²⁶ The *Excise Tax Act* imposes the same obligation on vendors in receipt of the GST.²⁷

²¹ Ibid.

²² Subsection 222(1.1) of the *Excise Tax Act*.

²³ *Bank of Montreal v. Scott Road Enterprises Ltd.*, 73 C.B.R. (N.S.) 273 (B.C.C.A.)

²⁴ Section 153(1).

²⁵ *The Queen v. Coopers & Lybrand* [1981] 2 F.C. 169 (F.C.A.).

²⁶ *Aprile v. R.*, 2005 DTC 585 (T.C.C.).

²⁷ S. 221(1).

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They are regarded as the deemed trust, because the statutes provide that the amounts withheld or collected are deemed to be held in trust for the Crown, until remitted. The deemed trust arises by operation of law. CRA does not take any steps for the deemed trust claim to take effect other than requiring that the withholding be done.

The statutory deemed trust has the advantage of not having to satisfy the common law requirement of tracing. For an actual trust to be enforceable, it must be possible to trace the property impressed with the trust.²⁸ By virtue of the deeming provision, the trust is effective, regardless as to whether the withholder or the collector actually kept the amount separate from the assets of the estate.

Regardless as to whether the withholder actually remits the amounts deducted and withheld, the employee receives credit automatically for those amounts. When filing an income tax return, the employee can claim those amounts, and could obtain a refund on amounts that the Receiver General did not receive.²⁹

The present deemed trust provisions of the *Income Tax Act*, the *Canada Pension Plan*, and the *Employment Insurance Act*; operate notwithstanding any law of Canada or a province or any other law, however; some exceptions exist. They are subordinate to sections 81.1 and 81.2 of the *Bankruptcy and Insolvency Act*, provisions dealing with the rights of unpaid suppliers and farmers, fishermen, as well as aquaculturalists. They are also subordinate to a prescribed security interest, which is later discussed.

The deemed trust provisions exist as well under the *Excise Tax Act* and the *Air Travellers Security Charge Act*.

In short some of the major features of the deemed trust provision are: it covers amounts actually deducted and withheld from an employee's pay, it arises by operation of law; CRA does not have to issue and particular document or take any particular step for the deemed trust to apply; also deemed trust does not require any notice of a claim to take priority over a secured creditor.

²⁸ *Graphicshoppe Ltd., Re*, 78 O.R. (3d) 401 (Ont. C.A.).

²⁹ S. 153(3) *Income Tax Act*.

PRESCRIBED SECURITY INTEREST

A prescribed security interest is defined as an interest in real property, granted by the tax debtor, when he was up-to-date in deducting, withholding and remitting the deemed trust amounts, before a debt occurs.³⁰ The secured creditor must perfect this security interest in a public property registry system before the tax debtor became liable for any deemed trust amount. If the tax debtor makes any payment to the secured creditor on account of the prescribed security interest, while failing to remit the deemed trust, Regulation provides that a claim in respect of the security interest will be reduced by such amounts.

ENHANCED GARNISHMENT

The ITA permits CRA to assert a property claim by way of a special statutory garnishment, referred to as an Enhanced Requirement to Pay (ERTP). These provisions contain both substantive and procedural features. That is, an ERTP confers substantive proprietary rights, only if and when CRA has issued one.

Some of the major features of the Enhanced Requirement to Pay are: the ERTP is a statutory garnishment exclusively for the benefit of the Crown, specifically designed for the efficient collection of taxes. It does not require any court application. The ERTP creates a property claim, which gives the Crown priority over all actual and potential security interests on the accounts of the tax debtor with the exception of a “prescribed security interest”. The ERTP captures all amounts assessed under the ITA as well as amounts assessed under the *Employment Insurance Act* and the *Canada Pension Plan*.

DEEMED SECURITY

Parliament amended the Income Tax Act to provide the Crown with a device – a deemed security interest – by which it could acquire, a security interest in a tax debtor’s property.

³⁰ Regulation 2201 of the Income Tax Act.

In the normal course of business a security interest would be received through consensual transaction, where the security interest in the collateral arises out of an agreement between parties. CRA can obtain security interest or rather deemed security through non-consensual transaction. There need not be an agreement between the parties; the deemed security interest arises by operation of law.

In Canada, it is provincial legislation, which governs the creation, validity and priority of secured interest against the assets of debtors. As such, each province determines the process through which a charge on property is created and when such a charge would become effective. For the Agency to obtain a charge, lien, priority on, or binding interest in a debtor's property, by virtue of a Federal Court registration (certified debt), the Agency must first look at the governing provincial legislation that creates such a charge, lien, or binding interest effect for a similar provincial judgment of debt.

Based on the applicable legislation, some provinces provide that a security interest arises upon the registration of the charge. In other provinces, where no such provisions exist, the security interest does not arise until such time as action is commenced under the Bankruptcy and Insolvency Act. In either situation, it is necessary for the charge to be registered in accordance with the prescribed system of registration with the province.

Once CRA registers the amount owing in accordance with provincial property legislation, it can file a secured claim in a bankruptcy or in a proposal. The statutes do not give CRA a security interest that will have priority over pre-existing perfected security interests. If, then, there are prior registered secured creditors, with claims that exceed the equity of any property owned by the tax debtor at the time that CRA wishes to assert a security interest, that provision would not be useful to the Agency. Registration, therefore, is not the sole determinant for attaining a security interest.

BANKRUPTCY AND INSOLVENCY LAW

A purpose of bankruptcy is to allow an honest but unfortunate debtor to free himself of debt, and to obtain a fresh start in life. The debtor can approach a trustee; and assign oneself into bankruptcy, thereby handing over his property to the trustee. One of the tasks of the

trustee is to liquidate that property, and use the proceeds to administer the estate.

CRA avails itself of the bankruptcy process, from time to time, to deal with taxpayers who have the ability to pay, but who are reluctant to pay, and who have shielded their assets from the Crown's reach. CRA participates in a bankruptcy in the same fashion as any other creditor and is not afforded priority in the proceedings.

CRA can ask that a bankruptcy be annulled if the debtor is proven not to have been insolvent at the time of assignment. CRA as well as any other creditor has the ability to oppose a bankrupt's application for absolute discharge. Receiving an opposition to discharge would require a bankrupt to make additional payments into the estate thus increasing the possibility of a dividend to the creditors.

In terms of proposals under the *Bankruptcy and Insolvency Act*, CRA takes the position that the starting point for negotiation in a proposal is 100 cents on the dollar. A consumer proposal is one of the few instances under which a compromise settlement may be reached.

Compromise Settlements

CRA recognises that it is common for creditors to compromise their collection efforts by accepting less than 100 cents on the dollar, when they are reasonably certain that other measures would bring in less. In Canada though, the tax statutes have no provision to compromise an amount. However, CRA is obligated to consider a compromise under the bankruptcy and insolvency statutes. Further, there are two additional possibilities where a tax debt could be compromised: in litigation or by remission.

In this respect, the Attorney General of Canada can arrange a compromise settlement in the course of litigation, pursuant to section 5(d) of the *Department of Justice Act*, where at issue is whether a debt exists or if one exists, the amount of that debt. Further, remission, pursuant to the Financial Administration Act may be available, when a debt has been established in accordance with the tax statutes, and affirmed by the courts, or where a tax debtor has not disputed the liability within the time allowed.

CHALLENGES

Despite the success that CRA has enjoyed with its priority tools, it will be remiss if this paper does not disclose some of the challenges that CRA endures in carrying out its mandate. Such challenges are attributed to inadequate or non-existent collection tools with respect to cross-border tax recovery, tax avoidance and self-employment for example.

Self-Employment

Statistics indicate that the self-employed, professionals, and commissioned salespersons owe a disproportionate amount of income tax. While the *Income Tax Act* requires taxpayers, who are not deducted at source, to remit taxes quarterly, the Act has no mechanism whereby CRA can enforce collection of such amounts. The opportunity to enforce arises if they file returns of income, and only after the expiry of enforcement restrictions. By then, they will have made themselves judgment proof, or taken shelter under bankruptcy and insolvency laws. What is most desirable is amendments to the Income Tax Act to enable CRA to enforce collection of the quarterly instalment remittances.

To make themselves judgment proof, it is not unusual for one of these individuals to acquire assets and out them in their spouses or children's names. Recently an amendment to the Income Tax Act has made it less easy for a professional to vest property by means of a trust to under-aged children. In that regard subsection 160.2, makes the parent jointly and severally liable for the amount that the minor is liable to pay. However, the provision is not effective unless a garnishable source is available.

Piercing the Corporate Veil

A corporation is a separate legal entity. Therefore, if a corporation has a liability to pay, recourse can only be taken against the corporation to effect payment. A court, however, can disregard this principle and assign such liability to the shareholders, directors or officers of that corporation, and when it does, it is referred to as "piercing the corporate veil".

A court may disregard the corporate entity in a way that is tantamount to filling the gaps in a contract, in effect, achieving what the parties would have agreed to do, had they considered the particular facts that have arisen in the case. As well, the corporation may be used in many ways as a means of avoiding a statutory provision, as can be seen in tax cases. In any situations, however, the court is reluctant to pierce the corporate veil.

Parliament has introduced a general anti-avoidance rule in the *Income Tax Act* to apply to an avoidance transaction, which would result in a tax benefit, or a transaction that is part of a series of transactions that would result in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit. The judicial interpretation of this provision to date has been mixed.

Provincial law has pierced the corporate veil in a number of ways. For instance:

The *Workers' Safety and Insurance Act* of Ontario holds successor employers liable to pay all amounts owing by the employer immediately before the disposition. This provision does not apply when the company is bankrupt or is insolvent.³¹

The *Employment Standards Act* of Ontario holds directors and shareholders liable for wages and vacation pay of the employees.³²

The *Liquor License Act* of Ontario provides that an applicant is entitled to be issued a license to sell liquor except if the past or present conduct affords reasonable grounds for belief that that the applicant will not carry on business in accordance with the law and with integrity and honesty.³³ It provides as well that a liquor license cannot be renewed or transferred when provincial sales tax is outstanding.³⁴

³¹ Section 146.

³² Sections 79 and 80.

³³ Subsection 6(2).

³⁴ Subsection 6(6).

Cross-Border Tax Recovery

Cross-border tax recovery, that is, collection of tax in a foreign jurisdiction, is subject to the 'revenue rule'. In general, this rule expresses that courts are barred from enforcing the tax laws of foreign nations. This allows courts to decline considering suits, or enforcing foreign tax judgments or foreign revenue laws. Simply put, one country does not enforce a revenue judgment of another country. Thus, a tax debtor benefits from this doctrine to the detriment of the revenues of the Canadian Government. However, the revenue rule may be modified by treaty.

Two leading cases provide the rationale for the revenue rule. In *Moore v. Mitchell* ("Moore"),³⁵ it was held that a court is not the proper government entity to review the statutes of a foreign state, and if it were to do so, it would violate the rules of comity, that is, it would have to decide on the validity of the foreign law. In *Govt. of India v. Taylor* ("Taylor"),³⁶ it was held that comity precluded it, enforcement of taxes is an extension of that state's sovereignty, and courts should avoid the administrative difficulties of interpreting another states revenue laws.³⁷

Canada and the United States have adopted these reasons when determining the application of the revenue rule. In the case *British Columbia v. Gilbertson*,³⁸ the province sought enforcement of a certificate of assessment, akin to a judgment of a court, for logging taxes assessed against residents of Oregon. In finding against British Columbia, the court relied on *Moore*, concluding:

*The revenue rule has been with us for centuries and as such has become firmly embedded in the law. There were sound reasons, which supported its original adoption, and there remain sound reasons supporting its continued validity. When and if the rule is changed, it is a more proper function of the policy-making branches of our government to make such change.*³⁹

³⁵ 30 F.2d 600, 600 (2d Cir. 1929).

³⁶ [1955], A.C. 491 (H.L.).

³⁷ *Ibid.*, p. 504.

³⁸ 597 F.2d 1161; 1979 U.S. App. LEXIS 15993.

³⁹ *Ibid.*

As alluded to in *Gilbertson*, the revenue rule can be overridden. Canada has entered into tax treaties with many countries, providing for exchange of information. Moreover, treaties with the United States, Germany, Holland, and Norway provide for general assistance in collecting taxes against citizens of the contracting nations. In general, such agreements limit the collection efforts, undertaken by the parties, to collect tax claims presented by the requesting country against its own citizens. They do not provide a mechanism for collecting taxes, owed to the foreign government by a citizen of another state.

A Canadian taxpayer tested the treaty between Canada and the United States.⁴⁰ He sought to have a tax lien, imposed by the Internal Revenue Service at the request of the Agency, set aside. The court refused to do so, finding that the tax lien was proper under the terms of the treaty. Thus, the treaty obligation created an exception to the revenue rule. Nevertheless, except for this specific assistance in collection, the revenue rule continues to be operative.

Tax Avoidance

Tax avoidance is a challenge to collections as it relates to not yet assessed amounts. Tax avoidance, described as the ordering of one's affairs in such a way as to minimise tax that would otherwise be payable, remains a challenge to the Agency. While the tax statutes sanction such behaviour in some instances, this behaviour becomes controversial when taxpayers order their affairs in an artificial way to minimise payment of tax.

Tax avoidance causes a loss of revenue to the Canadian Governments, and creates inequality in the sense that in general, opportunities for tax avoidance are not available to taxpayers whose income emanates from wages or salary and from whom tax is deducted at source. In this group of taxpayers, only those who have substantial investment or business income are usually able to profit from tax avoidance. Thus, the self-employed, professionals, and commissioned salespersons are the ones more apt to participate in tax avoidance schemes.

⁴⁰ *Tesher v. United States*, 246 F. Supp. 2d 297 (S.D.N.Y.).

CONCLUSION

Through continued effort, new remedies are being developed to assist in collections. It is safe to say that no tax administration will go without challenges and resistance; however, with proactive thinking and legislative backing challenges can be addressed and resistance can be resolved through education and the promotion of compliance.

Each new challenge will test the limits of the collections tool at hand. And with challenges come the discovery of innovative measures to enhance our current tools and assist in meeting the ever-changing needs of our tax administration.

The Canada Revenue Agency welcomes any suggestions to overcome some of the challenges it faces in tax collection.

Case study

TOPIC 3.1

**COMPETENCE AND ORGANIZATION OF THE TAX
ADMINISTRATION VIS-À-VIS COLLECTION - THE COLOMBIAN
MODEL**

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CONTENTS: Introduction.- 1. Theoretical Framework.- 2. Setbacks in the Coercive Collection Process.- 3. Tax Administration (DIAN) Administrative Collection Procedure.- A. jurisdiction.- B. Competency.- I. Functional competency.- II. Territorial competency.- C. Collection procedure stages.- I. Persuasive stage.- II. Coercive stage.- 4. Legal Provisions Applicable to the Collection Process.- 5. The Future of Collections with the Single Model for Automated Revenue, Service and Control (MUISCA).

INTRODUCTION

The State, without forsaking the power of protecting the public good and its regulatory power, shall perform on a prompter and more flexible basis, in order to adapt to current requirements and enhance its

productive processes' efficiency. The globalization of the economy, open markets, technological developments and the dawn of the technological revolution, are doing away with traditional legal structures that support the performance of public entities like Tax Administrations, the outcome of which shall be the attainment of the ends set forth by law. In other words, equitable distribution of government expenditures among the population with taxpaying capacity.

Therefore, an inherent task in Tax Administrations is the adoption of a new, broader and more modern mission statement to serve citizens. In this regard, the National Tax and Customs Directorate of Colombia (DIAN, as per the Spanish acronym) is focused on making the institution part of a comprehensive community service. Its modern vision that considers the citizen a customer, in order to provide an excellent service, has led to the definition of strategic solutions that entail an improvement effort and the creation of synergies to overcome reluctance arising from its present practices.

The DIAN administrative structure, in the framework of its institutional structure, whose mission is to recover the amounts owed by taxpayers stemming from the compliance of formal obligations set forth by tax legislation and the assessment and negotiation management process, fails to collect revenue on a timely basis given the frequent reluctance by taxpayers to meet such obligation.

Therefore, the DIAN is pursuing a process to strengthen its legal structures vis-à-vis issues such as collection, enhancement of the voluntary compliance culture, development of effective information systems, facilitating citizens' obligations, tax audits and addressing administrative corruption. In 1987 the appropriate legal grounds were set to start the transformation process. The tax reforms thereafter, especially those in 1992, 1997, 2002 and 2003, have enabled the optimization of tax liabilities' collection in compliance with the principles of prompt resolution and proportionality embodied in the Constitution for the administrative performance of government officials.

The Colombian Government has gone through great efforts to design and implement the SINGLE MODEL FOR AUTOMATED REVENUE, SERVICE AND CONTROL, MUISCA (as per the Spanish acronym). Such model consists of a new form of revenue and resource administration based on the new Tax Administration notion of executing complete controls based on IT and supported by the adoption of

technology and the strengthening of administrative procedures in the framework of customer service development.

As to the considerations regarding the Colombian tax system and, chiefly, the expected outcomes of the efforts to combat tax evasion, we may highlight the pressing need to strengthen collection and its administrative process, as basic and vital tools to provide economic resources to the State in order to finance its development.

1. THEORETICAL FRAMEWORK

This paper is based on the Colombian experience and is aimed at analyzing the legal-administrative institutions that govern the Colombian State's collection procedures. The document shall present the functional as well as territorial competence framework in which the collection process takes place for tax, customs and exchange obligations as well as the development structure thereof. We shall analyze the historical framework for State outstanding debts' collection actions. Likewise, it describes the tools deployed by the State along with the administrative coercive collection function, to recover liabilities and counter tax delinquency in Colombia.

2. SETBACKS IN THE COERCIVE COLLECTION PROCESS

Vis-à-vis national taxes' coercive collection, we shall highlight that prior to the Tax Administration modernization, the collection process faced huge issues, mainly as to its legal and administrative structure. With our legal structure and as time elapsed, we pursued legal tools and entities for the coercive process in line with the most orthodox and strictest guiding principles of procedural law. In doing so, the only achievement was a State that would stare unarmed at the consolidation of evasion given the lack of an effective collection process. The legal-administrative system in place was more focused on proceedings than on portfolio recovery.

Since 1970, the coercive collection procedure by the different State entities had been governed by the Civil Code of Procedure.

When we were unable to locate a taxpayer and it was impossible to notify him/her personally of the payment order, the Tax Administration

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has to resort to the legal instances supporting the enforcement powers thereof in order to designate legal counsel. The latter, based on the entity of the curator *ad litem* and having been previously designated, taken office and authorized, had to guarantee the debtor's right to a due process of law. The difficulty entailed in the designation of debtors' legal counsel was evident, in addition to the fact that the court would assess their fees, which had to be paid by the State.

The Tax Administration also lacked adequate information on taxpayers' assets. Therefore, garnishments became difficult to implement and given the strict regulations in place, the Administration was unable to identify any assets in banks or Real Estate Property Registries.

But maybe, what greatly contributed in preventing the adoption of a more dynamic collection process was delinquent taxpayers' resorting to dilatory actions for reconsideration based on the general provisions in civil procedural law (motions for reversals and appeals), rendering proceedings endless or fostering the delinquent taxpayer's insolvency.

In 1979, the first payment plans were developed, but since they were granted based on rules that required certain guarantees and requisites, they became a useless instrument.

From the analysis of collection processes prior to the 1987 and 1992 reforms, we may conclude that all the Tax Administration's actions were simply focused on tax assessment, achieved in the calculation and negotiation stages. Portfolio recovery was only supported by the Certificate of Good Standing, a document that was necessary for an endless number of civil and financial proceedings, such as the transfer of property and registration.

The current accounts' systems featured many inconsistencies and were outdated. Therefore, the collection units' work was focused on the correction of such accounts.

The portfolio was managed without preemptive criteria based on amounts and risk levels according to the taxpayer's legal or financial standing, such as bankruptcy or winding up.

As to human resources, we may mention deficient selection, induction, and reinduction procedures as well as lack of specialized training, performance evaluations, profiles, and working skills. Likewise, the internal control systems in place were poor.

The unprecedented regulatory changes in the country issued in 1987 and included in the different tax reforms of 1992, 1995, 1998, 2002 and 2003, changed the previous organization, vesting upon the Tax Administration the power to pursue the enforced collection process in full, from issuing the payment order and deciding on the appeals and objections filed and initiating the auction proceeding.

The progress vis-à-vis issues like collection process simplification is worth highlighting, as well as the streamlining of the asset garnishment phase, garnishment registration, the delinquent taxpayers' bulletin, the reallocation of payments and payment plans. Such effective legal instruments have enabled the DIAN to promptly recover tax liabilities with the inherent administrative cost and corruption risks' reduction. We shall elaborate on some of these topics herein, given their legal and administrative relevance.

3. TAX ADMINISTRATION (DIAN) ADMINISTRATIVE COLLECTION PROCEDURE

The Special Administrative Unit- National Tax and Customs Directorate – was organized by Executive Order No. 1071, June 26th, 1999 as an entity with legal status and administrative and budgetary autonomy.

The Entity is in charge of rendering the facilitation and control services for economic players to comply with the norms that make up the tax, customs and exchange system, in line with the constitutional principles of the administrative function, **with the purpose of collecting the appropriate revenue amount**, streamlining foreign trade transactions, fostering fair competition conditions, rendering reliable and timely information, and contributing to the social and economic wellbeing the Colombian people.

Internationally, collection procedures are based on three models: legal, administrative and mixed. In the legal model, collection procedures are fully pursued in the court system, that is to say, they involve judges, and officials participate as trial lawyers for tax debts. The administrative model is the most broadly implemented in Ibero-America, according to the Inter-American Center of Tax Administrations (CIAT, as per the

Spanish acronym) in its Model Tax Code; the main feature thereof is that the debtor's property garnishment is undertaken by the Tax Administration itself, without the need to resort to the Judiciary. Likewise, the debt payment and even the sale of garnished property remains an administrative function, regardless of the judicial review thereafter.

In the mixed collection model, the garnishment of debtor's property is undertaken by the Tax Administration, but with the mandatory involvement of the Judiciary either before or after. The procedure's development overall takes place in the administrative sphere, although the Judiciary may participate in certain stages thereof. The revenue collection powers are held by the Administration, but it requires a court mandate to enforce them or the Administration may issue a garnishment order but only a Judge may order the attachment of assets.

A. Jurisdiction

The tax, customs and exchange obligations' collection process in Colombia is of a purely administrative nature. It entails the coercive power vested upon the Tax Administration, as set forth by the Constitutional Court of Justice of Colombia as an extraordinary privilege of the Administration, consisting in the power of undertaking debt collection directly without any involvement of the Judiciary, with the double role of Judge and party. Such action is warranted to make the common good prevail, since said resources are promptly needed to enable the State to meet its purposes effectively.

The Administrative collection procedure is one of the State's inherent jurisdictions, enabling it to guarantee the effective collection of the amounts due through its own entities, by implementing expeditious procedures and preemptive proceedings that distinguish it from the collection process in the sphere of private law.

Although the coercive jurisdiction entitles a government entity to initiate and fully pursue the enforced collection proceeding to recover the outstanding amounts without the need to resort to the Court system, it does not render it a jurisdictional role. This implies it shall remain a power of the State, which has been vested upon an entity that is part of the Executive Branch of government. The administrative collection process does not entail the administration of justice, as it would for a Federal Judge, but it is aimed at the direct collection of a preexistent

obligation to be borne by the taxpayer, which stems from a law. That is to say, the administrative coercive collection procedure enforces the tax self-assessment as provided by law, as well as the administrative act that determined a tax burden for the taxpayer.

The legal nature of coercive collection in Colombia is administrative and not jurisdictional, since it does not refer to rights but seeks effective collection of tax obligations or tax liabilities arising from the State's tax enforcement power. Coercive collection shall be pursued when the taxpayer in this relevant tax relation fails to meet tax obligations, whether in part or in full.

The administrative officials with legal powers to further the coercive collection procedure undertake the role of party, since they represent the debtor, and judge, since they enforce the process.

This double role is warranted since they constitute the means or instruments that the power embodied by the State shall resort to in order to require citizens the payment of their tax obligations, whether stemming from self-assessments or assessments by the Federal Government.

The double role vested upon the tax official, judge and party in the coercive collection procedure, may seem a breach of the due process of law. Nevertheless, the contradiction of proof and defense are set forth in Colombian legislation:

- **The right to a due process:** Firstly, we may point out that the taxpayer is who participates in the tax negotiation and assessment process and, therefore, he/she may openly state the grounds that may bear an incidence on the tax assessment.

- **The right to litigate:** In the official assessment procedure as well as through the administrative channels, the tax proceeding grants the taxpayer the power to review the procedure, request or provide evidence and contest those he/she disagrees with, guaranteeing the right to be heard in a court of law. Likewise, in Colombia the acts that determine tax assessments or penalties may be argued in an Administrative-Contentious Court, for the Judge to initiate tax proceedings. This thus grants the citizen a non-administrative instance in which to argue the tax assessment and penalties imposed in order to obtain a favorable judgment.

On the other hand, with the administrative coercive collection process, the tax debtor may file motions and petitions as set forth by law with the purpose of proving the payment or reducing garnishments or other court decisions.

B. Competency

Competency is defined as the power of a Judge to enforce by Law, regarding a given matter, the authority inherent in the Republic, as well as the functional and territorial capacity conferred by the State upon certain officials to enforce such rights.

For the purpose of specifically analyzing the power to collect, it is relevant to examine competency from both legal aspects, the functional and territorial one.

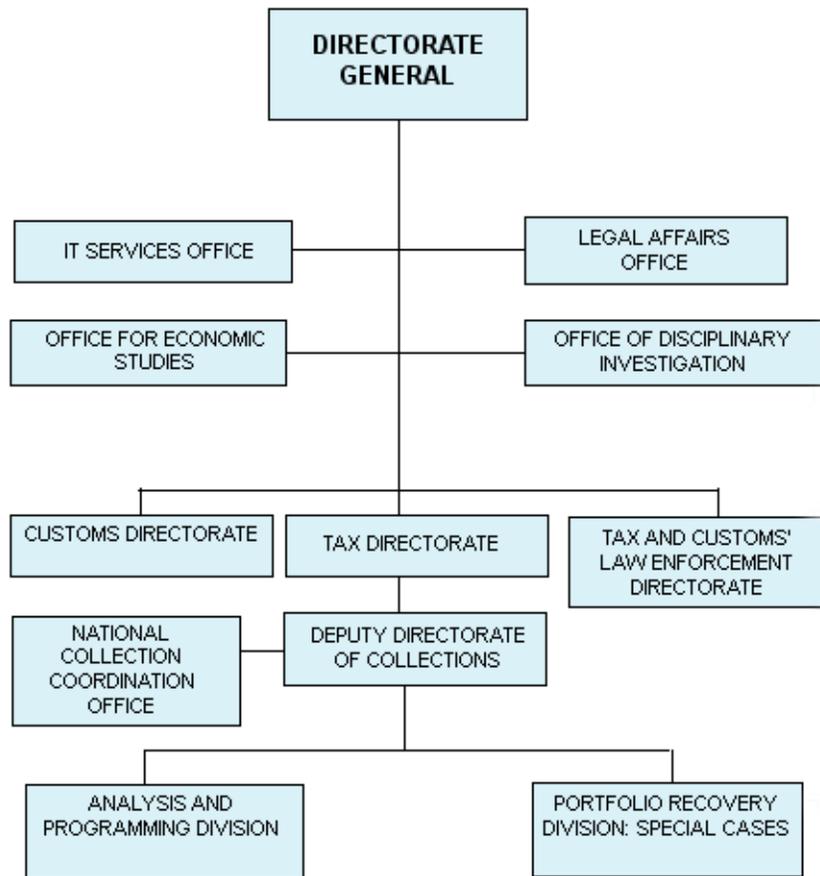
I. Functional competency

It provides for the enforcement of authority depending on the nature of the position held by the government administration official, who is called to exercise it to enforce one or more obligations of the principal debtors or the jointly and severally or subsidiarily liable parties or guarantors.

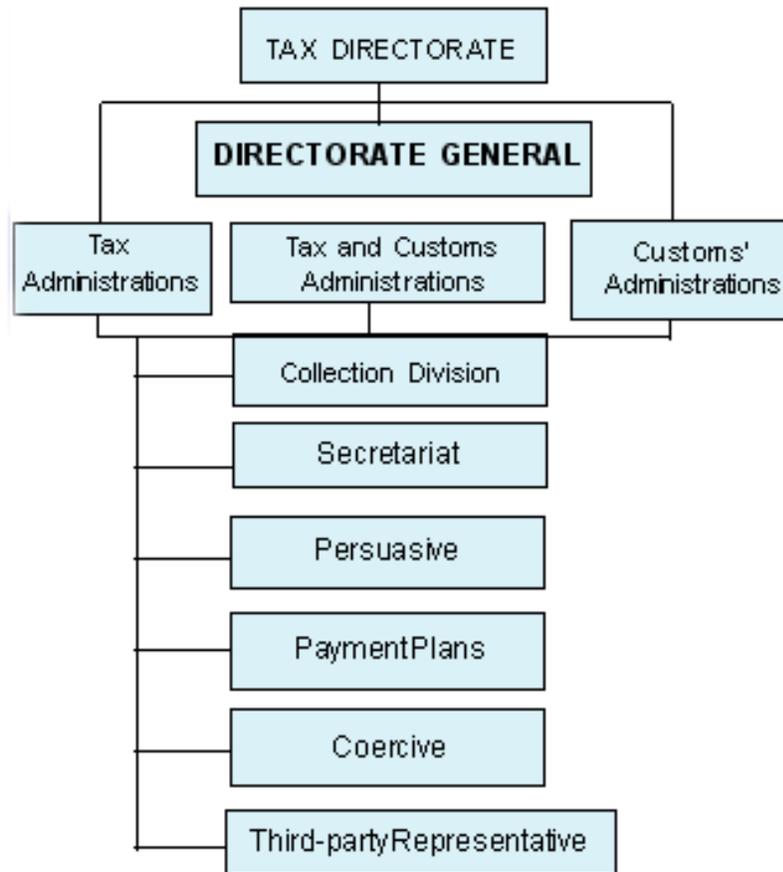
The Tax Code considers the following functionally competent parties for collection of tax obligations:

- ✓ The Deputy Director of Collections,
- ✓ The National Tax and Customs Administrator,
- ✓ The Tax Administrator,
- ✓ The Heads of the Collection Units and other officials vested with such competency.

1. Administrative Collection Structure- Central Level



2. Administrative Collection Structure- Local Level



II. Territorial competency

Territorial competency refers to the location on the national territory where the process is to be initiated. In order to determine such a territorial factor, the legislator takes into consideration the respondent's domicile and/or the place where the obligations arose (executable instruments). The claimant may choose the place to initiate collection proceedings.

Territorial competency is governed by Article 825 of the Tax Code, which sets forth:

“Territorial Competency. The coercive procedure shall be initiated by the administration’s collection office in the venue where the respective tax obligations originated or according to the location where the debtor is domiciled. In the case of pursuing a number of coercive procedures against the same debtor, joinder of claims shall apply.”

C. Collection Procedure Stages

For the effective collection of national obligations, according to the functional design, the collection process starts with a persuasive phase and ends in the coercive phase, as the last resource to succeed in recovering the tax liability.

I. Persuasive Stage

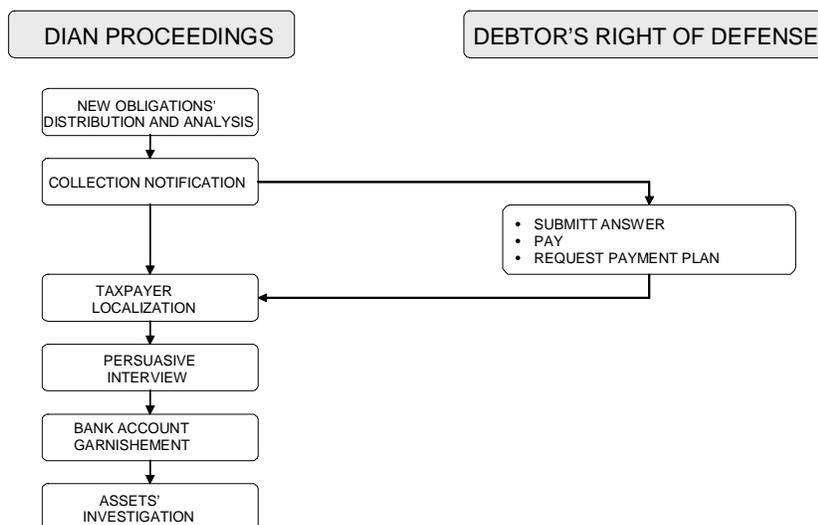
The persuasive procedure is the individual collection procedure employed by the Colombian Tax Administration with the purpose of achieving the payment in full of tax obligations or reaching a payment agreement with debtors. This process is undertaken by a collection official who enforces negotiations, requirements’ and interviews in order to achieve the payment of tax debts expeditiously and with lower administrative and financial costs, not only for the taxpayer but also for the Administration, avoiding to the maximum extent possible the administrative coercive procedure.

The relevance of persuasive tax collection lies in the fact that it accounts for the largest revenue amounts for the Nation, which entails benefits for the Tax Administration, since persuasive collection attains better results than coercive collection.

The tax official working in the collection area is hired and trained in skills regarding negotiation, financial analysis, valuations and legal matters, since tax and economic information on the delinquent taxpayer are insufficient.

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This stage involves officials called Managers, who upon receiving the records undertake the following activities for the purpose of debt recovery:



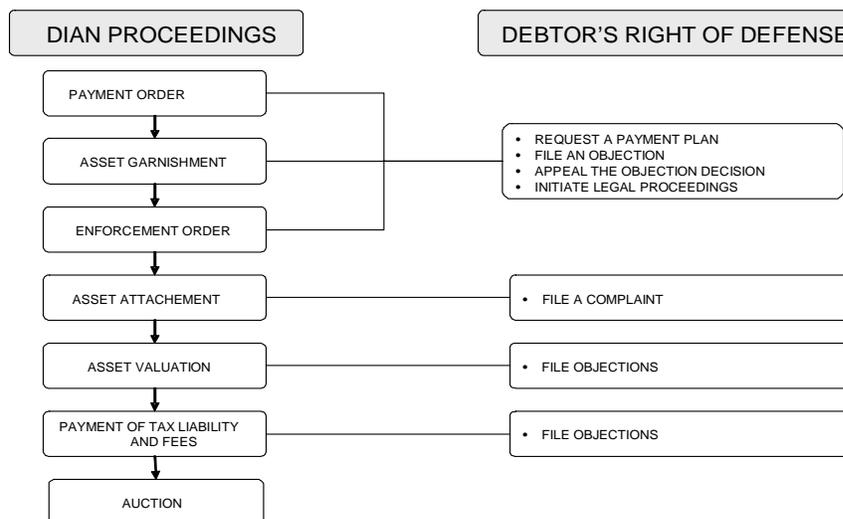
The foregoing flowchart indicates the Manager's competency and the focus of his/her activities:

- ✓ The taxpayer accepting the debt and deciding to meet payment immediately.
- ✓ The taxpayer who is unable to immediately meet payment may choose to subscribe a Payment Agreement.
- ✓ Undertaking the investigation of assets at the national as well as local level.
- ✓ Ordering the pre-judgment garnishment of the delinquent taxpayer's assets.

II. Coercive Stage

Upon exhausting the persuasive collection phase without the delinquent taxpayer paying the outstanding tax obligations or subscribing a payment plan, the record shall move into the coercive phase. The administrative coercive collection procedure is geared at achieving the effective payment of a clearly defined, specific and enforceable obligation as determined in the private and/or public assessments in favor of the National Tax and Customs Directorate. There are no rights discussed therein but it seeks payment or a solution for the obligations arising from the State's tax enforcement power.

Among the activities and/or actions deployed by the official called Tax Enforcement Officer, we may broadly enumerate the following:



The foregoing flowchart indicates the main competencies of the Tax Enforcement Official:

- ✓ To order injunctive relief.
- ✓ To enforce injunctive relief via asset garnishment.
- ✓ To order the assets' valuation. This power enables tax officials to value assets in advance by calling upon specialized officials for such purpose.
- ✓ To undertake the auction proceedings for the garnished and attached assets.
- ✓ To see that the effective payment of outstanding obligations is achieved by allocating the amounts obtained from the garnishment, attachment, valuation and auction of assets.
- ✓ To transfer the assets to the Nation in the cases in which the enforced sale is not obtained after the third bid.

4. LEGAL PROVISIONS APPLICABLE TO THE COLLECTION PROCESS

In order to approach this issue, we shall refer to the legal provisions that enable to define controls and pursue actions in the collection process with a view to facilitating debt recovery.

I. Payment Plans

In any of the two stages mentioned in the collection process, the taxpayer may choose to pay via a payment plan. In such case, with an administrative action and upon the debtor's request, a number of installments are defined to pay off the tax liabilities within a given term and requiring a guarantee.

Such plans are granted by the Director General of Taxes, the Deputy Director of Collections, the Special or Local National Tax Administrator, the National Customs Administrator, the National Tax and Customs Administrators, the Deputy Administrators of National Taxes and/or Customs, the officials designated by an administrative decision.

The payment plan request may be submitted to the competent Administration either by the principal, subsidiary or joint and several debtor and/or a third party.

In principle, the maximum term allowed is five (5) years and an additional two (2) year term is granted exceptionally in special cases. The authority of jurisdiction is the National Director of Taxes.

The functional competency for the payment plans may be defined as follows:

Tax Administrator or Deputy:

- ✓ Consider the payment plan request and compliance with qualification requirements.
- ✓ Issue the payment plan decision.
- ✓ Issue the noncompliance decision.
- ✓ Issue the motion for reconsideration against the decision that annuls the payment plan.

Director of Taxes:

- ✓ Issue the payment plan decision for plans with a term of more than 5 years.
- ✓ Issue the decision on noncompliance of the payment plan granted.
- ✓ Issue the motion for reconsideration against the decision that annuls the payment plan under his/her jurisdiction.

II. State Intervention in Special Processes

There are certain events in which the DIAN lacks the competency to intervene through the regular “Administrative Coercive Collection Procedure” and shall abide by the different procedures (collection and assessment) undertaken by different authorities (Superintendence, Judge, Chamber of Commerce, etc). The purpose of this function is to offer the capacity of generating the necessary actions to act on behalf of the DIAN and register the orders, acts and proceedings undertaken, as well as conducting the necessary controls vis-à-vis the intervention of an official in the special procedure, the obligations’ extinction, compliance with the agreement or order, deadlines, among others.

In such cases and based on the special conditions’ requirement for businesses and creditors, the Tax Administration shall cease to further its regular activity geared at recovering the amounts collectible and become integrated in the general group of creditors, preserving certain privileges by virtue of the nature of the debts, but waiving its inherent collection capacity, thus abiding by the decisions of the Court of jurisdiction.

Therefore, the collection process as well as the lapsing of the collection action term is tied to the initiation of special proceedings. Firstly, by the stay until such proceedings conclude, and secondly, by interrupting or staying the terms to undertake such action. Therefore, the Administration temporarily loses its competency to directly compel the debtor to the payment of liabilities.

The legal mechanisms established by law to recover and preserve a business as an economic unit and a source of employment are bankruptcy proceedings as well as the disposal of a debtor’s assets, when the debtor is unable to meet commercial obligations, whether individuals or corporations, including government-owned industrial businesses and public-private partnerships. Such proceedings include: Debtor’s reorganization proceedings and Auction of debtor’s assets.

On the other hand, Act No. 550, 1999, extended by Act No. 922, 2004, governs the State intervention in the national public and private economy, granting creditors and debtors numerous intervention instruments such as negotiation and execution of agreements, debt-equity conversion, collective temporary labor agreements, pension liabilities’ regularization, more flexible preemptive rights, so that in the framework of an out of court proceeding and under the authority of an promoter and nominator, the stakeholders may agree upon the organized payment of debts.

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Additionally, we shall consider that the extinction of financial entities results in their winding up, which may be voluntary or mandatory. In general terms, in the first case, the procedure is conducted according to the regular standards of the Code of Commerce and in the second, pursuant to the Organic Financial System Law.

The administrative enforced winding up regime applies not only to financial institutions, but also, as expressly referred by different norms, to the administrative enforced winding up of the corporations or entities subject to the surveillance and control of the Securities Exchange Commission, the Superintendence of Solidarity Economy, the National Health Superintendence and the Public Services' Superintendence. It is also applicable to individuals in the housing construction and sales business, as provided for in Act No. 66, 1968.

The administration's official has the following competencies in such procedures:

- ✓ To identify the enforceable and contingent obligations for the DIAN to proceed as applicable with the authority of jurisdiction based on its competencies.
- ✓ To forward the notifications as required by law.
- ✓ To file objections.
- ✓ To attend the hearings or meetings of creditors.
- ✓ To file the legal complaints and initiate the applicable proceedings in order to argue for tax debts.
- ✓ To control debtors' compliance with the provisions in the reorganization and winding up agreements or otherwise, the business resumption agreement or the decisions by the special process or proceeding Director.

III. Criminal Liability. Omission by the Withholding Agent

Article No. 402 of the Colombian Criminal Code sets forth a crime in which the withholding or collection agent may incur, by failing to report the revenue collected within a given period. The penalty provided for is less severe than in the case of embezzlement of public funds, since the punishment for a citizen shall be less severe than the one applicable for a government official who is required to be especially loyal to the Administration. This Article defines the failure to report source withholdings as well Sales Tax withholdings as criminal violations.

IV. Administrative Sanction: Temporary or Permanent Business Closure

Among the State's power to impose sanctions, Article 657 of the Tax Law sets forth the possibility of closing the taxpayer's business or the site where he/she pursues a business or trade, which shall be other than his/her domicile or residence when certain events occur, mostly tied to the obligation to issue invoices and keep accounting books. In other words, noncompliance with formal obligations. Nevertheless, Colombian tax law has also implemented a similar sanction in the case of noncompliance with the fundamental tax obligations, as amended by Act No. 488, 1998, incorporated into the letter of said Article as **Letter f.**

The business closure sanction is imposed according to a list of charges, the preliminary administrative act, which is mandatory in the process, by which the noncompliant taxpayer is notified of the sanction for failure to report source withholdings or Sales tax, or for having filed them without payment, within the terms established by law. The list is provided by the Audits' Division. The taxpayer is given one month to object it and exercise the right of defense, after which the Assessments' Division shall issue a punitive decision.

V. Preventive Measure: Registration of the Official Assessment Process

Act No. 788, 2002 introduced a tax law provision to provide the Tax Administration the tools required to control large tax amounts due as defined in official assessments. The Tax Administration makes great efforts to make a taxpayer's economic standing compatible with his/her taxpaying capacity. Notwithstanding, from the audit process itself, the case may be that taxpayers, upon facing a negative decision, decide to reduce or do away with their wealth, rendering the State's activity null, since the moment the administrative official assessment act becomes conclusive, the taxpayer shall no longer enjoy the economic status and the wealth for the State to recover the amounts due.

Along these lines, Article 719-1 has been introduced in Colombian tax legislation. Such norm has not been enacted to date and consequently, remains unenforceable. Notwithstanding, it shall enable the administration to implement precautionary measures for the future collection process of obligations arising from official assessments.

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The norm sets forth the registration of the official assessment (review or appraisal) and the sanction issued in the public registries, based on the nature of the asset. With such registration, the assets secure the taxpayer's payment obligations.

Registration shall be effective until the end of the administrative coercive collection procedure, if applicable, and shall be suspended in the following cases:

1. *When the respective obligation becomes extinguished.*
2. *When the private assessment is established based on the negotiation process.*
3. *When the official procedure is revoked by a government agency or court of law.*
4. *Upon setting up a bank guarantee or insurance policy for the amount assessed in the official procedure.*
5. *When the party whose assessment is registered or a third-party representative offers real estate property for attachment, for an amount equal to or greater than the registered assessed amount, prior valuation thereof.*

It is worth pointing out that the administrative procedures to assess tax obligations or the resolutions that impose sanctions may be appealed with the Administration itself. In this regard, Article 720 of the Tax Law sets forth that a motion for reconsideration usually applies against official assessments and decision that impose sanctions. Such motions shall be filed within the two months subsequent to the notification of such action. Only in the case the taxpayer fails to timely file the motions with the Administrative offices, Article 736 of the Tax Law enables him/her to file a motion for reconsideration directly within a two year term counted from the enforcement of the applicable administrative action. Upon exhausting the Administrative instance, such administrative actions may be argued in a contentious-administrative court of law. Article 730 of said Law points out the cases in which they are rendered null.

This registration is per se an anticipated injunctive relief that seeks to secure taxpayer's compliance with tax obligations with the registered assets. Therefore, they are object of a security interest for the tax obligation, by which the Administration may pursue them for coercive collection purposes regardless of the fact that they may have been transferred to third parties. Such security interest shall be in effect until said obligation becomes extinguished, unless the registered administrative action is revoked by an Administrative or court authority

or that in the negotiation process thereof, the private assessment is deemed conclusive. Notwithstanding, such a security interest may be replaced by another one or by a bank guarantee or insurance policy. In spite of the fact that the registration measure is an injunctive measure geared at guaranteeing the State's interest, the assets involved are not prevented from remaining in the business activity since they are still subject to acts of disposal. Nevertheless, it is worth acknowledging that, in fact, registration may entail a limitation to such availability.

VI. Tools for Assets' Investigation: Audit and Search Powers

Normally, the tax administration has been endowed with broad audit powers by virtue of which it is fully competent to pursue the necessary actions that contribute to establishing taxpayers' economic reality, as well as to control compliance with their formal obligations.

Likewise, a legal provision in effect grants the Tax Administration the power to search the offices of third-party taxpayers by conducting a search procedure, in order to secure the evidence in an official assessment process.

Such powers, inherent in the official assessment process, as provided for in Colombian Tax Law, may be exercised in the collection stage with the purpose of conducting assets' investigations as foreseen in Article 825-1 of the Tax Law.

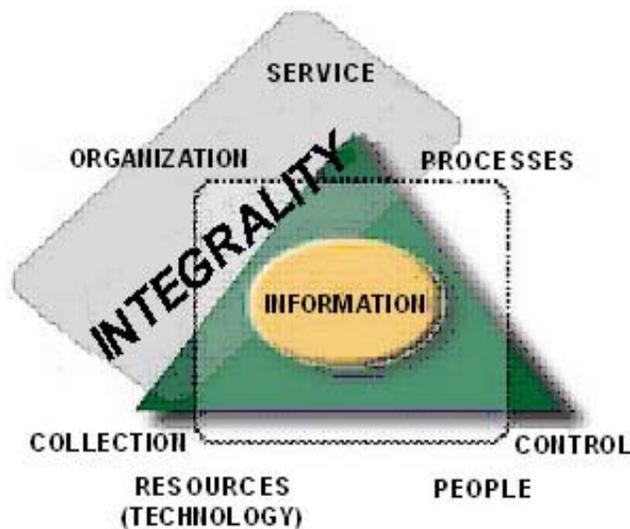
5. THE FUTURE OF COLLECTIONS WITH THE SINGLE MODEL FOR AUTOMATED REVENUE, SERVICE AND CONTROL (MUISCA)

The National Tax and Customs Directorate has defined as one of its institutional purposes to become an Entity that meets the needs of its customers, officials, government and citizens in general, equally serving the demands of a globalized and economically integrated world.

In effect, what started as the listing of ideals as to the Entity's duties, appropriately embodied in the institutional vision, is currently a project in the implementation phase, all under the leadership of the Entity's management team and the commitment of all its supporters.

Such intentions are materialized in the development of a model based on three fundamental principles that have been instrumental in the strategy definition as well as development: its broadness, unicity and feasibility and relevance.

Broadness: this principle encompasses all the institutional aspects required for a great quantitative leap as required by the country's pressing needs. Its *key aspect* is expressed in the following chart, in which the triangle's components (service, control and collection) entail the institutional mission and those in the square (organization, processes, people, resources and technology) make up management, administrative and technological notions. In the center; we find information as the pillar of the new model and finally all these aspects are integrated with an appropriate process management supported in the intensive use of information and telecommunication technologies.



Feasibility and Relevance: this principle enables the DIAN to consider itself an updated agency and move beyond its boundaries to integrate with other national and international entities, of relevance for the State's feasibility, through its different areas and administrations.

MUISCA's strategy provides for the entity's *vision*:

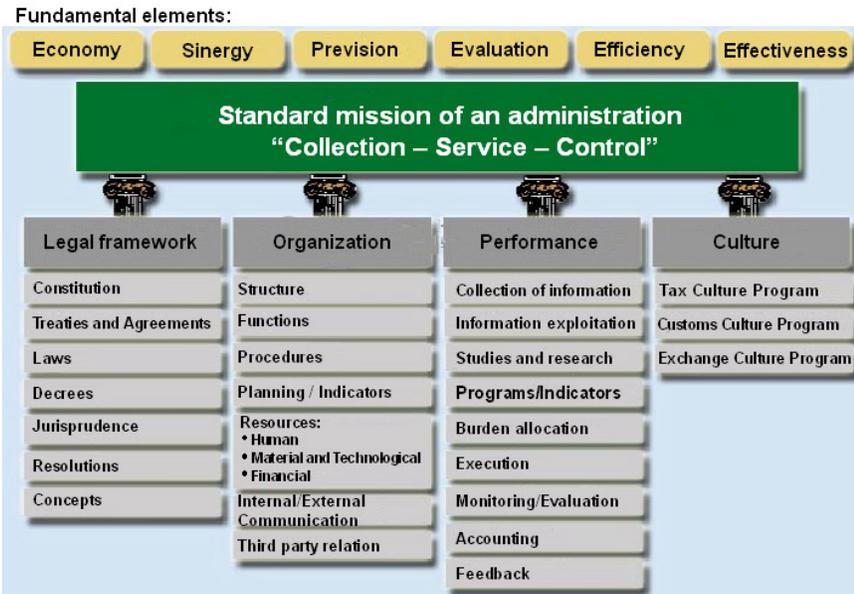
By 2010 the National Tax and Customs Directorate of Colombia shall have consolidated the State's tax enforcement authority, the institutional autonomy, the high voluntary compliance levels with the obligations it controls and facilitates, the integral nature and full use of information, processes and regulations, the contribution of technical tools to accommodate the tax burden and the simplification of the tax, customs and exchange system.

For such purpose we rely on a team of committed and trained government officials to safeguard the interests of the State with a sense of service, an integral and permanently updated technological support, and a special administrative system inherent in a modern entity that meets the needs of society, officials, taxpayers and users.

This vision poses two relevant challenges for the DIAN: the continuity in time and the State tax authority. Both call for effective processes to reduce the levels of evasion, contraband, and exchange violations, hindering tax fraud, facilitating national and international trade and generating confidence in the country. All of these are complex processes that require strengthening the entity's reflection capacity as well as knowledge vis-à-vis the depth and breadth of the perception by others. Also relevant is the broadening of their capacity to relate to others with the purpose of facilitating and enabling the compliance, administration and management of a government agency's responsibilities, in complex, ever-changing and multi-dimensional environments.

Unicity: on the basis of this principle, the MUISCA model structures the DIAN as a unique whole, defined with interrelated elements that serve a purpose or mission, while it operates within its own boundaries, fostering the interaction with other surrounding agencies

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Therefore, it enables to define a structure according to specialized and interrelated subsystems geared at attaining the mission. Such Subsystems are: organization and methods, technical support, and support; the mission-oriented ones, among which we may mention: customer service, massive collection, customs' operation, collections and accounting, audits and assessment, portfolio management and legal portfolio management, with their own specific services. All of them use the technical support subsystems and shall mutually interact.

Additionally, the **Portfolio Management Subsystem** shall enable better management effectiveness in the furtherance of the inherent formalities in the process, including the persuasive stage. It is based on new technology, information quality, prompt procedures, preventive delinquency control, interaction with other areas in the organization, the State and individuals, the assets' investigation process and the implementation of injunctive relief, information digitization, electronic transactions, Internet auctions and, in general terms, the implementation of high technical standards that spur the correct, fast and efficient enforcement of Colombian regulations.

This project phase is still under development, but already the effects within the process are undeniable, arising from the implementation of certain functionalities, such as:

- The Single Tax Registry (R.U.T., as per the Spanish acronym), which enables a more reliable and immediate localization of debtors and their legal representatives, the identification of joint and several and subsidiary debtors and the timely information as to the changes in a business, in order to focus collection efforts according to the legal standards applicable in each case to secure collection of tax obligations.
- Electronic and/or lithographic processing and filing of tax statements, which entail controlling inconsistencies at the time of entry and ensure the information quality of the collectible obligations.
- Submittal of external information in DIAN pre-defined files to allow for the creation of a database of reporting and reported parties, the use of which shall entail a cost, with a view to defining debtors' economic status.

In the new model, the forms containing the taxpayers' self-assessments as well as the Administration's assessments are received via the input/output Manager. Such function is based on the tools designed by each Subsystem; after completing the assessment and negotiation processes, internal procedures are triggered in the Financial Obligation Function to generate forms that allocate or mandate payments, calculate larger values and interest or update obligations to define the useful credit or debit balances for the specific areas, which guarantee complete and timely information. Upon defining the outstanding balances, it submits them for collection, calculating the amount as of a given date and at the applicable interest rates in the specific process, in other words, meeting of creditors or payment plan.

Once the database has been consolidated with all the types of obligations under the administration of the National Tax and Customs Directorate, massive collection programs shall be furthered via the Call Center as well as statements. The cases shall be fully supported by standardized processes, identifying debtors' assets in the reporting and reported database, and communicating injunctive relief electronically. Auctions shall be conducted via the Internet.

Debtors, in turn, shall rely on a service available on the National Tax and Customs Directorate Web page, which shall allow them to simulate the calculation of deadlines to pay off outstanding obligations and access the matters, cases and records in the collection area thereof.

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The Tax Administration, like any modern organization, works in the context of fast and sometimes unpredictable social, economic and industrial changes that impact the way in which it shall face the future and ensure sustainable growth and continuity. Our “business” consumes information, produces information and shall generate knowledge for the customer by excellence, the Nation.

The implementation of technology in its processes plays an increasingly strategic role. Tax administrators shall lead the technological innovation processes into their organizations, with the clear notion of the coordination and cooperation relation between the technology area and the other areas in the organization. Their focus shall be the attainment of the Tax Administration business strategy, aimed at achieving its fundamental mission in full: service, control and, ultimately, collection, which calls for a special review of the integration of technological processes into the other processes in the organization, as a critical and determining factor in the feasibility thereof.

Along such lines, the National Tax and Customs Directorate of Colombia defined the organizational strategy as follows: to manage its current performance with excellence, to integrally acknowledge its capacity, to envision its potential, to reduce latencies and increase productivity in order to secure State revenue, by the development of the Single Model for Automated Revenue, Service and Control, MUISCA, which is based on Information Technology, the best theoretical notions, open technological structures to facilitate adapting to changes in the environment and sustainability in time.

The MUISCA fully integrates the organizational, processes’ and technological aspects as fundamental axes thereof, representing the new form of managing taxes and customs in Colombia.

From the IT standpoint, sustainability in time is favored by the MUISCA’s introduction of state of the art concepts contributed by the best engineering practices and architecture geared at services, process development and control, and resource administration.

The DIAN continuity in terms of service production is safeguarded by a single security model, based on the most stringent IT security structures and standards. This model sets forth the procedural, logical and technological supports for the recovery of the service according to the applicable levels defined.

In such sense, the DIAN shall define, within the MUISCA model developments, the creation of the areas into which the responsibility over the process management and administration shall be divided, the authority and responsibility levels as to the use of resources and the coordination and interaction relations among them. Such aspects also entail strategic decisions within the organization and the structuring thereof.

The entity's modernization necessarily includes the modernization of control mechanisms. The purpose of such modernization is geared at, on the one hand, facilitating the task of efficiently serving the community for individuals, and on the other, endowing the organization with effective internal control for its successful performance.

Among the challenges the entity shall face is that of relying on simple, streamlined processes endowed with information technology, which, in addition to automation, ensures operating control of its performance and consequently, the correct decision making process.

According to this course of action, the DIAN has conceived the Internal Control and Quality Management System (SGCCI, as per the Spanish acronym) as the answer to integrate and link the different Entity processes with focus on customer satisfaction in order to improve the entity's performance and its capacity to provide products and/or services that meet the customers' needs and expectations. At the same time, it shall strengthen internal control and evaluation and promote design and implementation of working methods that adapt to the changes generated by the external and internal dynamics. Such effort shall require adapting human resources' profiles and competencies in the execution of working processes. Processes with such quality standards shall guarantee the same quality for the service offered to taxpayers, users and government.

To conclude, the National Tax and Customs Directorate shall lay the groundwork on which to build the new model. For such purpose, it requires reliable information and the appropriate and sustainable support that empowers its performance, automates routine and massive tasks in order to extend its coverage, respond more promptly and enhance its service to increase revenue collection and reduce tax evasion and contraband.

Case study

TOPIC 3.2

TOOLS USED IN AID OF COLLECTION

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*CONTENTS: 1. Introduction.- 2. Spain's AEAT Information System. –
3. The Role of Financial Institutions in Tax Revenue Collection.-
4. Collection Procedure Phases.- 5. Collection Risk.- 6. The AEAT
Collection Information System Data Model.- 7. Horizontal IT Tools
to Process Files.- 8. Due Dates' Control.- 9. Attachments.-
10. Management of Requests for Tax Deferrals.- 11. Final Remarks.*

1. INTRODUCTION

This document is geared at describing the main features of the IT solutions developed by the AEAT to manage collection of the tax liabilities assessed by the Administration or the unpaid self-assessments' amount filed by the taxpayer, whether on the basis of a tax deferral request, setoff or simply because the self-assessment is filed without payment to avoid a breach based on fraud.

For a better understanding of the IT developments, we must describe the context in which the AEAT conducts its activities.

The following are deemed the prevailing conditions:

1. Significant participation of third parties in the collection procedures for such amounts. This refers to financial institutions.
2. Strong implementation of IT tools for administrative procedures that generate tax assessments.
3. Robust information system: a single system for all taxpayers, all taxes and all the tax levying procedures.
4. The AEAT also undertakes collection procedures for liabilities assessed by public entities that entrust such procedure upon it.
5. Large number of tax liabilities to process, which entails that the officials of the enforced collection units are greatly dependant on IT tools.

Firstly, this document analyzes in further detail some of these features. Following, it briefly describes the collection procedure phases for a better understanding of the IT solutions developed.

Secondly, a comment follows regarding an unprecedented aspect: assigning a collection risk to every debtor. This enables to breakdown the records according to this risk.

The document also includes a brief description of the Integrated Collection System (SIR, as per the Spanish acronym), which is part of the AEAT Information System.

Thereafter, a description is provided for some of AEAT's IT infrastructure components. For example, we may mention the horizontal applications to select groups of records and their processing, which are used by IT applications that serve to support collection procedures.

Finally, a basic description is provided as to certain IT procedures, such as due dates' control, attachment management or tax deferral requests' processing.

2. SPAIN'S AEAT INFORMATION SYSTEM

Tax Administrations conduct an information-intensive activity in order to fulfill two of their main functions: facilitate compliance with tax obligations and prevent and redress tax fraud.

The AEAT's Information System was designed over 25 years ago. The decision was made to implement a single information system for all taxes including customs taxes, for all taxpayers and for all the procedures. Among them, we have included tax liabilities' collection procedures. The portion of the information system that stores the data relative to collection procedures is called Integrated Collection System (SIR, as per the Spanish acronym) and it is a part of the AEAT information system.

The current structure of the AEAT information system is organized according to three levels. The first one corresponds to structured information. They are data stored in a relational database's file records. The former are called rows and the latter tables. The data format fits a predefined structure, so that its position within this structure enables to infer their meaning. For such purpose, every basic data element is gathered in a record field between two fixed positions. If all the information is made up by data and their context, in the structured information assumption the context or meaning shall be inferred from the position of the data in the database.

Since in the Spanish case we rely on a Single Tax ID Number for all taxes, all the database records (or rows) of the files (tables) include this Tax ID Number.

The AEAT relational database stores information mostly derived from five sources:

- 1- Taxpayers' tax statements. In the Spanish case, the main liability assessment procedure is the self-assessment mechanism. Even in the IIT draft statement procedure, it is the taxpayer who undertakes the self-assessment, whether by accepting the information provided by the AEAT or by making the adjustments deemed applicable.
- 2- The payments made by taxpayers. This information is supplied by the financial institutions in which such payments are made. The AEAT does not collect money, it only manages information.

- 3- The tax relevant information provided by companies, financial institutions, social security institutions and other Government Administration offices or captured by AEAT investigation units. Among such information, we include, for example, information relative to bank accounts. This type of information also includes the data owner's Tax ID Number, which enables to allocate this information not only to the party who provides it, but also to the party affected by it. In Spain, this process is known as tax data allocation or referred information. The information is made available to taxpayers (owners of the allocated data) during the period in which the IIT statement is due.
- 4- The administrative activity inherent in the AEAT units. All the procedures entail an IT event upon pressing any function key. The information system has recorded this activity. This mechanism enables to obtain administrative assessments, refund agreements, requirements of all kinds, punitive records, etc. This contributes in the evaluation of the procedures undertaken by every administrative unit. This evaluation impacts the compensation or salary earned by the officials of each administrative unit.
- 5- Appeals and other procedures to challenge the acts of the Administration.

The second level of information corresponds to unstructured information. The data pertaining to this information may not be found on the basis of their position but are integrated into their context. Therefore, they are also known by the name of electronic documents, since the information is made up by data and context. This would be the case of the scanned image of a document. Web technology enables the browser installed in the user's workstation to reproduce the image contained in the document. Another assumption would be the audio file for a telephone conversation. Taxpayers may request a change of domicile over the phone should they consent to recording their telephone conversation with an AEAT operator. The data for the new domicile are included in the telephone conversation. By means of a voice player, the conversation may be played back.

Every digitized image or telephone conversation recorded constitutes a bit set stored in the database table rows, which, in addition to the owner's ID, includes the binary representation of the document's image or telephone conversation in a single field.

The third level of information allows for the multidimensional analysis thereof. Relational databases enable to easily analyze the information in two dimensions. Every file or table in the database corresponds to a different data element. Every record or row in a table corresponds to a different information element. Every record or row in a given table corresponds to a taxpayer. Every data element contained in a record or row is stored in a field. In order to access a data element, we must know the type of information (file or table) and the Tax ID Number. Direct access to the data element entails the creation of alternative access indexes. The resolution of the problem becomes difficult when we wish to search in the information system for taxpayers who meet certain conditions in different elements of information (fields) contained in different tables. We must develop a software for each case, and we fail to obtain a real time answer.

In order to provide an online answer to this type of queries, information must be organized differently. Information systems enable the multidimensional analysis. Data are downloaded from the database and loaded onto other files that are linked to as many indexes as elements of information (or fields) must be analyzed. Therefore, contrary to structured and unstructured information, information systems are not physically stored in the AEAT relational database but in other types of files.

The fact that all the collection procedures are supported by the same information system facilitates the AEAT's collection activity.

Thus, for example, the applications that support assessment procedures incorporate assessments immediately into the Integrated Collection System. There is no downtime.

Another example is tax refunds. A mechanism to settle liabilities, other than payment, is the tax setoff, which may be requested by the debtor or by the Administration's Collection Units in an enforced collection phase.

Should a credit in favor of the debtor be discovered in the course of the collection procedures, whether a tax refund or other, such credit may be set off by the Administration and be allocated partially or in full to the tax liability payment.

Tax refunds are electronically processed by the application called Consolidated Refund Management System (SCGD, as per the Spanish acronym). This application is related to the SIR. Every refund accepted is cross-checked against the creditor's information prior to its effective payment to verify whether the party is a debtor or not. Should the latter be determined to hold a tax liability, the refund is electronically withheld. The Collection units then setoff the amount, allocating the refund amount to the debts and returning the balance, if applicable.

All these procedures are supported by IT applications: the SCGD and the SIR setoff and attachments' applications, which are interrelated, so that the procedures performed in any of them are replicated in the others.

Another assumption is the processing of tax compliance certificate requests, required by law from individuals and corporations in order to participate in Government Administration's bids and request grants, subsidies or aid. The certificate shall not be extended if the requesting party has liabilities according to the AEAT information system. Moreover, in order to foster the payment of outstanding debts, prior to requesting such certificates, the requesting party may query the outstanding debts on the Internet. For such purpose, the requesting party shall provide proof of his/her identity remotely via an electronic ID certificate extended by any of the 22 certification offices authorized by the AEAT.

Another case that attests to the advantage of implementing a single information system refers to the electronic processing of administrative appeals filed by taxpayers.

Should a taxpayer disagree with an administrative decision issued by the AEAT, he/she may file an appeal for reversal with the same unit that issued such decision.

If the decision being appealed accrued a debt, the appeal resolution shall adjust the status or the debt amounts to the spirit of the resolution in the information system. Likewise, until the resolution is issued, debt collection procedures may be stayed. Such stay shall apply upon securing the debt and the interest accruable in the course of the procedure.

Should the final resolution dismiss the appeal, such stay ceases to apply and the debt collection procedures proceed, calculating the interest accrued during the time the stay was in effect.

An IT application is available to process any type of challenge to the decisions issued by the AEAT. Such tool also includes the automated effects that shall occur on the information system relative to the appeals filed against the decisions that stem from the AEAT's resolutions. This application generates stays, debt annulments and additions of guarantees or new assessments in the SIR.

3. THE ROLE OF FINANCIAL INSTITUTIONS IN TAX REVENUE COLLECTION

Almost all financial institutions operating in Spain constitute cooperating entities in revenue collection efforts.

They undertake collection procedures, as well as information and document processing on behalf of the AEAT.

Collection procedures entail paying the tax revenue amounts received in accounts held by the Administration and transfer such amounts every fortnight to *Banco de España* within a term not exceeding seven business days from the due date of each of the 24 collection fortnights within a year.

Every cooperating entity holds four accounts in the name of the Administration, in which the revenue amounts are deposited. Such accounts are restricted as to the type of transactions the financial institution is allowed to perform. For such reason they are called restricted accounts. The four restricted accounts may be described as follows:

1. Self-assessment revenues from certain statement models only applicable to businesses with transactions in excess of 6 million Euros in the previous fiscal year.
2. Other self-assessment revenues.
3. Revenues from AEAT assessments and from enforced collection procedures' that other public entities requested from the AEAT. These are also known as assessments incurred in advance, since the duty is recorded before the effective payment. In the case of self-assessments with

outstanding amounts, the duties' are incurred at the same time they are paid off upon knowing the amount paid.

4. Revenues from service charges whose collection in the voluntary compliance period is managed by the AEAT on behalf of General Government Administration's units and agencies.

We must underscore that the AEAT does not collect revenues directly, only through financial institutions.

Information management includes reporting the balance amounts of the accounts in the name of the Administration to the AEAT, as well as the breakdown of each revenue amount collected. This information is filed electronically on a fortnightly basis. A different balance and revenue breakdown report applies for each one of the four restricted accounts.

The breakdown is electronically filed to the AEAT seven days after the deadline for each fortnight. The content varies from self-assessments to administrative assessments incurred in advance to service charges, but it is identical for all taxes.

Thus, for example, in the case of self-assessments, the information filed may be described as follows: taxpayer's Tax ID Number (NIF, as per the Spanish acronym), the first three letters of the last name in the case of individuals, the receipt number on the self-assessment form, including the tax code, amount, date and office of entry. The financial institution does not gather any other data from the self-assessment form.

In the case of self-assessments incurred in advance, the data entered by the cooperating entity are: taxpayer's Tax ID Number, receipt number as provided by the AEAT to the debtor, amount paid, office and date of entry.

All these data are gathered by the entity upon entry. The application used by the banking institution's employees collects said data. Banking applications may thus validate every piece of information gathered in the presence of the client that is making a payment. For example, in the data in the Tax ID Number or the receipt number there is a control digit. The model codes that constitute the self-assessment's record number shall match one of the numbers authorized by the AEAT. The amount payable for the assessments

incurred in advance is tied to the payment record number. Upon detecting such discrepancies in a financial institution's application in the presence of the taxpayer, it is possible to correct them immediately.

After receiving the breakdown, the AEAT firstly determines that the amounts collected match the transfer made to *Banco de España*. For such purpose, this entity forwards the amounts transferred by the different financial institutions to the AEAT electronically. Once the data are examined, the information breakdown regarding revenue amounts is assigned to each taxpayer accordingly.

The management of documents by financial institutions is limited to the reception and storing of revenue collection documents, except for the annual Individual Income Tax self-assessment statements, Net Wealth Tax, Value Added Tax and Corporate Tax, which require filing the statements with the AEAT so that it captures the information filed by the taxpayer.

4. COLLECTION PROCEDURE PHASES

The Spanish case distinguishes two phases: voluntary compliance and enforced collection. In turn, the enforced collection phase may be distinguished by two stages: coercive collection and attachment.

The deadline for payments in the voluntary compliance phase is determined by the regulations applicable to each tax in the cases of self-assessments and by the General Tax Act for assessments incurred in advance. In this case, it depends on the assessment notification date: for notifications made in the first fortnight each month, the payment is due on the 20th of the following month. In the case of notifications made in the second fortnight, the deadline is the 5th of the month subsequent to the following month.

The enforced collection period runs from the day after the voluntary compliance period expires, unless the debt is stayed on the basis of a request for tax deferral, installment plans or setoff, or upon filing an appeal with a request for a stay. In such cases, the liability amount shall be severally secured with a guarantee by the lending institution, mortgage, lien, personal and joint and several sureties or any other deemed appropriate.

TOPIC 3.2 (Spain)

The first phase of the enforced collection period, the coercive collection stage, entails assigning a new payment deadline for the amount stemming from the administrative assessment or sanction, with a 20% increase for late charges in the enforced collection phase.

Notice of coercive collection is served upon the taxpayer setting forth the unpaid liability, assessed late charges for the enforced collection phase and the taxpayer is summoned to meet payment. The notification includes the necessary receipts for effective payment of such amounts. The coercive collection notice has the same force and effect as the court decision to attach the debtor's assets and entitlements. In order to enforce this power, a new payment period must elapse, with its deadline defined by the coercive collection notice. Should the coercive collection notice be issued between the first and fifteenth of each month, payment shall be made effective as of the 20th of the month of reception thereof. Should the notice be served between the 16th and the last day of each month, payment shall be made effective as of the fifth day of the following month.

The late charges for the enforced collection phase may be calculated according to three rates: 5% in the case of payment in full of the tax liability unpaid during the voluntary compliance phase prior to serving the coercive collection notice. It shall be calculated at 10% when the liability is paid in full as well as the late charges prior to the coercive collection deadline with the receipts included in the coercive collection notice. Should the debtor fail to meet payment within the coercive collection term, he/she shall pay a 20% late charge, in addition to late interest accruable, and the attachment phase is initiated. In this phase, a debtor's assets and entitlements are seized. The debtor is notified of such process by the coercive collection notice itself. Should the debt be secured, the first step shall be to enforce the guarantee.

The payment of the outstanding debt amount at any time shall stop the attachment procedures.

Contrary to the voluntary compliance phase and the coercive collection phase, during the attachment process all the outstanding debts after the coercive collection phase elapses shall accrue and the attachment procedures are conducted upon the total debt amount.

The attachment of a debtor's assets and entitlements is conducted according to an amount that suffices to cover the outstanding debt amount according to the original assessment, late interest accrued until the date of effective payment, the late charges of the enforced collection phase and the fees for the enforced collection process.

5. COLLECTION RISK

A collection risk is allocated to each debtor in order to analyze his/her potential behavior in the face of a payment obligation. It basically depends on three variables or parameters:

- the tax paying capacity;
- the outstanding debt amount;
- the volatility thereof.

The IT system assigns a collection risk to each debtor on the basis of the analysis of the information stored in the AEAT database.

The taxpaying capacity variable is determined on the basis of the following information elements: mortgage loans, real estate property, sale transactions in Spain, sale transactions in the EU, exports, Net Wealth Tax base, Individual Income Tax base or Corporate Income Tax base and yields' information records.

The volatility variable measures the likelihood of "vanishing" in the face of financial distress. It relies on the following elements of information: number of employees and payroll information, sales in Spain, VAT base; VAT self-assessment payments, withholding tax on wages and withholdings on payments for commercial property rentals.

The liability variable is obtained from the sum of the outstanding debt amounts.

Collection risk is broken down according to three levels: medium-high, high and very high.

Risk level one or medium-high is made up by taxpayers deemed to have sufficient taxpaying capacity to meet liability payments.

TOPIC 3.2 (Spain)

Risk level two or high is made up by taxpayers deemed to be highly volatile in spite of their ownership of assets, thus warranting additional consideration in order to adopt measures to ensure debt collection.

Risk level three or very high is made up by taxpayers deemed to have almost zero taxpaying capacity.

Collection risk is a variable that may be employed for a number of purposes:

1. It enables to prioritize procedures.
2. It enables to conduct a different follow-up of debtors according to their risk level.
3. It enables collection risk to be a variable that may be considered by the Heads of the Collection Units to assign records to the different units.

In the case of corporations, in order to assign a given collection risk profile, in addition to the taxpayer risk, which may be called the “principal” risk, we consider the collection risk for the potential parties responsible for debt payment. Consequently, the IT application also assesses such risk. In order to perform this transaction, potential taxpayers are deemed to be all the administrators by law listed in the AEAT information system.

Therefore, corporate taxpayers may be classified into a second risk level, which may be called “sub-level”, according to the risk level attached to the administrators by law.

Therefore, the IT application determines the risk for all the administrators by law by assigning their respective risk level, one, two or three and qualifies the “principal taxpayer” according to the sub-level for the administrator by law with the lowest collection risk.

For example, should an entity lack assets, and be assigned risk level three accordingly, but the AEAT’s Information System (BDC, as per the Spanish acronym) features five administrators by law and two feature risk level one, one features risk level two, and two feature risk level three, the entity shall be qualified according to risk level three and sub-level one; three being the risk level for the principal debtor (very high risk) and one the risk level of the administrator by law with the lowest risk assigned (medium or low risk).

We have also considered that collection units must analyze risk on a dynamic and ongoing basis, since a taxpayer's collection risk may change, for example in the course of examinations.

Therefore, we have developed the functionality of incorporating an unassessed debt amount into a simulation tool to calculate collection risk on the basis thereof.

Additionally, the information in the risk application to assign a collection risk profile (basically the data on wealth and business activity included in the Database) may be modified for the purpose of the simulation.

Access to collection risk may serve for a specific taxpayer or a group of taxpayers by means of an *Infoclase* that enables to group debtors on the basis of a series of attributes, rendering a description thereof as well as individual detailed information.

The collection applications use such variable. Likewise, there are other applications relative to other procedures such as refund requests' processing that also use such variable.

6. THE AEAT COLLECTION INFORMATION SYSTEM DATA MODEL

The Collection Information System (S.I.R., as per the Spanish acronym) is part of the AEAT Information System. It is made up by over one hundred different entities or files.

The following entities constitute its backbone: debtor, liability (unpaid assessment or self-assessment), due date, payment receipt and payment.

Additionally, there are other entities that correspond to the content in each type of procedure: tax deferrals, tax setoffs, attachments, shifting liabilities, insolvency proceedings, sureties, etc.

- The *debtor* entity gathers the basic information required for the collection procedures involving the individual or corporation holding outstanding debts. Obviously, it includes the Tax ID Number, as well as the collection risk assigned. Other identification data, such as domicile, are taken from

the AEAT's relational database identification table. It also gathers accrued outstanding amounts for all liabilities according to their collection procedure phase.

A very relevant piece of information on this entity is the administrative unit in charge of the collection procedure for the liabilities thereof. Every debtor is assigned to a collection unit, which is in charge of all the collection procedures thereof. The Collection System's IT applications employ this information to indicate the workload for the units and the procedures pending completion.

This unit is electronically determined on the basis of a series of predefined criteria. Should such criteria change (for example, upon new liabilities generated for this debtor), the unit in charge shall also change, and the information for this entity shall be updated. The unit appearing herein is the one currently in charge of the debtor.

In the course of the collection procedure a debtor may have been assigned to several collection units, and since the outcomes obtained by such units are measured on the basis of the procedures they conduct with their debtors, it is also necessary to know a debtor's time of permanence with a given unit in order to adequately assign the outcomes obtained pursuant to the date they occurred.

The AEAT Information System currently gathers information from 42 million taxpayers, 9 million of which are on the debtors' table or file for a past or present liability.

- The entity named *debt* stores information relative to the assessment undertaken by the AEAT or another public entity that requested the collection thereof, or the applicable unpaid self-assessment filed by the taxpayer. Each debt is identified according to an assessment number that enables to know the party that undertook the assessment (the AEAT, the debtor or another public entity), the administrative procedure originating the assessment and the unit that performed it. It also includes a control digit. Likewise, it gathers the tax item by which all the transactions undertaken with an accounting relevance shall be recorded by the AEAT.

It also includes information relative to the original assessment amount, the amounts paid and the outstanding amounts in each one of the collection procedures' phases. The case may be that a liability amount has been broken down into several amounts in different phases. For example, breakdowns that arise from a tax deferral request decision.

This entity currently stores 35.7 million records.

- The *due date* entity corresponds to an assessment amount that shall be paid upon a due date. Such amount may be made up by amounts corresponding to the original assessment as well as amounts that may have been added in the course of the collection procedure, such as the case of late interest, late charges and collection procedures' fees payable by the debtor.

According to the collection procedure phase, due dates are differentiated pursuant to the voluntary compliance period, the coercive collection or attachment phase. According to the origin thereof, due dates may be defined for an administrative assessment, an unpaid self-assessment or a tax deferral.

In the case of an assessment added in the system, a record is immediately generated in the *debt* entity and another one in the *due date* entity. The remaining due dates always derive from a prior due date. Every due date includes information on the previous due date.

This is the most relevant entity for the IT system, since it defines the outstanding amount for each due date. All the data control and update processes in the collection procedure are based on the *due date* entity.

This entity currently includes 63 million records.

- The *payment receipt* entity gathers data from the different receipts produced by the IT system. Receipts are always issued electronically. Upon every issue, a new record is added in this entity. Every payment receipt is electronically linked to a due date, although a due date may be linked to more than one payment receipt. For example, when the debtor requests a copy after losing the previous one.

Every receipt is identified by a single receipt number. In the case of issuing a copy, the number shall be different from the previous receipt number. This number incorporates a control digit, which is calculated on the basis of the amount payable. The control digit may be identified by the IT application of the financial institution that collects the amount, which ensures that the debtor pays the full amount stated on the payment receipt and prevents material errors by the financial institution upon keying in the amounts.

The *receipt* entity includes the amounts payable and, since it is linked to a due date, it enables the payments made with this receipt number to be automatically allocated thereto without the user's intervention.

- The *payment* entity includes information on each and every payment received. They are called payments in process when they arise from a payment deduction performed by the AEAT. This would be the case of a tax refund paid by the AEAT, in which an amount has been deducted to pay off an outstanding debt held by the party entitled to the refund.

For the remaining payments, the information is always supplied by a financial institution. When a third party forecloses on a debtor's asset or entitlement, the third party shall pay the resulting amount in a cooperating financial institution by means of a payment receipt issued by the AEAT. In the case of payments in process, the AEAT applications are in charge of directly incorporating the payment information upon the deduction from the payment amount.

The data gathered in the entity's records include, in addition to the data rendered by the financial institution (Tax ID Number, receipt number, amount, date and office of payment), other data, such as the date of incorporation into the system and the amounts refunded to the debtor, if applicable.

These entities constitute the SIR's backbone, since they participate in all the collection procedures and constitute the basis of other entities that support the specific procedures.

An example may be the entities linked to the attachment procedures. They include the entities relative to the assets and entitlements that are firstly attached and enforced thereafter. Likewise, they include the attachment proceeding that stores the file data, the description of the due dates applicable and the payment allocation proposal based on the priority attached thereto when the payment does not meet the overall outstanding amounts for such due dates.

In the case of setoff records, the information on the tax credit setoff is included in the applicable entities, as well as the data relative to the due dates to be setoff.

Tax deferral records include an entity relative to the debtor's request, another entity relative to the sureties provided and an additional one for the decision on the request on the basis of an agreement.

7. HORIZONTAL IT TOOLS TO PROCESS FILES

The Tax IT Department has developed two IT tools that support a large number of tax procedures' applications: the *record processing tool* and the *Infoclase*. These tools are interrelated and have been jointly designed.

Infoclases enable to select certain group of files on the basis of information attributes generated in advance. This enables to select group files according to different criteria without having to develop specific software for every type of selection. For such purpose, each file is tied to a matrix of zeros and ones that indicates whether they meet a given condition or information attribute or not. Thus, for example, in the case of the due dates' *Infoclase*, the matrix for each due date indicates whether it is being processed in a given stage or phase of the collection process or not, whether the time elapsed for such process occurs within a given time span, if the outstanding amount is included in any of the different amounts' intervals, if the source of the debt is an administrative assessment conducted by the Tax Administration, an unpaid self-assessment or a debt assessment conducted by a different public entity, which has been the assessment office (Inspection, Customs, Collection), whether there is a debtor's collection risk, which is the processing unit, etc. Up to 256 information attributes are available.

The processing tool enables the execution of actions for a tax procedure on an individual or group basis supported by a selection performed by the *Infoclase*. For such purpose, a previous definition of each procedure is required, indicating what statuses make up the processing thereof and the actions that may be executed on each of them to generate status changes.

The information reflected by these tools is updated on a daily basis via batch processes that update the zeros and ones matrix for each file. Therefore, every morning upon sitting down to work, users view an updated image of the information. It is used online, at the query as well as decision-making level, with real time answers.

If we compare this type of tools with conventional applications, the following may be the advantages worth underscoring:

- They enable individual or group actions.
- They do away with lists in hard copy.
- They put together all the possible actions into a single application.
- They offer users' a homogeneous look for the different management applications.

Among the disadvantages, we may mention:

- Greater effort in the definition phase.
- Daily processing time required to generate information.
- Requires storing larger information volumes.
- Change in the user's working philosophy.

8. DUE DATES' CONTROL

This is the basic SIR process. It identifies the due dates for which the payment deadline elapsed, without a payment recorded, and without a record in the information system indicating that its enforceability has been stayed.

This is a process executed for liabilities in the voluntary compliance period as well as those in the coercive collection phase.

The due dates' control tool considers the time allocated to financial institutions to submit the information on the payments collected, it

tags the due dates' elapsed, calculates the days from the payment deadline and analyzes certain due date, debt and debtor's attributes. It prepares the information to issue the coercive collection notice or provide for the initiation of the attachment phase.

These actions are materialized through the due dates' *Infoclase*, which also enables to issue the applicable documents: receipts, coercive collection notices, acknowledgement of receipts, etc. In the case of processes entailing massive printing of documents, such processes are conducted by the AEAT Printing and Mailing Center. This center prints and puts the documents into envelopes and generates a digital image thereof, which is stored in the information system.

The coercive collection notice issued upon a due date, entails canceling the latter and adding a new due date in the IT system. The new due date is assigned for the coercive collection process, with an additional 20% late charge included in the enforceable amount. Obviously, it lacks a payment due date since it shall depend on the coercive collection notice. The new coercive collection due date gathers information from the due date applicable in the voluntary compliance phase from which it derives. Therefore, both due dates are related.

The initiation of the attachment phase entails that the applicable coercive collection due date is tagged as elapsed, so that it may be treated by the processes in charge of issuing attachment orders.

The process enabling to issue these orders is parametrizable on the basis of the attributes configured in the *Infoclase*, to give a different treatment to the due dates bearing a different profile. Thus, for example, the due dates for debtors with a greater collection risk or a larger outstanding amount may be treated on a preferential basis and the documents for notification purposes shall be forwarded by AEAT officials and not through the ordinary mail service.

The competent user in the Collection Office relies on a transaction that indicates the number of due dates in the coercive collection phase or those that may be shifted to the attachment phase and the attributes mentioned herein. Implementing Boolean operators on such attributes, enables the dynamic selection of groups of due dates that fall under the coercive collection phase or those that shall be shifted to the attachment phase. The answer to such

parameterization of groups is obtained online. The responsible user obtains a real time answer from the computer by which he/she knows the group of due dates that meet the conditions of the attributes defined by him/her.

But, additionally, he/she may decide to execute the coercive collection process or initiate the attachment phase individually or for the groups selected. In the first assumption, the answer is obtained in real time, while in the second, the process is executed in a batch mode during the afternoon-night shift. The decisions adopted update the information system and are considered in the subsequent due dates' control.

Therefore, due dates' control in the batch process prepares the information to enable real time decision-making through the *Infoclase*.

9. ATTACHMENTS

An outstanding liability, both in the voluntary compliance period as well as the coercive collection phase, warrants initiating the attachment phase.

In the course of this phase, the entire debtor's known assets and entitlements are attached, and all the debts in this phase shall be included.

The assets or entitlements to be attached are determined by the Collection Rules, which also determine an order or preemptive right on the basis of the nature of the respective asset.

The information employed by the Collection units to identify the assets that may be attached chiefly stems from the AEAT Information System, which uses information filed by third parties. The AEAT Information System includes information from all the bank accounts of the financial institutions operating in Spain, taxpayers' interests in mutual funds, their shares or equity interest, their real estate property, their motor vehicles, employers, their clients' identity, etc.

Other assets may be disclosed by procedures performed by the Collection Units, which are incorporated into the Database.

Each attachment is documented in an attachment proceeding. The debts of a same debtor in the enforced collection phase may accrue in a single attachment proceeding. Such proceedings are delivered to the assets' receivers, other than the debtors' themselves. Once notice of attachment has been duly served, the receiver shall seize or enforce the asset, becoming responsible for the overall taxpayer's debt amounts defined in the attachment proceeding.

For example, the bank account balance belongs to the debtor, but the receiver shall be the financial institution in which the account is held. Therefore, the notice of attachment is served upon the institution, which shall seize the applicable amount. Thus, the financial institution shall be held liable by the Tax Administration.

Upon seizing the asset, notice of the attachment is served upon the debtor, who may pay the outstanding amount at any time prior to foreclosing on the asset.

Attachment proceedings are electronically linked to the debtor's liabilities in the attachment phase. For each proceeding, these liabilities are classified on the basis of a given order, which shall be used for the allocation of the payments potentially obtained in the process, since the payment that stems from the attachment phase may be insufficient to cover the overall debt amount set forth in the attachment proceeding.

The IT system basically features two attachment *Infoclases*:

- *Infoclase* for debtors in the attachment phase: It enables to obtain information on the debtor's assets' ownership recorded in the single Database, learn about any pending procedures on any type of asset and initiate the applicable attachment procedures.
- *Infoclase* for attachment proceedings: it renders information on all the attachment procedures for a debtor, as well as the processing thereof.
Processing of each type of asset entails a different IT application, since the procedures for each one of them and the parties involved are different.

Assets deemed liable to attachment are: bank accounts, mutual funds, sovereign debt, commercial loans, tax refunds, payments from public entities, leases, other short term loans, wages and salaries, real estate property, jewelry, vehicles, other movables, long term loans and cash.

Depending on the type of asset and using the appropriate IT applications, certain attachment procedures are fully automated, with minimum user's intervention.

Such is the case with bank accounts' attachment. Every month, a number of bank accounts' attachment proceedings are automatically generated on the basis of the information available in the accountholders' system rendered by the financial institutions themselves. These proceedings are electronically forwarded to the entities, who automatically seize the amounts indicated, reporting the results to the AEAT thereafter, also electronically. Should the debtor consequently pay the debts claimed on the attachment proceeding, an electronic order is issued to the financial institution to release the amount seized. If the financial institution fails to receive the release order within a predefined term, it shall deposit such amount in the AEAT accounts. This event shall be disclosed when the institution files the information on payments deposited in the restricted account for payments incurred in advance. The information on such payments shall be assigned to the payment of debts stated on the attachment proceeding, pursuant to the predefined order.

Since 2005, an electronic information exchange system has been implemented by which the local and autonomous entities may report on a daily basis the payments they shall make against their expense budget, for the AEAT to confirm that their creditors lack outstanding debts. In the case of debtors, the AEAT shall issue the applicable attachment proceeding.

A special collection unit may be mentioned, called the Smaller Debts' Collection Unit, which undertakes collection procedures against debtors with an overall outstanding debt that does not exceed a predefined amount. This Unit processes the largest number of debts, which given their nature, are the easiest ones to collect.

A number of IT processes support this Unit. They perform the largest number of attachment procedures automatically, thus minimizing users' intervention. In addition to bank accounts' attachment, such processes also include vehicle seizures and garnishment of wages and salaries.

Vehicle seizures consist in filing an electronic report to the Central Personal Property Registry with the license number of vehicles that may not be transferred. The sole notification to the debtor of this action makes him/her pay the outstanding debts. The General Traffic Directorate electronically supplies the AEAT with the information relative to vehicles and their owners on an ongoing basis.

The garnishment of wages and salaries consists in notifying the employer of the order to deduct certain amounts from the employee's payroll and deposit such deductions in a given financial institution. Employers file an annual report with the AEAT with the list of employees as well as their salaries.

If the attached asset is a bank account balance, a cash amount or a credit in favor of the debtor, the debt shall be paid off directly.

Other assets or entitlements shall be subject to disposal. The disposal price obtained is allocated to the payment of debts, and the surplus, if any, shall be delivered to the debtor.

The enforced disposal proceeding consists in a public auction. Firstly, the auctionable assets shall be appraised and the debtor notified thereafter. The auction shall be made public via the applicable auction announcements. Once the auction has been announced and the date determined, the auction may be held. If the asset is not awarded in an auction, a direct award process may be initiated, and upon failure to award it, it shall be awarded to the State.

Access to information on goods that shall be disposed of and the participation in auctions is enabled via the Internet.

The services offered on the Internet enable to:

1. Learn which assets are to be auctioned, as well as the venue and date and what is the type of bid (starting price).
2. Make the deposits required to participate in the disposal proceedings through the financial institutions involved, as well as obtain the refund thereof online, should the depositor not be awarded the auctioned asset.
3. Participate in an auction without moving to its venue.
4. Make an on-line payment of the auction price in the account defined by the awardee.

The bidder may directly bid via the Internet, considering the other bids by different bidders, or otherwise directly at the auction house. In order to know the bids performed via the Internet, auction houses are furnished with a giant screen showing the auction's evolution.

Additionally, the IT application enables the bidder that wishes to participate via the Internet, to use the automated bid option. Thereby, the bidder may indicate the maximum price he is willing to bid and in such case, the application shall bid for the online bidder in the course of the auction, until the maximum bid price entered is reached. The online bidder is not required to log on the day of the auction.

Since 2002, when the Internet bidding functionality became available, the positive outcomes have been evident. It has increased participation and transparency in such processes, facilitating and disseminating the access to information on auctionable assets.

The first Internet auction was held in Valladolid, on June 13th, 2002. The first time the successful bidder was an Internet bidder was November 19th, 2002, when a plot was awarded in Barcelona.

Since then, there has been a progressive participation of online bidders in auctions and moreover, in the direct award proceedings. The first time personal property was awarded was July 3rd, 2003, in Murcia. Fifteen vehicles were auctioned. Over 80 bidders participated via the Internet, with five vehicles awarded to Internet bidders (four in the first bidding process).

The level of participation is also reflected on the available access statistics on the AEAT auction Web page. Above a mean 132,000 monthly visits to these pages were recorded in 2005. This year, 68% of bidders were Internet bidders and 44% of the assets were awarded to Internet bidders.

On the other hand, the greater publicity given to the auctionable assets fosters the participation of bidders, which generates an increase in full compliance by taxpayers. Consequently, we have experienced an increase in the percentage of auctions called off upon full payment of liabilities by the debtor prior to the auction.

Another induced effect is that the overall percentage of awards increases. Among the factors contributing to this increase, we may mention the described services offered via the Internet (the number of auctions held in which assets were awarded has increased from 37% in 2002 to 50% in 2005).

10. MANAGEMENT OF REQUESTS FOR TAX DEFERRALS

The AEAT, upon request of the taxpayer, may defer or accept an installment payment agreement for the payment of liabilities. The request shall include, among other data, the reference to terms and other conditions for the requested tax deferral or installment payment agreement, as well as the description of the guarantee offered. The Collection Units shall examine and assess the lack of liquidity and the income generating capacity and consider the sufficiency and adequacy of the guarantees. In the case of requests for exemption of guarantee, they shall verify whether the necessary qualifying conditions are met. Upon completion of such proceedings, the applicable Collection Unit issues the decision on the request and notifies the requesting party thereafter.

In case of granting the requested tax deferral, late interest is calculated on the deferred debt for the time starting on the day subsequent to the deadline of the voluntary compliance period and the due date of the term granted. Should the tax deferral request be filed in the enforced collection period, the calculation base does not include the late charges of the enforced collection period. Interest accrued shall be paid together with the deferred liability.

In case of acceptance of an installment payment agreement, late interest is calculated on the basis of each installment. For each installment, interest accrued is calculated from the day subsequent to the deadline of the voluntary compliance period up to the due date of each installment granted.

In the case of a negative decision, upon notification thereof, a new payment term starts running. Should payment be made effective within this term, late interest accrued is calculated from the day subsequent to the deadline of the assessment payment term for which a tax deferral request was filed and up to the date of payment within the term running from the date the negative decision was notified.

In the case of granting such benefits, a new due date for each installment is generated on the IT system, with the amount payable for each one of them, including the interest amount applicable. A new payment due date is also calculated, which shall always coincide with the 5th and 20th of every month, according to the conditions granted.

In the case of a negative decision, a new due date is also generated, with a payment deadline restricted by the date on which the negative decision notification was served.

Requests and the decisions issued are processed via their respective *Infoclases*.

The requests' *Infoclase* enables to process requests according to actions such as request for additional information or documentation. It also enables to perform decision simulations to indicate the user how the installments would be generated according to specific conditions, so that they may finally select the most convenient one. A joint decision proposal may be produced for a number of requests. Once the most convenient alternative is defined, a draft agreement is generated on the basis thereof for the applicable unit to decide. Such draft agreements are processed by the agreements' *Infoclase*.

The attributes available in the requests' *Infoclase* may be classified according to the following categories:

- Subjective attributes, based on the debtor's features: government entity or other, collection risk level assigned, recently chartered business or other, profits filed in the last tax statement, etc.
- Objective attributes, according to the liability features: tax item, assessment source (unpaid self-assessment, examination record, other administrative assessments, debts with other entities), type of tax assessment office (Inspection, Customs, Collection, etc.).
- Request data: amount to be deferred or paid according to an installment payment agreement, number of installments, tax deferral term, filing method (Internet, offices, Customer Service), frequency, nature of the guarantees, etc.
- Request proceeding description: Status, dwell time in each status, etc.

The tax deferral agreements' *Infoclase* enables the applicable unit to confirm the draft decisions for the request, issue agreements and generate the applicable terms in the IT system, follow-up the process and calculate late interest.

Should the taxpayer not meet the terms agreed, this application enables to cancel the tax deferral benefit and generate a new due date for the outstanding amount.

This *Infoclase* records the proceeding statuses' applicable:

- Draft agreement entered.
- Agreement confirmed.
- Agreement issued.
- Agreement notified.
- Guarantee not formalized.
- Overdue installments.
- Case closed.
- Cancelled for noncompliance.

This *Infoclase*, just like the previous one, includes subjective and objective attributes, in addition to a series of attributes that report whether the expected payments are being made and whether the guarantees have been formalized.

In recent years, the following options have been incorporated to facilitate tax deferral requests' submittal for debtors, as well as compliance with installment payments:

- Filing requests on-line or through the Customer Service Center.
- Installment due dates' notices via mail, e-mail or SMS.
- Making payments in the financial institutions. Should the debtor select this option, the IT processes transfer the information on all the installments payable for that month to the financial institutions, on a monthly basis, which shall be deposited in the Administration's restricted accounts.

11. FINAL REMARKS

IT developments required to support the Administration's collection procedures are very complex. We may resort to some figures to illustrate this assertion. The portion of the AEAT information system devoted to collection procedures (SIR) contains over 100 files. In excess of ten thousand programs were created for this activity.

The availability of an information system with a large volume of benchmarked data facilitates enforcement actions against the debtor's wealth. Such actions may be initiated directly by the IT system when the debtor fails to meet his/her payment obligations.

Upon performing all the tax assessment procedures with the same information system, it is possible to control that no favorable actions are generated for the noncompliant taxpayer. This would also apply for tax refunds and administrative tax compliance certificates.

The AEAT avails itself of all the existing communication channels to facilitate collection procedures. We must especially underline the outcomes in the case of auctions that allow for Internet-based bidding.

Case Study

TOPIC 3.2

TOOLS USED IN AID OF COLLECTION

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CONTENTS: I. Background.- II. The Enforced Collection Modernization Plan.- Functional Architecture: Description.- Deterrence systems: 1. The System to Setoff Debts from Tax Refunds.- 2. The Tax Benefit Control System.- 3. The IT Debtor Disclosure System (SIPDEV).- Operating systems prior to coercion: 4. The Electronic Summons and Notifications' System (SECIN).- 5. The IT Procedural Incidents' Management System (SIGIP).- Operating systems for coercion: 6. The Third Party Institutions' Data Transfer Network (REDET).- 7. The Electronic Registry of Assets subject to Garnishment (CEAP).- 8. The Automated Garnishment IT System (SIPA).- 9. The Automated Attachment IT System (SIGVEC).- 10. Internet.- III. Project Implementation: Outcomes.

EXECUTIVE SUMMARY

In the last few years, the Portuguese Tax Administration has been developing a Modernization Plan for the enforced collection systems, relying on the use of new information and communications' technologies, as a tool to enhance enforced collection efficacy and effectiveness.

The Modernization Plan shall lead to the automation of enforced collection procedures and the use of the Internet as a correlative interface among the Tax Administration, taxpayers and all the participants in the enforced collection process.

I. BACKGROUND

In the last two decades, the Portuguese Tax Administration underwent three modernization processes, spurred by the three large tax reforms.

- In 1986, with the excise tax reform, the VAT assessment and collection transactions were centralized and computerized;
- In 1989, with the income tax reform, the respective tax assessment transactions were also computerized and centralized;
- In 2004 the property tax reform lead to the computerizing and automation of the respective taxes' administration system overall.

Regarding the administration of tax statements, tax assessment and voluntary tax collection, the Portuguese Tax Administration moved, within a 20 year period, from a manual administration system based on paper and featuring an organization disseminated throughout the territory with numerous offices, to a centralized and computerized system.

Such reforms, which ensured the normal performance of the system with compliant taxpayers, failed to go hand in hand with a system reform that ensured its performance with noncompliant taxpayers.

The enforced collection system in Portugal, which is a responsibility of the Tax Administration, continued to function based on traditional models, the paper paradigm and manual production of all the actions in the process. This entailed an ongoing increase in the outstanding debt balances and the increasingly complicated backlog in enforced collection processes.

In a first phase, the Portuguese Tax Administration faced this increasingly relevant issue by strengthening the local offices' enforced collection competencies and hiring new employees.

The introduction of IT in the enforced collection system started in 1991, with the implementation of a local recording application for tax enforcement procedures. Such IT solution served the sole purpose of keeping a processes' record, without operational production functionalities.

In 1999, we undertook the implementation of a national integrated system, in a Web environment and developed in a network, but mainly focused on processes' recording. Such records are now broken down according to phases and process actions, but still lack operational production functionalities.

Unable to sustain the increase in the debt balances, the Portuguese administrations resorted to a number of voluntary and exceptional tax compliance regimes that pardoned interest and costs. In 1994, 1996, 2002 and 2003, we conducted a debt securitization operation for the overall debts accrued.

As of 2004, the Portuguese Tax Administration finally decided to implement information and communication technologies on a broad basis as tools to enhance the efficiency and efficacy of the enforced collection system.

II. THE ENFORCED COLLECTION MODERNIZATION PLAN

We are currently finishing the implementation of an ambitious Tax Justice Modernization Plan, which shall be developed by the Tax Administration.

In 2005, we approved the Strategic Plan for Tax Justice and Efficacy (PEJEF, as per the Portuguese acronym) and the System for Tax Justice Modernization (NMJT, as per the Portuguese acronym) was established for the implementation thereof.

This Strategic Plan is based on four fundamental strategies:

1. digitization of all the processes and actions performed therein;
2. digitization of the supporting documentation for processes and actions;
3. automation of all the actions performed in the processes and all the back office functionalities, with massive use of data crossing procedures;

4. on-line availability of all the enforced collection functionalities, relying on the Internet as a relevant relational interface with all the parties in the process, including debtors as well as other channels, such as ATM's, e-mail, and the banking network overall.

A fifth strategy, to be undertaken in the course of the second phase, foresees that submittal of documentation to complete proceedings shall become electronic and no longer require the involvement of the Administration's officials. For such purpose, the systems shall be endowed with artificial intelligence to enable the automated selection of the proceedings' options provided by Law. Such requirement has been already fulfilled in a number of processes' segments and shall be broadly implemented as soon as the processes' databases are deemed fully reliable.

Functional Architecture: Description

The basis for the enforced collection system is the Tax Enforcement System (SEF, as per the Portuguese acronym), which contains the updated record of all the processes and all the actions performed therein. This is a network-based system operating in all the General Directorate for Taxation (DGCI, as per the Portuguese acronym) services.

The SEF receives the information on all the overdue debts from the assessment and collection systems and proceeds to automatically launch the processes.

The operating systems that automate all the enforced collection processes' actions work according to an ongoing interface with the SEF. They were implemented according to the PEJEF in the last two years and are enumerated hereunder:

Firstly, the deterrence systems:

1. **The System to Setoff Debts from Tax Refunds**, which makes the total or partial payment of debts from the total tax refunds to which debtors may be entitled on a fully automated basis. Provided that taxpayers for each type of tax are entitled to a tax refund, the Setoff System automatically detects whether there

are outstanding debts in the SEF and if so, such refund is allocated to the payment thereof. The system functions online and in the cases in which the tax refunds' amounts exceed the debt amount, such surplus is also automatically allocated to the respective taxpayer;

2. **The Tax Benefit Control System**, which prevents granting tax benefits to taxpayers with tax debts in the enforcement phase. This system receives all the requests for tax benefit allocations, automatically issues an order by crossing data with the other systems and reports to the process manager as to the result of the decision. The system crosses information with the Tax Enforcement System (SEF, as per the Portuguese acronym), among others, and should debts exist, the benefit requested is immediately rejected. This system has been implemented for the Municipal Real Estate Property Tax (IMI, as per the Portuguese acronym) and the Individual Income Tax (IRS, as per the Portuguese acronym) and shall be made extensive to the other taxes by the end of the year. Vis-à-vis the IMI, the tax benefit request may be filed via the Internet and applicants may be informed of the preliminary decision immediately.

The system still features a recording function that records all the tax benefits that apply automatically, by electronic collection based on all the assessment systems.

After acknowledging the tax benefits or upon applying those that operate automatically, this system conducts ongoing and online controls on the assumptions that continue to apply. Therefore, if the system verifies that a new debt has been recorded in the SEF, it automatically issues a taxpayer notice, with a view to canceling such a tax benefit. Should payment not be met, the tax benefit is suspended or cancelled.

3. **The IT Debtor Disclosure System (SIPDEV, as per the Portuguese acronym)**, which automatically selects the debtors that shall be disclosed by the Tax Administration. Since 2006, Portuguese legislation has provided for the Tax Administration to disclose the list of debtors in the enforced collection process pending. This IT system defines an interface with the SEF and undertakes the management of the administrative disclosure proceeding, including prior debtor audits, and updates the list posted on the Internet.

Secondly, the operating systems prior to coercion.

- 4. The Electronic Summons and Notifications' System (SECIN, as per the Portuguese acronym)**, which automatically summons debtors and sends all the notifications from all the institutions involved, in the framework of the tax enforcement process.

But the SECIN features an additional important function: it receives mail automatically, as well as the information on the mail status, whether it has been delivered or not, the delivery date, return thereof, etc. This information is recorded in the SECIN, which in turn inserts it automatically in the processes. The automation of the insertion of such information in the systems releases officials from the performance of a large number of manual tasks without any added value. But the most relevant aspect is that such automation enables systems to calculate deadlines and move procedures into the next phase, without the manual intervention of officials.

- 5. The IT Procedural Incidents' Management System (SIGIP, as per the Portuguese acronym)**, which computerizes and automates the processes for all the contentious-administrative or legal proceedings. This system interacts with the SEF and automatically suspends the enforced collection processes provided that, in a contentious case, a security interest is presented. Likewise, upon concluding the contentious proceedings, the enforced collection process is automatically resumed.

Thirdly, the operating systems for coercion.

- 6. The Third Party Institutions' Data Transfer Network (REDET, as per the Portuguese acronym)**, which obtains all information relative to debtors' assets and entitlements that may be garnished from all the possible sources or origins. The REDET, which identifies debtors, searches through different Tax Administration systems and those from other public and private entities, to determine their assets or entitlements that may be subject to garnishment. The system's philosophy is based on the principle that the wealth debtors gain by failing to meet their tax obligations with the State is available in files that the REDET must detect and retrieve in the system, so as to support the payment of the respective debts.

Currently, the REDET electronically gathers the following data:

- From banking institutions: All the transactions recorded or deposits made, bank accounts and other savings products;
- From insurance companies: The information relative to life insurance and savings-reforms plans;
- From Motor Vehicle Registries: The database for light and heavy-duty motor vehicles;
- From the General Customs Administration: The elements relative to motor vehicle imports, as well as imports and exports of goods;
- From businesses in general: The information relative to third-party credits and third parties themselves, as well as the identity of their key vendors and customers;
- From employers' registries: All the information relative to the payment deadlines of employee salaries, as well as the services paid to freelance professionals;
- From tenants and owners' income statements: All the real estate property income;
- From the Public Credit Institute: The identification of the Government bonds owned by individuals who hold debts with the State in the enforced collection phase;
- From Notaries and all the institutions that perform notarial proceedings: All the information relative to the transfer of real estate property and the execution of agreements of any nature, chiefly the transfer of equity interest;
- From the Port Authority: The information relative to the vessels registered therewith;
- From the Real Estate Registry: The information regarding all the plots, rural or urban, in Portugal.

The REDET information sources were selected for their implementation in the first phase of the project. As the system consolidates, it shall be made extensive to other types of assets and entitlements that may be subject to garnishment.

7. **The Electronic Registry of Assets subject to Garnishment (CEAP, as per the Portuguese acronym)**, which records and stores, on an automated and permanent basis, all the debtors' assets and entitlements that may be subject to garnishment. This system receives information from the REDET and only includes on a permanent basis all the types of debtors' assets and entitlements detected thereby. The CEAP constitutes a relevant

source of consultation and information for the offices, but it chiefly serves to support the automated garnishment proceeding via the SIPA, as we shall explain hereunder. This tool enables the Tax Administration to keep an updated control on a permanent basis of all debtors' assets that may be subject to garnishment.

8. **The Automated Garnishment IT System (SIPA, as per the Portuguese acronym)**, which automatically garnishes debtors' assets and entitlements that reach the outstanding payment amount. The SIPA provides officials, on a per debtor basis, the overall debt amount and the list of all their assets and entitlements as available in the CEAP. The processes' management official, by simply keying into the system, shall indicate the assets or entitlements to be garnished. The system performs all the necessary transactions in order to complete the garnishment proceeding. Thus, it issues the notifications for banking institutions, in the cases of garnishment of shares of stock and bank accounts; for the employers' organizations in the case of salary garnishments; for clients, in the case of credit garnishments, etc.

Currently, such notifications are issued in print and electronically at the same time. The notified entities may access the Tax Administration's Web site, by entering their access password and see the garnishments notified thereto and they may answer via the same site, confirming the garnishment and transferring the amounts claimed, without requiring a visit to the administration's offices.

In the case of attachment of property and vehicles, which are subject to registration, the applicable registration authorities access, the writs of attachment they receive through the DGCI Web site. The system enables them to view and copy the writs of attachment in an electronic document, as well as the registration requirements. Likewise, they may confirm the attachment registration via said Web site.

Therefore, without officials' manual intervention, the attached property and motor vehicles may move into the sale phase.

9. **The Automated Attachment IT System (SIGVEC, as per the Portuguese acronym)**, which fully automates the sale procedure for the assets attached and posts Internet notices on

the assets for sale. This system automates all the procedures previous to the sale, chiefly advertisements and notifications to all the applicable entities.

In August this year, all the real estate property sale notices have been posted on the Internet and they are available for consultation by any interested party. The Tax Administration continues to forward personal e-mails to all the parties that request them. This e-mail is forwarded whenever a new real estate property sale is determined, which matches the description provided by the interested parties.

Legislative changes are underway with a view to enabling the sale of attached assets in Internet auctions, thus increasing transparency in the procedure and convenience for the parties interested in purchasing the assets.

The Web site that advertises sales features different browsing tools, including a geographical information system with aerial photography, by which all the property on sale may be localized.

10. **The Internet** is a relevant relational interface between the Tax Administration and taxpayers. Since 2005, all debtors have been able to query and pay their debts via the Internet. Such payment may also be met through the ATM network, as well as Post Offices, any banking institution or the Tax Administration's offices.

Likewise, all the entities that participate in the attachment and sale of assets may use the Internet as a channel to obtain or deliver information to the Tax Administration.

In July 2006 we started to post the list of tax debtors on the Internet. We foresee that the complete list shall be available in the course of 2007.

The Tax Administration enabled a telephone line to serve all debtors and individuals interested in purchasing assets in a foreclosure sale and query the debtors' list.

Likewise, as the new Internet functionalities are being implemented, the General Director for Taxation has forwarded an e-mail to the 2.5 Million regular users of the DGCI Web site who expressed their interest in receiving such information.

III. PROJECT IMPLEMENTATION: OUTCOMES

Stemming from the use of new technologies as instruments of the Tax Administration efficacy and efficiency, enforced collection increased significantly since 2003. We foresee that in 2006 the revenue amounts collected shall double.

On the other hand, a new threshold was attained as to the simplicity and convenience of taxpayers proceedings to meet their tax obligations.

Taxpayers' use of the Internet was successful. The Portuguese media and public opinion have highlighted the Tax Administration's implementation of technological modernization projects, especially in the field of enforced collection.

This has fostered a friendly relation between taxpayers and the DGCI and also generates relevant effects in economic productivity.

The implementation of this project relieved the Tax Administration's offices from a large number of routine tasks without any added value performed by human resources, for them to pursue more productive tasks. This increased officials' motivation and their focus on meeting the objectives set forth.

The broad incorporation of new technologies in the productive process enhances efficacy and has endowed the DGCI with the power to answer the vast majority of requests.

The marked improvement of the DGCI capacity to combat noncompliance, defeating debtors' reluctance to compliance, enhances officials' motivation and productivity.

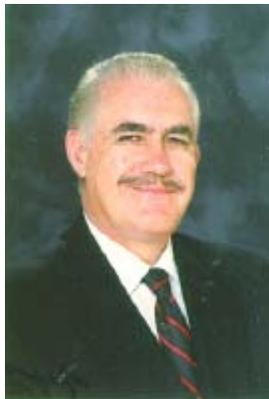
For the first time in many decades, the amount of the overdue and assessed debt in 2006 shall be under the 2005 debt amount.

But the most relevant outcome of the system implementation was, in addition to the debtors' culture, the dissemination of the notion that the Tax Administration achieved a greater efficacy and promptly reacts to taxpayers' noncompliance, effectively enforcing all the powers vested upon it by law.

CLOSING SESSION

GENERAL REPORT

GENERAL REPORT
Jorge Cosulich Ayala
Former CIAT Executive Secretary



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Former CIAT Executive

I wish to thank my dear friends from CIAT and the State Agency of Tax Administration of Spain (AEAT, as per the Spanish acronym), for kindly inviting me to draft the general report of this magnificent technical conference, marked by the quality of its agenda, the papers presented as well as the moderators, speakers and commentators.

I would also like to commend our Spanish friends for the excellent organization of this event, creating such a warm and cordial scenario, a characteristic of all CIAT technical conferences hosted by Spain, where the representatives of the tax administrations from numerous countries are welcomed to a friendly, kind and generous atmosphere.

On a personal note, I feel deeply moved by this reunion with old friends from the AEAT and the Institute for Tax Studies (IEF, as per the Spanish acronym); I specially recall the time when, 25 years ago, I had the honor of working with professor César Albiñana and Mr. Javier Paramio in the drafting of the first Spain-CIAT cooperation agreement, which is still in force, constituting the framework for the commitment and generous support between Spain and the CIAT and its member countries.

I would like to start this general report by quoting Miguel de Cervantes who, as many of you know, was a colleague of ours (a tax collector in the provinces of Granada and Seville); his prologue of the Quixote commenced with the statement “Idle reader: you may trust that my

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wish for this book, as the offspring of insight, is that it be the most beautiful, brave and discreet ever imaginable. But I have failed in contradicting the natural order, where each element conceives its own kind.” I take these words as my own and apologize for the errors or omissions that this general report may present, but as our colleague stated, I am also unable to contradict the natural order.

Before I move forward with the general report of the papers presented in this Technical Conference proper, I wish to make several brief comments on the scope of its main topic: **“An integral approach in preventing and combating tax evasion.”**

Firstly, I shall state that in this presentation I will employ the term Evasion according to a comprehensive definition that covers all the behaviors contrary to the tax law, which result in the elimination or reduction of the tax burden, regardless of whether such behaviors entail fraud or not.

Tax evasion is a worldwide phenomenon, present in almost all tax systems, with different degrees, modalities and nuances, and highly marked by globalization. This phenomenon attacks the tax bases themselves and may corrupt and destroy the fundamental pillars on which a good tax system rests, such as the principles of sufficiency, equity, equality, fairness and neutrality of revenue collection. Additionally, it may imply very serious consequences and effects on a country’s governance, by weakening society’s trust in the administration’s power to carry out its functions to promote social wellbeing and its capacity and reputation in enforcing the tax system according to the principles of generality, equity and efficacy.

In effect, tax evasion, apart from the fact it constitutes an expression of lack of social solidarity in the support of collective services, distorts the distribution of income and wealth, generating a deficient allocation of available resources, favoring unfair competition. Additionally, as stated by Mr. Luis Pedroche, citizens’ cooperation is seriously impaired if they bear witness to tax evasion that goes unpunished on a daily basis, with a very discouraging effect on society. Thus, this phenomenon calls for tax administrations to provide streamlined and broad responses and, at the same time, significant investment in material resources and moreover, qualified and well compensated Human Resources.

We observe that legally compliant individuals and corporations participate in such a phenomenon, with different levels of earnings and savings, which avoid meeting the tax payment applicable according to their taxpaying capacity and the tax regulations; multinational corporations that conceal and disguise profits under the tax systems of their headquarters and by resorting tax havens. Also worth mentioning is the network of international banks that undertake complex transactions requiring the transfer of money from one country to another until reaching the final destination -hurdling the identification and source of the funds and the owners thereof-, including illegal activities from drug trafficking, arms' smuggling and administrative corruption.

In the developing countries of America and the world, in addition to such tax evasion modalities, we find very serious issues arising from the phenomenon of the growing informal economy, which according to numerous studies would exceed 50% of the economically active population employed.

The struggle against tax evasion has been ongoing for the tax administrations of the world. Nonetheless, in the last few years the tax administrations of developed as well as developing countries have been adopting strategies to strengthen tax evasion prevention efforts. In effect, if during the '90s and up to the beginning of this decade the focus was taxpayer service, this is currently shifting to the tax control aspects. Proof of this is this Technical Conference, in which we have undertaken the extensive analysis of preventing and combating tax evasion from an integral approach.

Along the same lines, the World Customs Organization has been gearing its efforts towards the issues of tax control and the international logistics' chain security, fostering the drafting of customs' cooperation agreements among its member States.

Within the European Union, the new efforts are geared at attempting to bridge the gaps in the control systems originated by the removal of controls at borders between European countries and the full freedom of movement of people, goods and capital.

The Spanish Agency of Tax Administration Fraud Prevention Plan thus coincides with this general trend and intends to take advantage of other Administrations' experience. The idea is to implement, with the appropriate adjustments, the best practices developed by the most advanced administrations.

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Outside the European Union sphere, the OECD is paying increasing attention to the issues tied to tax control; it has created a working area through the Tax Administration Forum mainly focusing on sharing experiences in the efforts to combat tax evasion and tax fraud.

Lastly, we shall highlight the intensive work undertaken by the CIAT since the mid-80s, which has received financial support from the IDB and the missions from Spain and France. Presently, the CIAT is carrying out numerous initiatives for the prevention of tax evasion that include the drafting of manuals and models by Working Groups, sharing experiences, higher education and the identification, dissemination and implementation of models and good practices.

Now, I shall refer to the Conference itself. It developed with brilliant presentations and active discussions by participants who approached the general topic through three broad thematic areas:

Topic 1: Controlling tax compliance and tax evasion, with two sub-topics: integral strategies for control and prevention, and current challenges in controlling compliance.

Topic 2: Combating tax evasion, by identifying the different fraud types and the means to counter them; information systems; organizational structure and cooperation with other institutions.

Topic 3: Collection, with two sub-topics: Competence and organization of the Tax Administration vis-à-vis collection, and tools used in aid of collection.

The Technical Conference that concludes today was officially opened by the Secretary of State for Finance and Budget of the Ministry of Economy and Finance of Spain, Mr. Carlos Ocaña y Pérez de Tudela. In his opening remarks, he pointed out that we were participating in the greatest world forum to discuss tax administrations' issues, which evidences the relevance of the events organized by the CIAT.

The Secretary of State also underscored that tax evasion is not a new issue. He added that Tax Administrations face an additional responsibility, which is that they are the driving force for innovation and new technologies and that, subsequently, the implementation of such good practices is undertaken by other sectors of government administration.

Topic 1: Tax Fraud Prevention Plan, was addressed by Mr. Luis Pedroche y Rojo, Director of the State Agency of Tax Administration, AEAT, of Spain, with comments by Mrs. Carolina Roca, Superintendent of the Tax Administration Service (SAT, as per the Spanish acronym) of Guatemala.

Mr. Luis Pedroche elaborated on the Tax Fraud Prevention Plan created by the AEAT that is the reference framework enabling to deepen the modernization of the enforcement of the Spanish tax system.

The Spanish Agency of Tax Administration, by capitalizing on its experience in the drafting and management of plans to counter tax evasion, radically recast its control strategy to effectively meet the significant challenges that Spain faces in the 21st century. On the other hand, it is worth highlighting that such challenges are also shared by the other tax administrations of the world regardless of their degree of development.

The Spanish plan has been defined with a view to meeting the following challenges: (i) maintaining the quality of service rendered to citizens by the AEAT and improve the levels of effectiveness in the struggle against tax fraud; (ii) the need to increase the levels of collection sufficiency to improve the quality of public services and social benefits, remarkably impaired as a consequence of tax fraud; (iii) avoiding violations to the principle of equity and equality in the fair distribution of the tax burden among citizens; and (iv) avoiding the detrimental and distortive effects of the tax evasion phenomenon on the economy, on loyal competition and the productivity of the market's economic factors.

The Plan is based on a strict diagnostic study that identified the weaknesses in the systems of control, organization, regulations, information, internal and external coordination and communications, and is marked by the fact that it arises from a deep internal and external discussion with the participation of experts and civil society. It proposes an integral vision to put a stop to the phenomenon of tax fraud, it may be immediately implemented and is open to the adjustments required by the ever-changing economic and social scenario in which the Agency of Tax Administration performs.

This plan is based on four strategic procedural principles:

1) Changing the control model employed; 2) granting the plan an operative and immediate application nature; 3) using investigation as an effective method for the early detection of fraud; and 4) favoring fast and effective collection of the tax debt.

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The following aspects are also worth highlighting:

- a) It is comprehensive and functions as a process integrator, aimed not only at countering tax fraud but also preventing it. In such regard, the Plan sets forth the strengthening of investigation efforts, with special focus on real estate fraud, organized VAT and special taxes' schemes, money laundering, tax engineering, transactions with tax havens, abuses in the application of the modular regime and fraud in the collection phase, among others.
- b) It is an open Plan. The draft Plan was disclosed to the public inside and outside of the Agency, with over 500 suggestions submitted via the Internet and the Intranet. It shall be periodically reviewed to allow for new procedures, correct those that fail to meet the expected outcomes, and overall, to permanently adapt to the economic and social scenario in which the Agency performs.
- c) It has been intended for immediate implementation. Given its strategic nature, the Plan is multi-annual, but that does not prevent its immediate implementation. In turn, it recast the Agency's planning instruments and, specifically, the Annual Objectives' Plan.
- d) It features organizational changes, among which we may highlight the creation of the Central Large Taxpayers' Delegation, which started to operate on January 1st, 2006. This Central Delegation features all the competencies and functions with respect to taxpayers under its umbrella inherent in the Agency of Tax Administration for the enforcement of the government administration and customs system.
- e) It has made changes in the legal framework; it highlights the Bill on Measures to Prevent Tax Fraud that is currently in Parliament, which is based on a number of Bills to endow the Agency of Tax Administration with more resources and efficacy in its efforts to prevent and counter tax fraud.
- f) It attaches relevance to international tax evasion. As Mr. Luis Pedroche duly pointed out, globalization and the subsequent economic integration, along with the fast technological development, have fostered significant fraud mechanisms that severely impair countries' collection capacity and the distribution

of the tax burden. This scourge is becoming a genuine epidemic and calls for priority attention by the Agency of Tax Administration and in general terms, by all the tax administrations of the world. For such purpose, we shall employ and make the most of the agencies, mechanisms and international cooperation tools available.

On the other hand, Carolina Roca, in her comments on the presentation, pointed out that the CIAT member countries could find in the Spanish experience not only a great professional rigueur and know-how, but also many innovative ideas that may serve as inspiration to adjust them to their own scenarios in their struggle against tax evasion, constituting a benchmark in the efforts to combat tax evasion and tax fraud for tax administrations overall and for CIAT member countries in particular.

Likewise, she referred to the significant efforts by the SAT of Guatemala geared at strengthening tax control, pointing out the approval of the Tax Administration Empowerment Act and the customs modernization process that relies on the CIAT technical support.

Next, **Topic 1.1.- Integral strategies for control and prevention** was presented, with two case studies.

The first one by Mrs. Deborah M. Nolan, Commissioner, Large and Mid-Size Business Division of the USA Internal Revenue Service. Mrs. Nolan addressed the integral strategy to reduce the tax gap, which was jointly drafted by the IRS, the Tax Policy Department of the Treasury Office, and the US Congress.

Said strategy has been designed on the basis of three assumptions:

- Over 70% of the tax gap is attributable to individual's income tax, the main source of federal revenue.
- Over 80% of the tax gap is caused by the understatement of taxes. Approximately half that amount is attributable to the understatement of net income from individuals' economic activity.
- Noncompliance reaches the highest levels among taxpayers who are not subject to third-party information or withholdings.

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In turn, this Strategy includes seven elements, such as:

1. Reducing tax evasion opportunities. In this regard, the IRS 2007 budget includes five Bills to reduce tax evasion opportunities and enhance IRS efficiency.
2. A multi-annual investigation commitment.
3. Ongoing improvement of information technology. This effort shall enable the IRS to rely on better compliance improvement tools by the early detection and better case selection and management.
4. Improving the activities to enhance compliance: improve information exchange and auditing and collection efforts.
5. Improving taxpayer service.
6. Amending and simplifying tax laws.
7. Working in coordination with partners and stakeholders. A greater coordination between the IRS and the state administrations and those from foreign countries is required to share information and strategies to improve compliance.

Next, Mr. Ricardo Escobar, Director of the Internal Revenue service from Chile (SII, as per the Spanish acronym), presented the administration's experience. The SII has been a pioneer in studies to estimate tax evasion and is greatly experienced in using this information as an effective management tool. In fact, such studies enabled the SII to submit a Bill for the Anti-Tax Evasion Act, which was passed in 2002.

Said Law was aimed at punishing and hurdling sources of tax evasion and tax avoidance via legal amendments with a view to reducing such behaviors, strengthening the tax auditing and collection capacity, modernizing and fostering greater efficiency in the Chilean Tax Administration agencies.

Among the most relevant aspects of the law, the following may be highlighted: a greater efficiency and more equitable taxpayer treatment, new SII auditing plans, strengthening the tax administration's powers, improving tax laws (focus on presumptive income, controlling tax evasion and tax avoidance by large taxpayers, etc.), institutional adaptation of the Internal Revenue Service and the General Treasury of Chile by creating positions and increasing the number of human resources and the creation and increase of penalties.

The foregoing enabled to generate more control actions in all the areas: (a) strengthened tax audits on large and mid-sized businesses; (b) increased prevention and auditing presence; (c) deepened the scope and effect of the audits arising from VAT and Income Tax transactions' processes; (d) enabled to improve the investigation of tax crimes and invoice forgery; and, (e) increased the control over the change of VAT taxpayers.

The plan to combat tax evasion met all the goals set forth during in its development years, increasing revenue collection by US\$ 1,584 billion between 2001 and 2005.

The Chilean case is an excellent example of less painful alternatives to increase collection, which are not necessarily tied to the traditional practices of increasing tax rates or creating new taxes.

Ricardo Escobar also elaborated on the features of the auditing model and the facilitation and auditing processes. He highlights the importance of knowing taxpayers' social behavior; the relevance of creating a balance between the breadth and depth of auditing procedures, massive control procedures for income tax and VAT, extensively using digital media and information cross-referencing, and the extensive use of the Internet in the Electronic Life Cycle to facilitate compliance. All these control strategies have succeeded in achieving significant improvements for tax evasion reduction; for example, VAT evasion dropped from 21% in 2000 to 12% in 2005.

As to the SII projects and challenges for the future, we may highlight the compliant taxpayers' certification project, which is geared at setting a good tax status standard according to two certification ratings (AAA and AA) to show Corporate Social Responsibility, certainly a novelty that deserves serious consideration.

In his final remarks, he pointed out the need to consider a number of assumptions in the design of control strategies in order to guarantee the success of their implementation and sustainability in time, which are truly interesting. Among such assumptions, I would like to underscore the following:

- The need for a clear political support and leadership from the economic and tax authorities, so as to materialize the new definitions.

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- Taking into account the specific situation in each country, the legal framework, the markets' economic structure, while also considering the good practices developed in other countries in this field.
- The measures to be implemented against tax fraud shall be made up, to the extent possible, by a broad and diverse set of processes that enable to undertake adequate and sustainable planning.
- It is important to rely on the commitment of all the tax administration officials, who must feel part of the different strategies to be implemented; moreover, I would add that the largest number of officials possible should participate in the design thereof, based on their knowledge of the field.
- Finally, he stated the relevance of relying on an appropriate set of indicators to enable to measure the effectiveness of the strategies implemented.

Next, **Topic 1.2.- Current challenges in controlling compliance** was presented based on two case studies. The first speaker was Mrs. Ans J.M. Huisman, Director of the Intelligence Group for National Operations of the Netherlands, who showed us that the key in the tax compliance control strategy is the deep knowledge of the taxpayer's behavior profile; in other words, the more you know about taxpayer behavior the more compliance may be enhanced. To know means: knowing the activity that taxpayers carry out, the implications thereof (from the tax standpoint), which groups (high risk) they belong to, what may tempt them into noncompliance and the requirements to ensure compliance. In this respect, service, visible audits and horizontal audits are equally key notions to enhance taxpayer compliance and thus, tax administration effectiveness.

They also show us how the indicators of noncompliance with tax returns and payment from the past apply in the present, when they are analyzed against data from the Tax Monitor of the Netherlands. These are annual indicators obtained from taxpayers' behavior vis-à-vis the regulations and relative values for tax payment or tax evasion. An example of this is taxpayers' attitude towards their tax obligations, etc.

She also highlights horizontal audits as a novelty, which consist in shifting part of the auditing responsibility to private players and social organizations according to certain conditions. Mrs. Ans points out that there are clear opportunities for implementing horizontal audits in the

large businesses' segment. The main question in this sense is in what way the tax administration and businesses wish to relate as two professional stakeholders. The idea is to base the relation on transparency, understanding and trust, where both parties know the actual risks and are aware of their mutual standings. In my view, it is a very interesting idea worth looking into.

I also wish to underscore from Ans J.M Huisman's presentation, the relevance of audits' visibility. Taxpayers are more likely to meet their tax obligations if the administration discloses that fraud is detected and entails severe consequences. Therefore, audits should have a social impact, by disseminating the cases and transactions that reflect so. It is very important that tax administrations plan an adequate communication strategy, that they be capable of communicating to taxpayers the advantages of voluntary compliance with tax obligations and the risks arising from noncompliance therewith.

The second case was presented by Mr. Miguel Avilés, National Director of Planning and Administration Control of the Internal Revenue Service (SRI, as per the Spanish acronym) of Ecuador.

The new Internal Revenue Service, created as an autonomous entity in 1997, was based on the autonomy of its administration, political non-interference, human resources' professionalism, administrative innovation and the use of avant-garde technology, the implementation of massive control measures and maximization of voluntary compliance; additionally, a key factor for success worth underscoring is the management leadership that enabled the growth of tax pressure from 15% in 1998 to 19 % in 2005.

Miguel Avilés shows us in what way a tax administration, with a very complex economic, political and social scenario, has succeeded in achieving significant advances in the efforts to prevent and combat tax evasion, which undoubtedly constitutes an example for other Administrations with similar conditions. In this framework, he highlights the integrated invoicing system, the information sharing system to support tax control and the risk matrices for the selection of audits' procedures.

Lastly, he points out a serious tax management issue, common to all developing countries, in terms of the exponential dimension acquired by the informal economy, marked by the poor socio-cultural level of taxpayers, economic transactions' complexity, the disregard for tax

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compliance, contraband, etc., which constitute a genuine social and tax-compliance challenge for all tax administrations.

Monday ended with the presentation by Mr. Michel Danet, Secretary General of the World Customs Organization (WCO), who elaborated on the future trends for customs administrations, especially as regards the tax field.

Michel Danet stated the relevance of bilateral exchange agreements, which have been increasing in number, to the point that over 3000 agreements are expected for the forthcoming years.

He also indicated the trend towards the creation of regional customs entities, although not all of them are developing at the same pace, and the high degree of harmonization in international trade.

Lastly, we shall highlight the efforts the WCO is undertaking in cooperation projects for Customs modernization in emerging countries.

The second day of the Conference started with the discussion of **Topic 2.- Combating tax evasion**, with the excellent presentation by Mr. Marcelo Pablo Costa, Deputy Director General of Examinations of the Federal Administration of Public Revenues, (AFIP, as per the Spanish acronym) from Argentina, supplemented with the comments by Claudino Pita, CIAT Executive Secretary.

Marcelo Costa made a very clear review of the auditing strategies' evolution stages, the key aspects that influence tax fraud and the mechanisms for the prevention, detection and control thereof, emphasizing that in order to effectively combat tax evasion, the tax administrations shall be prepared to timely react to the political, social and economic scenario thereof, as well as the new modalities of tax fraud, being vital that they immediately detect, and even anticipate, the impact produced by such circumstances.

He underscored that if we fail to review the new modalities of fraud, mainly arising from economic globalization, our revenue collection capacity shall be seriously impaired.

The AFIP, taking advantage of its long-term experience in combating tax evasion and tax fraud, is recasting its tax control strategy by prioritizing fraud prevention, which is focused on the promotion and

subsequent application of legislative, organizational, tax education, structural and information exchange measures as well as the use of IT and technology as instruments geared at increasing taxpayers' tax risk perception.

I would like to highlight a number of initiatives mentioned by Marcelo Costa.

The participation of the revenue agency is vital in the creation of tax policies, since it has obtained a wealth of experience on a daily basis, which enables it to suggest new regulations or amendments of a procedural nature as well as specific to the different levies under its administration, in the face of legal vacuums or gaps in the legislation in force that may facilitate tax evasion or tax avoidance. From my standpoint, the tax legislator and the tax administrator are on the same boat and everyone should row in the same direction.

Along such lines, since 2004, the AFIP has been fostering a number of legislative reforms known as "Anti-tax evasion Plan I" and "Anti-tax evasion plan II".

On the other hand, we must mention an interesting tool implemented by the AFIP called Risk Profile System ("SIPER", as per the Spanish acronym), which is based on the theory of the discrimination factor, by which cases that are the exception to the general rule are identified. Such system enables the adequate selection of audits, and thus the scarce human and material resources of tax administrations with relation to the taxpayers' universe are optimized.

He also underlines as very effective AFIP tools, the employment of the broadly known withholdings, collection and advance payment regimes, as well as the access to the wealth of financial and banking information for information cross-referencing purposes. In this regard, the *e-bafis* software to support the central and regional investigation areas is remarkable.

Another aspect that I would like to highlight, which has been mentioned in this presentation, is the significant investment made by the AFIP in equipment, technologies and IT applications that have enabled very significant qualitative leaps in the strategy to facilitate tax compliance.

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Claudino Pita, in his comments on the presentation, pointed out that the Argentine Control model stands out due to its integral nature, for the elements considered that are tied to tax compliance, as well as the nature of taxes they refer to: internal taxes, customs and social security.

He underscores the evolution of audit management planning and control design as very significant, the identification of the main aspects that influence tax fraud and the mechanisms employed for fraud prevention, detection and control.

Next, **Topic 2.1.- The use of information in combating tax evasion** was developed with the interesting presentation of two case studies; firstly, Secretary Jorge Antonio Deher Rachid, of the Receita Federal of Brazil -SRF, as per the Portuguese acronym, presented an excellent paper on the relevance of the use of information in combating tax evasion.

Jorge Rachid underlined the role of information management and the use of leading-edge information technology in combating tax evasion. He highlighted that information constitutes one of the most relevant assets of tax administrations and the essential raw material thereof, which adds value to their functions. Using it appropriately to meet the organizational purposes entails much more than technology investment, since it calls for talent and creativity in order to identify opportunities, and persistence to reap the fruits. Stairs' definition of information is worth mentioning: "a set of events organized in such form that they gain additional value apart from the value of the event itself."

The speaker also mentioned that information quality and security are essential conditions that spur ongoing investment by the tax administration. Likewise, he presented a number of successful projects and initiatives put in practice by the Receita Federal, including specific information technology tools devised to combat tax evasion, such as the Unified Taxpayers' Selection System, the Integrated Records' System, Incompatible Financial Transactions' Information, the Corporate Data Warehouse or the INDIRA System.

Lastly, he presented other tools that are currently in the rollout stage, such as: the Flow Measurement System, the HARPIA Project and the Public Digital Title Deed System. It is self-evident that the Receita is relentless in its efforts to prepare and invest in technology towards the future.

Next, South Africa's case study was presented by Mr. Ighsaan Paruk, from the South African Revenue Service, SARS. As he clearly remarked, it is evident that in order to effectively counter tax evasion, the internal as well as external sources information shall be used optimally. In his presentation, he addressed the different initiatives undertaken by the SARS in order to obtain information, understand the scenario and counter tax evasion. Among other measures, he mentioned the possibility of a tax amnesty for small businesses and the strengthening of relations with different agencies.

As he stated, it is vital to review the factors that influence the SARS on an ongoing basis to determine the impact of the organization on society. This shall enable the SARS to adjust its strategy in the face of any change of scenario.

Next, **Topic 2.2.- Organizational structure required in combating evasion** was addressed with the presentation of the Trinidad and Tobago case study. Originally, a presentation of the Mexican case had been foreseen, but owing to force majeure the Mexican speaker was unable to attend the meeting.

Mr. Rawle Adimoolah, Commissioner of Internal Revenue of Trinidad and Tobago, made a very straightforward reference to his country's situation, pointing out the mistakes, the solutions and the lessons learned, which were very valuable for all. He stated the advantages and disadvantages of the forms of organizational structure commonly implemented by tax administrations that are based on the type of tax, functions and type of taxpayers.

An interesting reflection he suggested is that there is no optimal organizational structure for the universe of cases, but that the best structure for a given organization shall depend on the contingent factors of the environment where it operates. The structures shall adapt to the culture of society and should consider the country's economic, social, cultural, political, geographic and demographic characteristics. I fully agree with him on the fact that the worst mistake an administration can make is to adopt the structure and the characteristics of another country and apply them identically in their own.

Another notion I would like to highlight from his presentation is the need to make tax administrations more flexible. Indeed, the most modern approaches favor more horizontal and flexible structures to face the challenges of an increasingly volatile environment. Such need

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for flexibility may warrant the autonomy of the tax administrations, although as we have observed before, this is not an absolute truth. The greater the autonomy of the organization, the greater the flexibility to undertake the large organizational and procedural modifications required to modernize the tax administration.

Tuesday morning ended with the signing of two bilateral agreements, the Information Exchange Agreement between Chile and Argentina and the cross-border Cooperation Agreement between Portugal and Spain, based on the CIAT Model Agreement for Information Exchange. Such agreements constitute an example of the international reciprocal cooperation path that countries shall follow as an effective measure to prevent tax evasion, tax avoidance and tax fraud.

Next, **Topic 2.3.- Cooperation with other institutions** was presented according to two case studies, the first one by Mrs. Nahil Hirsh, National Superintendent of the National Superintendence of Tax Administration (SUNAT, as per the Spanish acronym) of Peru, who like the other speakers, expressed the importance of gathering information as one of the fundamental mechanisms to prevent and combat tax evasion. In this regard, Mrs. Hirsh provided a detail of the constitutional powers and the cooperation processes among institutions undertaken by the SUNAT as instruments to access information, without disregarding the other forms of cooperation, such as administrative assistance or aid.

The legal framework under which the SUNAT operates for this cooperation process enables it to provide and access information, training and logistical support, among other aspects, with the purpose of making effective the actions to prevent and combat tax evasion, even when by constitutional mandate this institution lacks access to banking information owing to the bank secrecy rules in place; nonetheless, as Nahil Hirsh underlined, this situation is partly addressed with the information obtained from the management system of the tax on financial transfers.

Electronic administration should play a very relevant role in the cooperation processes among institutions. Therefore, the strategy followed by the SUNAT of participating in the development of the national e-government initiative and implementing information integration with government administration agencies is very interesting.

The second case study was presented by Mrs. Luisa Perrotti and Mr. Graciano Gallo from Italy, who showed us that one of the tax administrations' objectives should be to reduce the tax gap between the information available to third-parties and the information effectively available to the tax administration. For such purpose, they elaborated on the different mechanisms employed by the Italian Tax Administration to obtain information on an international as well as national basis.

The day's sessions finished with the CIAT presentation of two very interesting products developed by two Working Groups; firstly, Mr. Juan Francisco Redondo, Coordinator of the Office of the Director of the AEAT of Spain, presented the updated version of the CIAT Tax Code Model, which was drafted in 1997, with the purpose of serving as a guide or general reference to support its member countries in the processes to systematize the regulations that govern the essential principles and the relations between the tax administration and taxpayers.

The time elapsed since the publication of the Model in 1997 and the convenience of considering the different aspects of the new Information and Communications' Technologies in the norms that govern the operation of the tax administration, the need to adapt the tax regulations to the evolution of the tax system itself, the increasing internationalization of economic relations, as well as the opportunity to adopt new procedures in terms of tax events' control, among others, were sufficient grounds to update the Model.

The new Model's methodological structure is made up by five broad titles: Title I, on the preliminary provisions, Title II governs taxes and substantive tax relations, Title III sets forth the tax enforcement procedures, Title IV deals on tax violations and sanctions and finally, Title V incorporates the regulations relative to the procedures to review the acts of the tax administration.

On the other hand, Miss María Raquel Ayala, CIAT Research and Training Manager, presented the CIAT Manual to support the implementation of the Model on Exchange of Information designed by the Center eight years ago. The Manual is made up by a General Module and eight Supplementary Modules. In certain items, the Working Group used the OECD Manual as the document's drafting basis and also included broad and new examples and a General Module based on the CIAT Model on Exchange of Information, supplemented with reference notes on the treatment defined in the OECD Manual.

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The purpose of this Manual is to offer CIAT member countries a general view of the enforcement of the information exchange provisions in compliance with the CIAT Model Agreement, which may serve as a technical and practical guide for the tax administrations' officials in charge of such exchange, and thus contribute to make it effective. The Manual is also deemed useful as a training program tool on the subject and constitutes a useful reference for tax administrations when designing or reviewing their own manuals and even when negotiating new agreements.

Wednesday, October 25th was a day for delegations to enjoy some leisure time. The visit to the beautiful city of Toledo was a valuable learning experience: we learned that for approximately 800 years, Jews, Muslims, and Christians coexisted in pursuit of the social wellbeing of their citizens, harmony with nature, sharing knowledge and living peacefully without ethnic and cultural discrimination. For certain, the CIAT as an institution, and this meeting as well, are examples of respectful and productive coexistence and union.

The last day of the Conference was devoted to the discussion of a very relevant subject, **Topic 3.- Collection**. The day started with the presentation by Mrs. Maxime Gauthier, Deputy Director of the Management Service of the General Revenue Directorate (DGI, as per the French acronym) of France, whose commentator was Mr. Francisco Fonseca Montero, Director of the General Revenue Directorate of Costa Rica.

Maxime Gauthier reviewed the legal and organizational framework for collection in France, as well as the main policies implemented to facilitate and secure enforced collection of tax liabilities. In this regard, she mentioned organizational measures such as the creation of a one-stop shopping system for professionals, which serves all procedures (assessment-collection-contentious proceedings) and the active promotion of remote procedures, with the purpose of creating a multi-service access point to the tax administration.

Likewise, Maxime Gauthier pointed out that since 2001, a global initiative has been implemented for the improvement of tax control quality, based on the notion of operations' pyramid, which sets forth that tax control quality is built on the basis of the intrinsic quality of every transaction carried out. These transactions cover all the processes, from the search for businesses eligible for control to collection itself. I believe it is very

important not to analyze transactions in isolation, but that they be part of a system or chain, calling for strong cooperation among the control services and the collection services, which mainly rests on the transmission of information and elements held by the tax authority to collection officials and on the implementation of specific follow-up procedures based on indicators.

Finally, she referred to the fact that the improvement in tax liability collection requires the active participation of all the stakeholders involved. In such respect, the different DGI services were instructed to make collection one of their main issues, from the control phase itself, defining the strategic objective as: “transmitting the right information at the right time.”

The implementation of precautionary measures is also very relevant. The latter should contribute to risk anticipation that may impact collection, moreover in the case of insolvency.

On the other hand, Francisco Fonseca highlighted that collection constitutes the basis for the tax administrations, regardless of their other objectives, and as such, it shall be imbedded in the tax procedure overall, so that all the initiatives carried out are based on this principle, from the very beginning of the tax procedure. To conclude, Francisco Fonseca underscored the relevance of sustaining an integrated audit and collection procedure, above all.

Next, **Topic 3.1.- Competence and organization of the Tax Administration vis-à-vis collection** was addressed, with the presentation of two case studies. Firstly, Mr. Mike Snaauw, Director General, Accounts Receivable Division of the Canada Revenue Agency (CRA), made a very straightforward reference not only to the successes but also the frustrations of the CRA, as regards the exercise of the collection powers thereof. Such frustrations are in many cases shared by other tax administrations, and to the extent possible should become new challenges for all of us.

A key idea discussed is that the CRA collects most of its debts by agreement with the noncompliant taxpayer, considering his taxpaying capacity and thus, avoiding the enforced collection proceedings. It is my understanding that this should be the first item in every collection procedure.

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Thereafter, he presented the different legal mechanisms and resources that the CRA enjoys for enforced or coercive collection of tax liabilities. Finally, he addressed the challenges faced by the CRA in the pursuit of its mandate, which may be attributed to the lack of adequate instruments with respect to the cross-border recovery of taxes, in the cases of tax fraud or tax evasion and self-employment.

I shall briefly refer to the first one, that is to say, cross-border tax recovery, which, as the Canadian speaker mentioned, is governed by the “revenue rule”; this rule determines that the courts are denied the power to enforce tax legislation from foreign nations. Nevertheless, the revenue rule may be modified by a treaty and this is where the CIAT shall play a very relevant role as a facilitator of such treaties, actively fostering information exchange agreements and, in general, mutual assistance mechanisms among its member countries.

Next, Mr. Néstor Díaz Saavedra, Director of the Directorate of Taxes and National Customs (DIAN, as per the Spanish acronym) of Colombia, presented the framework of competence from a functional as well as territorial standpoint for the tax, customs and foreign exchange obligations’ collection process, as well as their development structure. He made a historical account of the government revenue collection actions in Colombia, including the information systems employed.

As he duly stated, collection procedures at an international level are carried out on the basis of three models: judicial, administrative and mixed. In the judicial model, the collection procedure is fully pursued outside of the administrative jurisdiction, that is to say, in a court of law, with the participation of officials as defense attorneys for the tax credit. The administrative model is the most broadly applied in Ibero America and has been set forth in the CIAT Tax Code Model. Its main feature is that the garnishment of the debtor’s assets is performed by the tax administration itself, without need for the intervention of the Judiciary. Likewise, the credit assessment up to the disposal of garnished assets is undertaken in the administrative jurisdiction, without detriment to the subsequent judicial review thereof.

In the mixed collection model, the garnishment of a debtor’s asset is carried out by the administration proper, but it requires the intervention of the Judiciary, either before or after.

Colombia has decided for a purely administrative collection procedure, resorting to the coercive collection power vested upon the DIAN. Mr. Díaz concluded by mentioning that the answer to effective collection is the organizational integration, Human Resources, processes and information systems.

The Conference ended with two outstanding presentations on **Topic 3.2.- Tools used in Aid of Collection**. Mr. Santiago Segarra Tormo, IT Director of the AEAT of Spain, described the main features of the IT solutions developed by the Agency of Tax Administration aimed at the collection of outstanding tax debts.

He further clarified by reviewing the main features of the collection procedure developed by the Agency of Tax Administration. In Spain, the collection procedure is marked by the fact that almost all the financial institutions act as cooperating tax collection agencies, to the point that the AEAT does not accept payments in its offices unless they are made through a financial institution. Likewise, it relies on a strong information system, exclusive for all taxpayers and taxes, as well as all the tax allocation procedures. Finally, based on the number of debts to be pursued, the agency is highly dependant on IT tools.

As a novelty, Santiago Segarra pointed out the assignment of a collection risk for each debtor according to three variables: their taxpaying capacity, the outstanding debt amounts and their volatility. The IT system allocates the collection risk to each debtor upon analyzing the existing information in the database of the Agency of Tax Administration of Spain. This enables to assign priority to procedures and facilitates a specific follow-up of debtors according to their risk level.

He mentioned the development of two IT tools that are the basis used for a large number of tax procedures' management applications: the Record Processing Tool and the Infoclase. The Infoclase enables the selection of certain set of files on the basis of information attributes generated in advance, while the Record Processing Tool enables the execution of actions for a tax procedure on an individual or group basis supported by a selection performed by the Infoclase.

In his presentation, he made a clear point of the fact that the IT developments required to support the administrative collection procedure activity are very complex based on the complexity of administrative procedures. An example of the foregoing is that the

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portion of the Agency's information system for collection procedures includes over 100 files and over ten thousand programs have been developed for such purpose. Nevertheless, in my view and although it may seem a paradox, such system complexity should not be transferred to the end user of the applications, which shall be simple and reasonable to operate.

Next, the representative of Portugal, José Maria Pires, Administrator of the General Revenue Directorate (DGI, as per the Portuguese acronym), made his presentation. He confirmed that reliance on the new technologies as an instrument of tax administration efficacy and efficiency renders very positive results. In the case of coercive collection, it has significantly increased since 2003, with collection expected to double in 2006 against that year as a consequence of the modernization plan implementation, generating a new culture of efficacy and resorting to all the powers vested by law. Among the modernization projects, we may highlight the Strategic Plan for Fiscal Fairness and Efficacy and the functionalities of the IT coercive collection system that features the deterrence systems, the pre-coercion operating systems and the coercion systems proper. Among the latter, we may highlight the Third Party Data Forwarding Network, which electronically transmits all the information relative to the debtors' garnishable assets and entitlements and the Automated Garnishment and Automated Auction systems, which close the coercive collection cycle.

CONCLUSIONS

I would like to conclude with some final remarks and reflections.

1. The Conference fully met its purpose of identifying the advances in member countries as to the prevention and combat of tax evasion in terms of strategies, good practices applied in control processes, organization, information systems and information technology.
2. The fact was re-iterated that tax evasion is a worldwide phenomenon present in almost all countries, although with different degrees of extension, forms and nuances, and highly promoted by globalization. This phenomenon corrodes the tax bases and attacks the fundamental principles on which a modern tax system shall be built, such as: collection sufficiency, equity, equality and neutrality, in addition to the very serious

consequences and effects for the governance of a country proper by weakening society's solidarity and confidence in the government administration's capacity and its power to enforce the tax system pursuant to the principles of generality, equity and efficacy.

3. With the presentations and case studies presented, countries expressed coincidences in the form of approaching the issue of tax evasion control and tax fraud and the instruments employed to prevent and combat them. Among them, we may underscore:
 - a. The need to draft multi-annual and integral plans adapted to the political, social and economic environment, which respond to the new tax evasion modalities.
 - b. It is necessary to implement and/or improve risk investigation, analysis and management, the creation of tax evasion maps, profiles that render the tax evasion gaps, and the behaviors of noncompliant taxpayers, in addition to parameters' selection to measure the tax administration efficacy in reducing tax evasion.
 - c. Review of regulations in order to simplify them and bridge the tax avoidance gaps, granting the organization flexibility for adjustment and adaptation in the light of new challenges and reviewing the tax control processes to enhance efficacy and balance between control efforts and voluntary tax compliance.
 - d. Foster cooperation mechanisms at the national level with a view to identifying and strengthening the databases with third-party information and exploiting information cross-referencing efforts.
 - e. Decidedly invest in the development of human resources, IT and information systems with a view to transforming data into knowledge and efficiently manage information, ensuring the security and quality thereof.

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- f. Multiply the international cooperation efforts with international information exchange agreements and joint control procedures employing the excellent instruments developed by the CIAT for such purposes.

In this regard, since international tax evasion continues to erode the worldwide tax base in alarming ways and degrees, it is important that international agencies like the CIAT, the OECD, the ITD, the IOTA, the United Nations, the IMF, etc., and all the tax administrations of the world multiply and supplement their cooperation efforts, and above all, work together to fill the great gap opened by the lack of a World Tax Organization to effectively face such phenomenon, such as the honorable tax expert Mr. Vito Tanzi set forth in the framework of the CIAT Assembly held in Brazil in 1998, a challenge I consider we are still faced with.

- g. Strengthen the collection function, integrating it with the audit function, to effectively close the tax control cycle by disclosing the tax evasion cases identified and those successfully concluded, and lastly,
- h. To strengthen social awareness and tax education and call upon the public and private stakeholders to combat tax evasion.

Finally, I would like to refer to the words by Fernando Díaz Yubero who, in his final remarks to his brilliant General Report of the CIAT General Assembly held in Buenos Aires a couple of years ago, said that I would not be missed because I would remain very close to the CIAT; Fernando's words were prophetic, since I feel very close to the CIAT and I wish to thank Claudino Pita, the Executive Secretary for keeping the doors open of this dear institution for me, and thus allowing me to continue in close contact with all of you.

To conclude, I wish to express my deepest gratitude to the AEAT of Spain, especially Mr. Luis Pedroche y Rojo and my friend Mr. José María Guillén Mariscal, Chief of Mission of the Spanish Mission to CIAT, for his invaluable support in the drafting of this General Report.

TECHNICAL PROGRAM

DAILY PROGRAM OF ACTIVITIES

Main Topic: AN INTEGRAL APPROACH IN PREVENTING AND COMBATING TAX EVASION

MONDAY 23

Morning

- 9:00 – 9:30 **Opening ceremony**
- Moderator** Jorge Rachid, Secretary of the Secretariat of Federal Revenue of Brazil, and CIAT Executive Council President
- Topic 1** **Controlling Tax Compliance and Tax Evasion**
- 9:30 –10:10 **Speaker:** Luis Pedroche, Director General of the State Agency of Tax Administration of Spain (40')
- 10:10-10:25 **Commentator** Carolina Roca, Superintendent of the Tax Administration Superintendence of Guatemala (15')
- 10:25-10:45 **Open discussion (20')**
- Moderator** Andreas Neufeld, Deputy Minister of Taxation, State Undersecretariat of Taxation of Paraguay

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	Topic 1.1	Integral control and prevention strategies
11:40 –12:40	Speakers:	Deborah Nolan Commissioner of the Large and Mid-Size Business Division, Internal Revenue Service of USA, Ricardo Escobar, Director of the Internal Revenue Service of Chile – (30´ each one)
12:40 –13:00	Open discussion	(20´)
Afternoon	Moderator	Cedric Josepa, Director of Fiscal Affairs of the Netherlands Antilles
	Topic 1.2	Current Challenges in Controlling Compliance
14:30-15:30	Speakers:	Ans J. M. Huisman, Chair of the National Operations Intelligence Group of the Tax and Customs Administration of The Netherlands and Miguel Aviles, National Responsible for Planning and Administration Control of the Internal Revenue Service of Ecuador – (30´ each one)
15:30-15:50	Open discussion	(20´)
	Lecture	Future Trends in Customs Administrations with special reference to the tax functions
15:50-16:20	Speaker	Michel Danet, Secretary General, World Customs Organization
16:20-16:30	Open discussion	(10´)

TUESDAY 24

Morning

Moderator William Layne, Permanent Secretary of Finance, Government of Barbados

Topic 2 **Combating tax evasion**

9:00 – 9:40 **Speaker:** Marcelo Costa, Deputy Director of Examination, Federal Administration of Public Revenues, Argentina (40´)

9:40 - 9:55 **Commentator** CIAT (15´)

9:55 - 10:15 **Open discussion** (20´)

Topic 2.1 **The use of Information in Combating Evasion**

Moderator Carlos Alberto Lezama, Head of Innovation & Customs Development Office, Integrated National Service of Customs and Tax Administration of Venezuela

10:35-11:35 **Speakers:** Jorge Rachid, Secretary of the Secretariat of Federal Revenues of Brazil; and Ighsaan Paruk, Assistant National Operations Manager (Enforcement Division) of the South-African Revenue Service (30´each one)

11:35-11:55 **Open discussion** (20´)

Moderator Yamile Pérez Díaz, Tax Administrator of Havana, National Office of Tax Administration of Cuba

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16:35-16:55 Presentation on CIAT Manual – to Support the Exchange of Information

Maria Raquel Ayala, Research and Training Manager, CIAT

THURSDAY 26

Morning

Moderator Julia Atienza García, Collection Department Director, State Agency of Tax Administration of Spain

Topic 3 Collection

9:00 – 9:40 **Speaker:** Maxime Gauthier, Deputy Director of Taxation Management Service, General Directorate of Taxes, France (40')

9:40 - 9:55 **Commentator** Francisco Fonseca, Director General of the General Directorate of Taxation of Costa Rica (15')

9:55 – 10:15 **Open discussion** (20')

Moderator Eduardo Zaidensztat, Director General of Revenues of Uruguay

Topic 3.1 Competencies and organization of the Tax Administration vis-à-vis collection

10:35 - 11:35 **Speakers:** Mike Snaauw, Director, Account Receivables Division, Canada Revenue Agency; and Néstor Díaz Saavedra, National Director of Taxes of Colombia (30' each one)

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11:35 - 11:55 **Open discussion** (20')

Moderator Juan Hernández, Director of Internal Taxes of the Dominican Republic

Topic 3.2 **Tools used in Aid of Collection**

11:55 - 12:55 **Speakers:** Santiago Segarra, Director of the Computer Department of the State Agency of Tax Administration of Spain and José María Pires, Tax Administrator of the General Directorate of Revenues of Portugal (30' each one)

12:55 - 13:15 **Open discussion** (20')

14:30 - 15:00 Report by the General Rapporteur (30') Jorge Cosulich Ayala, Former Executive Secretary of CIAT

15:00 - 16:00 **Closing ceremony**

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CIAT Technical Conference

“An Integral Approach in Preventing
and Combating Tax Evasion”

Madrid, Spain

October 23 – 26, 2006

List of Participants

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