Case Study

Topic 2.1

TAX ADMINISTRATION POWERS AND TAXPAYER RIGHTS”

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PRESENTATION OUTLINE

I) From the 1980s to the end of the 2000s: greater protection for the taxpayer
II) From the end of the 2000s: tighter anti-evasion measures in an environment of economic and financial crisis
III) Balance between effective anti-evasion action and the right of defence

I. FROM THE 1980S TO THE END OF THE 2000S: GREATER PROTECTION FOR THE TAXPAYER

1. FROM POUJADISM TO THE AICARDI REPORT (1986) THE TAX FACE OF POUJADISM (AND THE FRENCH REVOLUTION)

One of the first formal expressions of relations between the administration and taxpayers in the history of France can be found in the 1789 Declaration of the Rights of Man and of the Citizen.

Article 13 of this Declaration states that, “For the maintenance of the public force, and for administrative expenses, a general tax is indispensable; it must be equally distributed among all citizens, in proportion to their ability to pay."

Article 14 adds that, "All citizens have the right to ascertain, by themselves, or through their representatives, the need for a public tax, to consent to it freely, to watch over its use, and to determine its proportion, basis, collection and duration."

Article 15 then stipulates that, "Society has the right to ask a public official for an accounting of his administration."

These measures were taken in response to the Farmer-General practice, which developed at a time when the monarchy was struggling with near-empty coffers. The farming out of the collection of duties and taxes had the advantage of giving the Public Treasury regular, predictable revenues while freeing it up from having to collect them.

The behaviour of the Farmers-General made them one of the most reviled institutions of the Old Regime and brought the wrath of the French Revolution down on them. The Farmer-General system was abolished on 21 March 1791.

In more recent times, a political, union-based tax protest movement emerged in France in the form of Poujadism in the Lot Department in 1953. It basically defended shopkeepers and small businesses and criticised the inefficiency of the parliamentarianism of the Fourth Republic.

The term stands more specifically for the activities of the UDCA (Union for the Defence of Shopkeepers and Craft Trades), the union led by Pierre Poujade, and the UFF (Union and French Fraternity).

The Union for the Defence of Shopkeepers and Craft Trades headed a movement by small shopkeepers against the tax administration and its officials. These shopkeepers were opposed to rising taxes on small retailers, growing tax audits and especially an amendment that was to become Article 33 of the Budget Act passed on 14 August 1954, providing for heavy sentences for those who tried to block tax audits.

In the 1970s, the French tax administration reformed its practices in house. General acts were passed on relations between the administration and the public (the Freedom of Information Act of 17 July 1978, the Act of 11 July 1979 on the statement of grounds for administrative decisions, and the Decree of 28 November 1983 governing out-of-court administrative remedies).

A large-scale tax audit reform was conducted in 1987 following work by a committee chaired by MP Aicardi and set up in April 1986 to improve relations between the public and the tax and customs administrations.

ii. The Act of 8 July 1987 made changes to the audit procedures:

iii. The rights of audited taxpayers were formally laid down in a charter (based on an administration initiative from 1975)
iv. The statute of limitations was shortened
v. The burden of proof was reversed in favour of the taxpayer

Some of the committee's recommendations were implemented by the acts of 30 December 1986 and 8 July 1987. These included:

· Placing the burden of proof on the tax administration (the reversal of the burden onto the taxpayer became the exception);
· Reducing the general statute of limitations for the administration from four to three years;
· The binding nature of individual rulings in favour of the taxpayer;
· Improving taxpayers' rights of defence in on-the-spot audits of individuals;
· Formally laying down the audited taxpayer's rights and obligations in a charter for the audited taxpayer that became compulsory and binding.

2. LEGAL CERTAINTY: GIBERT (2004) AND FOUQUET (2008) REPORTS

· Development of advance tax rulings and formal rulings during tax audits
· Secure rulings from the administration on transfer pricing
· Introduction of voluntary tax audits

In the 2000s, a competitive international tax environment made for a focus on the legal certainty that governments needed to provide economic players.

The French Minister for the Economy, Finance and Industry hence tasked Mr Gibert, lawyer, with a report in 2004 to propose measures to improve the certainty of tax legislation in order to increase the country's attractiveness.

This report led to 30 measures being taken to improve relations between taxpayers and the tax administration. These measures were designed to:

- Guarantee the legal certainty of businesses by developing advance tax rulings, especially on transfer pricing, limiting the retroactive application of tax legislation, making rulings during audits binding, and introducing voluntary tax audits;

- Create an administration with more respect for taxpayers in good faith: income tax return amendment request letters, information on the closure of documentary audits, rectification of a tax situation during an audit, limitation of the length of on-the-spot audits, introduction of a department tax mediator, and improvements to the way the department commissions are run;

- Help individuals conduct their tax formalities: easy applications for advance tax rulings, improvements to the tax service call centres, and more functions for the online tax accounts.

In 2008, Mr Fouquet, Section President, Conseil d'Etat (French Supreme Administrative Court), took this work forward in a report on improving legal certainty in relations between the administration and taxpayers.

The DGFiP accordingly set up two pilot tests. The first was "the tax guarantee" for auditors to issue an opinion, on their own initiative, as to whether sufficiently audited points comply with tax legislation.

The conclusions of this "investigative report" count as a formal position binding on the administration, subject to certain conditions, in the event of a future audit.

This pilot test returned mixed results. Businesses criticised the measure for the fact that they had no say in the choice of what the guarantee covers. It was also felt that this measure could create more work for auditors at the expense of their auditing assignment.

The second pilot tests concerned the certification of the tax audit units. An independent body certifies the units that comply with 15 benchmark specifications in recognition of their long-running work to smooth relations with users when conducting audits, especially in terms of lead-times and the quality of dialogue.

These pilot tests found that the constraints of certification by an outside body increased the units' workload and the paperwork already imposed by the legislation.

These drawbacks marked the end of the certification approach as such by an outside body.

However, the tests did point up some positive results with the sharing of certain good practices based on the certification standards.

3 IMPROVED RELATIONS BETWEEN THE ADMINISTRATION AND TAXPAYERS IN THE MANAGEMENT OF THE TAX RETURN SYSTEM AND AUDIT PROCEDURES

- **Simplification of tax formalities and development of online tax returns**

Simpler, streamlined tax return formalities are key to taxpayers' compliance. In view of this, the DGFiP has developed tools for individuals and businesses to file their main tax returns online and use paperless tax payment procedures.

- **Introduction of the pre-printed tax return and the tax return amendment request letter for individual**s

The tax administration derives some of its information on taxpayers' incomes from third parties (employers, banks, social security funds, etc.), which are required by law to declare certain sums. In 2005, the DGFiP introduced an option for taxpayers to amend any inconsistencies between their tax returns and these third parties' returns without requiring an audit.

In 2006, a further improvement was introduced. The administration now sends annual income tax returns to taxpayers already printed with the income data it has at its disposal.

- **Reform of penalties from 2003 to 2005**

The purpose of the reform was to realign a mechanism that had become opaque over the years as successive standards stacked up.

The idea was also to make the legislation more transparent by updating and harmonising the vocabulary and improving the way it was structured. For example, tax base references previously found in articles on fines were transferred to the relevant tax base articles (on tax break issues, for example).

Late payment interest was placed at the start of the General Tax Code section dealing with fines to highlight its nature as a pecuniary penalty, which differentiates it from other sanctions, and to show that it applies across the board. It was reduced from 0.75% to 0.4% per month in 2007.

The common law sanctions were grouped into nine main categories of offence under the tax sanctions heading in the General Tax Code. The range of sanctions was reduced and the provisions on fines were rewritten to harmonise their terminology.

· **Procedure to rectify a tax situation during an audit**

Article L. 62 of the Book of Tax Procedures allows for businesses to rectify mistakes made in good faith when their accounts are being audited. They are granted a reduction in their late payment interest if they pay the taxes due immediately.

This measure is taken up by an average 8% of audits and rectifications.

· **Improvements to the running of the commissions**

Article 26 of the Supplementary Budget Act for 2004 stipulates and extends the material responsibilities of the Département Commission for Direct and Turnover Taxes. The administration and taxpayers can refer audit disputes to this body.

The commission rules on the factual grounds for the administration's rectification proposal. Yet it can also rule on points that may be involved in a legal question without actually settling the said legal question.

· **Information to taxpayers audited by a documentary audit**

When the administration conducts documentary audits, it sends the taxpayers concerned a request for information in which it informs them that, if they do not hear from the administration within 60 days of sending their reply to the administration's request for information, they can consider their case closed on this particular point. In this way, taxpayers are not left in the dark as to what is happening with their case.

In addition, auditors are advised to include in the procedural documents the amount of taxes and penalties due following the rectifications proposed by the documentary audit.

4 FROM THE END OF THE 2000S: TIGHTER ANTI-EVASION MEASURES IN AN ENVIRONMENT OF ECONOMIC AND FINANCIAL CRISIS

4.1 Internal anti-evasion measures

- **Creation of new disclosure requirements**

Six disclosure requirements have been created or extended since 2009: for banking establishments on their international fund transfers for individuals; for telephone operators and internet service providers on their customers; for online gambling and casino operators and the regulator; and for craft trades and professionals selling antiques and second-hand goods.

- **Introduction of the flagrant tax evasion offence**

With the introduction of the flagrant tax evasion offence, the DGFiP can conduct precautionary seizures in the most blatant tax evasion cases (undeclared business, clandestine employment, carouseling and zapper software) and circumstances liable to jeopardise tax collection. It can do so without a ruling from a judge and before the tax return deadline.

- **Establishment of an advance VAT audit for businesses on the simplified VAT return system**

The administration can use this procedure for on-the-spot audits before the VAT return deadline of transactions conducted in the start-up year and current year in order to swiftly put a stop to and charge certain fraudulent practices (false invoicing, carousel fraud invoicing chains, and fly-by-night businesses in certain high-risk socio-professional fields).

- **Launch of the criminal tax inquiry procedure**

The judicial tax inquiry procedure authorises the DGFiP to apply for a warrant before the start of tax audit operations to give the administration criminal investigation powers to search for elements that can serve to establish and charge the most elusive tax evasion cases, in practice evasion via non-cooperative jurisdictions and falsification.

This procedure deals with particularly complex and short-lived fraudulent practices by enabling the administration to use tapping, police custody, searches and so on where its usual prerogatives (right of visit and seizure, accounts audits and audits in the taxpayer's presence) are not enough.

Warrants can be applied for at the audit programming stage or during an audit without the administration having to provide definite evidence that tax evasion has been committed. The taxpayer is informed neither of the referral to the Tax Infringements Commission nor of its ruling.

Cases must meet the all of the following conditions:

Scope restricted to three categories of tax evasion:

- The use, for the purpose of evading taxes, of accounts or contracts with entities established in a state or territory that has not concluded, for at least three years as at the time of the events, an administrative assistance convention with France for the exchange of all information required to enforce French tax legislation;
  - The fraudulent use, in this same state or territory, of front men or front companies or any similar body, trust or institution;
  - The use of a false identity or forged documents as defined by Article 441-1 of the Penal Code or any other forgery.

- **Reason to believe that evasion has been committed:** the tax administration must have sufficient evidence obtained from its administrative procedures.

- **A risk of loss of the integrity of the evidence:** There must be a risk that the elements enabling the administration to establish tax evasion will disappear or be altered.

The inquiry may be assigned to the National Tax Crime Unit (BNRDF), also known as the “tax police”. This structure reports to the Ministry of the Interior. It comprises criminal investigation police officers and tax officials who have attained the status of criminal tax investigation officers.

4.2 Cross-cutting anti-evasion action

· Information exchanges with all the administrations concerned, Social security bodies, Police, Gendarmerie and Customs, Justice (respecting the independence of the judiciary and educating the public on the criminal sanctions applicable to tax evasion)

· Action headed by the National Anti-Evasion Delegation (DNLF)

A National Anti-Evasion Delegation was set up in 2008 to ramp up action to combat tax evasion and welfare fraud. The DNLF reports to the Minister for the Budget. It is briefed to work within the strategic and operational remit of the administrations concerned to:

1° Ensure the effectiveness and coordination of the actions taken by the central administrations, social security bodies and unemployment benefit management bodies to combat evasion and welfare fraud;

2° Improve the government's knowledge of evasion and fraud that impact on public monies and, in particular, improve the current valuation of this evasion and fraud, the tracking of growth in these phenomena and the definition of evasion and fraud categories;

3° Contribute to guaranteeing the collection of public revenues and payment of welfare benefits, in particular by furthering the development of information exchanges and file interoperability and interconnectivity in keeping with the conditions laid down by the Act of 6 January 1978 on data protection and privacy;

4° Contribute to the implementation of a national prevention and communication policy;

5° Define guidelines for closer cooperation with foreign administrations and bodies;

The DNLF's coordination action is underpinned by the Department Anti-Evasion Committees, which cover all the relevant devolved services and report to the Prefect.

Information exchanges with social security bodies are restricted by means of withholding identifying data on individuals and by the scope of the fraud in question (benefit controls).

Closer cooperation with customs to combat tax evasion and smuggling took shape with the conclusion of a national agreement on 3 March 2011, which has now been rolled out locally throughout France. Under this agreement, the two administrations closely monitor the services' activities at central and local level with a focus on the most serious cases (especially VAT evasion) and broader cross-cutting access to both partner directorates' software applications.

Cooperation with the Ministry of the Interior is long standing, with 50 officials working at the National Business Investigations Unit (BNEE). Yet closer cooperation has been achieved by three innovative measures: the regional intervention units (GIRs) set up in 2002 and whose action was reaffirmed by the interministerial circular of 2 March 2010; the plan to fight crime in certain sensitive districts introduced following the memorandum of understanding signed by the interior and budget ministries on 23 September 2009; and the creation of the National Tax Crime Unit (BNRDF) at the Central Criminal Investigation Directorate (DCPJ) on 5 November 2010.

Cooperation with the Ministry of Justice respects the independence of the judiciary. The main action here is to educate the public on the criminal sentences applicable to tax evasion.

4.3 Action against international tax evasion and avoidance

The Liechtenstein tax evasion scandal and the financial crisis highlighted the harm done by tax havens.

Audit measures were ramped up to improve transparency and cooperation with the tax havens and to encourage taxpayers' compliance.

A first step was taken with the Supplementary Budget Act for 2008:

- The statute of limitations for the tax administration to recuperate unpaid income tax and corporation tax was extended to ten years (instead of three years), when taxpayers fail to declare a bank account or life assurance contract abroad or an entity owned in a tax haven country (crime tackling measures in articles 209 B and 123 bis) and the country concerned has not concluded an assistance convention for banking information exchanges with France.

- The fine that applies in the event of failure to declare a bank account in such a jurisdiction was raised from €750 to €10,000. The Supplementary Budget Act for 2009 adopted comprehensive provisions to combat non-cooperative countries and territories by:

- Stepping up the convention policy to conclude OECD-standard administrative assistance conventions with non-cooperative jurisdictions (28 conventions and 9 tax treaties have been signed; 26 conventions and 8 tax treaties have entered into force);

- Legally defining the notion of non-cooperative countries and territories (Article 238-0A of the General Tax Code), to which is attached a ramp of retaliatory measures. A black list of non-cooperative countries and territories is updated annually, taking into account the conclusion of new conventions and the effectiveness of information exchanges. As at 1 January 2012, eight countries and territories (Botswana, Brunei, Guatemala, Marshall Islands, Montserrat, Nauru, Niue and the Philippines) were on the black list.

- Adopting a ramp of retaliatory measures penalising transactions with non-cooperative countries and territories. These measures provided for:
  - A 50% increase in withholding tax and contributions on dividends, interest, fees and capital gains;
  - Limited deductibility in France of sums paid to a resident of a non-cooperative country or territory;
  - Withdrawal of the benefit of the parent-subsidiary arrangement and the long-term capital gains arrangement;
  - The stepping up of the crime-tackling measures in articles 209 B and 123 bis;
  - A stricter transfer pricing documentary obligation for transactions involving large corporations (Article L. 13 AA and L. 13 AB of the Book of Tax Procedures).

- Setting up a rectification unit in April 2009, through to the end of 2009, to encourage taxpayers to rectify information on their undeclared assets abroad. This was designed for individuals living in France with assets and income outside of France that they had not declared to the tax administration.

- Introducing a large-scale disclosure requirement in 2010 for all banks established in France to obtain information on capital transfers to non-cooperative countries and territories. A huge amount of information was obtained (40,000 transfers representing over €12 billion). This information was reprocessed and gave rise to the programming of over 500 audits in early 2012.

A similar operation was launched at the start of 2012.

Generally speaking, and excluding the cases of former non-cooperative countries and territories, cooperation to combat tax evasion and avoidance has produced good results. However, the situation is more complicated when it comes to deciding how to allocate the tax base among different countries (case of transfer pricing).

A recent development is helping to step up action against the cross-border concealment of earnings, irrespective of the relevant country's level of cooperation.

Combating international tax avoidance calls for more than just administrative assistance. The tax administration has to contend with the absence of a tax return from the taxpayer. This raises the issue of general access to information in the case of undeclared assets.

The tax procedure already deals with this issue on a domestic level.

Legislation was brought in over the 2011/2012 period to address this issue on an international level and independently of the cooperation criterion:

- The Supplementary Budget Act for 2011 extended the statute of limitations for the tax administration to recuperate unpaid corporation tax and income tax to ten years in the event of the concealment of assets or entities abroad, regardless of the jurisdiction concerned. In addition, its scope was extended to cases where trust administrators fail to meet their obligation to declare the creation, modification or termination of these legal entities, as required by the 2011 Supplementary Budget Act.
- Stricter, aligned tax sanctions now apply in the event of failure to declare bank accounts and life assurance contracts held abroad.

  For example, when undeclared bank balances or the value of undeclared contracts total €50,000 or more on 31 December of the year for which the declaration should have been made, the fine is 5% of the balance of each undeclared account or value of each undeclared contract (regardless of the country). This fine cannot be less than a floor of €1,500 or €10,000 in the case of a tax haven.
- The Supplementary Budget Act for 2012 introduced stricter criminal penalties for tax evasion.

· The fine for tax evasion was raised from €37,500 to €500,000 in general and from €75,000 to €750,000 when the evasion is conducted or facilitated by means of purchases or sales without invoices or false invoicing or where the intention is to obtain unjustified reimbursements from the administration;

· New penalties were created for ties with a non-cooperative country. In this case, sentences were increased to seven years' imprisonment and a fine of €1 million.

- Lastly, the Supplementary Budget Act for 2011 adopted a change to the criminal tax inquiry procedure. The cooperation criterion was maintained to target accounts held in tax havens, but these remain a further three years within the remit of the tax police as of the conclusion of an information exchange convention.

The ministers have announced further measures for the end of the year.

5 BALANCE BETWEEN EFFECTIVE ANTI-EVASION ACTION AND THE RIGHT OF DEFENCE

5.5 Tools for the administration to use in its audit assignments

· A range of auditing and investigative procedures
· Computer files on businesses and individuals and powerful databases

These developments have given the administration a range of procedures to collect and process information for its tax audit work: right of visit and seizure, right of inquiry, disclosure requirement, and the documentary and on-the-spot audit procedures.

It has used the onlining of business, individual and asset returns to build databases. Software analyses the tax risks of each population group and each file using a rating system based on tax behaviour and suspected anomalies and inconsistencies.

This selection method is rounded out by the information sent by the other auditing administrations.

2.2 The legal framework governing the administration's action

· The range of possible remedies during audits without having to resort to litigation
· Court cases (two types of court)
· Citizens protection bodies (National Commission for Data Protection and Privacy)

Tax audit procedures are generally conducted in the taxpayer's presence so that taxpayers, or their agents, can present their observations on the rectifications proposed by the tax administration. The administration is bound to respond to these comments in keeping with the conditions laid down by law.

Taxpayers also have various remedies available at different hierarchical levels (the auditor's department head and management) before having to resort to litigation and the possibility of referring an unresolved dispute to a department or national commission for direct and turnover taxes. The commission, made up of administration and civil society representatives and chaired by a magistrate, issues an opinion that is not binding on the administration (in the event of litigation, the burden of proof is on the administration if it charges tax higher than the commission's opinion).

Before submitting a court case, taxpayers must present an appeal to the administration, which has to inform of its decision within six months of the appeal. After this six-month period or on receipt of the administration's response, the taxpayer may bring the case before the relevant court: the administrative court for direct taxes, turnover taxes and equivalent taxes; and the judicial court for registration duty, real property registration tax, wealth tax, stamp duty and indirect contributions.

These many different remedies could raise the question to whether they might have any undesired effects. They could encourage the administration to stand firm on its rectification decisions or taxpayers to refuse to cooperate during the audit itself.

The administration conducts its action in compliance with privacy and confidentiality requirements. The National Commission for Data Protection and Privacy, established in 1978, is the official personal data protection watchdog in this regard, and has the relevant supervisory and sanctioning powers.

The administration is bound by its position, especially in the case of cross-referencing files and online disclosure requirements.

2.3 Moves to better meet taxpayers' needs

- Separating management and audit tasks
- For businesses: the Large Business Directorate (DGE) and the National and International Tax Audit Directorate (DVNI)
- For individuals: targeting high-risk accounts (large accounts audited by the National Tax Situation Examination Directorate – DNVSF)
- Taxpayer management improvements do not necessarily tie in with audits

Since the 2000s, the DGFiP has been adapting its organisation to the particularities of certain categories of taxpayer.

The Large Business Directorate (DGE) was set up on 1 January 2002 to cover:

- Businesses with a turnover or gross assets of over €400 million (core companies);
- Partners and over 50%-owned subsidiaries of core companies;
- Companies that belong to the same integrated group (Article 223 A of the General Tax Code) as one of the abovementioned companies;
- Companies that are members of a group that comes under the consolidated global profits tax system (repealed on 31 December 2010).

It manages approximately 36,000 businesses representing 1,350 groups.

Most of these groups and companies are the responsibility of the National and International Tax Audit Directorate (DVNI) for external tax audits. This directorate is made up of 26 tax audit units specialised by business sector (heavy industry, banking, luxury goods, pharmaceuticals, food industry, etc.). The DVNI conducts some 1,300 accounts audits per year.

At department level, small and medium-sized businesses have a one-stop contact in the form of the Business Tax Service (SIE). Department services audit the small businesses while interregional services audit the medium-sized businesses.

Individuals' taxes and tax account files are managed locally. Individuals are generally audited by specialised units in the most complicated and high-risk cases.

At national level, the National Tax Situation Examination Directorate (DNVSF) conducts documentary and on-the-spot audits of individuals presenting high-risk, complex or particularly sensitive tax accounts.