USAID'S LEADERSHIP IN PUBLIC FINANCIAL MANAGEMENT

Detailed Guidelines for Improved Tax Administration in Latin America and the Caribbean

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Detailed Guidelines for Improved Tax Administration in Latin America and the Caribbean

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List of Acronyms and Abbreviations

Acronym	Definition
ADDIE	Analysis, Design, Development, Implementation, and Evaluation
BOJ	Best of judgments
CAAT	Computer assisted audit techniques
CCECC	Center for Combating Economic Crimes and Corruption
CFO	Chief Financial Officer
CIAT	Inter-American Center of Tax Administrations
CIPRO	Companies and Intellectual Property Registration Office (South Africa)
CIT	Corporate income tax
CITP	Criminal Investigation Training Program
COTS	Commercial off-the-shelf
CPE	Continuing professional education
CRA	Canada Revenue Agency
CRM	Customer relationship management
EDTAX	Education Tax (Jamaica)
ERP	Enterprise resource planning
FAQ	Frequently asked questions
FLETC	Federal Law Enforcement Training Center (United States)
FTE	Full-time equivalent
GST	General sales tax *or* Goods and Services Tax if pertaining to Canada
HEART	Human Employment and Resource Training Trust (Jamaica)
HR	Human resources
IADB	Inter-American Development Bank
ICT	Information and communication technology
IFC	International Finance Corporation
IIA	Institute of Internal Auditors
ILEA	International Law Enforcement Academies
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
IRS	Internal Revenue Service (United States)
ISD	Instructional System Design
ISP	Internet service provider

Acronym	Definition
IT	Information technology
ITIL	Information technology infrastructure library
ITIS	Integrated tax information system
ITSM	Information technology service management
IVR	Interactive voice response
JMD	Jamaican dollar
LAC	Latin America and the Caribbean
LTC	Large taxpayer center
LTO	Large taxpayer office
LUQS	Large, unusual, or questionable items
MCTC	Model Customs and Tax Center (Egypt)
MIS	Management information system
MOF	Ministry of Finance
MTO	Medium taxpayer office
NIS	National Insurance Scheme (Jamaica)
NTH	National Housing Trust (Jamaica)
OCR	Optical character recognition
ODS	Operational data store
OECD	Organisation for Economic Co-operation and Development
OLACEF	Organization of Latin American and Caribbean Supreme Audit Institutions
OLAP	Online analytical processing
OPM	Office of Personnel and Management (United States)
PAYE	Pay as you earn
PIT	Personal income tax
SARA	Semi-autonomous revenue authority
SARS	South African Revenue Service
SAT	Superintendencia de Administración Tributaria (Superintendent of Tax Administration in Guatemala)
SII	Servicio de Impuestos Internos (Internal Revenue Service of Chile)
SLA	Service level agreement
SME	Small and medium-sized enterprises
SWOT	Strengths, weaknesses, opportunities, and threats
TIN	Taxpayer identification number
TIPP	Tax installment pre-payment plan
VAT	Value added tax

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Chapter 1. Introduction

Doug Pulse and Anton Kamenov

Taxation is a controversial topic in countries throughout the world. Opinions vary among tax practitioners, economists, and citizens in general as to how much tax a government should collect and which segments of the taxpaying population should shoulder the burden. In fact, there are disagreements about what even constitutes a tax. However, there is widespread agreement that a government needs to collect some level of revenue in order to provide goods and services to its citizens.

To collect revenues, governments use a variety of instruments. They derive income from property, charge fees, and impose taxes. For the purposes of this product, taxes are the compulsory, unrequited payments to the general government sector – a definition adopted by the OECD[1], the IMF, and the World Bank. The fact that taxes are imposed on taxpayers and not visibly proportional to the benefits or services that taxpayers receive from government has far reaching implications that are beyond the scope of this product. However, adopting the OECD's definition of taxes helps to frame the contents. Though they vary across and within countries, modern taxes are similar enough to fit into a few categories – i.e., taxes on income and capital gains, payroll, property, goods and services, and international trade[2] – and to allow practitioners to discuss 'modern' tax systems that rely on 'core' taxes, such as income taxes, value added tax (VAT) or general sales tax (GST), excise taxes, property taxes, property transfer taxes, and customs duties. These, save for customs duties, are the types of taxes discussed throughout this product.

The tax administration is the division of the government tasked with collecting taxes. To the extent that taxes are defined by law(s), the tax administration is tasked with implementing the provisions of the law(s). Through its interaction with the taxpaying public, the behavior and performance of the tax administration contribute significantly to the public's perception of the government overall. An effective, modern tax administration ensures adequate and timely revenues, allowing the government to deliver goods and services, and minimizes hindrances to private businesses and economic growth. In practice, countries may have more than one tax administration. For example, many countries have a separate tax administration (Customs) to collect taxes on international trade (customs duties) and VAT on imports, as distinct from the tax administration responsible for 'domestic' taxes. The tax administration responsible for the core 'domestic' taxes is the focus of this product.[3]

1.1. Purpose

Of course, not all tax administrations are on equal footing (e.g., in terms of their resources, scope of responsibilities, performance, etc.). A 'modern' tax administration is one that is effective and efficient.

[1] OECD (2012), p. 322.
[2] IMF (2001), p. 49.
[3] Whether or not Customs and the 'domestic' tax administration should be discussed separately is highlighted in Chapter 4.

In other words, a modern tax administration collects the right amount of tax, at the right time, and does so at minimal cost to the government and the least burden to taxpayers. The purpose of this product is to detail the workings of a modern tax administration. Specifically, this product is designed to enable tax administration officials and staff to assess their own performance against leading practices across the core components and functions of an effective tax administration. This product will also provide a tool for USAID officers, and other donors and practitioners, to engage with tax administrations on potential areas of technical assistance and to prioritize interventions. Finally, the product will be of interest to academia, as it presents an array of knowledge around effective tax administration practices.

While much of the content of this product is applicable across regions (e.g., leading practices in various aspects of tax administration, key benchmarks, etc.), each chapter also includes a specific focus on Latin America and the Caribbean (LAC). USAID has a long history of providing support to tax administrations in the LAC region, including substantial assistance in the 1990s after the end of civil wars in Central America. Current USAID assistance on tax administration in the region is largely limited to El Salvador and Jamaica. However, in recent years, the international community has shown increased, high-level political attention to the need for countries to mobilize domestic revenues to invest in their own development. While tax administration in the region has progressed in recent years, there is wide variation among countries, with many continuing to lag behind comparator countries and international standards on a variety of indicators related to revenue mobilization and tax administration.

Much has been written about efficient and effective tax administration. For example, the OECD Forum on Tax Administration has put forward significant information organized by topic (compliance, services, etc.) and by taxpayer segment (individuals, large businesses, other). The World Bank's online collection of publications on tax policy and administration is extensive and organized similarly to the thematic structure outlined for this product below. Of course, the International Monetary Fund (IMF) is well-known for its expertise in this area and offers a great number of research papers and related products. The World Bank, IMF, USAID, and others have also developed benchmarking methodologies and tools focused on tax administration. The International Finance Corporation (IFC) has written extensively on taxation, particularly as relates to tax simplification and reducing the taxpayer compliance burden. With respect to LAC, the Inter-American Center of Tax Administrations (CIAT) has published manuals on organization, management, audit, internal audit, and other topics, and is expending significant efforts in collecting comparative information and publishing guidelines on leading practices. This product builds on and contributes to the existing body of work by providing a comprehensive, user-friendly guide with a unique structure (detailed below) and a regional focus on LAC.

1.2. Reading the Product

This product is a relatively large undertaking. Although it aims to derive the key benchmarks that tax officials, practitioners, and donors can use to evaluate tax administration performance, it also strives to provide sufficient detail to those who may be interested in delving deeper into the tax administration's functions and operations. Readers who would like to see high-level highlights should turn to the Overview (a separate document), which can also be used as a reference, guiding the reader to specific topics. Readers who are interested in specific areas should turn to individual chapters, which can be read sequentially as a full product, or as stand-alone 'leading practice' notes on the subject topics.

This product contains seventeen chapters as follows.

- Chapter 1 is this **Introduction**.
- Chapter 2 presents a **Conceptual Framework** for the document and discusses the key tasks and main functions of the tax administration, as well as the environment in which the tax administration operates.
- Chapter 3 presents the **Legal Framework** that enables the tax administration to perform its duties.
- Chapter 4 focuses on the tax administration's **Organizational Structure and Management**.
- Chapter 5 discusses taxpayer **Registration** and the need of the tax administration to know and manage its taxpayers.
- Chapter 6 addresses **Taxpayer Services** – the information, education, and support that tax administrations provide to taxpayers.
- Chapter 7 details the process of **Filing and Payment**, which are the two primary obligations of the taxpayer, and areas of related non-compliance.
- Chapter 8 discusses the monitoring of taxpayer compliance through **Audit**.
- Chapter 9 focuses on **Fraud Investigations** of taxpayers, who are suspected of knowingly falsifying declarations in order to minimize tax payments, and on taxpayers suspected of tax evasion and who pay no tax whatsoever.
- Chapter 10 discusses enforcing taxpayer compliance through the **Collections** of outstanding taxpayer debt.
- Chapter 11 addresses taxpayer recourse through **Objections and Appeals**.
- Chapter 12 details the number of ways in which **Information Technology** can support the tax administration.
- Chapter 13 focuses on the tax administration's **Human Resources**.
- Chapter 14 focuses on **Budget Planning and Resource Management** for tax administrations.
- Chapter 15 addresses **Strategic Planning** for tax administrations.
- Chapter 16 discusses the importance of **Internal Audit** to the continual improvement of tax administration's operations.
- Chapter 17 details considerations of **Integrity**.

Save for Chapters 1 and 2, all chapters follow the same structure. Namely, each chapter:

- Begins with a short introduction of its subject topic.
- Lists leading practices in its respective area.
- Discusses common trends in its respective area. 'Common trends' refer to practices that tax administrations around the world may be implementing or considering, but that are not yet proven leading practices.

- Presents a four-level maturity model. Each level of the maturity model shows the practices of tax administrations at various stages of development – from basic to leading. Such a model is useful as, besides allowing officials to identify their own administration's level of maturity, the model presents a path forward for the administration (i.e., striving to achieve the characteristics found at the next level). The authors and editors of this document have attempted to make the maturity models practical and 'vertically' integrated across sections. That is, to the extent that tax administrations evolve along the maturity scale from one level to the next in one subject area, it is likely that they would be in a similar maturity level in other areas. Of course, there may be exceptions.
- Describes the state of tax administrations in the LAC region with respect to the specific subject topic and, to the extent possible, with respect to the maturity model of the section, but without presuming in any way to score or rank individual countries.
- Presents key guidelines in the form of rules of thumb, benchmarks, or questions that can provide an initial, high-level indication of tax administration performance in a given area.

In other words, although each chapter is designed as an independent 'leading practice' note, the chapters follow a common structure and combine to form a coherent overall product. While understanding that points of contention exist on many of these topics and that practices must be adapted to fit different country contexts, the chapter authors have strived to present detailed and unambiguous guidance wherever possible. The authors intend for this ambitious product to provide a comprehensive view of tax administration functions and operations, including actionable guidance to help tax administrators and donors understand leading practice, pinpoint areas with potential for improvement, and identify steps for moving forward.

Chapter 2. Conceptual Framework

Arturo Jacobs

The purpose of this chapter is to establish the conceptual framework, or major aspects of tax administration – basic mission, core functions, main responsibilities, and operating environment – that will be used to guide the remaining chapters of this document. As defined in Chapter 1, "taxes are the compulsory, unrequited payments to the general government sector" – a definition adopted by the OECD, the IMF, and the World Bank. The tax administration is the division of government tasked with collecting taxes.

Each major aspect of tax administration is fully addressed in subsequent chapters. The purpose of this chapter is to highlight features that deserve special emphasis, including the concept and practice of self-assessment and voluntary compliance, lessening the cost and burden on taxpayers, taxpayer identification numbers (TIN), taxpayer current accounts, and computerized integrated tax information systems (ITIS). The operating environment in which the tax administration conducts its business processes is also described in this section. "Operating environment" includes a country's economic and technological development, the business enabling environment, the complexity of the universe of taxpayers that a tax administration needs to control, and the tax administration's relationships and coordination with other government institutions and private sector groups that are engaged in various activities related to tax administration.

A maturity model is presented in this chapter to describe the general level of development of any tax administration. The model is adapted and applied in subsequent chapters to describe four maturity levels with respect to each of the major aspects of tax administration. As described below, the 'maturity model' contains sets of characteristics that describe tax administrations at various levels of maturity, from emerging to leading ones. Interested tax administrators and practitioners can use these characteristics to assess a particular tax administration, describe its current level of maturity, and understand the steps needed to take the tax administration to a new level of maturity. Aspects of the maturity model can also serve as "rules of thumb" that interested officials can reference to conduct self-assessments of their organizations' strengths and weaknesses.

2.1. Exclusions from the Term "Tax Administration"

This product does not discuss the administration of taxes on international trade or tax policy.

2.1.1. Customs

A few countries around the world have merged their domestic tax administration and Customs. For example, an OECD study[4] determined that, as of 2010, only nine OECD member countries had merged

[4] OECD (March 2011), p. 15.

tax administrations and Customs. In Latin America, a recent study by CIAT[5] found that seven of 17 countries – Argentina, Brazil, Colombia, Guatemala, Honduras, Mexico, and Peru – have merged tax administrations and Customs. With Caribbean countries included – which were not included in the CIAT study – non-merged administrations exceed merged ones by a ratio of three to one. The CIAT study concluded that the merging of tax administrations and Customs, after gaining some momentum in the late 1990s and early 2000s, suddenly came to a standstill. One of the possible reasons was the reversal by Canada in 2003 – a country seen as a model for tax administration in the region – which had merged Customs and the domestic tax administration many years earlier but decided to separate them again. Other reasons included the fact that actual mergers had proved to be mere formalities, rather than meaningful in terms of day-to-day operations.

Whether Customs and the domestic tax administration should be merged is further addressed in Chapter 4. Current leading international practices – the guiding principles for this product – strongly suggest separate administrations. The term "tax administration" in this product does not include Customs. This, however, does not diminish the very important need for both agencies to establish ongoing cooperation and coordination through memoranda of understanding and legal documents that authorize and formalize information sharing agreements to the extent provided by law, as discussed later in this chapter.

The authors' decision to exclude Customs from this product is not intended to discount the great importance of Customs in LAC countries in terms of tax revenue. However, the authors' believe that a separate product on Customs would likely be the better approach and a very worthwhile undertaking.

2.1.2. Tax Policy

An early decision was made to exclude tax policy from this product, as this would similarly be a large undertaking of its own. The tax administration, however, does play an important part in the development and amendment of tax policies, by requiring its Legal Department to closely monitor, analyze, and report on the positive or negative impact of tax policy and legislation on the operations of the tax administration, as well as to recommend changes.

2.2. Core and Support Functions of Tax Administration

The core or basic functions that a modern tax administration performs in its direct operations are:

- Taxpayer registration – the collection, recording, and maintenance of basic identifying taxpayer information in the tax administration's master database that permits the tax administration to understands its taxpayer base and to plan accordingly;
- Taxpayer services – the information, forms, publications, and tax education that the tax administration provides taxpayers to help them comply with their tax obligations, to demonstrate that they are considered valued customers of the tax administration, and to reduce the need for extensive enforcement, given limited resources;

[5] Inter-American Center of Tax Administrations (CIAT) et al. (2012), p. 13.

- Processing of tax declaration filings and tax payments – the processes and forms designed by the tax administration for taxpayers to file their tax return(s) and pay their tax liabilities on specified dates, and the processes used by the tax administration to receive, document, review, correct if necessary, and archive the tax returns;
- Taxpayer audits – the processes used by the tax administration to monitor compliance, by selecting filed tax returns to audit/verify income, expenses, and supporting information reported by the taxpayer and to make additional assessments which require collection action;
- Taxpayer objections (administrative appeals) – the processes offered to taxpayers to first dispute proposed additional tax assessments in forums within the tax administration's field offices;
- Taxpayer appeals[6] – the formal processes available to taxpayers under the law to protest proposed additional tax assessments or other actions by the tax administration at forums away from the direct jurisdiction of the tax administration's compliance offices, including judicial reviews and hearings;
- Collection of tax arrears (as opposed to current tax payments) – the business processes used by the tax administration to collect taxes which are due, assessed, and not paid by the due date under the law, including use of enforcement measures, such as liens, levies, and seizure and sale of taxpayers' property; and
- Tax-fraud investigations – the processes used to investigate financial transactions declared by taxpayers on their tax returns in cases in which the tax administration has a reasonable cause to suspect that the taxpayer has committed tax fraud. Tax-fraud investigations also involve cases of tax evasion, when taxpayers subject to tax do not register, file, and pay their taxes.

Support functions provide the resources, support, and guidance to the staff that perform the core functions. These support functions are:

- Information technology – computerization of systems and business processes of the tax administration, and data networking;
- Legal services – services provided to technical and management personnel by a cadre of attorneys of the tax administration, including legal interpretation of tax laws and regulations, and representation of the tax administration in all judicial forums, including tax appeals;
- Human resources – personnel management, training, and development functions;
- Budget planning and resource management (physical space, facilities, and other property management);
- Strategic and operations planning – the formulation of long-term strategic plans of the tax administration and the drafting, implementation, and monitoring of annual work plans for all its departments consistent with the objectives of the strategic plan;

[6] Objections and appeals are discussed in together in Chapter 11. However, there is an important distinction between the two. Objections are reviewed by the tax administration, whereas decision-making related to appeals is outside the span of control of the tax administration.

- Internal audits – the processes of conducting periodic reviews to ensure that selected regulations, operations, and administrative procedures and programs conform to specified standards and are being implemented efficiently and effectively, including the analysis and verification of accounts, financial transactions, and reports; and
- Integrity investigations – investigations about the conduct, such as alleged or suspected corruption, of any member of the tax administration's staff.

The core and support functions are staffed with three general categories of staffing – management, technical, and administrative. In large countries with large taxpayer populations and large numbers of tax administration staff, the tax administration is organized around a headquarters office, two or more regional offices, and multiple district/field offices. In smaller countries, with fewer taxpayers and tax administration staff, regional offices are not established, and their usual roles are performed by the headquarters office. The roles of the headquarters and regional and district or local offices are discussed in Chapter 4. Each of the core and support functions is fully described in its respective chapter, as are the roles of the categories of staffing and the division of roles and responsibilities among headquarters, regional, and field offices.

In many LAC countries, tax administrations organize and staff some non-tax-revenue support functions. Staff usually provide information, assistance, and collection services for various government licenses and fees. For example,[7] while it has no legal authority for them, Tax Administration Jamaica provides information and assistance on the following processes:

- Drivers' licenses and motor vehicle documentation;
- Payment of traffic tickets;
- Property taxes;
- Titles for motor vehicles;
- Trade licenses; and
- Stamp duty and transfer taxes.

Unfortunately, these activities detract from the core functions and performance of a modern tax administration and should be re-assigned to other agencies in Jamaica, as was observed and recommended by the IMF in its 2010 mission report and by other advisors. Therefore, despite their practice by tax administrations of LAC countries, this product excludes such support functions from discussion.

2.3. Main Mission and Responsibilities of the Tax Administration

All national governments must have the revenue necessary to fund the operations of their various departments, to provide infrastructure and services for the population, to invest in economic development, and to advance various other priorities. The main mission of the tax administration is to

[7] Jacobs et al. (2012), p. 28-29.

collect the tax revenue due and needed by their governments from taxpayers, under the country's tax laws, without hindering private sector development. Its main responsibilities are:

- Facilitate and encourage voluntary compliance by taxpayers with the country's tax laws;
- Administer the tax laws fairly and impartially;
- Minimize the cost and burden on taxpayers to comply with their tax obligations;
- Monitor compliance;
- Enforce the country's tax laws in cases of non-compliance;
- Use its resources efficiently and effectively; and
- Ensure tax officials perform their functions with integrity and honesty.

In pursuing their mission, all tax administrations confront similar challenges, such as how to: broaden the tax base by continually bringing non-registrants and non-filers into compliance, strengthen organization and management, control tax evasion, improve tax collection, and facilitate voluntary compliance. The greatest challenge for any tax administration is achieving and maintaining a high degree of voluntary compliance, which can be facilitated by vigorous taxpayer service and education programs and creative measures to minimize the burden on taxpayers in complying with their tax obligations.

2.3.1. Self-assessment and Voluntary Compliance

There are three principal methods to determine and assess the amount of tax liability due from each taxpayer: (1) one-on-one assessment on taxpayers by staff of the tax administration, usually in a tax administration office, upon presentation of taxable information by the taxpayer at designated times, (2) self-assessment and declaration by the taxpayer, and (3) tax withholding by third parties at the source. The first method has been used in countries in early development of their tax administrations, where very few taxpayers are registered in the tax administration's registration database. Given limited resources this method is inadequate, ineffective, and inefficient to handle tax computation and assessment for more than a very small percentage of any country's taxpayer population. Furthermore, the one-on-one approach has proven to be a gateway for collusion and corruption between taxpayers and tax administration staff and should be avoided.

The second method, self-assessment and declaration by the taxpayer, coupled with effective risk-based audit programs and other verification mechanisms by the tax administration, is the preferred method to determine and collect the amount of tax liability due from each taxpayer. For a self-assessment system, the country's tax laws must include provisions to the effect that taxpayers will: provide to the tax administration the facts on which their tax liability can be computed; compute the tax liability themselves; file a tax return on specified due dates showing and declaring the result of the computation and the tax due; and pay the amount of tax owed at the time of filing. In effect, taxpayers are expected to comply on their own with the country's tax laws (i.e., to exercise voluntary compliance, under the self-assessment/declaration method). Of course, the usual complexity of tax laws in most countries, coupled with low literacy rates in many developing countries, cause taxpayers to rely on vigorous and extensive taxpayer service programs from the tax administration and/or assistance from professional tax practitioners in order to meet their tax obligations, as discussed later in this chapter.

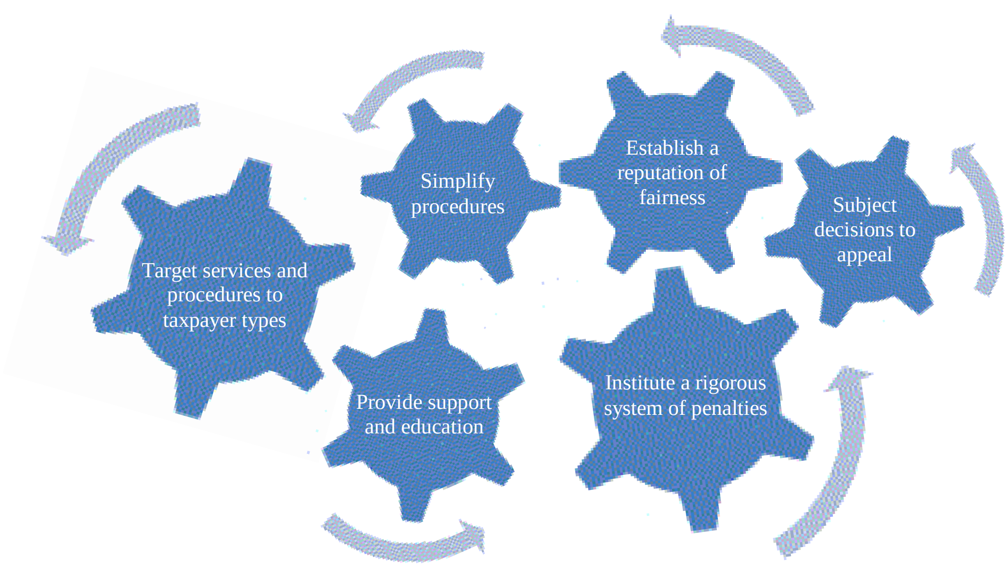
The third method, withholding of tax at the source, is discussed in Chapter 3. Examples include the legal requirement for employers to determine, withhold, and pay to the government income tax from employees' wages and for retailers to collect from consumers and pay to the government value added or general sales taxes.

The paramount objective of any tax administration is to encourage, facilitate, attain, and maintain a high degree of self-assessment and voluntary compliance by taxpayers with their tax obligations. A high degree of voluntary compliance in any country allows the tax administration to concentrate its resources on identifying and dealing effectively with those taxpayers who fail to fully comply with their tax obligations. In effect, extensive self-assessment and voluntary compliance by taxpayers, combined with targeted compliance and enforcement programs that are based on risk assessment strategies, allows the tax administration to administer the tax system effectively and efficiently by lowering administrative expenses and raising revenues. Without a doubt, the most successful tax administrations around the world continuously encourage, attain, and maintain a high degree of voluntary compliance.

2.3.2. Measures to Minimize Cost and Burden on Taxpayers

Of course, a high degree of voluntary compliance among all taxpayers does not just simply "happen." It is incumbent on the tax administration to design, implement, and practice complementary measures to encourage a self-assessment and voluntary compliance culture.

Figure 2.1. Measures to encourage voluntary compliance



Among such measures are efforts to minimize the cost and burden of complying with the tax laws, such as providing simple overall procedures and facilities for taxpayers to file and pay their taxes. For example, small businesses, farmers, and self-employed individuals in developing as well as developed countries represent a large number of taxpayers, but they may lack proper books and accounting records to determine and self-assess their tax liabilities. For these reasons, it is very difficult and expensive for the tax administration to assess and collect taxes from these groups. Consequently, many small businesses in the informal economy simply elude the tax "net" and are not taxed at all. For these groups, the tax administration can design, promote, and establish simple, optional presumptive tax schemes, such as: (1) standard assessments to assign lump-sum taxes to taxpayers on the basis of occupation or business activity; (2) assessments based on a taxpayer's estimated income from indicators or proxies of wealth specific to a given profession or economic activity, where key indicators can range from location of property to numbers of skilled employees or seating capacity; (3) alternative minimum taxes, such as a minimum tax irrespective of the taxpayer's level of income or economic activity, and (4) payment of a lump sum based on the small business' turnover to be declared and filed on a single-page income tax declaration.

Box 2.1. Turnover taxes for small businesses

There are several advantages to a turnover tax. It can apply to all small businesses; it imposes little tax on businesses getting started; it is reduced when businesses experience difficult times and increases when business sales increase; it requires business persons to start rudimentary record keeping that can act at least as a crude proxy for a business' profits; and, it can be designed to ease the transition and encourage small businesses to move into the formal economy.[8] There are, however, disadvantages. Taxpayers with the same amount of net income will pay the same amounts of tax, if their turnover is the same. Consequently, the perception of fairness in the tax system may be lost.

For business taxpayers subject to the value added tax (VAT), tax administrations can and should establish variable tax-filing periods and requirements to lessen the cost and burden on small and medium taxpayers. Even for large taxpayers, who should and usually are required to file monthly, tax forms can be simplified through re-designs that eliminate the requirement to attach extraneous data. For example, a simplified filing system can just require a list of registered suppliers and customers, total purchases and sales, and total taxes paid and levied – and avoid requiring superfluous information, such as lists of all sales which some tax administrations require even though they are not necessary for audit verifications.

Also, for voluntary compliance to flourish, the tax administration must offer a wide variety of high-quality taxpayer services and taxpayer education programs with a dedicated staff to demonstrate that those taxpayers who comply voluntarily are respected and treated as valued customers by their government. A staff dedicated exclusively to the Taxpayer Services function is required to:

- Assist and advise taxpayers in understanding their rights and meeting their tax obligations;
- Attend the public counters and telephones and provide a high level and quality of assistance to taxpayers;
- Respond promptly to written inquiries regarding tax questions, procedural requirements, etc.;

[8] Daniel (2009), p. 43.

- Ensure that adequate supplies of explanatory and information pamphlets, guides, return forms, applications for income, VAT, and excise tax registration, and other materials are available in public access offices;
- Carry out taxpayer education activities (e.g., classroom orientations about tax laws for importers) and on-site visits to advise taxpayers about effective ways to establish and maintain books and records relevant to tax obligations;
- Resolve taxpayers' problems with the tax administration promptly; and
- Explain taxpayers' administrative objections and formal appeals procedures to dispute proposed tax assessments and other actions of the tax administration.

Concurrently, the tax administration must continually explore and execute vigorous compliance monitoring and enforcement programs aimed at taxpayers who are not in full compliance at any given time to lessen the burden on taxpayers who comply voluntarily. However, even compliance/enforcement staff engaged in their duties must encourage voluntary compliance. To do so, they must perform their duties in a manner that demonstrates all due respect and courtesy to taxpayers and third parties.

Another taxpayer incentive for voluntary compliance is a strong but fair penalty system for non-compliance. The country's tax laws should provide substantial financial penalties for non-filing; non-payment and under-payment of tax liabilities; under-reporting of income; and failure to keep adequate books and records, as required by the tax law. In addition, the tax laws must provide for severe penalties for tax fraud and tax evasion convictions, including incarceration. Convictions of taxpayers for tax fraud and tax evasion should be highly publicized to the general public as strong examples of consequences for those who do not comply voluntarily with their tax obligations.

Establishing a reputation for efficiency and effectiveness in the tax administration helps promote voluntary compliance. The tax administration establishes such a reputation when it continually minimizes the potential risk of revenue loss by identifying and prioritizing its compliance monitoring and audit verification activities. The tax administration should focus first on the country's largest taxpayers, who contribute between 60-75 percent of the tax revenue, then on medium taxpayers, and so on. Also, the tax administration establishes a reputation for efficiency and effectiveness when it designs, implements, and uses risk and case management systems to ensure that its staff continually works those audit and collection cases that have the highest risk of error and/or potential revenue loss to the government. Concurrently, under risk-based systems, taxpayers who generally comply fully with their tax obligations are not selected for needless, time-consuming, and expensive audits and other verifications – an indirect but powerful message that taxpayers, who comply voluntarily, are treated as valued customers.

A final incentive for taxpayers to comply voluntarily with the tax laws is to know that the tax administration has a reputation for administering fair and impartial administrative objections and appeals programs for taxpayers to dispute proposed tax assessments and other actions of the tax administration.[9]

2.4. Operating Environment

The purpose of this sub-section is to describe the operating environment in which the tax administration conducts its business processes. Tax administrations all over the world are faced with powerful opportunities as well as challenges to use modern information technology in all of their operations. For developing countries, the opportunities offered by technology are more elusive and challenges are greater for several reasons, of which inadequate budgets are at the top. Beyond technology limitations and inadequate budgets, tax administrations in developing countries face additional daunting challenges, such as the complexities of the taxpayer population and the generally large informal or "underground" economy, the need to tailor different service and compliance strategies for small, medium, and large taxpayers for effective risk management, and the need to establish and maintain positive and productive relationships and coordination with various other institutions at all levels, such as Customs, the judiciary, academia, as well as various private sector groups, such as Chambers of Commerce, national and international associations of accountants and attorneys, and business and professional associations.

In developed countries, tax administrations have been fast embracing many technological advances used in the private sector, such as electronic commerce, interactive telephone systems, and the capture of data by the scanning or imaging of paper documents. Tax authorities have been moving quickly to redesign their basic business processes and to rapidly implement electronic receipt, processing, and delivery methods. They have been facilitating increased use of the internet for transmission of information and access to tax forms by taxpayers. They have also been implementing interactive telephone methods for taxpayers to file their tax returns and resolve queries and tax-account problems. Furthermore, they have developed and heavily utilize data-warehouse research methods to supplement traditional compliance tools. Direct interfaces with the sources of information, i.e., with external information systems, are becoming more and more common.[10]

Tax administrations in most developing countries are also confronted with many external obstacles on the path to modernizing their organizations. For example, they still face a weak legal/regulatory institutions, outdated tax policies, inadequate or non-existent civil service rules, regulations, and compensation-levels for attracting and retaining qualified staff, an absence of international accounting and professional standards, which are indispensable for tax purposes, and a lack of modern financial and banking standards and institutions. Computer equipment, data networks, and communications lines are still in short supply and expensive in many countries, and governments have very meager financial resources for their acquisition. Therefore, electronic and internet tax filing systems, electronic funds transfer and payment systems, and integrated tax administration data systems that enable electronic

[9] Even though it is not within the purview of the tax administration, there is another incentive for taxpayers to comply voluntarily – effective, transparent, well aimed, and efficient public expenditures. The main incentive for taxpayers is to know that the tax revenues are well utilized.
[10] Jacobs (2003), p. 2.

forms processing – among the many tools in the "options basket" being adopted extensively by tax administrators of developed countries – are options available only to a limited degree for tax administrations in many developing countries that are engaged in the early stages of information technology modernization efforts.[11]

The tax administration must learn not merely to cope, but to continually navigate successfully in its very difficult operating environment to attain its basic mission and successfully accomplish its main responsibilities.

2.4.1. Underground Economy

The problem of the "underground" economy is a serious problem to tax administrations all over the world. In developing countries, in particular, the number of "non-filers" is very high. "Non-filers" are taxpayers, who are required to, but have never registered for tax, and consequently have escaped paying their tax obligations altogether. They conduct their businesses or professions "under the radar" and go largely undetected. Tax administrations have a huge, continuous challenge to broaden the tax base by continually identifying large numbers of non-filers and bringing them into compliance, thereby lessening the burden on those taxpayers who do comply voluntarily.

There are a number of administrative tools that tax administrations can use to bring unregistered or non-filling taxpayers into the tax net.[12] For example, an effective tool to identify non-filers and verify the accuracy of income and expense reporting by taxpayers is legislation that enables the tax administration to receive and match third-party financial data of taxpayers to its master file and mount compliance programs for omissions and discrepancies.[13] Such legislation requires that financial institutions, contractors, and employers routinely submit third-party financial data, such as data on the payment of interest, dividends, wages, and other payments. Unfortunately, such legislation does not exist in many developing countries. This issue is addressed in Chapter 3.

2.4.2. Taxpayer Segmentation

As stated above, tax administrations must tailor different service and compliance strategies for small, medium, and large taxpayers for effective risk management. Therefore, over the years, more and more tax administrations have developed and implemented strategies for controlling their universe of taxpayers by type-of-taxpayer segments. The most common segmentation strategy has been to establish a Large Taxpayer Office (LTO) to control and provide services to those taxpayers who collectively account for between 60-75 percent of the government's overall tax revenue each year. Inclusion in the LTO program is usually determined by a large annual turnover value and/or amount of tax liability of the taxpayer for the prior two or more years, plus other criteria. The nature of the business is also a factor. For instance, in many countries all taxpayers in certain industries—such as

[11] Ibid., p. 3.
[12] These are discussed in Chapter 7.
[13] Chapter 9 covers a variety of issues and compliance programs to deal with the underground economy.

financial institutions and mining - are included in the LTO program, regardless of their turnover and actual size.

Additional segmentation of taxpayers has recently been extended in some countries to designing and implementing strategies and offices to control medium-size taxpayers, who usually contribute around 10-15 percent of the government's annual tax revenue. Medium taxpayers have less formal structures and many deal mostly in cash, resulting in more opportunities to under-report income. Medium Taxpayer Offices (MTOs), by default, control those taxpayers neither covered by the LTO nor considered small taxpayers.

Small taxpayers, as stated above, are by far the largest taxpayer segment in most countries, and also the most difficult to control because of their sheer number and their lack of adequate record keeping. In lieu of applying scarce audit and compliance resources to this taxpayer population, presumptive tax strategies have been introduced in many countries, as described above, thus allowing these taxpayers to opt to pay, for example, a standard assessment based on occupation; an estimated assessment based on income activity; a minimum tax; or simple turnover tax, rather than be subject to more complex income tax requirements. Chapter 3 recommends that the country's tax laws authorize the tax administration to design and implement effective presumptive schemes for small taxpayers, to be published in regulations. Presumptive taxation is considered an optimal method of curbing widespread non-compliance without employing excessive government resources, because it addresses the concerns of both the taxpayer and the tax authority. Presumptive taxation provides taxpayers with a simplified option for tax compliance without requiring full financial transparency. Although presumptive regimes may bring about significant simplification, they may also result in unequal tax burdens. Care should be taken to ensure that some level of equity is preserved – i.e., that all taxpayers with similar levels of income are allowed to opt into the presumptive regime (preferred), or that all taxpayers with similar levels of income pay similar amounts of tax, whether under the simplified regime or not.[14]

One disadvantage of too much taxpayer segmentation is duplication and fragmentation of functional units of the tax administration. For example, LTOs not only perform audits and collections with their own audit and collection staff, but they also provide taxpayer services to large taxpayers with their own taxpayer services staff. To ensure the uniform application of the law and a perception of fairness, when MTOs are also segmented to control medium taxpayers, functional staffs need to be established in MTOs for audit, collection, and taxpayer services as well. Similarly, and at the same time, functional units should be maintained for control of small taxpayers.

2.4.3. Coordination and Cooperation with Public and Private Sector Groups

There are many government agencies and institutions at various levels that play important support roles for tax administration. For example, the financial activities of importers and exporters and corresponding data in declarations that Customs documents and maintains are of vital importance for

[14] The latter is a form of "horizontal" equity. "Vertical" equity, between taxpayers with different levels of income, is beyond the scope of this discussion.

the tax administration in its audit verification program and other compliance activities. Similarly, some information maintained by the tax administration applicable to importers and exporters is important to Customs for its own assessment purposes. Often, however, there are very strict legal restrictions to the sharing of information between the two agencies, even though both are usually under the Ministry of Finance and, in some cases, may even be under the same Director.[15] Therefore, it is very important that the Heads of both agencies establish ongoing cooperation and coordination through memoranda of understanding, and legal documents that authorize and formalize information sharing agreements to the extent provided by law. In some cases, joint cooperation and coordination between the two agencies may be necessary to introduce and enact legislation to ensure that the most pertinent data to each may be shared.

Tax administration officials should also work in coordination with officials of the Ministry of Finance to identify and cultivate positive relationships with officials of parliament, or other legislative bodies, who can be "champions" to lead legislative initiatives of vital importance to the tax administration. Proposed legislation to authorize the tax administration and information technology to enable the administration to routinely receive and match third-party financial data is one example. Chapter 3 cites several other examples.

There are many other public institutions at local, regional, and national levels in most countries that record information about natural persons, partnerships, and corporations regarding registration, public tenders, purchases, rentals, licenses, etc. – information that is very important for all aspects of the tax administration's compliance activities. Therefore, it is of great interest and importance for the tax administration to seek and establish positive relationships with these institutions to be able to access information on an ongoing basis.

The judicial institutions that routinely handle tax administration cases – appeals, prosecution of fraud cases, civil trials regarding enforcement issues, etc. – require ongoing, special attention by the tax administration to cultivate and establish positive relationships. Unfortunately, in many countries, it is not unusual for appeal cases of proposed tax assessments – often related to large taxpayers, with a great deal of money at stake – to linger for years without receiving attention from the judges. In many, if not most developing countries, the judges may be unfamiliar with the tax laws and reluctant to hear the cases. Even when the courts hear appeals, fraud, and other tax cases that have been well-developed and researched by the tax administration's technical and legal experts, negative outcomes are not unusual. Therefore, it is incumbent on the tax administration to be proactive in establishing positive relationships and coordination with relevant judicial actors. For example, the tax administration's tax attorneys and senior tax auditors can offer and provide classroom training in tax law for judges, and can also be available to judges upon request to discuss technical questions and issues.

The tax administration must also offer periodic forums for Chambers of Commerce, industry groups, business and professional associations, and other groups to share their views and concerns about the country's tax laws, the tax administration's practices, and any other issues that adversely impact on

[15] Chapter 4 discusses the separation of Customs from the administration of domestic taxes.

their respective members. Of these groups, the associations of chartered accountants or similar groups whose tax practitioners prepare and file tax returns and legally represent taxpayers on audit, collection, objections, appeals, and tax-fraud cases deserve special attention from the tax administration. Because of the volume of taxpayers they represent collectively – particularly large and medium taxpayers – they could even be considered "informal partners" in the administration of the tax laws. They, too, must have opportunities to express their views to the tax administration about problems and issues, and the tax administration is obligated to review these issues and take corrective action promptly, wherever necessary. Leading international practices require that tax administrations establish a regular, periodic forum to meet with tax practitioners.

Since they almost always represent multiple taxpayers and/or prepare multiple personal and business tax declarations for taxpayers, individual professional tax practitioners (accountants, legal professionals, etc.) are very important stakeholders in promoting and maintaining voluntary compliance among the taxpayers they represent. While their first responsibility is to their clients, the great majority of professional tax practitioners abide by ethical standards and considerations, including a responsibility to their respective governments to abide by the law, regulations, and decisions that govern their field of tax practice.

Unfortunately, particularly in developing countries, professional tax practitioners often do not receive effective and efficient treatment and services from the tax administration.

Box 2.2. Taxpayer services in Curacao prior to 2008

The inadequate service provided by the tax administration to professional tax practitioners and taxpayers in Curacao in 2008 is representative of the level of service that professional tax practitioners routinely encounter in many developing countries. In Curacao, right before and on any "peak days" (due dates of monthly/quarterly tax declarations and tax payments), very long queues at the taxpayer service premises of the tax administration resulted in excessive waiting time, high costs, and dissatisfaction among taxpayers. To the chagrin of taxpayers and tax practitioners alike, professional tax practitioners were required to wait in line alongside individual taxpayers. Individual taxpayers experienced much longer waiting times than necessary, as the tax practitioners delivered multiple clients' documents and payments for acceptance and validation.

Similar situations have been observed in several other LAC countries and in many other countries around the world in recent years. Some countries have simply established a separate delivery point for tax practitioners, away from the taxpayer service area.

Box 2.3. Taxpayer Representatives' Center in Puerto Rico

In order to provide the necessary level of service to professional tax practitioners, Puerto Rico's Sub Secretary of Internal Revenue established the Taxpayer Representatives' Center in San Juan in 2000 and staffed it with five taxpayer service technicians. The Center was separate from the regular taxpayer service premises. The center's telephone and fax numbers were not generally publicized, but were made available to tax practitioners. Tax technicians at the center handled and resolved more difficult and complex cases, particularly the more complex tax account analysis cases of large employers, corporations, and multiple clients of tax practitioners. Once cases were resolved, resolutions were communicated to the representatives by fax, telephone, correspondence, and occasionally, with personal visits by practitioners to the center. The Center had grown to 22 technicians by 2004. Congestion, aggravation, and cost for all parties at the regular taxpayer service premises were reduced considerably and Sub Secretary of Internal Revenue and practitioners were equally pleased with the outcomes of the center's special services.[16]

Finally, colleges and universities comprise another group of institutions that are worthy of special attention by the tax administration.

Box 2.4. Partnering with academia in El Salvador

Academia can be a very valuable partner for tax administration. A partnership between El Salvador's Dirección General de Ingresos Internos (DGII) and academia is a good example. In 2003, the DGII was experiencing severe budget shortfalls that had made it difficult to fund the staff necessary to accomplish many of its program objectives. The taxpayer service program was hit particularly hard. On "peak days" – due-dates of tax declarations and tax payments – taxpayer queues in taxpayer service facilities throughout the country were extremely long. On-site, line managers had to continually divert audit and other taxpayer compliance staff from their regular work to provide service to taxpayers. Consequently, the audit and other taxpayer compliance programs, already persistently understaffed, suffered further adverse effects, year after year.

Starting in 2003, the DGII began to draw upon the universities to supplement its meager staffing. To graduate, university students in El Salvador were required by university authorities to complete one year of public service. The DGII, in collaboration with academia, recruited 300 students in 2003 and 500 in 2005. The students were assigned to support the various program functions, particularly the Taxpayer Service program. Students were also assigned as aides to the technical staff of the Audit and Taxpayer Non-Filer programs.

By turning mostly to seniors majoring in economics, accounting, law, and related fields, the DGII not only recruited those students more likely to be familiar with the DGII's work, but also students who could become good prospects for permanent employment. The students were trained for three days on tax law related to the functional program tasks they would perform and on some task techniques, such as verification of records regarding taxpayers' compliance. Whether three days of training were sufficient was a subject of periodic debate. Nevertheless, the DGII was fortunate to have the students at its disposal. The cost to the DGII (government) was only $8 per day for each student. The cost/benefit ratios in programs of taxpayer service, audit, and non-filers were reportedly analyzed frequently and consistently proved very favorable. Plans were made to recruit 700+ students in 2006 and beyond.

Budget shortfalls are a way of life, particularly in developing countries. Collaboration of tax administrators with academia to have students spend a year in public service as a prerequisite for graduation is a "win-win" strategy for the universities, the students, the tax administrations, and taxpayers. The students benefit from temporary employment and practical work experience; the tax

[16] Jacobs (2009), p. 1.

administrations get much needed staffing support; the countries receive public service from thousands of students; and taxpayers enjoy improved (taxpayer) service.[17]

2.5. Integrated Tax Information System (ITIS)

Chapter 12 addresses information technology in depth. This sub-section does not attempt to address technical aspects of information technology; rather, it covers the conceptual framework of what users need for the design and implementation of a computerized ITIS. The intent here is to describe, for tax administrations in developing countries, the functional components, data systems, and communications networks that need to be brought together to comprise an ITIS to support efforts to modernize operations – again, from the standpoint of the users.

The overall objective of information technology modernization efforts is to develop an ITIS that brings together most information that tax administrations need for successful operations in a way that facilitates ease of access and use by the ultimate users. The design of the overall system must address effective applications for various types of taxes generally levied in developing countries, including VAT or sales tax, individual income tax, corporate income/profits tax, excise taxes, property taxes, and property transfer taxes.

Notwithstanding the daunting challenges in the operating environment described earlier, tax administrations in developing countries still have to jump-start their modernization efforts through technological improvements to help meet their governments' critical, ongoing, and ever-increasing needs for sufficient tax revenues to fund their operations. In the early stages of design and implementation of modern information technology solutions, they must replace systems that are still largely manual.[18] At best, tax administrations often count only on a smattering of computer equipment at a few office locations, much of it old equipment supported by outdated technology. Yet, the design and implementation of modern, computerized, and integrated information systems and networks are indispensable to meet all major challenges.

Five constant challenges, which face all tax administrations and dominate their operations, were cited earlier. The successful design and implementation of a computerized ITIS is essential for overcoming these five challenges, as briefly illustrated in the following examples:

Broaden the Tax Base

A computerized ITIS is necessary to implement a taxpayer numbering system that controls the issuance of a unique TIN for every taxpayer. The TIN is a necessary initial step to establish a "master file of all taxpayers" and define any meaningful tax base, under the existing tax laws of the country. Computerized systems also are indispensable in preparing for the conversion and implementation of a new or revised TIN system (e.g., in storing and tracking pre-registration lists of potential taxpayers

[17] Ibid., p. 1.
[18] The tax administration may need to improve processes through analysis and re-engineering, rather than simply automate poor manual procedures.

derived from various sources). Tax administrations should assign a single TIN to each taxpayer for all taxes, rather than different numbers to the same taxpayer for different types of taxes.

Modern compliance surveys that aim to broaden the tax base also require the use of a computerized database to gather and track survey information, as well as to import data stored electronically in other systems, where possible, in order to facilitate cross-checking of information and identify potential new taxpayers.

Strengthen the Organization and Its Management

A computerized ITIS supports efforts to strengthen the tax administration's organization and management. The design and implementation of administrative systems that provide management with critical data for planning and monitoring operations and progress on objectives, performance measurement, budgeting, accounting, personnel management, and asset management is very important for achieving this objective.

Control Tax Evasion

An ITIS that accurately collects and links information on all payments and liabilities within the tax system, with customs duties and payments, with land ownership and taxation, and with motor vehicle registration is an incredible force against tax evasion. Experiences in countries that have the ability to make queries and compare such data continually reveal many incidences of potential tax evasion. For example, the audit of taxpayers, who pay relatively little income tax, but are identified in related systems as owners of several profitable companies and one or more expensive automobiles, often reveal substantial under-reporting of income and lead to prosecution (and/or substantial penalties) for tax evasion.

Modern audit selection procedures based on risk analysis require effective, integrated computer systems to apply audit selection criteria for a specific tax or across taxes. However, cross-checking of information is only effective given accurate and complete storage of information on most or all taxes for each taxpayer, which is impossible to accomplish with manual systems. When taxpayers become aware that the tax authority has the ability to cross-check information on a routine basis using a computerized system, there is a positive impact on controlling tax evasion.

Improve Collection of Tax Arrears

The current situation in many countries requires the collection of tax arrears with very unreliable paper ledger cards and systems. Unless there is an accurate picture of open taxpayers' liabilities, it is very difficult to confront taxpayers to collect taxes that may or may not be in arrears. An ITIS can easily identify amounts in arrears and compute and apply appropriate penalties and interest when requested by authorized officials. The automatic production and issuance of notices to taxpayers on a periodic basis with accurate collection information greatly improves collections of amounts due. For those notices that fail to elicit collection in full, the tax authority can easily identify arrears accounts and assign field enforcement personnel.

Facilitate Voluntary Compliance

An effective ITIS is one of the most powerful tools to facilitate voluntary compliance, because it enables the tax administration to establish and maintain:

- An up-to-date taxpayer registration system;
- An accurate taxpayer accounting system for taxpayers' accounts;
- Effective audit/verification programs; and
- Timely monitoring of filing and payments for quick follow-up on omissions, etc.

In short, a strong ITIS allows the tax administration to establish a reputation for efficiency, effectiveness, accuracy, and reliability – qualities that encourage taxpayers to comply voluntarily.

2.5.1. Taxpayer Current Account and Taxpayer Identification Number

The taxpayer current account (sometimes referred to as the taxpayer ledger) is one of the pillars of modern and successful tax administrations, and it is a vital part of an ITIS. A taxpayer current account is really an accounting system for each taxpayer by which the tax administration tracks liabilities owed and payments made by each taxpayer for all types of taxes. All debit and credit transactions must be recorded in a timely manner—no matter where the activity takes place—to track all financial activity (liabilities and payments, respectively) on a taxpayer's account. Automated current account systems are able to track and record tax declarations filed by the taxpayer, whether through the banking system, electronically (e.g., e-filing), or at a tax administration office anywhere in the country. Tax payments made at all locations must also be recorded to the taxpayer's current account as quickly as possible. Prompt and complete posting of these data provide an audit trail with debit and credit transactions to track all financial activity (liabilities and payments, respectively) on each taxpayer's account.

A given taxpayer's current account is first established at the time the taxpayer registers with the tax administration and is given a unique TIN, another vital part of an ITIS. The TIN for each taxpayer is the electronic address where all transactions are recorded. At the time of registration, the particular taxpayer's tax obligations are entered in his own current account in the tax administration's master file database of taxpayers, using the unique TIN as the main identifier. The particular current account for that taxpayer lists the types of tax declarations for which the taxpayer is liable (VAT, income tax, excises, etc.) and the due dates of each tax return and payment. Thereafter, the automated system monitors the taxpayer's current account for compliance or non-compliance with tax obligations. If the taxpayer does not file any of the required declarations by the due date, a non-filer case is issued soon thereafter by the automated system to the appropriate compliance unit for contact with the taxpayer (by mail, telephone, or field visit).

Similarly, if the taxpayer does file, but does not pay all or part of the tax due, then the automated system issues a tax arrears case to the appropriate division for contact with the taxpayer. The system also automatically calculates and records information to the taxpayer's current account, including: penalties and interest assessed for each tax and period; tax deficiencies assessed, after audit; each payment made for each tax and period; and, refunds made. The taxpayer's physical address for tax purposes - or that of his legal representative - must continually be updated for issuance of official notices.

In short, all tax filing and financial activity must be entered and tracked in a timely manner so that the tax administration can identify instantly the status of any given taxpayer, and determine whether any compliance action or other response is required. Ideally, each taxpayer should be given electronic access to his/her current account. This can only be accomplished with a modern, computerized ITIS.

2.6. Maturity Model for Tax Administration

This section presents a four-level model to allow interested officials to self-assess the general level of maturity of the tax administration in a given country, using "rules of thumb" to assess strengths and weaknesses. An overview of the maturity model is provided in the figure below. In addition, this and subsequent chapters provide the detail of this same four-level maturity model for each of the major aspects of the tax administration to assist officials in making targeted self-assessments.

A maturity model is a tool that can be used by institutions, tax administrations in this case, to assess their current capabilities and to plan for improvement. The maturity model presented in this product is an integration of USAID's human and institutional capacity development (HICD) approach with specific application to tax administration. The authors of the various chapters have used the maturity model to depict the general state of tax administration in LAC, although LAC countries vary widely in terms of tax administration challenges and successes. This product does not place individual countries at various maturity levels.

The purpose of using a maturity model is similar to that of a benchmarking exercise, but the maturity model is more powerful. In addition to describing and providing benchmarks for leading practices, a maturity model describes the usual practices in tax administration at lower levels of maturity. With this additional information, a maturity model has several advantages over benchmarking. Tax administrations that use a maturity model rather than benchmarking to leading practice or international norms:

- See a clearer progression from their current state to leading practice;
- See the potential progression of all components, and thus understand what is needed to sustain improvement and performance, rather than focusing on isolated, unsustainable interventions; and
- Are more appreciative of the capacity that they already have and are able to leverage existing systems, processes, and tools in planning for improvement.

Simplistically, a maturity model is usually presented in tabular format, where the columns of the table describe several levels of maturity (e.g., from basic to leading) and the rows of the table describe the specific parameters along which progress can be described and/or measured. The following is an example:

Figure 2.2. A maturity model for tax administrations

	Ad Hoc	Formalized	Integrated	Strategic
Operations	Operations are informal, sporadic, and ever changing.	Operations are formalized, evidenced by regular practice or documentation.	Policies, programs, processes, and tools are consistent.	Organizational strategy and performance goals filter through all levels.
Stakeholders	Stakeholders have different levels of understanding and awareness and variable commitment.	Stakeholders have a shared understanding, but programs may not be coordinated.	Cross-functional ownership and information-sharing promote integrated programs and operations.	Stakeholders engage in behavior that directly supports desired outcomes.

The example above uses four levels and shows two (high-level) parameters. While four levels are appropriate, a useful maturity model must be comprehensive. The maturity model should cover all areas of the tax administration's delivery framework and must contain parameters for all core functions (e.g., registration, collections, audit, etc.), support functions (information technology, legal services, etc.), as well as governance and management.

A maturity model must be vertically integrated. This means that if a tax administration is at a specific level of maturity with respect to one area, it will likely be at the same level across other areas. Vertical integration ensures that the model is realistic. In tax administrations, for example, if third-party data are not available and not used in identifying non-filers, they are likely not available and not used in indirect audits, the registration database is likely not well maintained, and the collection function is likely not fully effective. The levels of the maturity model must draw on practical examples of tax administrations in leading or emerging economies to be useful.[19]

Conceptual Framework: Maturity Level 1

Key word: "Unaware"

- The tax administration lacks awareness of its taxpayer population due to ineffective, inefficient, and/or inaccurate taxpayer registration, taxpayer accounts, and compliance strategies and surveys.
- There are no provisions in the tax laws for self-assessment, so one-on-one assessments are the rule, with very limited compliance coverage, and the potential for corruption is extensive.

[19] In addition, maturity models may have additional dimensions (e.g., systems and tools vs. performance), may contain a scoring mechanism to assign scores to tax administration capacity, and may contain quantitative benchmarks for each characteristic. A complex maturity model with all such characteristics, however, deserves separate research. The maturity model presented here is accessible. Thus, to the extent that quantitative benchmarks for the tax administration are available, those are discussed in the section on key benchmarks in each chapter.

- Voluntary compliance is unknown or not a trusted concept, and the informal economy is rampant.
- Service to taxpayers is largely non-existent.
- Mutual hostility exists between the tax administration and taxpayers.
- The tax administration has neither conclusively identified large taxpayers nor brought them under control.
- Necessary written policies and procedures for staff of core and support functions do not exist, and staff act independently, inconsistently, and erratically.
- Strategic plans and annual operations plans are non-existent. Ad hoc, day-to-day operations are the norm for every department, each of which acts independently.
- Little modern technology or equipment is available, and most work and information systems are manual.
- Relationships with public and private-sector institutions are lukewarm, at best, and even border on hostility in many cases.
- There is a substantial lack of legal/regulatory institutions, modern tax policy, civil service rules and regulations for attracting and retaining qualified staff, international accounting and professional standards, and modern financial and banking standards and institutions.

Conceptual Framework: Maturity Level 2

Key word: "Awakening"

- Formal registration of taxpayers, usually with unreliable TINs, has begun, but taxpayer accounts are largely unreliable.
- Informal identification of large taxpayers has begun, but criteria for inclusion is not defined, and even those considered large taxpayers have not yet been brought under control.
- There are still no provisions in the tax law for self-assessment, but the tax administration is aware that one-on-one assessments severely limit their scope of operations and breed unlimited opportunities for corruption, and begins to seek legal changes to advance self-assessment and the concept of voluntary compliance.
- Taxpayer service programs have been established but are disorganized and severely understaffed, with erratic levels of competence among the existing staff.
- Compliance strategies and surveys, even if ill-conceived and without a focus on high-risk segments and individuals, are launched irregularly to identify non-filers. They generally identify an abundance of very small taxpayers with very small tax liabilities, who require an inordinate share of the tax administration’s scarce resources to control.
- Annual operations plans of the departments are loosely drafted independently by the various core functions, without coordination among them, but long-term strategic plans for the overall tax administration still do not exist, and there is no concept of "direction" for the tax administration.
- Little modern technology or equipment is available, and that which does exist is supported by outdated technology, so most of the work is still done manually.

- Institutionalization of procedures varies across departments, as do skills of the staff, and procedural manuals are minimal, developed on an ad hoc basis, and sparsely used.
- "Hot-and-cold" efforts by top-level officials to establish good relationships with some public and private sector groups – particularly with Customs and public accountants – are initiated but lack coherence and stability.
- There is still a substantial lack of legal/regulatory institutions, modern tax policy, civil service rules and regulations for attracting and retaining qualified staff, international accounting and professional standards, and modern financial and banking standards and institutions.

Conceptual Framework: Maturity Level 3

Key word: "Poised"

- There are provisions in the tax law for self-assessment, with limited opportunities for corruption, and an estimated 70-75 percent of taxpayers comply voluntarily.
- Formal registration of taxpayers, with a "best-practice" system of TINs, has largely been completed, and taxpayer accounts are usually accurate.
- Formal definition, identification, and fairly good control of large taxpayers have been accomplished. However, the criteria for selecting and deselecting taxpayers that fall under LTO control are nebulous, and so the number of taxpayers under control is never certain.
- Compliance strategies and surveys that begin to focus on high risk taxpayer segments and individuals are launched in a timely manner and in accordance with annual work plans. However, the tax administration only has a partial grasp of the size of the informal economy and non-filer population.
- Long-term, strategic plans are drafted and used to develop and coordinate annual operations plans of the various core functions. However, while the tax administration may achieve many of the objectives in its strategic and annual work plans, there is greater focus on short- and medium-term objectives, with a lack of focus on long-term direction.
- Procedural and policy manuals have been developed for each of the tax administrations' functions and are closely followed by skilled staff, but the manuals suffer from a lack of timely updates.
- Relationships with public and private sector groups are usually positive – memoranda of understanding with Customs for exchange of data are generally successful, as are forums for public accounting and Chamber of Commerce groups, etc. However, there are exceptions, such as less than cordial relationships with the judiciary or other groups.
- Modern technology and equipment are available, but there is often a shortage in specific departments, and funds for purchase are often somewhat limited.
- There is an obvious presence of legal/regulatory institutions, modern tax policy, civil service rules and regulations for attracting and retaining qualified staff, international accounting and professional standards, and modern financial and banking standards and institutions. The tax administration has started to embrace many technological advances used in the private sector,

such as electronic commerce, interactive telephone systems, and the capture of data by the scanning or imaging of paper documents.

Conceptual Framework: Maturity Level 4

Key word: "Solid"

- Provisions in the tax law for self-assessment have existed for several years, and at least 85 percent of taxpayers comply voluntarily. Incidences of corruption within the tax administration are extremely rare.
- Registration of taxpayers has been tested over several years and proven to be very accurate, and taxpayer accounts are rarely inaccurate.
- Multiple criteria have been established for selecting and deselecting large taxpayers, who are continually identified for control by the LTO and have a high level of compliance, as confirmed by various tests and other verification measures. The LTO itself has experienced staff.
- Vigorous enforcement programs and targeted surveys, which consistently identify risk by segments, are launched periodically to effectively bring into compliance and under control small pockets of taxpayers who are not in compliance.
- Strategic plans, with a clear focus on "the big picture" and the long-term objectives of the organization, strongly guide the development and implementation of annual work plans, and objectives of the strategic and annual work plans are almost always met.
- Clear, concise procedural and policy manuals are available electronically for each of the tax administrations' functions, are closely followed by skilled staff, and are promptly updated electronically.
- Relationships with public and private sector groups are very positive – memoranda of understanding with Customs for exchange of data are very successful, as are forums for public accounting and Chamber of Commerce groups, the judiciary, etc.
- The tax administration has reliable information systems supported by the latest technology and has already embraced and implemented many technological advances used in the private sector, such as electronic commerce, interactive telephone systems, and the capture of data by the scanning or imaging of paper documents.
- There is a strong presence of legal/regulatory institutions, modern tax policy, civil service rules, regulations and competitive salaries for attracting and retaining qualified staff, international accounting and professional standards, and modern financial and banking standards and institutions. The tax administration has embraced technological advances used in the private sector, such as electronic commerce, interactive telephone systems, and the capture of data by the scanning or imaging of paper documents.

Chapter 3. Legal Framework

Arturo Jacobs

This section outlines the legal framework that enables the tax administration to operate effectively and efficiently, while safeguarding the rights of taxpayers at the same time. The types of taxes, tax rates, schedules, and similar features of tax law are not within the scope of this document. Instead, the focus is on the type of legal framework and selected administrative provisions of the tax laws.

3.1. Leading Practice

Although not a good practice, it is fairly common among many developing countries around the world to have their legal framework for taxation dispersed across a series of tax laws, each with its own set of provisions for tax administration (e.g., an income tax law, a value added tax (VAT) law, an excise tax law, etc.). These tax laws are always supplemented and supported by an assortment of regulations, executive instructions, and ad hoc decisions issued from a variety of sources. Both the tax administration and taxpayers find it difficult to follow such an assortment of multiple laws, regulations, instructions, and decisions, particularly since administrative provisions are usually inconsistent and always dispersed among the various laws and related documents.

Rather than a series of tax laws for each tax type, the international best practice is for government to enact a tax code, which incorporates all legal aspects of taxation into one comprehensive, coherent piece of legislation, and determines the legal principles of taxation. The tax code should include all national taxes, i.e., tax on the income of physical persons, tax on the income of legal persons, VAT, excise taxes, social insurance contributions, land and property taxes, taxes on the processors of minerals, and others.

Box 3.1. Unified tax code in the United States

The 11 subtitles of the U.S. Internal Revenue Code include provisions for all major taxes imposed by the U.S. Federal Government: income taxes, estate and gift taxes, employment taxes, and excise taxes. The Code also includes a single subtitle (section) for the administration of all taxes, with provisions for registration, filing and payment requirements, assessment and collections, penalties and interest, and other. The Internal Revenue Code, however, does not include all tax related provisions. The U.S. bankruptcy law – Title 11 of the U.S. Code – describes the filing of tax returns by the debtor.

Several influential international institutions have drafted model tax codes to encourage and guide officials of countries that want to improve their tax legislation. For example, several years ago the IMF's Legal Department developed a sample tax code for a hypothetical country (the Transition Republic of Taxastan) for use as reference material to provide assistance to countries in the preparation of legislative tax acts and the application of laws.[20] Also, a project sponsored by Harvard University's International Tax Program developed a tax code[21] several years ago to help developing countries with a legislative framework as they formulate modern tax policies and tax laws. Even though both models are several years old, they still offer excellent guidance for the development of a comprehensive tax code.

This sub-section draws on both hypothetical models cited above and from international best practices to describe a few very important features for the tax administration and for taxpayers that a modern tax code should include. Among those features are the principles of the tax code; basic provisions, including creation and organization of the tax administration; responsibilities and powers of the tax administration; rights of taxpayers; international taxation features; and some of the compliance and enforcement provisions most needed by the tax administration to administer the tax laws fairly, efficiently, and effectively.

3.1.1. Principles

Among the most important principles to be included in a tax code is the principle of self-assessment, as stated and described in Chapter 2. The code should also emphasize cooperation between taxpayers and the tax administration and should promote voluntary compliance rather than the enforcement of compliance by the tax administration.[22] Other important principles which need to be addressed in a tax code are:

- All amendments should be made to the tax code, rather than by enacting supplemental or separate pieces of legislation;
- In an ongoing effort to make the tax law simple and clear, regulations and rulings, which interpret the tax laws, should be published regularly by the tax administration and should be made easily available to individual taxpayers;
- Transparency and predictability of the tax laws and operations of the tax administration should be the norm;
- Some provisions should be included in the code in general terms, or certain changes should be permitted by executive order, to allow flexibility and avoid rigid, possibly unworkable requirements which could not be changed without costly and time-consuming amendments to the law, such as presumptive tax regimes for small taxpayers, as described in Chapter 2;
- Clear statements to the effect that, when there is conflict with provisions of laws at other levels of government, the tax code should prevail;
- On the other hand, tax treaty provisions of the country supersede tax code provisions, should there be a conflict; and
- There is deference to some provisions of common law, e.g., exempting tools of a trade or profession from seizure and sale for unpaid taxes.

[20] IMF Legal Department (2000), *Tax Code of the Republic of Taxastan. A Hypothetical Tax Law*, http://www.imf.org/external/np/leg/tlaw/2000/eng/stan.htm.
[21] Hussey, Ward and Donald Lubick (1996), *Basic World Tax Code and Commentary*, Harvard University's International Tax Program.
[22] The need for focus on facilitating voluntary compliance is discussed in Chapter 2.

3.1.2. Basic Provisions

Of course, in addition to principles, tax codes must clearly cite and describe basic provisions of taxation. These provide the basic legal authority to the tax administration to collect taxes. Among the basic principles are:

- The requirement for taxpayers to acquire a tax identification number from the tax administration and register with the tax administration;
- The general content and requirements of tax returns, and filing and payment due dates;
- The place for filing tax returns to be determined in regulations and publicized by the tax administration in order to allow flexibility for changes in organization and technological changes, such as e-filing;
- The requirement for taxpayers to maintain adequate books and records;
- The responsibility of the tax administration to conduct audits and other verification measures;
- The requirement for third parties to collect tax at the source, such as the withholding of income tax by employers from employees' salaries and wages;
- Provisions for computation, assessment, and collection of tax, interest, penalties, and other charges for other than full compliance with the tax laws; and
- Definitions of violations punishable by fines or imprisonment, such as tax evasion and tax fraud, and the right of the tax administration to publicize convictions of such offenses.

To emphasize the importance of voluntary compliance and mutual cooperation between the tax administration and taxpayers, the tax code must outline the basic rights of taxpayers, including:

- The right to examine records of audits performed by the tax administration;
- The right to present explanations to tax authorities regarding his computation and payment of taxes with respect to the records of audits performed;
- The right to be represented by a qualified legal representative of their choice in matters before the tax administration;
- The right to reconsideration of decisions of the tax administration (objections);
- The right to formally appeal decisions of the tax administration in a manner stipulated in the tax code;
- The right to apply for and receive advance rulings about the position of the tax administration with regard to a proposed business transaction;
- The right to receive credits, refunds, and interest for overpayment of taxes; and
- For those taxpayers who have filed tax returns, protection with statutes of limitations for assessment and collection of taxes.

3.1.3. Provisions to Create and Organize the Tax Administration

The tax code must also provide the necessary organization and machinery to enforce and collect all taxes, including provisions to:

- Authorize creation of the tax administration, headed by a tax administrator/director general/commissioner (the "Head");
- Organize the tax administration into headquarters, regional (if necessary), and local offices along functional lines of core taxes in an efficient way that avoids duplication, overlap, and underutilization of staff (see also the discussion of semi-autonomous revenue authorities in the next sub-section);[23]
- Allow flexibility for future changes of the organization structure deemed necessary to the Head of the tax administration, with concurrence by the Minister of Finance;
- Establish procedures to select employees based solely on merit and their ability to do the work and to make promotions based on competitive procedures;
- Authorize the Head of the tax administration to determine whether, when, and how much tax is due, as provided for in the tax code and regulations, and the authority to enforce collections, perform audits, and otherwise perform the necessary administrative functions;
- With certain safeguards, authorize the Head of the tax administration to delegate his/her legal authorities to designated subordinates; and
- Protect tax officials acting within the scope of their official duties from personal liability to taxpayers.

The main responsibilities of the tax administration outlined in Chapter 2 – to facilitate and encourage voluntary compliance by taxpayers with the country's tax laws; administer the tax laws fairly and impartially; minimize the cost and burden on taxpayers to comply with their tax obligations; monitor compliance; enforce the country's tax laws in cases of non-compliance; and use its resources efficiently and effectively – should also be clearly stated in the tax code. Other, specific responsibilities of the tax administration which should be included in the code are:

- Organize and carry out taxpayer service and education programs to provide information to taxpayers which they need to comply with the tax laws;
- Design and implement effective presumptive schemes for small taxpayers and variable tax-filing periods for medium taxpayers, to be published in regulations (to avoid stipulating in the code systems which may prove unworkable and would require legislative action to change); and
- Safeguard and keep confidential all information provided by the taxpayer to the tax administration.

3.1.4. Critical Compliance and Enforcement Provisions

The tax code must include certain very important provisions that encourage voluntary compliance and grant a variety of compliance and enforcement tools to the tax administration. One of the most important is the provision which requires banks and other financial institutions, contractors, and

[23] Hussey et al. (1996), p. 185, for example, contains a relatively general provision, stating that "The Tax Service shall be mainly organized along functional lines. Functions shall be divided among the departments in such a way that every function is allocated, but also in such a way that the duplication of tasks is avoided." This provision defines only the broad principle and allows flexibility in the organization and avoids costly legislative amendments.

employers to routinely and regularly submit to the tax administration for its matching and compliance programs third-party financial information documents, such as the payment of interest, dividends, wages, and other payments. In fact, under the requirements of the tax laws of many countries, an extremely wide variety of transactions must be reported to the revenue body, generally in electronic format, including agricultural payments, brokers' transactions, capital gains distributions, non-employee compensation and fees, commercial fish purchases for cash, interest, dividends, real estate transactions, rents, sales of securities, wages, large cash purchases, etc. Such legal provisions enable the tax administration to receive and match third-party financial data of taxpayers to its master file and mount compliance programs for omissions and discrepancies detected from the matches. This use of third-party financial data is one of the most effective tools that a tax administration has for identifying non-filers and verifying the accuracy of the income and expenses reported by taxpayers.

The tax code should also legally require banks and financial institutions, as well as other government institutions such as Customs, to furnish specific taxpayers' financial information in their custody, when such information is requested by tax administration officials engaged in official activities, such as audits and enforcement. This provision not only is important for enforcement and compliance programs, but also strengthens the legitimacy of international exchange of information agreements. For example, in the context of negotiating a Tax Treaty or Tax Information Exchange Agreement, other countries are often interested in financial information on large, multinational corporations and very complex transactions, such as transfer pricing, between or among subsidiaries based in various countries.

The tax code needs to grant several other powers to the tax administration, if it is to perform its duties and responsibilities effectively. Examples of such powers are (not all-inclusive):

- Administratively compel testimony or the production of documents, i.e., enable the subpoena of documents or persons in order to conduct comprehensive audits and discover assets subject to enforcement for non-payment, etc.;
- File a tax lien for unpaid taxes, a legal claim which attaches after assessment, notice, and demand to all personal and real property of the taxpayer;
- Garnish funds due the taxpayer from third parties (accounts receivable) and funds of the taxpayer on deposit in banks or other financial institutions;
- Seize and sell many types of personal and real property, after notice and demand;
- Subject individuals or corporations to investigations for tax fraud/evasion, if warranted, and recommend criminal prosecution and severe penalties, including incarceration;
- Administratively determine and report certain tax arrears accounts as uncollectible, i.e., suspend collection activities in those cases where the likelihood of collection is nil or very low or the taxpayer cannot be located; and
- In exceptional circumstances, where collection of the tax obligation is deemed to be in jeopardy, as determined by the tax administrator, make a jeopardy assessment and enforce collection without regard to the rights of taxpayers to object and appeal proposed assessments, subject to a claim for refund and, if denied, subject to the right to file judicial proceedings for recovery.

3.2. Common Trends

While a tax code is generally viewed as superior to separate tax laws for a country's various tax types of taxes, some countries have chosen to pursue other alternatives for improvement, such as a tax procedures code, because of political or other circumstances. Also, in lieu of a tax code with specific provisions, some countries have experimented with "framework laws" for their tax legislation, which establish "intent" and defer procedural details for the subsequent regulations phase, thereby giving much more discretion to the drafters of secondary legislation (regulations). On the limiting side of trends, more and more countries are amending their tax laws to remove discretionary powers of the Minister of Finance or other government officials to grant certain tax "favors". The following is a discussion of these and similar trends.

3.2.1. Tax Procedures Code and Other Trends

While the Ministry of Finance and/or the tax administration may acknowledge the benefits of and wish to enact a unified tax code to replace separate pieces of legislation for each type of tax, it may not be feasible to do so, politically or otherwise. In such cases, the international best practice is for the Government to extract the administrative provisions from each of the tax laws and consolidate them in a single, uniform tax procedures code, separate from the substantive pieces of tax legislation. A uniform tax procedures code enhances transparency, clarity, and consistency in the application of the country's tax laws. Recently, countries such as Indonesia, New Zealand, Republika Srpska, Montenegro, and Serbia have implemented Tax Procedures Codes (Acts) successfully; and other countries are currently developing them, including South Africa, Namibia, Ghana, Malawi, Tanzania, Botswana, and Turkey.[24]

Another trend is for countries to draft legal, administrative provisions of tax legislation in general terms that grant "flexibility." For example, some countries, such as the United Kingdom[25], have relied on "framework laws". Framework laws are statutes which are drafted in general terms and merely lay down a framework, mostly in the form of overall principles, objectives and guidelines. With framework tax laws, the details are left to regulations to be designed, published, and made available to taxpayers by the tax administration. Examples of such flexibility are the general provisions described in Chapter 2 for presumptive assessment regimes for small taxpayers or, as may be required for e-filing and other technological advances, for the provisions for where tax returns should be filed.

One change in tax legislation gaining international momentum is to remove the discretionary power of the Minister of Finance or any other government official to grant exemptions or to negotiate "tax agreements." The practice has been generally viewed by taxpayers as one that opens opportunities for corruption and cronyism and one that treats taxpayers grossly unequally. Also, in some cases, countries

[24] Hook (2011), p. 1.

[25] The United Kingdom, with a decision of the House of the Lords in the case of Respondents vs. HM Commissioners of Inland Revenue ex parte Wilkinson [2006] STC 270, is likely moving away from framework type laws. The decision focused on the validity of concessions, but in general also discussed the power of HM Revenue and Customs to choose how to apply the law. Since the United Kingdom has been and is a trend-setting model in tax administration around the world, this type of "flexibility" trend in other parts of the world will likely vanish.

are removing the power of the Head of the tax administration, Permanent Secretary, Minister, or any other government official to remit taxes and interest. The majority of countries now have a constitutional or statutory provision that allows exemptions only by a law of general application.[26]

3.2.2. Legal Provisions to Meet Technological Changes

To succeed in the modern world, tax administrations must have well-designed Integrated Tax Information Systems (see Chapter 12). Legal provisions, therefore, must be included in the tax legislation to enable the tax administration to operate effectively alongside economic, business, and social environments fully engaged and immersed in modern technology.

Tax authorities all around the world have been quickly moving to redesign their basic business processes and to rapidly implement electronic receipt, processing, and delivery methods. They have been facilitating increased use of the internet for transmission of information and access to tax forms by taxpayers. More and more, all large taxpayers are being required to file their tax returns and accompanying documents electronically. Electronic filing/electronic signatures improve the ease of compliance for taxpayers.[27] At the same time, the tax administration enjoys decreased costs from higher accuracy and greater compliance through electronic processing of tax returns.

Another very significant trend among tax administrators around the world is to legally authorize commercial banks to receive and process tax returns and tax payments. Tax administrators have recognized that cashier functions in their own operations represent a very outmoded method of doing business which lends itself to corruption and risk of revenue loss. Given provisions in the tax code or other tax legislation that enable alternative methods of cashiering, cashier functions in many countries have been outsourced under contracts negotiated by the Ministry of Finance or by the tax administration with commercial banks. Under these contracts, commercial banks receive and process tax payments, send key taxpayer-entity and payment information to the tax administration for reconciliation, and transfer funds electronically to the Ministry or the Central Bank. Many negotiated contracts also require the banks to receive and process tax returns together with payments; provide taxpayers with receipts; forward taxpayer-entity and payment information electronically daily to the tax administration; and bundle and forward tax returns and related paper documents once or twice per week. Free of charge, commercial banks have been provided software developed by the tax administration to perform all these tasks.

3.2.3. International Taxation

As is readily obvious from some of the basic international provisions of tax codes, the variance in tax rates across different countries gives rise to a number of complex international tax issues that confront tax administrations all over the world, such as:

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[26] Ibid., p. 3.
[27] This, of course, depends on infrastructure levels and the actual requirements of the law. A recent tax compliance cost survey of Nepal by the International Finance Corporation indicated a common perception that the e-filing process is "tedious" (International Finance Corporation (n.d.), p. 42).

- Deciding which parts of capital should be treated as "domestic" or "foreign" in residence based taxation;
- Deciding what is "foreign" and what is "domestic" income (source rules);
- Matching of expenses and income to whichever expenses relate;
- Deciding which foreign taxes are paid against which income (cross-crediting); and
- Defining related-party transactions and arms-length transactions, including "transfer pricing".

Some basic legislative provisions to ease the tax administration in handling complex international tax issues include:[28]

- A clear definition of the object of taxation, including what constitutes residency, what constitutes a permanent establishment and what income is attributed to it and is subject to tax;
- Providing for credit for taxes paid to other jurisdictions wherever income from outside of the own jurisdiction is taxed, but setting limits on such credits to avoid transferring revenue to these other jurisdictions;
- Allowing for the withholding of tax on payments to nonresidents;
- Providing for rules that prevent the recognition of income or loss from the reorganization of entities;
- Providing for rules that do not allow deferral of taxation (e.g., taxing residents on income from abroad only when this income is remitted to the own jurisdiction); and
- Providing for anti-avoidance related to tax havens, including treating income from a tax haven as taxable, imposing restrictions on deductibility of expenses, imposing taxes on unrealized capital gains when a taxable person leaves the own jurisdiction, and as discussed below, adopting transfer pricing rules.

One of the most difficult international tax issues relates to transfer pricing. Transfer pricing is a way to allocate the profits of the taxpayer by manipulating the prices charged on intra-group (within related legal entities) cross-border transactions. This is done in such a way as to maximize taxable profits in low tax jurisdictions and minimize such profits in high tax countries. The law should include provisions in line with international practices to curb this type of tax avoidance, prescribing methodologies, documentation requirements, and penalties.[29]

Of course, without access to financial information in other countries of cross-border corporations which are residents, tax administrations are impotent. The increasingly important objectives of bringing large, multinational taxpayers under control and their complex, cross-border financial transactions with related entities under closer scrutiny have given rise to the urgent need for provisions in tax legislation for tax treaties and international exchange of information. The tax administration has the responsibility

[28] In addition, many countries may impose additional levies on nonresidents or on specific transactions under the argument that these are non-transparent.

[29] Comprehensive transfer pricing guidelines are published, for example, by the OECD. See *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2001*, OECD Publishing, 2001.

to participate with Ministry and/or foreign affairs officials in negotiations of tax treaties and agreements for exchange of information.[30]

Box 3.2. Addressing international tax evasion in Canada

In 2005, CRA reported that over 16,000 Canadian corporate taxpayers were reporting some type of foreign transactions amounting to over $1.5 trillion in taxes to the government.[31] As a growing number of Canadian individuals, trusts, and corporations undertook transactions with entities in foreign jurisdictions, it was imperative for CRA to ensure that the correct amounts of taxes were withheld and that non-residents filed returns and paid the taxes they owed. In the same year, CRA budgeted for an additional $30 million to respond to the growing risk of international tax avoidance and implemented a new Aggressive International Tax Planning initiative. The initiative placed emphasis on increasing audit coverage and research studies on emerging international tax schemes, developing new risk assessment models, and recommending necessary legislative or treaty changes. In addition, in 2004 Canada enacted changes to its Income tax act to allow the government to deny a tax benefit under a tax treaty for abusive tax avoidance and, in 2006 CRA restructured its Compliance Programs Branch. According to a 2012 testimony before Parliament, these reforms had a total fiscal impact of over $2.5 billion in just four years.[32]

Canada's Economic Action Plan 2013 further enhances the capacity of CRA to combat international tax evasion and aggressive avoidance.[33] The Plan:

- Includes a new Stop International Tax Evasion Program that allows the CRA to pay individuals who supply knowledge of major international tax non-compliance;
- Requires financial institutions and others who currently report information on international electronic funds transfers greater than $10,000 to the Financial Transactions and Reports Analysis Centre of Canada to also report those transactions to the CRA;
- Streamlines the judicial process that provides the CRA authorization to obtain information from third parties such as banks; and
- Introduces additional requirements for Canadian taxpayers with foreign income or properties to report more detailed information, and extends the amount of time the CRA has to reassess those who have not properly reported this income.

3.2.4. Semi-Autonomous Revenue Authority (SARA)

As noted, tax administrations in developing countries face many formidable obstacles to modernize their institutions. Among their biggest challenges are meager budgets for space, equipment, and other resources necessary for operations. In fact, it is common for tax administrations to face budget shortfalls, even against meager preliminary budgets. Furthermore, under the Civil Service regulations of most developing countries, staff remuneration is generally very low and far from competitive with the private sector. Consequently, one often observes significant levels of corruption.

In response to these circumstances, one trend in developing countries (especially in Latin America and Africa), is for tax administrations, usually through legislation, to become semi-autonomous revenue

[30] Exchange of information agreements, along with provisions to avoid double taxation and for conflict resolution, are usually part of bilateral tax treaties between countries. See *Model Tax Convention on Income and on Capital 2010*, OECD Publishing, 2012.
[31] Auditor General of Canada (2007), Chapter 7, p. 1.
[32] Downe (2012), para. 2.
[33] Canada Revenue Agency (2013), para. 5.

authorities (SARAs) in hopes that this arrangement will lead to more adequate funding, higher salaries and other benefits. With legal authority given to Tax Administration Jamaica in April of 2013 to establish a SARA, SARAs currently exist in twelve LAC countries. The SARA model has received a great deal of attention among tax and customs administration experts, Ministries of Finance and international donor organizations. SARAs are tax administrations that have greater than usual autonomy along several organizational design dimensions, including: legal character, financing, governance, personnel policy, procurement policy, and accountability relationships.[34] Many advocates see SARAs as solutions not only to inadequate budgets and salaries, but also to low rates of tax compliance, ineffective tax administration staff, and corruption.

As a SARA, in effect, the tax administration is taken out of the MOF and established as a semi-autonomous entity. While there are many variations around a similar basic theme, the principal characteristics include: personnel systems outside of the civil service purview; self-financing mechanisms (usually with a given percentage of gross collections); and boards of directors that usually include the Minister of Finance, other key Ministries, and private sector representatives. A recent IMF conference listed several common arguments in favor of establishing SARAs, including easier reform, addressing civil service rewards, reduced corruption, autonomy from political motivations, etc. However, the IMF added that, except for "autonomy from political motivation", most of the expected benefits have not been realized.

There are nearly 40 SARAs around the world clustered largely in Africa and Latin America[35], according to an IMF study in 2006. In another study conducted in 2004, Arthur Mann[36] examined arguments in favor of and against establishing SARAs, identified elements associated with the "success" or "failure" of the SARA experiment, and offered estimates of overall performance through analyses of indicators such as tax ratios and tax collection productivity measures. Among his major conclusions, he found that a clear picture of success or failure of SARAs could not be detected.

Nevertheless, the objective of this sub-section is not to advocate for or against the SARA model, but to recognize the trend and confirm that a legal framework is absolutely necessary to establish a SARA. From among the many "lessons learned" cited in Mann's study, he strongly recommended that SARAs "be established under Parliamentary Acts to give the SARA sustainable legal and political legitimacy."[37] The legal framework to establish a SARA comprises too many required provisions to cover here, but the articles cited by Mann and the World Bank offer practical guides for interested tax administration officials.

[34] World Bank (2005), p. 1.
[35] Kidd et al. (2006), p. 11.
[36] Mann (2004), p. 98.
[37] Ibid., p. 56.

3.3. Tax Administration Maturity

Four levels of maturity of the legal framework of tax administrations are presented below to help interested officials make determinations about the level of legal maturity and as rules of thumb to make self-assessments about strengths and weaknesses of their respective tax administration.

Legal Framework: Maturity Level 1

Key word: "Dispersed and Chaotic"

- The legal framework for taxation is dispersed across a series of tax-type laws, each with separate provisions for tax administration, and each administered by a separate tax department, with no coordination among them.
- There is no consistency among the administrative provisions of the separate income, corporate income, and VAT laws, each with different rates of penalties and interest for the same offenses, such as for late-filing, underpayments, etc.
- None of the tax laws establishes self-assessment or other principles of taxation. Consequently, collection by the tax administration, rather than by self-assessment, is the rule.
- No regulations, which interpret the tax laws, are ever prepared, and taxpayers are always in a state of confusion and subject to whatever interpretations are made by the tax administration.
- None of the laws officially creates its respective tax administration, and their organization structures are left to the discretion and mandates of their top tax administrators, who make frequent changes.
- None of the tax laws cites specific responsibilities of the tax administration nor rights of taxpayers.
- Segmentation and control of large taxpayers are not mandated.
- What few compliance and enforcement provisions exist in the separate laws are vague and conflict with laws at other levels of government. Enforcement is non-existent, and non-compliance is widespread.
- None of the laws provides for possible incarceration for tax fraud/evasion.
- There are no legal provisions in the separate laws for the use of banks for receipt of tax returns and payments. All payments are made at separate tax administration cashiers' offices, with very long queues the norm on payment due dates.
- Provisions for e-filing and electronic signatures do not exist in any of the tax laws.
- The Minister of Finance and/or other officials are given discretionary power in the tax laws to grant tax exemptions or negotiate tax agreements with legal and physical persons.

Legal Framework: Maturity Level 2

Key word: "Still Dispersed but Seeking Codification"

- In the second level of maturity, there are still separate laws for each type of tax, but the tax administrations may have been placed under one Director General/Commissioner (the Head), who, with Ministry backing, is exploring initiatives to prepare proposed legislation to enact a tax code or a tax procedures code.

- There is still no consistency among the administrative provisions of the separate income and corporate tax and VAT laws, which each have different rates of penalties and interest for the same offenses, such as for late-filing or underpayments, etc.
- There is now recognition at Ministry and Head levels that relying on collection by the tax administration, rather than by self-assessment, is failing to raise the levels of tax revenue required by government.
- Taxpayers and their legal representatives have pushed the tax administration to prepare a few regulations, which interpret the tax laws, but their timeliness and clarity are usually poor.
- None of the laws officially creates its respective tax administration, but the Head and Ministry officials are exploring re-organizing from type of tax to functional structures[38].
- The various tax laws have been amended to include a few rights of taxpayers, such as the right to appeal proposed assessments, but there is little clarity about mechanisms and court levels involved, and coordination with the judiciary is poor.
- There is no segmentation and control of large taxpayers mandated. However, there is general recognition by the Head and management of the need to do both.
- There are no international tax treaties or exchange of information agreements with other countries.
- What few compliance and enforcement provisions exist in the separate laws are still vague, and they conflict with laws at other levels of government. Enforcement is rare, and non-compliance is still widespread.
- None of the laws yet provide for possible incarceration for tax fraud/evasion.
- There are still no legal provisions in the separate laws for the use of banks for receipt of tax returns and payments. All payments are made at the separate tax administration cashiers' offices, with very long queues the norm on payment due dates.
- Provisions for e-filing and electronic signatures still do not exist in any of the tax laws, but there are some locally initiated projects for e-filing.
- The Minister of Finance and/or other officials continue to have discretionary power in the tax laws to grant tax exemptions or negotiate tax agreements with legal and physical persons.

Legal Framework: Maturity Level 3

Key word: "Codification"

- Either a tax code or a tax procedures code for administrative provisions applicable to all tax laws has recently been enacted.

[38] Functional organizational structures group staff according to their special skills, training, and primary function. In a functionally organized tax administration, for example, auditors will form an audit division and collectors will form a collections division, irrespective of the type(s) of taxes or taxpayers they handle. Functional and other types of organizational structures for tax administrations are discussed in Chapter 4.

- There is now a high degree of consistency in the administrative provisions of the law for violations, but what varies is interpretation and application by tax administration staff.
- The principle of self-assessment is established in the law, but some of the compliance staff still act as if collection by the tax administration is the best method for dealing with taxpayers.
- The tax administration regularly prepares and issues regulations, which interpret the tax laws; however, in too many cases each year, the timeliness and quality of the regulations are poor.
- The tax code/tax provisions code officially creates one tax administration, and generally requires a functional structure, with headquarters, regional (if necessary), and local offices. The Head, with concurrence by the Ministry of Finance, has discretion over the exact organizational structure and future changes.
- The tax code or tax procedures code cites specific responsibilities of the tax administration and rights of taxpayers. However, there are too many proven cases where taxpayers' rights have been violated by tax administration officials.
- Segmentation and control of large taxpayers are authorized by law.
- A few tax treaties and exchange of information agreements authorized by the tax code/tax procedures code have been negotiated, but a few necessary ones are still pending.
- There are some compliance and enforcement provisions in the law, with a certain degree of clarity about their position with regard to laws at other levels of government. There is some ongoing enforcement, such as garnishing taxpayers' funds on deposit in commercial banks. However, seizure and sale of property for non-payment of taxes is rarely undertaken because of conflicts with common law or other laws.
- There are still no provisions to require banks or other third parties to regularly provide information on payments to taxpayers to the tax administration for matching with its master file.
- The tax code/tax procedures code provide for fines, penalties, and/or possible incarceration for tax fraud/evasion. However, the tax administration uses these provisions mainly to raise revenue rather than to encourage voluntary compliance by setting examples of the consequences of non-compliance.
- There are now legal provisions in the tax laws that provide the Ministry and the Head with the option of using banks for receipt of tax returns and payments. However, the Ministry and Head choose not to exercise this option and continue their cashier function.
- Provisions for e-filing and electronic signatures now exist, and there is a fair degree of e-filing, including that of large taxpayers, whose e-filing is still optional in the law.
- There is now a statutory provision that allows exemptions only by a law of general application. Therefore, the Minister of Finance and/or other officials do not have discretionary power in the tax laws to grant tax exemptions or negotiate tax agreements with legal and physical persons.

Legal Framework: Maturity Level 4

Key word: "Model Tax Law"

- A comprehensive tax code is in place.

- There is almost 100 percent consistency in the provisions of the law for violations of any type of tax, and the application of these provisions by the tax administration is highly and consistently accurate.
- Self-assessment is the established principle of taxation in the law, and the degree of voluntary compliance determined by reliable compliance studies is consistently above 85 percent each year.
- Regulations which interpret the tax laws are regularly prepared and issued, including advance rulings requested by taxpayers, and their timeliness and quality are excellent.
- The tax code officially creates the tax administration with a functional structure and gives authority to the Head of the tax administration, with concurrence by the Ministry of Finance, to make future changes, as necessary. These are, in fact, made periodically, with very good results.
- All the rights of taxpayers and responsibilities of the tax administration cited above are incorporated in the tax code and are realized regularly by both parties.
- A Large Taxpayer Office (LTO) for control of large taxpayers, mandated in the tax code, is established and the tax administration and taxpayers are both satisfied with the LTO's operations.
- Required tax treaties and exchange of information agreements authorized by the tax code have all been negotiated and are updated periodically.
- Most, if not all, of the compliance and enforcement provisions critical for successful operations of the tax administration are part of the tax code and fully applied by the tax administration.
- Provisions in the tax code require banks or other third parties to regularly provide information about payments to taxpayers to the tax administration for matching with its master file, and the tax administration enjoys a very successful matching/compliance program.
- The tax code’s provisions for sanctions, including possible incarceration, for tax fraud/evasion are vigorously applied, and convictions and prison sentences are widely publicized.
- Under tax code provisions, banks handle 10-15 percent of filings of tax returns and 45-60 percent of tax payments for the tax administration, under contracts negotiated by the Ministry and the Head.
- Provisions for e-filing and electronic signatures in the tax code have helped the tax administration accomplish a 60-70 percent e-filing rate by general taxpayers, and a 100 percent rate by large taxpayers, as required by law.
- A statutory provision that allows exemptions only by a law of general application has been part of the tax code for several years.

3.4. Latin America and the Caribbean

With respect to many aspects of the overall legal framework for tax administration, several countries in Latin America – Argentina, Brazil, Chile, Colombia, and Mexico, for example – have sophisticated tax administrations. Overall, LAC countries generally are at the third level of maturity above. In a few very important features of their legal frameworks, however, almost all LAC countries are at the second level of maturity. Examples of legal features of LAC countries at the second level of maturity are:

- Almost all Latin American countries now have and are required to follow a tax code as their sole, respective legal authority for tax administration[39], but some Caribbean countries still have their legal framework for taxation dispersed across a series of tax laws, each with its own set of provisions for tax administration, together with the usual assortment of regulations, executive instructions, and ad hoc decisions issued from a variety of sources. With some exceptions in countries like Chile, Colombia, and Mexico, there is a general absence of implementing regulations;
- Some principles of taxation, several rights of taxpayers, and several responsibilities of the tax administration are either not part of the tax code or tax laws or are vague and widely dispersed;
- Substantial provisions to enhance compliance, which should be granted to the tax administration in the laws, are lacking. For example, there are generally no legal requirements in the tax codes or tax laws of LAC countries for financial institutions and other payers to routinely and regularly provide information about payments to taxpayers in order to match such information with the tax administrations' files.[40] For example:
    - Judicial authorization is required for the tax administrations to access financial information from banks in eight Latin American countries;
    - Bank information can be requested individually only on case-related investigations in seven countries; and
    - Only three countries – Colombia, Chile and Peru – can access bank information that is not case-related;
- Separately, bank secrecy laws, which further thwart compliance with tax laws, are widespread throughout the region;
- Since tax legislation does not provide authorization to Ministries of Finance and tax administrations of many countries to enter into agreements with banks or other financial institutions to receive tax payments and tax returns on behalf of the tax administration, many continue to operate antiquated cashier functions, which are not only inefficient and risk-prone, but are also sources of dissatisfaction and frustration for taxpayers and their legal representatives, particularly because of long queues and delays required simply to file tax returns, make tax payments, and generally comply with tax obligations;
- There is limited authority to compel testimony or summons persons and documents and to conduct criminal investigations for tax fraud and evasion (the latter is, on occasion, vested in other agencies). Sanctions in the law for tax evasion/fraud consist mainly of monetary fines;
- Garnishment, seizure, and sale of personal and real property are very limited under the tax laws of most LAC countries, and provisions are often in conflict with other national laws of the country. For example, in Latin America,[41] the tax administrations of Brazil, Costa Rica, Guatemala, Honduras, and Paraguay have no authority to enforce collection of delinquent taxes; judicial review before enforcement is required in Argentina, Nicaragua, and Paraguay;

[39] Inter-American Center for Tax Administrations (CIAT) et al. (2012), p. 31.
[40] Ibid., p. 33.
[41] Ibid., p 8, 15.

and the tax administrations of Chile and El Salvador have no legal authority whatsoever to collect delinquent taxes;

- Generally, throughout the LAC region, the use of sanctions to deter non-compliance is weak. For example, sanctions are low in number and not rigorously applied, which "renders this enforcement tool an ineffective instrument as a deterrent to non-compliance";[42]
- In most LAC countries, there is no authority to administratively report tax arrears accounts as uncollectible, even in bankruptcy "no-asset" cases, no-asset death cases, etc. Coupled with weak enforcement provisions, the lack of write-off authority swells the stock of tax arrears, of which many are old and uncollectible, throughout the LAC region. For example, the percentage of tax arrears inventory or stock older than 5 years in Latin American countries is quite high, ranging as high as 86 percent (Peru), with an average of 42.37 percent for countries in Latin America;[43]
- Almost universally in the tax codes or tax laws of most LAC countries, there is a general absence of formal delegation of authority to the lowest appropriate levels in order for decisions on cases and administrative issues to be promptly made, rather than to be routed to upper levels of management for decisions; and
- With regard to the current prominence of international taxation issues, and specifically to exchange-of-information and double taxation agreements, the maturity level of the legal framework in LAC countries is mixed, as evidenced in part by the number of double taxation agreements in the various countries. For example, in Latin America, three countries have no double taxation agreements at all, four have only one each, and three other countries have only 10 in total among them.[44]

Of particular concern, in almost all LAC countries, legal sanctions for tax fraud/evasion are either very weak and/or are seldom applied to the full extent of the law. In developed countries, every so often, authorities pursue felony cases of tax fraud, which may receive a high profile in the news media and serve to highlight for the general public consequences for tax non-compliance. In the developing world, many countries have made tax fraud a criminal offense only recently. In some cases, despite having the laws in place, these sanctions are seldom applied. In El Salvador, which enacted its tax fraud felony legislation about ten years ago, for example, only a handful of cases have been brought to courts for enforcement in recent years – none between 2006 and 2009 and only 3 cases in 2010. Generally, "the number of convictions for tax fraud/evasion in too many Latin American countries is very low, while there have been no convictions at all in other countries of the region during the last 5 years."[45]

However, there are promising developments. For example, the Inter-American Center of Tax Administrations (CIAT) has drafted a model tax code to help member countries that are interested in further improving their current legal frameworks, particularly those at the second level of maturity described above. Also in the region, Jamaica, one of the few countries that do not have a tax code,

[42] Ibid., p. 36.
[43] Ibid., p. 52.
[44] Gomez Sabaini et al. (2012), p. 56-57.
[45] Inter-American Center of Tax Administrations (CIAT) et al. (2012), p. 38-41, 73.

drafted a tax procedures code in 2011, which is being considered for possible enactment. There are also positive developments with regard to collaboration with commercial banks to assist tax administrations with the receipt and preliminary processing of tax returns and tax payments. Guatemala and El Salvador, among other countries, have negotiated contracts with commercial banks and developed software for processing payments that they provide to the banks free of charge. Under this arrangement, commercial banks receive and process tax declarations, together with payments, and provide taxpayers with receipts for tax declarations and payments received.[46]

Furthermore, LAC countries have led the way with regards to developing legislation for the establishment of SARAs. The oldest SARA was established in Peru in 1988,[47] and, as of 2010, Argentina, Barbados, Bolivia, Colombia, the Dominican Republic, Ecuador, Guatemala, Guyana, Mexico, Peru, and Trinidad and Tobago had Revenue Authorities.[48]

3.5. Key Benchmarks and Guidelines

The key benchmarks for the legal framework of tax administrations are very similar to the fourth level of maturity described in Section 3.3:

- A comprehensive tax code has been enacted and there is 100 percent consistency in the provisions of the law for violations of any type of tax, and the application of these provisions by the tax administration is highly and consistently accurate. If a tax code has not been enacted, a tax procedures code which consolidates all the administrative provisions from the various tax laws has been enacted;
- Self-assessment is the established principle of taxation in the law, and the degree of voluntary compliance determined by reliable compliance studies is consistently above 85 percent each year;
- Regulations which interpret the tax laws are regularly prepared and issued, including advance rulings requested by taxpayers, and their timeliness and quality are excellent;
- The tax code officially creates the tax administration with a functional structure, and it gives authority to the Head, with concurrence by the Ministry of Finance, to make future changes, as necessary;
- All the rights of taxpayers and responsibilities of the tax administration cited in section 3.1.2. above are incorporated in the tax code;
- Most, if not all, of the compliance and enforcement provisions critical for successful operations of the tax administration cited in Section 3.1 are authorized in the tax code or the tax procedures code;
- Provisions in the tax code require banks or other third parties to regularly provide information on payments to taxpayers to the tax administration for matching with its master file, and the tax administration enjoys a very successful matching/compliance program;

[46] Gallagher et al. (2009), p. 69.
[47] Kidd et al. (2006), p. 11.
[48] USAID's Collecting Taxes database (http://egateg.usaid.gov/collecting-taxes).

- The tax code includes provisions for sanctions, including possible incarceration, for tax fraud/evasion and authorizes publicity for convictions;
- Under tax code provisions, commercial banks are authorized to handle filings of tax returns and tax payments for the tax administration, under contracts negotiated by the Ministry and the Head;
- The tax code/tax procedures code authorizes e-filing and electronic signatures and requires 100 percent of large taxpayers to file electronically;
- A statutory provision that allows exemptions only by a law of general application is included in the tax code/tax procedures code; and
- Required tax treaties and exchange of information agreements authorized by the tax code are all negotiated and are updated, as required.

Chapter 4. Organizational Structure and Management

Arturo Jacobs

The purpose of this chapter is to discuss the organizational and management structures and approaches to tax administration. Specific focus is given to functional organizational structures, with segmentation for certain types of taxpayers, as this has proven to be the most effective and efficient model. Typical functional organizational structures for headquarters, regional, and district/field offices are presented graphically. Several selected best practices by tax administrations are also discussed, such as those relating to categories of staffing, centralization of staffing, and delegations of authority.

4.1. Leading Practice

To collect the national tax revenues, tax administrations around the world have organized the bulk of their staff and other resources and executed their programs around one of four traditional types of organizational structures:

- Type of tax (e.g., with departments responsible for income tax, value added tax, excise taxes, and other taxes);
- Functions performed (e.g., with departments responsible for taxpayer audits, collection of tax arrears, and other functions);
- Type of taxpayer/client (e.g., with departments responsible for large enterprises, small/medium enterprises, wage and salary earners, and other taxpayers); or
- Combinations of two or more of the types of organizational structures above.

The type-of-tax organizational structure was the favored structure early on and for many years. The British Empire has structured its tax administration – the Board of Taxes and the Board of Stamps, later to become the Board of Inland Revenue – by type of tax since the 1690s. The United States also structured its tax administration by type of tax for decades, then operated according to functions performed from the early 1950s to the late 1990s, when it changed to a type-of-taxpayer structure mandated by Congress' 1998 IRS Restructuring and Reform Act, with 4 major divisions – Wage and Investment Income, Small Business and Self-Employed, Large & Mid-Size Business; and Tax Exempt & Government Entities. Other countries, like New Zealand and Australia originally structured their tax administrations by type of tax, changed to functional structures for many years, and then restructured according to the type of taxpayer/client in the early 1990s. Particularly in developed countries more recently, combinations of two or more of the structures listed above have been designed and implemented. Each of the four types of structures has advantages and disadvantages.

4.1.1. Disadvantages of the Type-of-Tax Organizational Structure

The following are among the longstanding problems of prolonged operations by separate type-of-tax departments, as cited by World Bank experts after in-depth studies of one LAC country during 1993-94,[49] but typical in many other countries as well:

- Duplication of effort was persistent among six front-line tax departments, because each department had been conducting the same functions for its own tax, including taxpayer registration, taxpayer audits, and compliance, separately and routinely for years.
- Fragmentation of resources for enforcement was widespread among the departments.
- Inefficiencies in operations, caused by this fragmentation, impacted on organizational performance, resources, procedures, and staff development.
- Shortcomings in management and staff performance of all tax departments were persistent.
- Weaknesses in collections and poor control of tax evasion lessened the government's revenue for economic development.
- A widespread lack of voluntary compliance by taxpayers was evident.
- Coordination and data sharing among tax departments led to advantages for those taxpayers who were evading or avoiding taxes.

Structuring by type of tax creates significant burdens for taxpayers, including increased time and expense when they are subjected to multiple registrations, audits, and other interactions with the separate tax departments.

4.1.2. Superiority of the Functional Organizational Structure

The most prevalent and successful organizational structure for many years has been the functional organizational structure; that is, a tax administration structured on the basis of the type of work performed, rather than the type of tax, business, product, or customer. The functional organizational structure is based on the theory that, by grouping together activities that require similar skills or specialties, real gains are achieved through an increased depth of knowledge in core areas of business expertise.[50]

Most international experts, including from the International Monetary Fund (IMF), the World Bank, and the Inter-American Development Bank, who have conducted countless tax reform missions all over the world over a span of several decades, have strongly and consistently favored and recommended functional organizational structures for national tax administrations. The functional structure has proven again and again that it:

- Permits standardization of similar processes across all taxes, which enables easier and simpler interactions by taxpayers, e.g., only one access point for registration, service and payment;

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[49] KPMG Peat Marwick (1995), p. 1.
[50] Kidd (2008), p. 2.

- Facilitates simplification of procedures which taxpayers are required to follow to comply with their tax obligations;
- Permits greater uniformity across the organization enables grouping of all core functions together geographically for better management oversight and control, and for design of the same operating procedures for each core function in all field offices;
- Facilitates computerization of all work processes;
- Allows greater specialization, training and career development of staff;
- Promotes greater efficiency and higher productivity of the overall tax administration, as it avoids the duplication of processes across types of taxes;
- With a complete view of taxpayer behavior across all tax types and early detection of non-compliance trends, yields improved compliance results; and
- Decreases the incidence of intrusion on taxpayers common in organization by type of tax as it avoids, for example, separate audits at different times by different tax officials focused solely on income tax, value added tax, or other types of taxes.

Other benefits of functional organizations include:[51]

- Functional organizations enable units to focus on primary activities, which promotes efficiency – auditors, for example, are able to audit tax returns for all types of taxes;
- Functional organizations allow an integrated look at the taxpayer during registration, audit, and collections, as well as at the taxpayer base for planning purposes;
- Functional organizations enhance control and accountability, because no single tax official is responsible for all administrative elements related to a single taxpayer; and
- Functional organizations can accommodate major legislative changes, such as the introduction of a new tax, with minimal changes to the organizational structure.

It is not surprising, therefore, that functional structures are in extensive use in most developed countries and in developing countries as well. A recent study by the Organisation for Economic Cooperation and Development's Forum on Tax Administration[52] confirms that, despite some significant variations in the organizational structures of revenue bodies from country to country, "there appears to be a substantial reliance on the functional model of organization—13 out of the 49 surveyed revenue bodies indicated that the functional model has been adopted as the primary criterion for structuring their tax administration operations, while 30 revenue bodies reported that a broad mix of criteria, including function, are applied in practice." In other words, 43 out of 49 tax administrations count on functional structures. It should also be noted that those few countries that rely exclusively on taxpayer segmentation (type of taxpayer) invariably organize the taxpayer segments, like Large Taxpayer Offices, under a functional structure, with components for audit, collection, and taxpayer service.

[51] Murdoch et al. (2012), p. 3.
[52] OECD (March 2011), p. 43.

4.1.3. Pros and Cons of the Type-of-Taxpayer Organizational Structure

The main rationale for organizing tax administration by type-of-taxpayer, or taxpayer segments, is that the various taxpayer groups have different characteristics, tax-compliance behavior, and levels of risk for loss of tax revenue, and should each be handled differently. Advantages of this organization model include:

- Ability to appoint and dedicate a fixed management team to oversee all compliance and service operations of each unique taxpayer segment, which strengthens responsibility and accountability for achieving organizational objectives;
- Ability to better research and understand compliance issues of each taxpayer segment;
- Ability to develop and implement compliance strategies unique to each segment, such as more targeted audits;
- Facility to provide better service and taxpayer education to targeted groups;
- Better management of various risk levels unique to each group;
- Ability to allocate resources of the tax administration commensurate with the risk level of each taxpayer segment; and
- Greater ability to closely monitor those taxpayers who account for the largest proportion of tax revenue.

Functional organization structures, with partial segmentation for large taxpayers is most common, but some countries have begun to establish Medium Taxpayer Offices (MTOs) as well to segment those taxpayers who account for 10-15 percent of the tax revenue. The IRS "Large and Medium-Size Business" established in 1999 is another example of segmentation based on this model.

Like with other organizational structures, there are disadvantages with the type-of-taxpayer structure:

- Administrative costs are likely to increase by duplicating common core and even some support functions, like IT, across the taxpayer segments;
- Duplication and fragmentation of staffing limits the ability to apply the best practice of centralized staffing, whereby adequate personnel is assigned to a limited number of centrally located tax offices to carry out all of the core functions of tax administration efficiently and effectively;
- Inconsistent application of tax laws, policies and procedures across different taxpayer segments is more likely; and
- There is too much dependence on a limited and scarce number of highly skilled managers and technical staff to design and administer the respective enforcement and educational programs for each group.

4.1.4. Core and Support Functions

Although listed in Chapter 2, the core or basic functions that a modern tax administration performs in its direct operations are repeated here so that the reader may easily associate them with their placement in the organizational charts introduced in the subsections that follow:

- Taxpayer registration – the collection, recording, and maintenance of basic identifying taxpayer information in the tax administration's master database that permits the tax administration to understands its taxpayer base and to plan accordingly;
- Taxpayer services – the information, forms, publications, and tax education that the tax administration provides taxpayers to help them comply with their tax obligations, to demonstrate that they are considered valued customers of the tax administration, and to reduce the need for extensive enforcement, given limited resources;
- Filing and processing of tax declarations and tax payments – the processes and forms designed by the tax administration for taxpayers to file their tax return(s) and pay their tax liabilities on specified dates, and the processes used by the tax administration to receive, document, review, correct if necessary, and archive the tax returns;
- Taxpayer audits – the processes used by the tax administration to monitor compliance, by selecting filed tax returns to audit/verify income, expenses, and supporting information reported by the taxpayer and to make additional assessments which require collection action;
- Taxpayer objections (administrative appeals) – the processes offered to taxpayers to first dispute proposed additional tax assessments in forums within the tax administration's field offices;
- Taxpayer appeals – the formal processes available to taxpayers under the law to protest proposed additional tax assessments or other actions by the tax administration at forums away from the direct jurisdiction of the tax administration's compliance offices, including judicial reviews and hearings;
- Collection of tax arrears – the business processes used by the tax administration to collect taxes which are due, assessed, and not paid by the due date under the law, including use of enforcement measures, such as liens, levies, and seizure and sale of taxpayers' property; and
- Tax-fraud investigations – the processes used to investigate financial transactions declared by taxpayers on their tax returns in cases in which the tax administration has a reasonable cause to suspect that the taxpayer has committed tax fraud. Tax-fraud investigations also involve cases of tax evasion, when taxpayers subject to tax do not register, file, and pay their taxes.

The support functions which provide the resources, support, and guidance to the staff that perform the core functions are:

- Information technology – computerization of systems and business processes of the tax administration, and data networking;

- Legal services – services provided to technical and management personnel by a cadre of attorneys of the tax administration, including legal interpretation of tax laws and regulations, and representation of the tax administration in all judicial forums, including tax appeals;
- Human resources - personnel management and training functions;
- Budget planning and resource management (physical space, facilities, and other property);
- Strategic and operations planning – the formulation of long-term strategic plans of the tax administration and the drafting, implementation, and monitoring of annual work plans for all its departments, consistent with the objectives of the strategic plan;
- Internal audit – the processes of conducting periodic reviews to ensure that selected regulations, operations, and administrative procedures and programs conform to specified standards and are being implemented efficiently and effectively, including the analysis and verification of accounts, financial transactions, and reports; and
- Integrity investigations – investigations about the conduct, such as alleged or suspected corruption, of any member of the tax administration's staff.

There are several features that distinguish successful tax administrations with functional organizations around the world. A set of international leading practices from many of these features is discussed below.

4.1.5. Taxpayer Segmentation

The most common segmentation strategy in many countries, as discussed in Chapter 2, has been to establish a Large Taxpayer Office (LTO) program to control and provide service to those taxpayers, who collectively account for between 60-75 percent of the government's overall tax revenue each year. In some countries, inclusion or exclusion for LTO control is simply determined by the amount of tax liabilities of the taxpayer in a given period. However, simply using tax liabilities in a single period is a flawed basis, because fluctuations of tax liabilities over several taxable periods usually distort the classifications. Instead, a "size" for inclusion or exclusion should be determined by multiple factors, such as the value of assets, gross/net income, the number of multinational entities, and the amount of tax liabilities. More specifically, the following parameters can be considered: the volume of sales during the past two years, the amount of taxes paid during the past two years, the amount of total assets from the most recent financial statements, the volume of payroll, the number of employees, etc. The nature of the business is another important factor in some countries, where all taxpayers in certain industries, such as financial institutions, telecommunications, and mining, are included in the LTO program, regardless of their turnover, tax liability, or other factors.[53]

Historically, many developing small/medium countries have established criteria that have initially singled out around 500 large taxpayers in their respective countries for LTO control, but this figure has gone up and down with time. The tax administration should define and abide by an "exit strategy",

[53] Businesses in these sectors are usually large. This said, there are other reasons why a specific sector will require additional control, including past experience of the tax administration with monitoring compliance in the sector or the fact that businesses in the sector may be difficult to tax with the regular tax regime.

removing taxpayers from LTO control when their economic and financial status for two consecutive years have fallen below the initial classification status and they have consequently been re-classified as medium taxpayers. Conversely, companies not under LTO control that later meet the LTO criteria for two consecutive years should be inducted into the program. In short, since several of the parameters can vary significantly from year-to-year for specific taxpayers, the list of large taxpayers should be updated periodically. The most important consideration to determine the number of taxpayers for LTO control at any given time is revenue risk. The number of taxpayers that contribute between 60-75 percent of the country's tax revenue should be controlled, no matter how large or small the number. Adequate staffing of the LTO at all times is of top priority, because the group of large taxpayers represents the biggest risk of potential revenue loss to the government.

The segmentation and control of large taxpayers has been in practice for many years. For example, the Internal Revenue Service (IRS) of the United States established and operated large taxpayer branches in a few key district/field offices around the country in the 1970s. However, the staff of these large taxpayer branches were tasked only with performing only audits and not any other core tax administration functions. They were therefore placed in audit divisions in district/field offices around the country, i.e., within branches responsible for audits of medium and small taxpayers. As of 2004, the LTOs of the tax administrations in Austria, Canada, Japan, and Korea similarly operated only within the audit function. On the other hand, LTOs established in recent years in developing small/medium countries not only perform audits, but also carry out collection and compliance functions, provide taxpayer service, and perform all duties associated with international exchange of information agreements.

Additional segmentation of taxpayers has recently been extended in some countries to the design and implementation of strategies and offices to control medium-size taxpayers, who usually contribute around 10-15 percent of the government's annual tax revenue. Medium Taxpayer Offices (MTOs), by default, control those taxpayers that are not included in the large taxpayer program and those that are not classified as small taxpayers. However, when multiple MTOs are established, each with a separate organizational structure for the core functions of tax administration – audit, collection, taxpayer service, etc. – there is a risk of fragmenting the tax administration's functional staff into too many small, ineffective, and inefficient units.[54] For effective and efficient audit and collections, tax administrations should have integrated, computerized systems to grade and rank taxpayers on the basis of risk and complexity. One option in lieu of MTOs is to establish in-office audit and collection work units, or to assign audit and collection cases of less technical difficulty and lower risk to less experienced audit and collection staff. Other disadvantages to too much taxpayer segmentation are discussed above.

[54] See the discussion on centralized staffing below.

Box 4.1. Large Taxpayer Center in Egypt

USAID's Technical Assistance for Policy Reform project in Egypt assisted the government during 2002-2005 with the establishment of a Model Customs and Tax Center (MCTC). The MCTC was open to taxpayers of minimum size, located in Cairo, and classified as importers. Although participation in the MCTC was voluntary, the number of participating taxpayers grew quickly from 300 in 2003 to 2,000 in 2005. Improvements in taxpayer services, such as shortening the time for customs clearance from seven days to one day, were quoted as the main reason for the interest. After the MCTC was converted into a Large Taxpayer Center (LTC) in 2005, at the recommendation of the IMF, the center handled roughly 70 percent of total Egyptian tax revenue. The LTC was cited as one of the reasons for the reduction of Egypt's overall negative fiscal balance from 9.6 percent in 2004-2005 to 6.8 percent in 2007-2008. USAID's Technical Assistance for Policy Reform II (2005-2010) assisted the government of Egypt with the merger of its tax departments into a single Egyptian Tax Authority (2006). As a result of the merger and other project activities, more than 1 million active self-assessing taxpayers in 2006 and more than 600,000 in 2007 were added to the tax rolls, income tax collections grew albeit lower income tax rates, and overall tax collections increased by reported record-breaking 20 percent year-over-year in 2006.[55]

4.1.6. Integrated Administration of Withholding Taxes and Contributions

Taxpayers and employers in many developing countries experience a heavy and ongoing burden to comply with laws and regulations related to withholding taxes and contributions.

Box 4.2. Withholding in Jamaica

For example, in Jamaica several years ago:

- Employers were required to withhold income tax (PAYE), Education Tax (EDTAX), National Insurance Scheme (NIS), and National Housing Trust (NHT) from the employee compensation. They were also required to pay a percentage of the employee compensation as EDTAX, NIS, NHT, and Human Employment and Resource Training Fund (HEART);
- Employers were assigned multiple TINs by the different authorities responsible for the administration of these transfers to the government; and
- Self-employed taxpayers were required to pay EDTAX, NIS, and NHT on their total earnings.

Applicable rates were different for each type of tax/contribution, as was the base (ceilings, exclusions, etc.), and thus accurately computing the correct amounts due presented a challenge to taxpayers/employers. Further complications for taxpayers and employers arose in dealing with the tax administration authorities. The collection of all of these taxes and contributions was centralized in the country's tax administration, except for NHT and NIS. NHT was deposited in commercial banks. NIS was either collected by the tax administration or through post offices, utilizing the sale of NIS stamps for the self-employed, domestic workers, and voluntary contributors. Generally, separate monthly payments of each type of withholding were required, as well as annual returns for PAYE, EDTAX, NIS, and NHT.

Recommendations were made to consolidate all audit activities under the jurisdiction of the audit function of the country's tax administration to enhance compliance monitoring and enforcement. Tax auditors conducting either specific audits of withholding taxes or "package audits" of all types of taxes, for which a taxpayer was liable, were given the responsibility to verify compliance with all withholding taxes and contributions during the audit. The other functions of the tax administration – collection, taxpayer service, etc. – similarly assumed their respective responsibilities regarding withholding taxes and social contributions.

[55] Murdoch et al. (2012), p. 5.

The integration of tax revenue with social contributions has been the subject of recent analytical work undertaken by officials of the OECD, who documented the following reasons a number of countries chose to integrate operations over the last decade:

- Commonality of core processes involved in collection of tax and social contributions;
- Efficient use of resources;
- Lowering government administration costs; and
- Lowering taxpayer burden and costs.[56]

4.1.7. Roles of Headquarters, Regional, and Local Offices and Staff

In large countries with large, active[57] taxpayer populations of approximately 2.5 million or more and more than 10,000 tax administration employees, the staff of the tax administration is organized around a headquarters office, two or more regional offices, and multiple district/field offices. In medium and smaller countries, with smaller numbers of taxpayers and tax administration staff (medium staff: 5,000 – 10,000; small staff: 5,000 or less), regional offices are usually not established, and their usual roles are performed by the headquarters office. Roles of district/field offices are the same in either case. A benchmark for the ratio of active taxpayers to administrative staff is 150-250:1.

The headquarters office of a country's national tax administration is meant to provide planning, support and normative guidance for all field operations, but not to actually carry out any of those operations in dealings with taxpayers. The specific roles of the various organizational components in the headquarters office generally include:

- Preparing strategic plans;
- Preparing, issuing, monitoring, and evaluating annual work plans for audit, collection, taxpayer service, fraud Investigations, and monitoring progress on meeting objectives;
- Developing case selection criteria for the compliance functions in the field;
- Determining human resource needs and recruiting, training, and allocating personnel;
- Providing financial resources;
- Providing legal services;
- Providing IT hardware, software, and expertise; and
- Developing and providing the norms and procedures by which the entire organization is governed.

The normative role that headquarters office staff performs, particularly setting organization-wide policies and operating procedures and laying these out in written procedural manuals, is vital to the success of any tax administration. Clear policies and methodologies – the norms – are the guides for consistency in the application of tax laws, policies, and administrative procedures by staff at all levels, and help ensure fairness, transparency, and predictability in the tax system.

[56] OECD (2004), p. 10.
[57] Active taxpayers are those, who filed tax returns in the latest year.

The principal role of district/field offices and staff is simply to execute the annual work plans developed by the headquarters office. In so doing, they perform the operations role of the tax administration. The staff of district/field offices – auditors, collection officers, fraud investigators, customer service specialists, and some of their managers – are the ones who represent the tax administration exclusively, as they deal with taxpayers to provide information and assistance, perform audits, hear objections cases, enforce compliance, collect tax arrears, and investigate cases of possible tax fraud/evasion. Unfortunately, staff of headquarters offices in many developing countries either perform direct operations, such as audits, regularly or get involved with taxpayers on selected cases. Either is detrimental to the overall success of the tax administration, because such actions create confusion for taxpayers and tax administration staff at all levels about "who is in charge" and dilute program responsibility and accountability.

Large tax administrations should establish one or more regional offices, to provide technical assistance to local office staff. They, rather than the headquarters office, should monitor, control, and evaluate the execution of work plans by district/field offices. Progress reports should be delivered back from the districts through regional offices to headquarters on a timely basis. Staff at the three levels of the organization should have clear contact points for communication on a particular functional subject and, at the headquarters office in particular, there should be one focal point for the formation of administrative policy for a particular core function.

4.1.8. Centralized Staffing

Another important practice in successful functional organizations is to centralize staffing rather than fragment it in small numbers at too many locations. Centralized staffing ensures the adequate provision of personnel to a limited number of centrally located tax offices to carry out all of the core functions of tax administration efficiently and effectively. The central geographic locations of offices around the country make them accessible to a high percentage of the taxpayers in each tax jurisdiction, while also ensuring that taxpayers in the wider geographic area are still aware of and "feel" the presence of the tax authorities "nearby."

To provide adequate coverage in more remote areas, technical staff are assigned to travel periodically from these central locations to perform audits, collect tax arrears, hear taxpayer objections, and conduct taxpayer education sessions. Connectivity at all locations to centralized databases allows each site to provide services to taxpayers anywhere in the country.

4.1.9. Adequate Budget to Support Operations

Management, supervisory, and technical officials in modern, successful tax administrations throughout the world should be given the necessary human and financial resources to perform their principal core and support operations efficiently and effectively. Managers must have certainty that the resources allocated to them each year will be available as the expenditures become necessary. Furthermore, they must have the authority and independence to manage their own budgets, while being held accountable for results and for efficient use of their allotments.[58]

4.1.10. Internal Audit and Integrity Functions

Internal audit and integrity functions are cited above as important support functions within tax administration but are emphasized here, because, surprisingly, in many developing countries, these two functions are often the responsibilities of other governmental jurisdictions. The term "internal audit" refers to the process of conducting periodic reviews to ensure that selected regulations, operations, and administrative procedures and programs conform to specified standards and are being implemented efficiently and effectively. All modern tax administrations have internal audit staff in the headquarters office who conduct independent and professional internal audits on behalf of the head of the tax administration to detect and deter inefficiency and waste and identify better ways to carry out tax administration operations. Audits by internal audit staff of the tax administration are much more effective than audits conducted by external auditors of central government Auditor General Departments, because, as discussed in Chapter 16, the former are much more knowledgeable about the tax administration’s financial controls and complex operations.

The internal audit function is sometimes grouped with the integrity investigation function, although these two functions are somewhat different. Whereas internal audit staff focus on the quality and efficiency of tax administration systems, procedures, and processes, integrity staff focus on allegations of corruption and misconduct by tax officials. Integrity staff conduct professional and timely investigations of such misconduct and then recommend and carry out sanctions against those officials in confirmed cases. An effective, independent integrity function helps to preserve public confidence in the tax administration personnel. Since the internal audit and integrity investigation functions work closely together on some integrity-related cases, as discussed in Chapter 16, both functions can be combined, under one top-level official who reports to the Director General. However, the option to place them separately in the organization structure is also acceptable.

4.1.11. Typical Functional Structure for Medium and Small Tax Administrations

Typical functional organizational structures for headquarters and district/field offices of medium and small tax administrations are shown in Appendix 4.A. Note that the district/field organizational structures mirror the structure of the headquarters to a large extent, but that their respective roles are very different in that the Headquarters staff perform planning and normative roles, while field staff execute work and programs. Note the very critical operational role designed in the functional structures for the Deputy Director General of Operations. All district/field office Directors, including the Large Case Director, report directly to him or her. In effect, he or she is responsible and accountable for successful direct operations of the tax administration. He/she and all other Deputy Directors General, such as for Administrative Services or for Planning as in Appendix 4.A, report to the Director General. The Large Case Director has his/her own audit, collection, and taxpayer service staff, as well as the highly

[58] The budget planning and management for tax administrations is discussed in Chapter 14.

specialized staff, which supports the Legal Department's staff on international exchange of information agreements with other countries.[59]

In smaller tax administrations, some core and/or support functions are integrated at the district/field office level. For example, taxpayer registration, listed above as a separate core function, is a sub-function of the taxpayer services division. This grouping together of activities that require similar skills or specialties is an example of one of the strong advantages of functional organizations.

In addition, at the district/field office level, shown in Appendix 4.A, note that:

- Where MTOs have not been established, the Collection Division has an Office Collection Section with staff that handle less technically difficult or lower revenue risk in-office cases, and a Field Collection Section with staff that handle the more technically difficult or higher revenue risk cases during field visits to taxpayers and third parties;
- Similarly, the Audit Division has an Office Audit Section, which handles less difficult or lower revenue risk in-office audit cases, and a Field Audit Section, which handles the more technically difficult or higher revenue risk cases;
- The Audit Division relies on a Quality Review Section – a staff of experienced auditors who select samples of audit cases completed by the division's auditors, review them for compliance with all provisions of the tax law, regulations, and administrative policies and procedures, and issue advisory "common error" notices to improve the quality of the overall audit program;
- The Audit Division has an Objections Section – a staff of experienced auditors who preside over objections or protests by taxpayers to proposed tax assessments in administrative proceedings;
- The Collection Division has a Special Procedures Section with experienced collection staff who perform quality reviews from samples of completed collection cases and issue advisory notices to improve the quality of collection work. In addition, the staff handle cases where the taxpayer is involved in bankruptcy, insolvency, or other legal proceedings; and
- The Fraud Investigations Division has an Intelligence Gathering Section with staff, who not only gather intelligence from within the tax administration, from third parties, and from the media to develop fraud and evasion cases, but also review, accept, or reject potential cases referred by the Audit and Collection Divisions or initiated by information obtained from informants. In other words, the Intelligence Gathering Section determines which cases are assigned for investigation to the Investigation Groups.

4.1.12. Typical Functional Structure for Large Tax Administrations

Typical functional organizational structures for headquarters, regional, and district/field offices of a large tax administration are shown in Appendix 4.B.[60] Note that regional and district/field organizations

[59] The Legal Service division, typically the Legislation, Treaties and International Tax Matters section, has the primary responsibility for and works with Ministry of Finance officials on international tax matters. The organization unit in the LTO supports the main unit in the Legal Department.
[60] OECD (2004), p. 15.

also mirror the headquarters to a large extent, as they do for medium or small tax administrations, but again, their respective roles are different.

Almost all the notes cited above for medium and small tax administrations apply to functional structures for large tax administrations. One exception – in part, since it applies to small and medium tax administrations as well, but to a lesser extent – is that in large countries with large tax administrations, there are many external stakeholders, issues, and events, which requires much time and effort from top-level officials. It is often necessary to have two top-level officials – a Director General (or Commissioner) and a Deputy Director General (or Deputy Commissioner). The Director General tends to external activities, while the Deputy Director General manages the day-to-day operations of the tax administration. Usually, the Director General or Commissioner is the public "face" of the tax administration and spends a great deal of time at the Ministry of Finance, at parliamentary hearings on budget issues or complaints, at professional group meetings of accountants, lawyers, chambers of commerce, industry groups, at media appearances. For example, in the IRS, the Commissioner, a political appointee, usually performs this "external facing" role and the Deputy Commissioner performs the "internal management" role. The roles are not mutually exclusive and some IRS Commissioners took a more active role in operations, but also tended to the external activities.

A few other exceptions include:

- As shown in Appendix 4.B, the Director General has a Deputy Director General, rather than a Deputy Director General (Operations), to whom the Regional Directors report;
- The District/Field Office Directors report to their Regional Directors, rather than directly to headquarters;
- Regional Directors report to the Deputy Director General and so, in effect, the Deputy Director General is responsible and accountable for operations; and
- A Large Case Section is part of the Audit Division (as it is in the regional and national structures), and not a separate organizational unit, because a high number of large taxpayers throughout the country require multiple large case units at various locations. Therefore, taxpayer service and collection work targeting large taxpayers is assigned to top-level technical staff of the regular collection and taxpayer service divisions.

4.1.13. Successful Management Practices

Roles as Managers

The principal functions of management at all levels are planning, organizing, staffing, coaching (directing), and controlling. Organizational structures must have managers at all levels spend most of their official work time performing managerial functions. Higher-level managers especially should spend little time on the technical aspects of tax administration work. Of course, first-level managers/supervisors must conduct sample technical reviews of case work and coach inexperienced subordinates on technical issues. Nevertheless, even they need to spend much of their time on the functions of management.

Many international experts have noted the non-practice of the traditional roles of management throughout the tax administrations of many developing countries. Specifically, these experts have observed:

- Substantial time is spent by most of managers at all levels as technicians;
- Managers are often selected without proper credentials;
- Managers are selected and not given appropriate management training;
- Managers are not performing basic management tasks; and
- There is inadequate accountability for performance of managers.

Successful tax administrations all around the world invest in their management. They undertake extensive and continuing management training. To institutionalize the profession and practice of management, training programs are developed and specifically designed for each level of management – first, mid, and top levels - with major emphasis on teaching methods which blend management theory with everyday management tasks, such as assignment of work, reviewing work, and employee development. International leading practice suggests that effective methods of instructions for management training include lectures and discussions, case studies, and role plays which demonstrate practical application in everyday work at the various management levels, with topics such as the recruitment of personnel, the selection of personnel, postings, promotions, performance appraisals, training, transfers, and discipline.

Delegations of Authority

Functional organizations have a strong, vertical chain of command. District/Field Office Directors in large tax administrations report to their respective Regional Director, who reports to the Director General and Deputy Director General. In small tax administrations with no regional offices, the District/Field Office Directors report directly to the Deputy Director General (Operations). However, District/Field Office Directors and their staff are also required to receive and accept technical work assistance and guidance for their respective functions from Assistant Regional Directors or Headquarters Directors for Audit, Collection, etc. if there are no regional offices.

In the most successful tax administrations, tax officials in headquarters offices, regional offices, and district/field offices are given sufficient authority by law and delegated by the Director General to make and carry out technical and administrative decisions with a high level of independence, while being held fully accountable for their organization's performance.[61] In fact, modern functional tax administrations rely heavily on a system of cascading delegations of authority. Without such delegations, work piles up as personnel await decisions from successive, higher level officials, stifling productivity and breeding frustration among staff and taxpayers alike. In the traditional chain of command, authority is given in the law to the Minister of Finance or/and to the Director General of Taxes to perform all duties necessary to execute the country's tax laws. The Director General is also authorized by law to delegate authority to his or her Deputy Directors in headquarters, to Regional Directors, and to District/Field

[61] These authorities are discussed in Chapter 3.

Office Directors. In turn, District/Field Office Directors make similar written delegations of authority to their respective Division managers and assistant senior managers, who then can delegate to their managers and supervisors. Finally, managers are able to delegate sufficient authority to their trusted technical staff to make necessary decisions relating to their work to ensure that work gets done efficiently, effectively, and in a timely manner. Given sufficient, documented authority[62], employees at each level of the tax administration are able to deal with most operational, personnel, and administrative matters expeditiously and with a high degree of confidence and independence. Each level of management periodically monitors the proper exercise of authority through monitoring reports, on-site reviews, and internal audits.

Limit Taxpayer Access to Work Areas

Taxpayers and/or their legal representatives should not be allowed access to compliance work areas of the audit, collection, and fraud investigation functions in the offices of the tax administration. This management practice helps prevent the unauthorized disclosure of information on other taxpayers, and at the same time reduces opportunities for improper, "closed door" contact between taxpayers and tax officials. Interview rooms in taxpayer reception/customer service areas away from the work areas should be made available for objections cases, in-office audits, in-office collection, and other compliance cases.

Tax administrations should also explore innovative means for delivering customer services to further reduce the need for taxpayer visits to compliance work areas. In Moldova, for instance, the State Tax Inspectorate, the country's tax administration, established "internet café"-style taxpayer service centers inside municipal government facilities, where taxpayers were able to register, obtain forms and instructions, update their status, or access their tax statement via an intranet portal. Increasingly, and especially as tax administrations move to centralized processing and bank payments, taxpayer information and assistance should be made available via their websites, call centers, and at "one-stop" taxpayer service centers.[63]

Summary of Good Management Practices

The most successful functional tax administrations around the world are those whose management:

- Defines, communicates, and applies clear roles for the normative, functional support and operations levels of the organization;
- Provides clear communication channels between different levels and among interdependent units;
- Maintains a comprehensive, up-to-date record of all taxpayers and their tax obligations;
- Directs the allocation of the bulk of their financial and human resources to the front-line functions and to those support functions directly related to tax compliance, enforcement, and taxpayer service;

[62] The powers and responsibilities of the tax administration are discussed in Chapter 3.
[63] Taxpayer services are discussed in Chapter 6.

- Delegates authority to all operations levels and officials of the organization;
- Encourages development and application of technology in all functions, including integrated tax information systems; and
- Provides functional and management training, career opportunities, and a work environment that helps attract and retain a high caliber career workforce.

4.1.14. Legal Services

Tax laws are complex and becoming ever more so in most countries. Tax rulings often require extensive legal analysis, can have significant tax revenue implications, and may require the involvement of legal counsel with specialized tax knowledge. The complexity of the law can be used to the advantage of large taxpayers, who often employ the best legal talent available. Often, provisions in the tax legislation are prepared by different legal draftsmen, and possibly by persons with minimal tax knowledge, causing provisions to have dissimilar wording or unintended consequences, introducing uncertainty into the interpretation and application of the law, and requiring legal analysis. In some cases, the courts can render decisions that are adverse to the intent of the law, which requires the tax administration to appeal or seek legislative amendments with the services of legal counsel. Last but not least, tax collection efforts may require the assistance of the court and legal counsel that is well-versed in the tax collection requirements of the law.

Tax administrations use various approaches to obtain legal service counsel. These can include:

- Ad hoc assignments of legal counsel from the Ministry of Justice/Attorney General to represent the tax administration for specific tax cases;
- Permanent assignment of legal counsel from the Ministry of Justice/Attorney General to represent the tax administration in all tax matters;
- The hiring of practicing lawyers/barristers/solicitors to form an in-house legal department;
- The hiring of private practice lawyers to represent the tax administration for a particular case (usually a tax arrears collection case);
- The hiring of law students (who may have graduated, but not yet passed the bar exam) to work on tax rulings or in the collection divisions; and/or
- Using their most senior person, who may not have any legal training, to work on cases involving legal issues, which may include legal drafting, collections, and rulings.

Many tax administrations do not have adequate access to specialized legal services. There are a variety of reasons for this problem. In some countries, the Ministry of Justice/Attorney General has the sole mandate to employ practicing lawyers. In some cases, the tax administration does not have adequate funds or the government's pay scales are inadequate to attract talent. Often, the tax administration lacks a career path for legal talent and, on rare occasions, may not recognize the need for in-house legal services.

The absence of proper legal counsel in a tax administration is a serious threat to its ability to function properly and apply the tax laws in an appropriate manner. The legal function within functionally organized tax administrations is subject to wide variation. For the purpose of this discussion and as depicted in Appendix 4.B, a separate department has been presented that coordinates all legal activity to ensure quality and consistency in the application of the tax laws. This 'legal department' is the advocate of the tax administration, and its primary role is to represent the tax administration in all legal proceedings with taxpayers. Secondary roles include providing legal advice to appeals, helping to interpret legislation, assisting with tax collection and enforcement efforts that require court action, and helping government officials to negotiate tax treaties and international exchange-of-information agreements.

Operating Principles

Persons working in the legal department are public servants and must always represent and advocate only on behalf of the tax administration. Adherence to the following principles is a requirement for legal staff to ensure integrity, confidentiality, and professionalism.

- Legal staff must make their best efforts to resolve disputes between the tax administration and taxpayers in a fair, timely, and professional manner;
- As with anyone who has access to tax information, legal staff must maintain strict confidentiality and not reveal information or a litigation strategy to any person, unless necessary for the resolution of the matter and specifically authorized by law;
- Legal staff must act free from outside influence;
- Each tax case may be unique, and legal staff must use their professional judgment when deciding the most effective manner for handling a case; and
- As representatives of the tax administration and the government, legal staff must always maintain professionalism and objectivity and not initiate or advance any actions that are not in the interests of justice.

4.1.15. Computerization and Data Networking

As emphasized in Chapters 2 and 12, the successful execution of every function of a modern, functional tax administration requires the effective use of computers, automation, and data networking systems. To perform their respective jobs well, employees in all core and support functions rely heavily on information, and unless this information is accurate and complete and can be retrieved in a timely manner, the information becomes virtually meaningless. All levels of management rely on automated integrated tax information systems (ITIS) to monitor progress on strategic and annual objectives and report monthly and annual progress on objectives within the tax administration and to the Ministry of Finance. Taxpayers also benefit when the tax administration makes effective use of computerization and data networking systems, as this helps ensure timely registration and service and accurate taxpayer accounts.

4.2. Common Trends

4.2.1. Organizational Structure Trends

In recent years, tax administrations around the world have designed and tested new organizational structures in order to deal with a diversity of challenges presented by the global economy. Despite the clear advantages of functional organizational structures for tax administrations, recently some countries, including Australia, New Zealand, and the United States, have moved away from the wholly functional structure to either the client-type or to a hybrid structure, which combines elements of the functional and the client-type, or segmented, structures.

For example, in the mid-1990s, the United States replaced the functional organizational structure that the IRS had used very successfully for more than 40 years with a new structure organized under 4 client-type divisions: (1) Wage and Investment Income; (2) Small Business/Self-Employed; (3) Large and Mid-Size Business; and (4) Tax Exempt and Government Entities. Early in the 21st century, however, several countries which had switched from functional to client-type structures exclusively, including the United States, restored the major features of functional structures and combined them with client-type structures.

The shapes and structures of tax administration field organizations have also changed in recent years. In some cases, government pressure for greater efficiency has forced a review of the field office network and resulted in a smaller number of larger offices. Equally, the increasing presence and power of information technology as a tax administration tool has changed the nature of service delivery, with more tax administrations relying less on physical presence and more on the Internet and telephone. However, in many countries—and especially in developing economies—decisions on the field organization continue to be driven by the need for a physical presence across the country.[64] Where tax administrations have not been able to fund information technology throughout the country and where taxpayers do not have access to modern technology, physical presence is paramount. Small offices, for example, one that primarily provide taxpayer service, forms and publications are common throughout many developing countries.

Segmentation for large taxpayers has been in use since at the least the 1970s, and the trend to establish LTOs has gathered momentum in recent years. In 2010, 27 of 34 OECD countries had a "dedicated large taxpayer office".[65] In a sample of 17 member countries of CIAT taken in 2010, all but one had LTOs.[66]

4.2.2. Creative Organizational Structures

Fiscal Compliance Centers

With ever-mounting needs for additional revenue for governments and their own budget shortfalls, many tax administrations have attempted to boost tax revenue, incurring the least cost possible, by

[64] Kidd (2008), p. 5.
[65] OECD (March 2011), p. 43.
[66] CIAT et al. (2012), p. 59.

experimenting with special organizational units. Those that have designed and implemented centralized fiscal compliance centers, in conjunction with centralized automated tax returns and documents processing centers, have enjoyed a very high degree of success.

The compliance programs that lend themselves to placement under a centralized fiscal compliance unit include: (1) matching third-party information documents with amounts reported on tax returns; (2) non-filers and stop-filers;[67] (3) delinquent taxpayer accounts; (4) the collection of payroll and estimated tax; and (5) auditing questionable deductions/exemptions through correspondence audits[68]. Much of the work of fiscal compliance centers is automated, including the issuing of notices for the various types of non-compliance. Even some telephone calls to taxpayers can be automated.

Box 4.3. Automated call system in El Salvador

In El Salvador, for instance, the General Directorate of Internal Taxes deployed a new "robo-call" system – an automated program that calls stop-filers and other non-compliers with recorded messages instructing them to rectify their particular non-compliance issue by a specified date. In addition, there were compliance technicians on live telephone systems to work on cases not resolved by such "robo-call" systems. Cases not resolved by any of these methods were assigned to district/field offices for enforcement. This new approach brought 2,685 stop-filers into compliance in the first half of 2009, compared to 917 who had responded to mailed reminder notices in the first half of 2008. The call center was able to deliver 34,721 robo-calls in 2009 as opposed to 3,495 letter notices in 2008 and corresponding tax collections from stop-filers rose from $1.57 million to $3.12 million.[69]

Experience has shown that a large percentage of non-compliant cases are resolved by Fiscal Compliance Centers much more efficiently than through one-on-one efforts in field operations. Some countries have experienced a yield on average of 15:1 for their investment in fiscal compliance centers, i.e., an additional $15 in taxes collected for every $1 authorized and invested in these centers. A functional organization for a Centralized Fiscal Compliance Division recommended for Puerto Rico's Tax Administration by BearingPoint's advisors in 2004, among many other tax reform recommendations, is shown in Appendix 4.C. The Centralized Fiscal Compliance Division is still in operation to this date.

One-Stop Revenue Service Centers

> *"Voluntary compliance with tax laws creates more tax revenue and lowers the cost of enforcement. In an effort to encourage voluntary compliance, some tax administrations have found various ways to treat taxpayers like valued customers. For example, Jamaica established two one-stop tax service centers a few years ago. These now issue taxpayer identification numbers and tax compliance certificates, collect stamp duty and transfer taxes, and receive tax returns and payments. One of the centers also maintains the central motor-vehicle registry. Most transactions can be handled in a single visit by the*

[67] Non-filers are taxpayers who should have, but did not file. Stop-filers are taxpayers who filed before, but not in the current year.
[68] Correspondence audits are audits that the tax administration performs via mail. These are typically audits of low risk activity.
[69] Murdoch et al. (2012), p. 8.

> *taxpayers. These taxpayer services centers in Jamaica—and in several other countries—are also equipped with electronic numbering systems ("QMatic Systems"), and taxpayers are provided chairs to await their automatic, numbered turns in getting needed services. Such efforts go a long way toward making taxpayers feel like real customers. World Bank consultants recently proposed a one-stop revenue service center for Tanzania to replace the current system, which required multiple visits to different agencies."*
>
> *Gallagher et al., 2009*

More recently, Jamaica's tax administration combined part of its One-Stop Revenue Service Center/Centralized Fiscal Compliance Branch with its Customer Care Center at one office that provides very good telephone taxpayer service. Through October 2011 of fiscal year 2011/12 the center had achieved 64 percent customer satisfaction against a target of 70 percent. The center also collects substantial sums of early stage tax arrears accounts. Through March 2012 of the same fiscal year, the center collected JMD 568.5 million ($5.68 million) from 12,140 accounts.

Problem Resolution Offices (Taxpayers' Advocates)

Invariably, some taxpayers encounter a variety of non-case-related problems in dealing with the nature and complexity of tax administration through normal channels. Therefore, there has been a trend among tax administrations all around the world to establish Problem Resolution Offices to provide special services to taxpayers.[70] In the United States, the IRS established its Problems Resolution Program in the mid-1980s. The objectives and everyday tasks of the Problem Resolution staff are to:

- Demonstrate quick responsiveness on the part of the tax administration to resolve difficult and frustrating problems of taxpayers in dealing with tax administration officials;
- Show concern for taxpayers involved in various ways with the tax administration and encourage their voluntary compliance with the country's tax laws; and
- Provide the top officials of the tax administration with information to improve the organization's overall efficiency and effectiveness of its systems, procedures, and performance of its personnel.

To qualify for referral to the Problem Resolution Office, a taxpayer must already have tried to resolve the problem through normal channels without success. The nature of cases for which relief is sought by taxpayers involves a variety of common tax problems, such as:

- Getting proper VAT credits;
- Getting a TIN issued to them promptly;
- Securing proper action to correct payments applied to wrong tax periods;
- Getting correct answers to technical questions about tax forms and tax filing requirements; and
- Getting necessary blank tax declarations timely.

[70] Hussey et al. (1996), p. 221.

Complaints about delays in the completion of audits or other investigations do not qualify for special services. Instead, such complaints are referred to the respective Audit, Collection or other managers of the technical employee handling the case for their intervention and resolution. Complaints about offensive behavior of tax administration auditors, collectors, etc., are not the responsibility of the Problem Resolutions Office, either. Such complaints are also routed to the manager of the named technical employee for investigation and resolution, and information copies of the investigation and resolution documents are sent to the proper management officials at higher levels.

In a functional organization, the Problem Resolution Officer and staff are most effective if they report directly to the office of the Director General. In regional offices, Problem Resolution Offices report directly to the Regional Directors. The traditional normative headquarters and technical guidance and monitoring regional roles are performed by these officials. At district/field offices, the Problem Resolution Offices are attached to the offices of District Directors. The District Problem Resolution Officer and his/her staff receive special services cases and assign them to the Chief of the appropriate division, control them, and follow-up on all cases assigned to division officials to ensure timely (usually around 10 days) and satisfactory completion of work.

4.2.3. Outsourcing

Outsourcing some core and support functions to the private sector or to other government institutions has become somewhat of a trend among tax administrations around the world. Information technology (IT) is the most commonly outsourced function. Germany, Luxembourg, Slovak Republic, Denmark, Iceland, Turkey, the U.K.'s Inland Revenue Department, and the U.K.'s Customs and Excise Tax Administrations have all outsourced information technology, either to the private sector or to other governmental entities. Maintaining IT as a support function within a tax administration, however, is advisable. In some cases, even core compliance functions have been outsourced to the private sector. For example, some countries' tax agencies have outsourced to the private sector the programs described above for Centralized Fiscal Compliance Centers in hopes of improving compliance levels and increasing tax revenues. Hungary has outsourced its fraud investigations function to a police body. In the United States, the IRS outsourced a portion of its inventory of tax arrears cases to a private sector company for collection a few years ago. However, after several reviews over a period of about three years, the U.S. Treasury's Inspector General concluded that the results were very poor, and the outsourcing contract was soon terminated.

The common belief that everything can be done better by the private sector is, in fact, a myth. Outsourcing to the private sector may work in some cases, but requires in-depth analysis of what programs can be outsourced, the corresponding legal issues, the expected results and finances, and a reference base to make meaningful comparisons of results periodically and thus determine success or failure.

4.2.4. Customs and Tax Administration – to Merge or Not

Mergers of tax departments in developing countries and/or, in particular, considerations to establish revenue authorities often give rise to the question whether the tax administration and Customs should be combined or separate. After all, most developing countries display a tax structure that relies heavily on customs duties and the VAT and excises collected on imports.

It should be noted that even in merged bodies, in most cases, customs and tax functions under the same Director General conduct their respective operations independently for a variety of reasons, including:

- Very dissimilar daily processes and procedures of the two agencies;
- Different historical, cultural, and functional bases;
- Different skills and processes:
    - Customs operates in "real-time" border control and revenue collection on traded goods;
    - The tax administration operates retrospectively;
- Customs is concerned about national health, security, and safety;
- Difficulty in integrating IT, which is almost always developed separately to meet the differing needs of each agency; and
- Dissimilar status and rates of modernization between the two agencies, including risk-and-strategic planning and information technology, where Customs lags tax administration in many countries.

In his study of revenue authorities, Mann concluded that "many developing countries that have already established SARAs have chosen to concentrate solely on strengthening internal tax administration (i.e., mainly income taxes, VAT, and excises), and have not incorporated customs operations into the SARA"[71]. With respect to OECD countries, as of 2010 only 9 member countries have aligned tax and customs operations within a single agency/directorate and 36 have separate bodies.[72] Clearly, the best international practice is to keep the two agencies separate. However, the need for ongoing cooperation, close coordination, and legal exchanges of information between tax administration and Customs is of great importance to the work of either agency, as discussed in Chapter 3.

4.3. Tax Administration Maturity

The maturity levels of tax administrations, with regards to organizational structure and management, are discussed below.

Organizational Structure and Management: Maturity Level 1

Key word: "To Each His / Her Own"

[71] Ibid., p. 8.
[72] OECD (March 2011), p. 19.

- Based on the various tax laws, there are multiple tax administrations, each with its own organizational structure based on type of tax.
- The administrations of withholdings and social contributions are separate.
- Each tax administration has its own audit, collection, and other units, and the staff of these units conduct their compliance activities independently. Consequently, many taxpayers, and especially businesses, are subjected to multiple, uncoordinated, time-consuming, and costly audits and other compliance actions.
- Some core and support functions, such as investigation of tax fraud, internal audit, and integrity, do not exist in any of the tax departments and are the responsibility of other government-wide or Ministry institutions, whose staff are unfamiliar with tax administration programs and are ineffective with infrequent audits, or totally absent.
- The tax administration does not have its own legal department and is not concerned with the void in legal expertise. All litigation cases are referred to the Ministry of Justice or Attorney General. Attorneys of the Ministry of Justice/Attorney General are not well versed in tax law and, consequently, the majority of fraud, appeals, and seizure cases are lost in litigation.
- There are no advance-ruling services provided to taxpayers by the tax administration and so taxpayers have to make high-risk business decisions with regard to possible tax consequences.
- Legal interpretation of recurring problematic tax provisions and positions of the tax administration are not available either to taxpayers or to technical staff of the tax administration and uncertainty is widespread.
- There are no international tax treaties or exchange-of-information agreements; so some multinational taxpayers practice tax avoidance schemes extensively.
- Each tax department has separate headquarters and separate field offices scattered throughout the country, seldom at the same location, with little rationale about the size of staff of each department at each location.
- At the field office locations of all the tax departments, taxpayers that request by mail or telephone to meet with case agents are routinely sent from reception areas to work stations to meet and deal with the case agent, thereby facilitating possible collusion and risking possible disclosure of tax information of other taxpayers.
- None of the tax administrations has defined specific, exclusive roles for headquarters and field offices, and some headquarters staff in all tax administrations are heavily involved in direct operations dealing with taxpayers, as are the staff of field offices. Consequently there is a constant state of confusion among taxpayers and among staff of all tax administrations about "who is in charge".
- Between 60-75 percent of managers and staff are political appointees, are not well qualified for their jobs, and receive meager on-the-job training, but no formal training, for tax department work.
- Managers of all tax administrations spend most of their time working cases and do little management work.

- There are no formal, written delegations of authority in any tax administration, and many completed audits and other technical cases are submitted to successively higher levels of management for review and approval, resulting in a constant backlog of semi-completed cases.
- None of the tax administrations has segmented organizational structures for control of their large taxpayers.
- The number of taxpayer complaints is high in all tax departments.
- Productivity is low and inefficiency is high in each of the tax departments. For example, 40 percent of audited cases in a year result in no changes to original tax assessments, whereas the standard is 10 percent. This shows the poor selection of cases to be audited or the inefficiency of audit. For taxpayer service in tax administration offices, most taxpayers wait in queues or in reception areas at least 40-45 minutes before given service requested, whereas the standard is no more than 20 minutes. Other major program's objectives fall short of international or regional-country benchmarks.

Organizational Structure and Management: Maturity Level 2

Key word: "Floundering"

- Despite the country's various tax laws, the formerly separate tax administrations in the country have recently been merged under one Director General, except for withholding and social contributions.
- A functional structure has been designed and has recently been implemented.
- Based on the functional structure, the locations of consolidated headquarters and district/field offices around the country have been decided, and respective management and technical staff have been assigned to the various functional departments, divisions, and units at headquarters and district/field offices.
- Office and staff locations, however, have been decided without regard to the best practices of centralized staffing, adequate spans-of-control, adequate budgets, and adequate computerization and data networking. Consequently, functional staff at various office locations are fragmented in small units with ineffective staff-to-workload ratios and without the necessary equipment and information to perform their work efficiently and effectively.
- Some core and support functions, such as collection, internal audit, and integrity, still do not exist in the tax administration and are the responsibility of other government-wide or Ministry institutions, which are ineffective at best, or totally absent.
- The tax administration does not have its own legal department, but the Minister of Finance and the head of the tax administration are aware that one is required and have initiated efforts to establish it. Temporary assignments of attorneys from other agencies are occasionally requested and represent the tax administration on particularly important prosecution cases for tax fraud and appeals. Attorneys of the Ministry of Justice/Attorney General are not well versed in tax law and, consequently, the majority of fraud, appeals, and seizure cases are lost in litigation, but visiting attorneys from other agencies assigned to the tax administration temporarily are winning a few cases.

- There are no advance-ruling services provided taxpayers by the tax administration and so taxpayers have to make high-risk business decisions with regard to possible tax consequences.
- Legal interpretation of recurring problematic tax provisions and positions of the tax administration are not available either to taxpayers or to technical staff of the tax administration and uncertainty is widespread.
- There are no international tax treaties or exchange-of-information agreements and some large multinational taxpayers practice tax avoidance schemes extensively.
- Despite the functional structures, because of unfamiliarity with other types of taxes and lack of formal training for the transition, technical staff continue to work only in their own tax specialty area.
- At the field office locations, taxpayers that request by mail or telephone to meet with case agents are still routinely sent from reception areas to work stations to meet and deal with the case agent, thereby facilitating possible collusion and risking possible disclosure of tax information of other taxpayers.
- The Director General and his or her immediate staff have not defined specific, exclusive normative and planning roles for headquarters and operations/execution roles for field offices, and some headquarters staff of all tax departments continue to be heavily involved in direct operations dealing with taxpayers, as are staff of field offices. Consequently, a constant state of confusion among taxpayers and among staff of all tax departments about "who is in charge" persists.
- Civil service regulations have been enacted with pertinent qualifications criteria used for recent recruitments into the tax administration. However, about half of current managers and staff are still political appointees, are not well qualified for their jobs, and have received no formal training for their functional work specialties.
- Managers in all tax departments spend too much of their time working cases and perform management tasks sporadically.
- There are still no formal, written delegations of authority in the tax administration, and many completed audits and other technical cases continue to be submitted to successively higher levels of management for review and approval, such that a backlog of semi-completed cases is an ongoing reality.
- The tax administration has begun to identify the country’s large taxpayers, but does so based on one criteria only – the taxpayers’ tax liabilities for the prior year – and is organizing an LTO based on a functional structure.
- The number of taxpayer complaints is high.
- Productivity is still low and inefficiency is still high throughout the tax administration. For example, the audit and no additional assessment rate is 20-30 percent each year, whereas should be no more than 10 percent. Average wait time for taxpayers in taxpayer service reception areas is 35 minutes, whereas it should be 20 minutes or less. Other major program’s objectives fall short of international benchmarks.

Organizational Structure and Management: Maturity Level 3

Key word: "Shaping Up"

- A functional organizational structure has been in place for several years, as mandated by the country's tax code or tax procedures code, and the tax administration handles withholdings and social contributions.
- Based on the functional structures, headquarters and district/field offices around the country have been operational for several years and have been staffed according to workload studies, centralized-staffing concepts, and acceptable manager-to-technical staff ratios.
- Some of the district/field offices and functional groups have limited and/or outdated computerization and data networking equipment necessary to perform their work efficiently and effectively.
- Some core and support functions, such as investigation of tax fraud, internal audit, and integrity, have been operational in the tax administration for only a few years and are not yet very effective.
- The tax administration has established its own legal department within the last five years and has, only recently, fully staffed it with qualified attorneys assigned to the organizational units for legislation, litigation, and advisory services, tax treaties, and international exchange-of-information agreements. All litigation cases of the Tax Administration are handled by attorneys of its legal department, who have attained a 60/40 win/loss rate the last two years.
- Advance-ruling services are provided to taxpayers by the legal department of the tax administration, although 30 percent of the rulings are issued beyond the 60-day time objective.
- Legal interpretation of recurring problematic tax provisions and positions of the tax administration are regularly made available by the legal department to taxpayers and to enforcement staff of the tax administration.
- Attorneys from the legal department have assisted in the successful negotiation of a few international tax treaties and exchange-of-information agreements and control of multinational taxpayers by the Large Taxpayer Office has improved somewhat.
- Taxpayers that requested by mail or telephone to meet auditors/collection officers/investigators at field office locations are met and escorted to interview rooms in the taxpayer service reception area, where they are met to conduct the necessary business by the case agent. Taxpayers do not enter staff work spaces.
- The Director General and his immediate staff have defined specific, exclusive roles for headquarters (normative and planning) and district/field offices (operations/execution) so that any occasional contact between headquarters staff and taxpayers is usually detected and corrected.
- Civil service regulations are in place, with pertinent qualifications criteria used for recruitment into the tax administration, and existing staff are generally well qualified for their positions. However, inordinate delays by the Civil Service Agency on new recruitment requests by the tax administration are fairly common.

- Good classroom training courses and formal on-the-job training programs, which include all tax types for each of the specialized functions, have been in place several years, but they are not regularly updated for changes in tax law, regulations, and procedures. Also, there is a lack of continuing professional education programs to "refresh and update" those whose training is out of date.
- All mid-level managers and first-level supervisors have attended management training, and they mostly perform management functions, but there are no courses for top-level management.
- There are some formal, written delegations of authority in the tax administration, but they are not granted below senior technical staff levels because of fear that authority will be abused or opportunities for corruption will be given to too many people, and so experienced, journeyman (fully qualified to act independently on the job) level auditors and collection staff are not as efficient and productive as they could be.
- The country's largest taxpayers, selected based on several criteria, have been under the control of a functionally organized LTO for several years, but with no defined exit criteria or ongoing monitoring, and some taxpayers who no longer meet the entry criteria are still under LTO control.
- An effective problem resolution program has been in place for several years, and taxpayers generally feel that their complaints are resolved in a timely manner by the tax administration.
- Productivity has been fairly high for the last several years throughout the tax administration and performance indicators are generally being met. For example, the audit and no additional assessment rate of at most 10 percent has been met 2 of the last 3 years. Taxpayers in reception areas are usually given service requested within 20 minutes of their arrival in the office. International or regional-country benchmarks for other major programs have been met for 2 of the last 3 years.

Organizational Structure and Management: Maturity Level 4

Key word: "Ship Shape"

- A functional organizational structure has been in place for several years, as mandated by the country's tax code or tax procedures code.
- Based on the functional structures, headquarters and district/field offices around the country have been operational for several years and have been staffed according to workload studies, centralized-staffing concepts, and reasonable manager-to-technical-staff ratios.
- Up-to-date computerization, data networking equipment, and links to databases necessary to perform work efficiently and effectively are provided and available to all necessary users.
- All core and support functions have been operational in the tax administration for several years and are all consistently effective.
- The tax administration has had its own legal department for more than ten years, fully staffed with qualified attorneys respectively assigned to the organizational units for legislation, litigation, and advisory services, tax treaties, and international exchange-of-information

agreements. All litigation cases of the tax administration are handled by attorneys of its legal department, who have attained at least an 85/15 win/loss rate during the last five years.

- Advance-ruling services are timely provided to taxpayers by the legal department of the tax administration 100 percent of the time.
- Legal interpretation of recurring problematic tax provisions and positions of the tax administration are regularly and timely made available by the legal department to taxpayers and to enforcement staff of the tax administration.
- Attorneys from the legal department have assisted in the successful negotiation of a number of international tax treaties and exchange-of-information agreements, and multi-national corporations are all under full control of the Large Taxpayer Office.
- Taxpayers that requested (by mail or telephone) to meet auditors, collection officers, or investigators at field office locations are escorted to interview rooms in the taxpayer service reception area, where they are met to conduct the necessary business by the case agent.
- Specific, exclusive roles for headquarters (normative, planning) and district/field offices (operations/execution) have been defined and in existence for several years, and respective roles are generally practiced.
- Civil service regulations are in place, with pertinent qualifications criteria used for recruitment into the tax administration, existing staff are very well qualified for their positions, and new recruitment requests by the tax administration are usually met in a timely manner by Civil Service officials.
- Excellent classroom training courses and formal on-the-job training programs, which include all tax types for each of the specialized functions, have been in place for several years and are regularly updated with changes in tax law, regulations, and procedures. Technical staff in need of updated and refresher training are regularly sent to continuing professional education courses.
- All top and mid-level managers and first-level supervisors have attended management training and perform their respective management functions the majority of their time on the job.
- Formal, written delegations of authority have been granted to the lowest managerial and journeyman (fully qualified to act independently on the job) technical levels throughout the organization, and ongoing management and internal audit reviews monitor for violations of authority for necessary corrective actions.
- The country's largest taxpayers, selected based on several criteria, have been under control of a functionally organized LTO for several years. Close monitoring by LTO officials every year has resulted in new taxpayers being added and others being dropped from LTO control, based on the qualifying criteria.
- An effective problem resolution program has been in place for several years, and taxpayers generally feel that their complaints are resolved in a timely manner by the tax administration.
- Productivity for the last several years has been high throughout the tax administration and performance indicators have been met or exceeded. For example, the audit and no additional assessment rate of 10 percent has been met or exceeded in the last 5 years. Most taxpayers in reception areas have been given service requested within 20 minutes of their arrival in the office

for the last 5 years. International or regional-country benchmarks for other major programs have been met for the last 5 years.

4.4. Latin America and the Caribbean

In developing countries, just as in developed countries, organization by type of tax was the dominant structure for many years and still prevails in many countries. However, the functional structure has been fast displacing tax-type structures during the last ten years in developing countries. For example, in Latin America and the Caribbean (LAC), most of the member countries of Inter-American Center of Tax Administrations (CIAT) have had functional structures and some level of taxpayer segmentation for many years. In a study by the author from as early as 1999,[73] all of the 13 sample countries employed functional organizational structures in both headquarters and at the operation level. All but two had LTOs.[74] A study published April 2012 by CIAT, IMF's Regional Center for Technical Assistance, Panama and the Dominican Republic (CAPTAC-DR), and the Inter-American Development Bank confirms that the functional organization structure prevails in most LAC countries, together with some form of type-of-taxpayer feature, such as large taxpayer offices.[75]

With regard to the 4 levels of maturity in terms of organization and management, there is some degree of diversity among LAC countries. A few countries are clearly between the third and fourth levels. Several countries, however, should be placed between the second and third levels, for the following common reasons:

- Respective roles for headquarters and district/field offices are understood but not well defined, and some headquarters officials in some countries get involved with taxpayers on case-related activities;
- The concepts of centralized staffing and optimum spans-of-control are not always practiced, resulting in too many small offices around the country and too few technical staff under each manager;
- Managers spend too little time on management functions and too much time on technical work;
- Formal delegations of authority are largely non-existent;
- Budgets each year are increasing but are still insufficient for necessary operations;
- Mainly because of inadequate budgets each year, computerization and data-networking equipment are insufficient for necessary operations in all tax administration offices;
- Access to work areas in tax administration offices by taxpayers who visit the offices and others is not strictly controlled;
- Some core and support functions do not exist within the tax administration. For example, as of 2010 the collection function in El Salvador had been carried out for many years by staff of the Minister of Finance, and the integrity function in Jamaica as of 2012 is still being carried out by the Revenue Protection Division, a unit under the Ministry of Finance;

[73] Unpublished.
[74] Generally, LTO organizational structures in LAC countries include taxpayer services, collections, and audit.
[75] Inter-American Center for Tax Administrations (CIAT) et al. (2012), p. 16.

- One-stop-service centers and centralized fiscal compliance centers are not used (though there are exceptions, such as Jamaica and El Salvador, respectively); and
- Problem Resolution Offices are largely non-existent.

4.5. Key Benchmarks and Guidelines

The following are key benchmarks for this chapter, discussed throughout the chapter and summarized here.

- The tax administration should employ a functional organizational structure both at headquarters and at operational offices, or an organizational structure that is a matrix of functional and type-of-taxpayer divisions. All core and support functions should be included.
- Where there is a segmentation of large taxpayers, there should be multiple criteria for inclusion in LTOs. Exit criteria should also be defined.
- Taxpayers should not be allowed to enter or exit LTO's premises unescorted and, preferably, not at all. They should instead be met in interview areas;
- A strict division of roles between headquarters, regional offices, and district and field offices should be practiced. Headquarters should have normative and planning functions. Regional offices should have advisory, guidance, and monitoring functions. District and field office should have execution / operational functions.
- Successful management practices require that managers manage, that there is a formal delegation of authority to the lowest practical level, and that staffing is located in a limited number of centralized locations.
- Institutional and professional credibility is achieved with high stability of top-level management and with the recruitment of educated top-level and technical staff.
- The following ratios are indicative of international leading practice:
    - Proportion of human and financial resources allocated to the core functions or field operations in relation to those provided to the support functions in headquarters: 70 percent;
    - Technical positions/administrative and support positions: 3:1.
    - Ratio of active taxpayers to tax administrators: 850:1.

Chapter 5. Registration

Terry Murdoch

This chapter defines and discusses the process of registering taxpayers and how this key activity can significantly impact on other key tax administration functions. The registration and recording of taxpayer information is one of the fundamental functions of the tax administration and, to a great extent, drives how other core administrative functions operate.

An inaccurate taxpayer database will inevitably lead to ineffective compliance programs. The timely and accurate collection and recording of basic identifying information of the taxpayer will permit the tax administration to understand its taxpayer base, staff itself accordingly, and to effectively plan other core tax administration functions. In short, the administration cannot manage its taxpayers if it does not know who they are, where they are located, and whether they are active or inactive.

5.1. Leading Practice

Of course, there is no single 'tax registration model' and much is dictated by the content of the tax law and/or regulations of the country. Whatever the size and the content of the register, there are leading practices that should be adopted by the administration and that will go a long way to ensure the integrity of the taxpayer database.

5.1.1. Definition of Registrant

The definition of 'registrant' is likely set out in the law and/or regulations, but invariably falls somewhere in the spectrum between a regime where every individual or entity who is obliged to pay tax and file a return (universal self-assessment) must register, to a more restricted regime where only businesses or individuals with complex tax affairs must register. The latter scenario is common in a tax system in which the overwhelming majority of salaried individuals pays tax at the source (i.e., through their employers) and, therefore, is not obliged to file a tax return. Understandably, these different definitions result in substantially differing sizes of taxpayer registration databases.

Registrants should be restricted to those who are obligated under the tax laws to file a return or pay tax directly to the administration. The overall tax regime and breadth of taxes will affect the size of the taxpayer register. Leading practice dictates a simplified tax system, such as the establishment of a reasonably high income tax filing threshold, and the introduction of final tax withholding on salaries, interest, and dividends. These and similar measures can significantly reduce the number of taxpayers obliged to file returns.

5.1.2. Information Requirements

In keeping with the leading practice of reducing taxpayers' cost of complying with their tax obligations, the tax administration should be mindful of its own information needs. In general, the administration must oblige the taxpayer to provide any data required under the law and any additional data that it deems necessary to allow it to provide some assurance of taxpayer compliance. Taxpayers should not be instructed to provide superfluous data that is 'nice to have,' but is never actually used. The following checklist provides an indication of the minimum key data required of the taxpayer at the time of registration:

- Name (plus trading name), address, and contact details;
- Type of legal entity (individual, partnership, corporation);
- Business registration details (for those entities required to notify the government's business registry of a new business);
- Partner details (for partnerships only);
- Type of business activity;
- Financial year end;
- Actual (or estimated) annual turnover; and
- Type of tax(es), for which the taxpayer is liable.

The initial four bullets are base data that provide the tax administration with the 'who' and 'where.' The latter four bullets provide ample information for the administration to better inform its future planning and the allocation of an initial compliance rating.[76]

Registration data should be captured on a simple form, with the taxpayer obliged to provide the minimum amount of verification data needed. After processing the registration application, the tax administration should provide the taxpayer with a unique taxpayer identification number (TIN) and a registration certificate.

Notwithstanding the above, some taxes, in particular property taxes, require 'discovery' and not just a simple act of registration. That is, the tax administration not only needs to know who and what to tax, but it also needs to know the value of the taxable base, including the name, address, and value of the property. As such, a separate property valuation system will be necessary and must interact with the taxpayer registration database.

5.1.3. Single Registration Process

Clearly, it is preferred that the tax administration have a single, integrated registration process for all taxes. This reduces costs for both the administration and the taxpayer. It will also immediately give the administration a complete picture of the taxpayer and permit it an integrated and comparable view across taxes. There are occasions, however, when a single registration process is not possible, such as when separate administrations administer different tax types (e.g., property taxes are often administered locally rather than nationally).

[76] Tax administrations generally use information from tax returns as a major input to their risk-based compliance systems. Given that there is no such data at the time of registration, the administration must make use of what limited data is available to make preliminary allocations according to perceived risk.

Registration for all taxes may not be possible at business start-up. This is particularly relevant for the value added tax (VAT), which normally has a compulsory registration threshold, i.e., the taxpayer is only obligated to register for VAT when their taxable turnover exceeds the legal threshold (unless the taxpayer wants to voluntarily register). As such, a taxpayer that has just started or is about to commence activity will not necessarily be registrable for VAT at that time. Given the potential risks with VAT registration, a more robust process is often put in place by the administration, as discussed below.

5.1.4. VAT Registration

The threshold level at which registration for the VAT becomes compulsory is critical for its successful implementation. This is especially the case in countries with weak administrative capacity, where it is obvious that the capacity of small businesses to issue invoices and maintain proper books and records is problematic. In these countries, absent a sufficiently high (turnover) registration threshold, implementation of an account-based, self-assessed VAT is unrealistic.

However, "a sufficiently high registration threshold" is difficult to determine and establish. Globally, in 2010[77], the average VAT threshold was US$60,000, but thresholds varied widely, from $0 to over $700,000. Among LAC countries, the average threshold was $37,000, but similarly varied. Average thresholds are not very meaningful or useful. In short, VAT thresholds need to be determined for and by each country based on its tax policies, its unique taxpayer population, and on the resources and capabilities of its tax administration.

On a related issue, VAT registration can be the entry point to serious fraud, and it is important that the administration take steps to detect and prevent abuse of the VAT system. This includes rigorous pre-registration checks of businesses suspected of missing trader fraud[78], which involves the sale of goods/services at a VAT inclusive price, after which the trader disappears without paying the VAT to the tax administration. A key part of deterring this fraud is to deny the fraudsters the VAT registration, without which the fraud cannot be perpetuated.

5.1.5. Taxpayer Identification Numbers

Problems in the registration database can often be traced back to poor control of the issuance and allocation of TINs. A unique TIN controlled by the tax administration and used for all taxes, including those collected at importation, is essential for effective tax administration. It is important that responsibility for the issuance of TINs is restricted to the tax administration. Equally important is that the administration identify and put in place controls to check that no TIN is assigned to more than one taxpayer and that no taxpayer is assigned more than one TIN. This single and unique identifier for all tax administration purposes simplifies taxpayer compliance and eases compliance monitoring. A unique TIN also facilitates the exchange of information between government agencies and the matching of information reports with tax records to detect non-compliance.

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[77] USAID's Collecting Taxes database. http://egateg.usaid.gov/collecting-taxes.
[78] Missing trader fraud and VAT fraud in general are discussed in Chapter 7.

While some differences of opinion remain on the allocation of identification numbers, there is a growing consensus that a unique, single TIN for all taxes is essential for effective tax administration. Some countries have opted for issuing separate TINs for different types of taxes, arguing that this protects taxpayer information (e.g., having a VAT number that can be printed on invoices to customers but an income tax number that will remain confidential). In general, those countries issuing multiple TINs are a smaller group that have, or used to have, different administrations for the main direct and indirect taxes. Clearly, having many identification numbers in use increases the likelihood of error and/or fraud. In practical terms, however, having different identifiers for different taxes does not have to be a major problem, provided they all map back to a single, unique TIN in the administration's database.

5.1.6. Intra-Governmental Coordination

Effective compliance monitoring requires third-party data for comparison purposes. Specific to the registration arena, there are two key government entities which gather and maintain data likely to assist in the determination on whether an individual or legal entity is registrable for tax.

Invariably, countries require new businesses to register with the Ministry of Business/Trade, Companies House, or other relevant entity before undertaking any activity. Although some of these businesses may never trade, the vast majority will assume some level of taxable activity and, accordingly, must be registered with the tax administration. It is, therefore, incumbent on the tax administration to obtain (preferably in electronic format), a regular extract of new and/or amended business registrations, which can be compared against the administration's registry. Formal legislation should not be required for such an exchange, but a bilateral memorandum of understanding between the agencies may prove useful.[79]

The second key government entity is Customs. Customs may be within the same entity as the tax administration, under the umbrella of the Ministry of Finance, or may be a separate agency reporting to the Ministry of Finance. Given that Customs often collects a higher percentage of government tax revenue than the tax administration, it is essential that the two liaise closely and share information regularly. In general, Customs will be dealing with a sub-set of the tax administration's registry. All entities importing or exporting goods in commercial quantities are in business and must be registered with the tax administration. To simplify the flow of information, it is preferable that both entities adopt the same single TIN.

5.1.7. Registration and the Use of Automation

The use of automation is essential in order to create and maintain an effective registration database. Automation also reduces the compliance cost for both the tax administration and taxpayers through a significantly reduced and more efficient processing time and procedure. Indeed, tax administrations

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[79] Other forms of cooperation are possible and needed. For example, the government agency responsible for business registration could make tax registration forms available to taxpayers. In all cases, however, the tax administration should not be in a position to depend on other government agencies and should be able to register a taxpayer whether or not that same taxpayer registered with the business registry.

using automation to best effect will provide taxpayers the opportunity to complete and file an application for registration online. This eradicates the need for the taxpayer to appear at the tax office and interact in person. Automation refers not only to an automated tax administration system, but also to the increasing use of email and mobile phones as communication channels.

Many tax administrations have emphasized the importance of reducing the burden of taxpayer compliance, with improved operational efficiency as a clear secondary goal. A clear majority of OECD tax bodies signaled increasing the range, quality, and take-up of their Internet-based services as their number one priority.[80] Indeed, there has been not only a massive expansion of e-government over the last five years, but also the introduction of m-government services (using mobile phone technology).

5.1.8. Maintaining the Register

The creation of the registration database is critical to the ongoing compliance functions of the tax administration. This can only be effective, however, if the registry is accurately maintained on a timely basis. Given that the aim of the registry is to provide the administration with an accurate list of taxpayers, where those taxpayers are located, and whether those taxpayers are active, it is essential that mechanisms are in place to ensure that this aim is achieved at any time. The tax registry is constantly dynamic as new taxpayers come into being, taxpayers cease operations, taxpayers' particulars – name, address, contacts – change, entities change through mergers and acquisitions, etc. Unless the administration keeps on top of these changes, it will lose its ability to identify the active taxpayer population.

Perhaps one of the greatest challenges for the tax administration is to manage the process of how and when it receives notifications of changes to the registry. One of the simplest and most effective methods is through legislation and/or regulation, where taxpayers are obligated to notify the administration of changes to registration particulars, for example, within 15 days of the change. However, this method is likely to disappoint if the tax administration does not design and implement a fixed penalty regime for failure to comply.

It is equally important to have a formal internal mechanism in place to detect and report changes to the registry. Indeed, many changes will be discovered by other functions of the administration. For example, an auditor might note a change while trying to fix an appointment to visit a taxpayer, or otherwise during an audit. Likewise, collections might note a change while trying to contact a taxpayer about an overdue liability, while pursuing stop-filers, or while trying to obtain an outstanding return, and so on. Therefore, it becomes incumbent on the function that discovers a change in a taxpayer's particulars to notify the registration section for prompt correction.

[80] OECD (January 2009), p. 166.

Box 5.1. Maintaining the taxpayer register in Bosnia and Herzegovina[81]

USAID's Tax Administration Modernization Project in Bosnia and Herzegovina (2001-2006), with assistance from the U.S. Treasury, focused in 2002-2003 on setting up of new taxpayer registration systems. Prior to this, taxpayer registries were out of date, inconsistent, and contained entries for defunct taxpayers and "ghost" taxpayers to whom real traders would book transactions in order to avoid tax liability. The project developed automated taxpayer registries with harmonized administrative procedures and a standardized database across the three entities of Bosnia and Herzegovina, and provided new forms, educational materials, and manuals for registration. The systems enabled data sharing between the entities for the first time, providing an effective tool for fraud abatement. The tax administrations in the three entities simultaneously launched campaigns to clean up taxpayer registries and to assign unique taxpayer identification numbers. In Republika Srpska, registered businesses grew by 35 percent between 2002 and 2004. In the Federation – one of Bosnia and Herzegovina's entities – registered businesses almost tripled for the same period.

5.1.9. Registration/ Deregistration by the Tax Administration

The onus to register for tax and to notify the tax administration of changes which may lead to deregistration, for example, is generally placed firmly with the taxpayer. Common practice, however, shows that many taxpayers do not take this responsibility seriously[82] – knowingly or otherwise – which means that tax administrations must have the legislative authority to compulsory register or deregister taxpayers as it deems fit.

The power to compulsory register taxpayers is used relatively frequently when the tax administration has credible information that an entity is in business and/or has exceeded a filing threshold (date or monetary). This allows the administration to get the business on its register and then apply appropriate compliance measures.

As noted above, the effective management of taxpayers will only happen when the tax register is accurate. Allowing taxpayers who have ceased trading, are deceased, or have changed legal form to remain on the register as active will seriously affect the efficiency of the administration. Unless these taxpayers are deregistered and re-categorized as ‘inactive,’ they will continue to be sent returns to file, identified as non-compliant, and flagged for action by audit or another function. Removing these taxpayers from the active role will get rid of the clutter in the register and permit the administration to focus on true non-compliance.

Of course, deregistration does not mean the removal of all taxpayer details from the database. All details and information on the taxpayer should remain in the system, at a minimum, for the statute of limitations duration, but changing status from active to inactive removes the taxpayer from the regular compliance activities.

[81] Development Alternatives, Inc. (2006), p. 5.
[82] Particularly small businesses.

5.1.10. Administration and Organization

Staffing needs to handle registration are generally fairly limited and, provided the taxpayer database is automated in some form or another, it is likely that no more than one staff member is required to process applications and maintain the register at each location open to the public. Additional staff may be necessary if the tax administration also has some sort of centralized service facility. Registration section staff normally come under the purview of the taxpayer service function, as this is where the activity best fits operationally. Clearly, there is a close correlation between registering for tax and providing education/service to new taxpayers. The provision of information on filing and payment obligations to newly registered taxpayers is a common practice and needs to be applied vigorously in countries with low levels of voluntary registrations.

5.2. Common Trends

The advent of web-based, taxpayer self-service systems has also brought about significant changes in the way registrations are handled. The days when taxpayer-inspector interaction (and approval) was required for registration and, indeed, most other functions have all but disappeared. Provided the taxpayer enters his or her data accurately, and the data are subsequently validated by the system, a taxpayer can be registered and allocated a TIN and electronic certificate in a matter of minutes. Indeed, given the pressure on governments to reduce public spending but increase revenues concurrently, administrations are focusing diminishing staff numbers more on front-line compliance activities rather than routine administrative tasks. Secure and integrated tax administration systems allow the administration to do just that.

Some significant differences remain in the ways in which highly developed and modern tax administrations operate, as compared to those in developing countries. Much of the difference could be attributed to the greater use of enhanced automation. However, one key area where the variance is noticeable is the level of authorities required in the approval process. Developing countries, in particular, remain unconvinced that the vast majority of taxpayers are voluntarily compliant, which, coupled with a fear of questionable staff integrity, leads them to prescribe numerous layers of approvals across the administrative functions, including registration. Excluding VAT, which deserves separate treatment, there is no good reason to require the approval of tax registrations before granting them. Indeed, voluntary registration gives the tax administration the benefit of knowing the identity of taxpayers and where to find them. Many advanced tax administrations no longer insist on a completed registration form with supporting evidence and will accept the taxpayer's particulars over the telephone or via email. Provided the details given pass computerized validation checks, the taxpayer is registered and allocated a TIN automatically.

Some countries do not specifically provide for a taxpayer to register formally with the tax administration. The only requirement of the taxpayer may be to file the appropriate tax return and pay any tax liability by the due dates set out in the law. This means that the first contact some tax administrations have with a taxpayer may be more than a year after the taxpayer commenced business. For example, a taxpayer may start a business on 1st January 2013 and operate for a tax year ending on

31st December 2013. With a likely minimum 3 month time limit to file a return for the period, the first 'notification' to the tax authorities will be 15 months after the business is initiated. This is not good practice, and administrations may well be forced to issue regulations in order to build an information register sufficient to permit proactive taxpayer management.

Registration is generally not regarded as one of the key ‘compliance’ functions of the tax administration, but, technically, it does have responsibility for the discovery and registration of ‘non-filers.’ A non-filer is defined as a taxpayer who has never registered for tax and, therefore, has escaped his or her tax obligations. Tax administrations must regularly conduct programs to detect those who are wholly outside the net of the authorities and take steps to bring them under their control. Identifying non-filers, assessing their tax liability, and collecting their tax due is a multi-step process involving the coordinated activity of several functional departments. Given the significant compliance aspect of this work, the non-filer activity is generally allocated to the collections or audit functions to manage, with the registration section only providing information and intelligence.[83]

Given its predominantly ‘service’ role, the registration function is normally a sub-section of the larger taxpayer services function. This permits smooth coordination between initial tax registration and education, providing newly registered taxpayers with information on their filing, payment, and notification obligations. At a minimum, taxpayers should be advised of their obligations, but making more guidance and assistance available contributes to a more voluntarily compliant taxpayer population.

As noted below, registries of most LAC countries are either incomplete or out of date and generally unreliable, as is the case with registries of many developing countries all over the world. With the realization that improved operations of tax administration and revenue collection greatly depend on clean and reliable taxpayer registration databases and systems, a current trend in many countries around the world is to clean registries that have been poorly designed, mishandled, or neglected. There is a wide variety of registry "woes" among tax administrations of developing countries and a few general maintenance and "cleansing" concepts, techniques, and tools are provided below:

- In the first place, the TIN should include a check digit. This digit is computed from the remaining digits of the TIN every time the TIN is entered into the system. If the system computation results in a check digit that is different than the one included in the TIN, then there is an error in the TIN entry. The inclusion of the check digit minimizes data entry errors;
- The computerized system must provide security to prevent unauthorized use of the taxpayer registration system;
- The issue of TIN numbers should be automated, rather than manual. Usually, the system must provide assignment of the next sequential TIN available to a new taxpayer;
- The TIN database structure must support the association or linking of taxpayers to other entities (partnerships, companies) via the TIN. Examples of this would be identifying partners of a partnership and owners or officers of a company. Such linking is extremely important in audit

[83] Non-filers are discussed in Chapter 10.

selection, since much can be learned from associated information about the liabilities of an individual taxpayer;

- The system must include procedures to find TINs via alphabetic and other types of inquiry, to determine if a taxpayer is already registered and prevent issuance of duplicate TINs;
- For "cleansing," the current TIN file should be validated and updated before assignment of the unique TIN. This can be accomplished by sorting and printing the alphabetic registers by surname and then by other names, rather than by surname and TIN only. Computer programs that can assist in this and have worked in various countries look at other key data as potential fields for detecting or eliminating the possibility of two or more TINs applying to the same taxpayer (e.g., date of birth);
- As taxpayers with two or more TIN numbers are discovered, the TIN data must be consolidated under a single TIN number. The taxpayer must be informed, since only one of the TIN numbers will remain valid;
- In countries where taxpayers were registered with one or more tax departments, the taxpayer registries must be converted to a unique TIN computerized database. Experience has proven that it is best to concentrate on an initial database of only business and limited company taxpayers, since this is a much smaller database and represents a large portion of the income tax revenue. Income tax is the obvious tax to use for the building of this database, because all businesses that pay other taxes (e.g., VAT and customs duties) should also pay income tax;
- The tax administration must send notification letters to taxpayers to inform them of their unique TIN, together with taxpayer registration certificates with the taxpayer's name, address, and TIN;
- Taxpayer contact programs must be designed and mounted for stop-filers. The tax administration must secure delinquent returns or determine if the taxpayer should be de-registered because the taxpayer is deceased, bankrupt, out-of-business, etc.; and
- For inactive TINs, issued one year or longer ago to taxpayers who have never filed any tax returns, the tax administration must design contact programs to determine whether the taxpayer should be de-registered or whether delinquent tax returns should secured.

5.3. Tax Administration Maturity

Four levels of maturity are presented below to help interested officials make self-assessments about the strengths and weaknesses of the registration function in their respective tax administrations.

Registration: Maturity Level 1

Key word: "Unaware"

- Limited registration information is recorded. Information for third-party data matching (e.g., business registry numbers) or information needed for good planning (e.g., expected turnover) is not included.
- Necessary written policies and procedures for registration staff do not exist, and staff acts independently, inconsistently, and erratically.

- Tax file numbers are issued by different entities and are not controlled by the tax administration. Taxpayers identify themselves by name and may be unaware of their assigned file number, which may change from year to year.
- There are separate registration forms and procedures for each type of tax. Registration requires visits to multiple tax offices and the approval of tax officials.
- Registration information is not properly maintained (e.g., during business reorganization or liquidation) and contains taxpayers that are no longer in operation.
- The tax administration does not use third-party information to track non-compliance.
- Registration systems are manual, with little modern technology and equipment available.

Registration: Maturity Level 2

Key word: "Unreliable"

- Some basic registration information is recorded (e.g., taxpayer name, contact, responsible parties, etc.); however, information for third-party data matching (e.g., business registry numbers) or information needed for good planning (e.g., expected turnover) is not included.
- The issuance of new file numbers is done solely by the tax administration. Taxpayers continue to identify themselves by name.
- There are separate registration forms for each type of tax, although registration procedures may be similar. Registration requires a visit to a single tax office and, still, the approval of a tax official.
- Some parts of the registration process have written instructions, but there is inconsistency in application across the tax administration's field offices.
- Registration information is not properly maintained (e.g., during business reorganization or liquidation) and contains taxpayers that are no longer in operation.
- The tax administration does not use third-party information to track non-compliance.
- Most of the registration work is still done manually, with little modern technology and equipment available. What little computerization equipment is available is supported by outdated technology.

Registration: Maturity Level 3

Key word: "Formalized"

- Almost all registration information is recorded, including information for third-party data matching (e.g., business registry numbers). However, information needed for good planning is not available (e.g., expected turnover).
- TINs are issued by the tax administration and used by taxpayers to identify themselves. TINs are not sufficiently well controlled by the tax administration to ensure uniqueness.
- Registration is integrated across taxes with a single form and a single facility to register for all tax obligations. No tax administration official approval is needed, but taxpayers still experience delays.

- Step-by-step operational procedures for the registration process are available and are consistently applied across the organization.
- Registration information is maintained through occasional ad hoc programs, but not in a timely manner. Maintenance includes both adding new registrants as well as removing taxpayers, who are no longer active. It does not include updating information upon taxpayer reorganization.
- The tax administration uses third-party information to track non-compliance, but does so in an ad hoc manner and irregularly.
- Modern technology and equipment are available for registration, but there are often ongoing maintenance issues and funds for purchase are often limited.

Registration: Maturity Level 4

Key word: "Timely and accurate"

- All necessary basic taxpayer information is recorded, including information that allows third-party data matching (e.g., business registry numbers) and information that allows for good planning (e.g., expected turnover).
- Unique TINs are issued and controlled by the tax administration and used by taxpayers to identify themselves.
- Registration is integrated across taxes with a single form and a single facility to register for all tax obligations. Registration is automated and expedited.
- Operational procedures are integrated into the IT tax administration system with as many steps as possible being automated.
- Registration information is maintained regularly and in a timely manner, not only by adding new registrants, but also by removing taxpayers who are no longer active, and by updating information upon taxpayer reorganization.
- The tax administration regularly uses third-party information to track non-compliance.

5.4. Latin America and the Caribbean

With respect to registration, countries in Latin America and the Caribbean (LAC) should be placed between the second and third level of the maturity model above. Registration in LAC is, in fact, similar to that of many countries around the world that have undertaken significant efforts to institute a formal registration process that is simple and expedited, but have yet to take steps to ensure that registration is accurate and effective and that the information collected during the registration process is appropriately used for planning and compliance.

On the one hand, taxpayer registration in LAC is formalized, with relatively simple and quick procedures. Even in Venezuela, in which starting a business is time and labor intensive, registering with the 'fiscal registry' of the tax administration and Customs only requires that the new registrant file an electronic form, which is downloadable from the tax administration's site, and the time to obtain an identification number is usually only one day. Another day may be needed to obtain a tax clearance certificate at the municipal level.[84] According to a recent CIAT study[85], all Latin American countries assign a unique TIN (except Brazil) and, except in Uruguay, this TIN is used to record the transactions of the taxpayer with the tax administration. In addition, in all countries except Panama, taxpayers are required to report changes that would impact their registration status to the administration.

According to the World Bank's Doing Business survey[86], LAC countries have recently taken a number of steps to facilitate the process of starting a business – streamlining procedures by setting up a one-stop shop and making procedures simpler or faster by introducing technology – and a number of countries have made recent advances in doing so with respect to tax registration. For example, Costa Rica moved to electronic tax registration records and reduced the time to start a business considerably. Guyana streamlined the registration with the tax authorities and introduced a unique TIN system and later reduced the time needed for obtaining a TIN. Honduras improved the registration for tax purposes at its one-stop business start-up shops. Brazil 'eased' business start-up by further enhancing the electronic synchronization between federal and state tax authorities.

On the other hand, the registries of most LAC countries are either incomplete or out of date and generally unreliable. For example, CIAT's report states that a number of countries have an urgent need to cleanse the registry of a large number of taxpayers, who are registered but no longer have economic activity, and notes that the ratio of the number of registered taxpayers to the population is low – 23 percent in Latin America versus 59.2 percent in OECD. In addition, a recent article by the Inter-American Development Bank notes that countries in Latin America face low levels of registration of micro[87] and small businesses. Examples include Mexico, where nearly 70 percent of micro businesses are not registered and pay no taxes and only 63 percent of small and medium enterprises are registered, and El Salvador, where it is estimated that only 1 percent of all micro businesses and 3 percent of all other businesses are registered.[88]

5.5. Key Benchmarks and Guidelines

Questioning the taxpayer database should be one of the first steps to take when assessing the current state of a tax administration. As noted in the introduction to this chapter, an administration cannot manage its taxpayers if it does not know who they are, where they are located, and whether they are active or inactive. If the administration fails to maintain a consistently accurate taxpayer database, its compliance programs will be incomplete and ineffective. The following are some key areas where further inquiry may be warranted to test performance of the tax administration and to pinpoint areas for improvement. Although two of the four activities below are compliance in nature, it is important to include them here to highlight the absolute necessity for a clean and accurate registration database:

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[84] International Finance Corporation (n.d.), para. 10-11. This is so even though in Venezuela the federal government, the states, and municipalities all have taxing powers.

[85] Inter-American Center of Tax Administrations (CIAT) et al. (2012), section 5.1.

[86] International Finance Corporation (2013), p. 17. Relevant report years are 2009-2012.

[87] Companies with fewer than 10 employees.

[88] Inter-American Development Bank (2010), para. 9-10.

- The administration should be able to easily provide an accurate breakdown of total tax registrants into active/inactive categories;
- The administration should operate an institutionalized 'stop-filer' program.[89] Such a program follows up on taxpayers who used to file tax returns but have ceased to file in a timely manner. The program must be institutionalized within the organization's formal roles and responsibilities and not done on an ad hoc basis. This program requires an accurate taxpayer registration database as well as a return filing register;
- The administration should perform formalized 'non-filer' programs. Such programs, which may be ad hoc, should be initiated by the administration to discover taxpayers operating outside the tax regime and to bring them within the tax net. These are often implemented across a trade category or geographical area to ensure they are manageable; and
- Information collected during registration should be used to align the tax administration's performance metrics to its operations. For example, the tax administration's knowledge of the size and location of its active taxpayers should be used to rationalize the location and staffing of its offices.

In terms of registration, the types of benchmarks or measures that a tax administration may consider include:

- Time to complete the taxpayer registration process (assuming the taxpayer has provided an accurate and complete application form) – administrations should aim to register a taxpayer 'while you wait';
- Percentage increase in the tax register due to the implementation of (a number of) non-filer programs; and
- Time (number of days) to process all amendments to the register.

[89] A robo –call automated system implemented in El Salvador in 2009 to call stop-filers and other taxpayers has had excellent results as described in Chapter 4.

Chapter 6. Taxpayer Services

Yassie Hodges

The international trend is for tax authorities to administer the tax regime in a way that encourages and expects taxpayers to self-assess their tax liability and then remit the relevant amount of tax to the government. Conceptually, this is a sound approach for two reasons:

- The taxpayer generally has better information on his/her sources of income and expenses; and
- It is relatively expensive for the government to assess every taxpayer's return.

Through the self-assessment process, tax administrations rely on a system of voluntary compliance, where taxpayers pay what is due, when it is due, and without coercion. However, self-assessment will only work if the majority of taxpayers know what their obligations are and are able to comply with them. The overall level of compliance is also improved if the costs borne by taxpayers in carrying out self-assessment are low. Therefore, an essential element of tax compliance is helping taxpayers understand their tax obligations and promoting the inexpensive, voluntary, timely, and accurate reporting of tax liabilities.

Taxpayer service plays a critical role in maximizing voluntary compliance by providing taxpayers with the information and assistance they need to enable them to meet their tax obligations. Taxpayer services curb compliance costs by providing programs that enable taxpayers to fulfill their obligations more easily, thereby minimizing the need for the tax administration to expend more costly resources to enforce compliance. With effective public information, forms, and services, and by convincing non-compliant taxpayers that they can comply with relative ease, taxpayer services can also encourage and help accomplish greater voluntary compliance.

The purpose of this chapter is to address capabilities of a modernized taxpayer service program, outline strategies to assist tax administrations in developing and implementing effective taxpayer service programs, and provide performance indicators to ensure taxpayer service programs are delivering the results intended.

6.1. Leading Practice

Generally, the term "taxpayer services" refers to the manner in which taxpayers are treated (e.g., respectful, fair, professional, etc.). Although these are characteristics of an effective taxpayer services program, taxpayer services in the context of this chapter is defined as a set of strategic initiatives undertaken by the tax administration to assist taxpayers in complying with the tax laws. An effective taxpayer services strategy integrates three broad themes:

- **Tax simplification:** Most tax administrations agree that simplified policies and procedures greatly facilitate voluntary compliance. Without institutional simplification enabling taxpayers to fulfill their responsibilities more effectively, even the most comprehensive services offered to taxpayers will not be effective;

- **Taxpayer assistance:** Taxpayer assistance means providing taxpayers with information to prepare tax returns and to resolve issues of filing, as well as questions and adjustments that may arise after the tax returns have been submitted to the tax administration. These areas of assistance have also been referred to as the pre-filing, filing, and post-filing stages of assistance; and
- **Facilitation of tax collection and enforcement:** The ultimate goal of the tax administration is to collect the proper amount of taxes due to the government. Therefore, providing the mechanism to facilitate the payment of taxes – especially for business taxpayers who are required to regularly remit multiple tax payments for different taxes – is an essential enabling tool to encourage voluntary compliance.

6.1.1. Organization of the Taxpayer Services Program

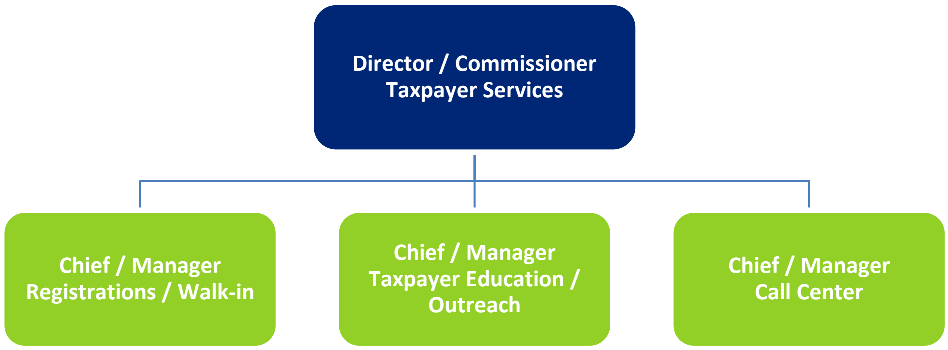
As a tax administration formulates its organizational structure around various functions and/or activities, questions often arise relative to who is responsible for "taxpayer services." Although each employee within the organization must embrace the concept of providing effective taxpayer services, the tax administration should establish a dedicated unit responsible for programs, product design, planning, and coordination of initiatives related to taxpayer services.

The section within a tax administration that is responsible for activities related to taxpayer services has taken on various titles, including: Taxpayer Services Directorate (Costa Rica); Stakeholders, Partnership, Education, and Communication (United States); Service and Collection (Mexico); etc. No matter what the actual function is called, the core responsibilities consistently center on three basic activities:

- **Registration/walk-in:** The objective of this activity is to assist those taxpayers who believe their issues are best handled face-to-face. The scope of the activity includes answering taxpayer questions, furnishing tax forms and publications, and assisting in the preparation of tax returns;
- **Taxpayer education/outreach:** The objective of this activity is to develop and deliver integrated strategic communications and educational products to employees, taxpayers, and other stakeholders, including practitioners and industry groups. The scope of this activity is to develop forms and publications and to review and update these periodically based on changes in law, policies, and procedures; delivered via a variety of channels, e.g., face-to-face, online services, telephone, written, etc.; and
- **Call center:** This activity is dedicated to addressing telephone inquiries to minimize disruption to normal operational activities. Call center operations supported by modern telephone technology are becoming an increasingly significant element in service delivery.[90]

[90] While the tax administrations of some countries, such as El Salvador and Jamaica, have chosen to establish in-house call centers as discussed in Chapter 4, some tax administrations around the world, such as India, have outsourced selected core and support functions, including call centers.

Figure 6.1. Taxpayer service organization



6.1.2. Responsibilities of the Taxpayer Services Program

The taxpayer services division, which generally consumes about 10 percent of a tax administration's human resources[91], generally has responsibility for developing comprehensive taxpayer services strategies linked to the organization's overall compliance strategy and taking into account taxpayer demands, needs, geography, and service channel options.

Most modern taxpayer service functions are the centralized point for providing taxpayer information and educational services and typically include the following activities:

- Registering taxpayers/assigning a unique taxpayer identification number (TIN);[92]
- Maintaining and updating taxpayer registers;
- Interacting with taxpayers who visit, call, or write;
- Providing and staffing taxpayer service counters and call-in operations;
- Responding to general inquiries, including but not limited to registration, filing or payment requirements, basic tax law, and ensuring that taxpayers are routed to other areas as appropriate;
- Providing tax returns and instructions;
- Developing informational and educational publications;
- Conducting seminars on changes to tax laws and procedures for targeted business audiences;
- Monitoring subjects of queries to determine the need for additional educational materials for taxpayers, internal tax administration training, and/or internal operational changes; and
- Developing and maintaining the content of the tax administration website.

Of all the various operating functions of the tax administration, the taxpayer services staff has the most interactions with the general public. They are, in effect, the public face of the tax administration. The staff assigned should therefore have good inter-personal and communication skills, a genuine desire to

[91] IMF (2012), p. 31.

[92] For the reasons stated in Chapter 5, it is important that responsibility for the issuance of TINs be restricted to the tax administration, although in some countries this function has been outsourced to IT service providers.

assist the taxpaying public, the ability to listen effectively, and the ability to stay calm when faced with adversity. Since the taxpayer services function is the initial point of contact with taxpayers, the staff should also have a good working knowledge of tax law, office procedures, and the tax obligations for all tax types.

As the initial entry point for most walk-in, phone-in, or written (paper or electronic) contacts, taxpayer services staff will generally respond to the most common questions and route more complex questions to staff from other functions, such as audit or collections, when appropriate.

Since the information provided by the taxpayer services function may ultimately be utilized to determine a taxpayer's final tax liability, it is essential that advice given to a taxpayer be correct and consistent. Unfortunately, in some jurisdictions, taxpayers have been penalized for relying on incorrect advice provided by the tax authority. In the United States, for example, the courts have ruled that incorrect information provided by Internal Revenue Service (IRS) employees is not binding on the organization, and the taxpayer is ultimately responsible for any additional taxes due, although relief is generally provided to the taxpayer in the form of penalty abatement. The correct tax ultimately has to be computed according to the law, regardless of the quality or lack thereof of respective "inputs." Incorrect advice provided to a taxpayer can be extremely embarrassing to the administration and could negatively impact the public's perception of the administration's overall effectiveness. As a result, staff should be encouraged to seek assistance, when necessary, to ensure that the taxpayer receives the correct information.

As a means to provide more consistent advice and to maximize resources, the international trend is to focus on self-service channels (e.g., online services or telephone interactive tax assistance) for taxpayer service delivery. These services direct taxpayers through a series of prompts for a range of services including e-filing, registration, account balances, etc. However, the OECD 2012 report on "Working Smarter" indicates a continued high demand among taxpayers for live telephone and walk-in assistance – which is the most labor intensive and costly means of service delivery. Therefore, an increased focus has been placed on determining the reason for the service demand and developing strategies to either reduce the demand or shifting to more cost effective service delivery channels.

Figure 6.2. Identifying drivers and root causes of service demands[93]

Methodologies and technologies	Countries
Feedback through interviews with call center agents	Belgium, Canada, Estonia, Finland, Korea, Poland, Singapore, Switzerland
Coding by call center agents on the call topic or tax type (also referred to as Fast Key Codes or Work Codes)	Australia, Canada, Hong Kong, New Zealand, United Kingdom
Interactive Voice Response (IVR) Systems	Australia, Canada, New Zealand, Singapore, United States
Call listening/Quality assurance data	Australia

[93] OECD (January 2012), p. 18.

Methodologies and technologies	Countries
Caller surveys	Australia, Canada, Finland, Hungry, United Kingdom
Databases information on the services provided to taxpayers	Chile, Italy, Mexico, Spain, United States
Contact / speech analytics	Australia, New Zealand, United States
Customer relationship management (CRM) systems	Belgium, Singapore

6.1.3. Developing and Implementing Effective Taxpayer Service Strategies

Taxpayers have come to expect the same level of service from public organizations as they receive from the best private sector organizations. Taxpayers are increasingly becoming more comfortable using new technology and are looking for easier, more efficient, and time effective ways to obtain information and interact with government agencies. To effectively meet taxpayer demands, administration staff must embrace the concept of viewing the taxpayer (customer) as the most important person to the organization. Outlined below is a strategy for developing and implementing an effective taxpayer services program.

A. Identify the Target Group

Customer segmentation approaches to the delivery of services have become increasingly significant, and there is a growing understanding that taxpayers cannot be treated as a homogenous group.

1. The tax administration should begin by identifying the target taxpayers and by considering point of service delivery or receipt;
2. Taxpayers should be clustered or segmented based on their common behaviors (e.g., small, medium, and large taxpayers);
3. The tax administration should determine the priorities of various clusters of taxpayers; and
4. Consideration should also be given to the needs of tax practitioners, tax preparers, and other third parties involved in facilitating taxpayer compliance.[94]

B. Determine What Taxpayers Want … From the Taxpayer's Perspective

The objective here is to understand the root causes of service demands. Utilizing the information secured, the tax administration should develop strategies to reduce demand by identifying the most effective and cost efficient means to address issues presented.

1. The tax administration should determine what target taxpayers want by simply asking them via interviews, surveys, focus groups, etc.;
2. Taxpayer service can be improved by conducting periodic surveys[95] to monitor taxpayer perceptions about taxpayer service and other compliance issues;

[94] Such as the Taxpayer Representatives' Center established in Puerto Rico (see Chapter 2).
[95] Guidance on these types of surveys is provided in World Bank (2011).

3. The tax administration should use focus groups, surveys, and other feedback methods before implementing new services and procedures. In order to minimize the burden on taxpayers, these should be coordinated with other planned activities;
4. Trends from data collected in house reflecting type of service demand, volume, etc. should be evaluated to enhance service delivery;
5. The tax administration should consider whether input secured via surveys, focus groups, etc. is something that the organization does, is capable of doing, or wants to pursue;
6. Agreed upon feedback should be incorporated into business process improvement initiatives; and
7. In order of priority, the tax administration should determine which input taxpayers provide would most impact revenue, cost, trust, or compliance, if performance delivery were to be improved.

Box 6.1. Taxpayer feedback in Sweden[96]

The Swedish population trusts the Swedish Tax Agency to a higher degree than any other Swedish government agency. In 2011, 62 percent of citizens and 68 percent of businesses stated that they trust the way the agency handles its duties, and 96 percent of visitors and 97 percent of callers stated that they were treated respectfully. The following are extracts of a paper[97] presented by the Swedish Tax Agency at the 2012 46th CIAT general assembly:

- The agency understands that their service should not be built on their own internal view of reality, as what its staff think is efficient or a good service may not be viewed as such from the perspective of the taxpayer;
- The agency uses quantitative and qualitative methods to measure service quality and taxpayer feedback and engages external companies to collect the information;
- In quantitative surveys, the agency scans taxpayer experiences with various taxpayer service channels. These surveys are normally carried out four times during the year, with some broader surveys performed once a year; and
- With qualitative studies, the agency hopes to get more information to understand the underlying factors affecting taxpayer experiences. These studies are focused and are usually not repeated.

C. Establish an Organizational Culture Supportive of Taxpayer Service

Utilizing the information gathered from taxpayer feedback, the tax administration should establish its taxpayer-focused vision and mission statements to help clarify and communicate the administration's purpose.[98] The mission and vision statements must be understood and shared by every staff member within the agency.

1. The key function of a tax administration is to collect revenue. As a result, every activity undertaken should be geared to the ultimate objective of enhancing revenue collection. At the same time, the manner in which revenue is collected must be fair, professional, and respectful;

[96] Swedish Tax Agency (2012), p. 3-6.
[97] Ibid., p. 3-6.
[98] The tax administration's mission and vision are also discussed in Chapter 15.

2. The vision and mission statements should clearly address both "Revenue" and "Service" – two key elements that are essential to meeting the agency's objectives; and
3. The tax administration should continually reflect on the vision, goals, and the way services are delivered to taxpayers, and should be willing to change existing practices to integrate improvements.[99]

D. Implement a Strategic Service Concept with a Focus on external Stakeholders

The strategic service concept with a focus on external stakeholders establishes how the tax administration designs, markets, and delivers services to taxpayers.

1. The tax administration's strategy should focus on taxpayer/stakeholder needs, rather than on organizational priorities. For example, Large Taxpayer Offices (LTOs) in many tax administrations around the world have their own taxpayer service units to handle their clients' more complex issues, including international taxation issues;
2. It should incorporate agreed upon feedback solicited from taxpayers/stakeholders in improvement initiatives;
3. Utilizing taxpayers'/stakeholders' feedback, the tax administration should develop a range of service options for interacting with taxpayers. These are also referred to as "channel" options and may include face-to-face, telephone, online, and other interactions as presented in the figure below;
4. Advertising/educational outreach strategies should meet appropriate taxpayer expectations;
5. A continuous feedback loop should be provided for incorporating taxpayer comments and complaints into the planning processes; and
6. Taxpayer satisfaction with the services provided should be measured regularly, and feedback should be used for continuous improvement.

Figure 6.3. Strengths and weaknesses of channel options[100]

Channel	Description	Strengths	Weaknesses
Electronic			
Internet	Websites for one-way **information** dispersion from one to many **Interactions**, such as the use of online calculators and other tools Web portals that include **transactional** services with secure log-in options, such as e-filing	• Can be accessed 24 hours a day/7 days a week • Low cost per visit. Cost per visit decreases as accessibility increases • Can address small segment needs in a cost effective manner • Can be personalized • Can present complex information in an easy way, • Can push information to the client, either through list service or by placement of account specific information	• The user must actively search the information (pull) • Not all have access to internet • Content may be too general • Can be difficult to find information • May require rigorous security measures • Can trigger more contact with revenue body.

[99] As discussed in Chapter 15.
[100] OECD (2007), p. 24.

Channel	Description	Strengths	Weaknesses
		in secure space	
E-Mail	Structured: mainly via web forms on the Internet Unstructured: free text from an email program or website **NOTE:** Used significantly less than other channels	• Can send e-mail 24/7 • Many are familiar with use of email	• Often not a secure solution for sending personal information • Difficult to meet client expectations, they often expect immediate answer (almost as a phone call) • Time sensitive and labor intensive • Can trigger more contact with revenue body.
Interactive Kiosks	Different types of unmanned kiosks. Can be used for information, interaction, or transactions.	• Can be available 24/7 if in a public space • Low cost	• Security, vulnerable for hackers • Can be uncomfortable to deal with your personal data in a public space.
Telephone			
Telephone – Live Representative	Calls to local tax offices or different types of call centers or contact centers (which also includes other channels) **NOTE:** Most popular service delivery	• Immediate answer, interactive • Ability to probe effectively • Facilitates channel integration, e.g., co-browsing, click-to-talk Web/Phone integration and making face-to-face appointments • Often preferred channel by taxpayers • Can handle large volumes	• Can be high cost • Can be challenging to accommodate flexible capacity, in particular for peak periods
Telephone - Automated	Automated services that can provide both information and interaction services, as well as transactional services, in some cases.	• Access 24/7. Independent of time and geography • Easy to use if properly configured • Low cost • Flexibility, popular	• May be limited to a narrow range of services • Low client tolerance for automated systems • Poor customer service when poorly configured • IVR can be expensive and difficult to configure • Phone Charges Can be expensive
SMS	Messaging via mobile phone. Can be used for notification services (outbound) and for filing or ordering forms (inbound) in a few countries	• Access 24/7. Independent of time and space • Mobile phone readily available • Low cost • Easy to use • Appeals to young people	• Limited options, small screen • Security • People changing mobile numbers • Not yet the acceptance as channel for self-service (still an emerging technology)
Written			
Letter	Outbound letters from the tax administration, or inbound from taxpayers. Increased use of scanning for automation of handling process **NOTE:** Downward trend in demand	• Most people are very comfortable with paper products	• Takes time from sender to receiver • Time consuming handling. • Expensive to process

Channel	Description	Strengths	Weaknesses
Mass Distribution	Distribution of mass-produced written material, like forms and brochures, from the tax administration to target groups or all taxpayers	• Proactive from tax administrative perspective (push) • Most people are very comfortable with paper products • Suited for presenting information in a logical order. • Easy for taxpayer to study content as many times as needed	• Can be very expensive • Received by users who may not need info • Uncertainty related to recipients level of understanding • Tends to prompt high volume of low value inbound contact • Encourages traditional behavior
Face-to-face[101]			
Walk-in	Counters at local tax offices, or counters at local public offices shared with several other public agencies **NOTE:** One of the primary service delivery channels	• Provides direct and personal contact • Allows for assisted self-service to encourage channel migration • If by appointment, eliminates waiting times	• Limited access in time and place. • High cost • Less equitable, limited number of office mostly in larger urban communities
Outreach Activities	Tax officers offer face-to-face services in public spaces like shopping malls, libraries, schools, railway stations, airports, place of business, etc.	• Can target special user groups. From one to many – meet many at once • Proactive. Can prevent unnecessary contact	• Time consuming

E. Implement a Strategic Service Concept with a Focus on Internal Stakeholders

The internally oriented strategic service concept establishes how the internal processes of the tax administration will support the taxpayer-focused vision. The premise is capable workers, who are well trained and fairly compensated, provide better service, need less supervision, and are much more likely to stay on the job.

1. The tax administration should ensure leaders of the organization exhibit the administration's values. Leaders must foster the creation and testing of new ideas and be willing to change existing practices to integrate improvements;
2. The tax administration should identify employee groups that are important to implementing the externally oriented service concept. Frontline workers are of central importance;
3. There should be a focus on continuous training and employee development;
4. The tax administration should not assume staff knows how to treat taxpayers in a friendly, helpful, and professional manner. These skills can – and should – be taught to ensure that everyone in the organization is on the same page in terms of taxpayer service;

[101] Face-to-face interaction is not limited to public offices. The tax administration can partner with local chambers of commerce, industry associations, and other private or commercial groups and use their premises to provide taxpayer services.

5. Frontline employees should be empowered to take initiative to satisfy the taxpayer. Management must support employee empowerment, while clearly defining the parameters of that empowerment and remaining flexible to encourage creativity;
6. In addition to skills and empowerment, frontline personnel should be equipped with the technology, information, and internal resources to meet taxpayers' needs;
7. The tax administration should ensure that individuals throughout the organization communicate. Frontline employees need information and a support network.

The overall objective of a strategy for taxpayer services is to educate the taxpayer, develop effective processes and procedures, and make access to appropriate information so easy that the taxpayer will have minimal or no need to contact the tax administration in order to comply with tax payment responsibilities.

6.2. Common Trends

As a result of advances in technology and service delivery in the private sector, taxpayer's expectations of tax agencies have increased. However, with increased budget constraints, agencies are continuously exploring ways to deliver services better, faster, and at lower cost. From these efforts, several trends are emerging, including use of taxpayer feedback / involvement, increased focus on the use of technology, and analyzing root cause of service demands to determine appropriate service delivery channel.

Taxpayer feedback and taxpayer involvement: Agencies are increasingly engaging taxpayers, soliciting their feedback, and making improvements based on information received. The feedback received is used to help determine the service enhancements needed to improve taxpayer satisfaction. Improvement initiatives and new service strategies are incorporated into the Agency Strategic Plan and Annual Performance Plan to ensure agreed upon actions are pursued.

Use of technology: Tax administrators are aggressively exploring the use of technology to enhance service delivery. The trend is to migrate to self-service channels, which are deemed to be more cost effective than face-to-face and/or live telephone interactions.

Box 6.2. Self-service options in the United States

The U.S. IRS provides a number of self-service options. Through the IRS online portal, and without interventions by tax officials, taxpayers can:

- Use the "Where's My Refund?" portal functionality to check on the status of their refunds and the estimated date of refund payment.
- Use the "Free File" functionality, maintained by an IRS authorized e-file provider, and electronic fillable forms to file and pay electronically.
- Pay via the Internet or by phone through the U.S. Department of Treasury's Electronic Federal Tax Payment System.
- Use the Interactive Tax Assistant to obtain responses to tax law questions on a limited set of common topics.
- Apply for a TIN and receive one immediately.

- Register to become a tax preparer or an "enrolled agent" – a person who can represent taxpayers before the tax administration.

The service options range from a simple list of frequently asked questions to advanced online applications that give taxpayers access to detailed information and services to address their inquiry. Instead of contacting taxpayer service representatives, they can access information via telephone or online to find a solution twenty-four hours per day - seven days per week. Some agencies have closed offices and promoted online services as a viable option for service delivery. Examples of the type services that may be available include:

- Securing copies of forms and publications;
- Securing transcripts of accounts;
- Registering a business;
- Checking the status of refunds;
- Filing returns;
- Paying taxes;
- Securing installment payment agreements; and
- Accessing responses to tax questions, etc.

Root cause analysis: In order to develop the most effective channels to assist taxpayers, a trend is leaning towards evaluating root causes for service demands – the reason the taxpayer needed to contact the agency, the rationale for the channel option they decided to use, as well as the reason for the taxpayer experience with the service.[102] For example, if significant resources have been invested in developing responses to Frequently Asked Questions and access to this information is readily available via online or automated telephone delivery channels - yet taxpayers continue to utilize face-to-face options – the question should be why? The answers may be poor website design, difficult to use, improper links, lack of awareness, etc. The root cause analysis would help in addressing the core of the problem in an effort to devise mitigating strategies to eliminate, reduce, or shift taxpayer demands to more efficient service delivery channels.

Other trends in taxpayer service delivery are outlined in the table below.

Figure 6.4. Trends in taxpayer services[103]

Trends in Taxpayer Service
1. Understanding an appropriate balance of resources between enforcement and service is a critical tool in achieving higher overall tax compliance as a measure to improve voluntary compliance.
2. Treating taxpayers as clients with rights that are codified in the form of charters, etc., and publicized.
3. Public Agencies work together to provide coordinated services to clients.

[102] In the case of the latter and as discussed in the example above, the Swedish Tax Agency has opted for qualitative taxpayer surveys to get a better understanding of the experiences of taxpayers with specific, focused issues.
[103] IMF (2012), p. 31.

Trends in Taxpayer Service
4. Tailored approach of service delivery to match the needs of various taxpayer segments and the risk to revenue.
5. Modern marketing techniques are extensively utilized to influence taxpayer behavior.
6. Services staff are highly qualified in terms of being able to match the expectations of taxpayers and those of professional tax accountants and advisors.
7. Establishment of client call centers and a move towards larger and more centralized service centers to ensure delivery of consistent, high quality service that enables specialization (e.g., by taxpayer segment or tax type and procedure).
8. Services are available independent of time and place in step with the growing possibilities for electronic services (e.g., interactive telephones, e-services, and websites).
9. Provision of dedicated inquiry services for tax professionals.
10. Goal to move taxpayers to web and e-services with compulsory e-filing and payments requirements for certain taxpayer segments (e.g., large taxpayers) and annual targets for take-up rate.
11. Taxpayer services (excluding staff involved with returns filing and coding) consume about 10 percent of tax agencies' human resources.
12. Consulting widely with taxpayers and/or their representatives prior to the implementation of changes.
13. Establishing and monitoring service delivery performance according to prescribed performance standards; measuring client satisfaction; and demonstrating accountability by publicizing the levels of performance achieved against service standards set.

6.3. Tax Administration Maturity

The use of a maturity model allows an organization to assess its policies and procedures against a set of benchmarks. The four levels of maturity with respect to taxpayer services are described below to help interested officials make self-assessments about strengths and weaknesses in their respective tax administrations. It is estimated that an organization can take two to four years to progress through the first three levels of the maturity model. Therefore, management must view the taxpayer service improvement process as a multi-year effort.

Taxpayer Services: Maturity Level 1

Key word: "Ad hoc"

- The tax administration may undertake a number of different initiatives to improve taxpayer services as a vehicle for improved voluntary compliance and enhanced revenue, but without making any major investments. A series of uncoordinated taxpayer services efforts have been initiated.
- Taxpayer service units are severely understaffed, with personnel not trained to do the job effectively, resulting in a high level of taxpayer contact.

- New employees only receive informal on-the-job training on procedures (e.g., for visits), communications techniques, and managing conflict. Existing employees do not receive refresher courses or other training.
- Information, support, and education are usually limited to a single channel – a visit to the tax office – and are hence specific to each taxpayer's individual inquiry and provided only when the taxpayer visits the office.
- Taxpayers frequently wander into work areas to deal with technical staff, increasing potential for collusion and disclosure of confidential information.
- One-on-one assessments, rather than self-assessment, are the rule and create extensive face-to-face contact with the taxpayer.
- Unreliable registration, TINs, and taxpayer accounts create difficulty for taxpayer service staff in resolving taxpayer accounts, thereby negatively impacting the level of service provided.
- Most of the work is done manually since little modern technology and equipment is available, and that which does exist is supported by outdated technology, thereby limiting access to taxpayer account information and hindering the level of service provided.
- The level of service is ad hoc and inconsistent, with little communication between functions, due to different levels of institutionalization of procedures across taxpayer service units and varying staff skill levels. Minimal procedural manuals are developed on an ad hoc basis.
- Efforts by top-level officials to establish good relationships with some public and private sector groups – particularly with public accountants – are initiated but lack coherence and stability.

Taxpayer Services: Maturity Level 2

Key word: "Formalized"

- The tax administration recognizes that it is worth investing capital and personnel in taxpayer services. The overall approach to taxpayer service becomes more organized with an emphasis on fixing problems.
- Managers focus on the level of service provided to taxpayers via the goals and objectives outlined in strategic plans, along with the development of vision and mission statements with an emphasis on service.
- Recruitment of personnel with customer service friendly skills is undertaken, and staff development and training are initiated. New tax administration staff receive some formal course training and on-the-job training on procedures (e.g., for visits), but ad hoc, irregular training on communication techniques and managing conflict. Existing staff receive occasional, but irregular, refresher courses.
- Within tax offices, taxpayers may on occasion be sent from reception areas to work stations to meet and deal with technical staff, thereby facilitating possible collusion and risking disclosure of information.
- Brochures, informational publications, and Frequently Asked Questions have been developed and are available in hard copies and via the administration’s website.

- Information, support, and education are limited to ad hoc, very high-level instructions for common processes (e.g., filing). These are updated very rarely, usually with changes in the law.
- Information, support, and education are tailored to type of tax, but not to types of taxpayers. Information, support, and education are limited to a couple of channels and vehicles (typically narratives on the government's web sites and paper brochures).
- Coordination between the functional areas is initiated in an effort to enhance the level of service provided. There is a somewhat proactive effort to promote the concept of voluntary compliance through outreach and educational campaigns.
- Taxpayer service personnel are aided by more aggressive campaigns to clean up the registry, TINs, and taxpayer accounts.
- The level of taxpayer service provided is more consistent due to procedural and policy manuals for each of the functional units.
- Relationships with public and private sector groups are improving.
- Only limited modern technology and equipment are available to enable access to information to assist in resolving taxpayer concerns.
- Because of the investments made in taxpayer services, senior management becomes anxious and wants quick results, adding pressure on a function that is not yet at a sufficient level of development to make significant improvements.

Taxpayer Services: Maturity Level 3

Key word: "Integrated"

- The tax administration embraces taxpayer services, because it understands the direct impact on domestic revenue mobilization. Taxpayer service is no longer limited to the Taxpayer Services Department, but rather has become a major transformational effort across the administration. Instead of fixing problems, the focus turns to business process reengineering to enhance the level of taxpayer service provided. There is a focus on improving the level of service provided across the full life cycle of a taxpayer interaction with the organization – from registration to deregistration.
- Units are properly staffed with personnel trained in effective communication, conflict resolution, etc. New and existing tax administration staff receive formal course and on-the-job training on procedures (e.g., for visits), communication techniques, and managing conflict. However, the curriculum and course content are not updated regularly.
- Separate interview rooms have been established to protect taxpayer privacy and to secure confidential information. Technical functional staff meet taxpayers in interview rooms in the taxpayer service reception area, and taxpayers are permitted to enter staff work spaces only on rare occasions.
- Various channels have been established to interact with the tax administration, including face-to-face, telephone, and online. There is, however, a need for expert technicians for complex queries.

- Information, support, and education are provided through somewhat detailed instructions and usually for common processes (e.g., filing, but not audit or collections). These are updated rarely and not on the basis of taxpayer feedback. Taxpayer services are tailored by taxpayer segment (individual / business, large / small, etc.) and by type of tax.
- A business process review begins, with an evaluation of current practices, through an analysis of people, process, and technology focusing on efforts to enhance the level of service provided.
- The tax IT system ensures that taxpayer service personnel have ready access to appropriate information to properly address taxpayer concerns.
- The administration places increased focus on training and enabling employees to deliver excellent taxpayer service.
- Relationships with public and private sector groups have improved, and regular outreach forums have been initiated.

Taxpayer Services: Maturity Level 4

Key word: "Strategic"

- Taxpayer experience is a key concern of every initiative undertaken. All employees feel ownership for maintaining a culture of strong taxpayer service, and executives no long focus on change management.
- Every decision within the organization takes into consideration the needs of the taxpayer.
- Units are properly staffed with personnel trained in effective communication, conflict resolution, etc.
- New and existing tax administration staff are subject to formal course and on-the-job training on procedures (e.g., for visits), communication techniques, and managing conflict. The curriculum and course content are updated regularly.
- At the field office locations, technical functional staff meet taxpayers in interview rooms in the taxpayer service reception area, and taxpayers do not enter staff work spaces.
- Information, support, and education are provided across all tax administration functions (e.g., registration, filing, payment, etc.). These are detailed and are updated regularly based on taxpayer feedback. Taxpayer services are tailored by taxpayer segment (individual / business, large / small, etc.) and by type of tax.
- Taxpayer services use multiple channels (telephone, web, paper) and vehicles (FAQs, instructional brochures, expert technicians responding to complex questions, and generalists for other questions).
- Stakeholder boards consisting of members from the general taxpayer population of small, medium, and large taxpayers, accounting firms, and chamber of commerce groups have been established to provide feedback/input prior to initiating new laws, policies, and procedures.
- Employees are fully aware of the administration’s service policies, which are part of the hiring process, the new employee training programs, and reinforced by management leading by example on a day-to-day basis.

- As a result of a robust tax IT system, taxpayer service personnel have ready access to appropriate information to properly address taxpayer concerns.
- Taxpayers can interact with the administration's data base to file returns, make payments, secure account information, and quickly secure answers to tax questions via self-assessment tools.
- The tax administration has achieved its overall objective of educating the taxpayer, developing effective laws, processes, and procedures, and making access to appropriate information so easy that taxpayers have minimal or no need to contact the tax administration in order to comply with tax filing and payment responsibilities.

6.4. Latin America and the Caribbean

Almost all Latin America and the Caribbean (LAC) countries have initiated some form of taxpayer service program. For example, Peru's tax administration – Superintendencia Nacional de Administración Tributaria (SUNAT) – makes constant outreach and education efforts among taxpayers to inform them of their tax rights and obligations as a means to facilitate voluntary compliance. Costa Rica has adopted a similar approach via its tax reform bill – Proyecto de Ley de Ordenamiento Fiscal – and incorporated a one-stop filing process, in conjunction with other government agencies, for taxpayers registering a business. Bolivia has developed a series of brochures for its outreach programs. Chile has made intensive use of IT to facilitate taxpayer assistance. Several countries (Argentina, Chile, Dominican Republic, and Mexico) have increased reliance on web portals to provide services and confidence to taxpayers.[104]

The Chilean tax agency can be viewed as leader in LAC in terms of its strategic decision to use the Internet as its main channel of interaction with taxpayers, as highlighted in the box below.

Box 6.3. Taxpayer services in Chile

In 2003, the tax administration of Chile Servicio de Impuestos Internos (SII) won the United Nations Good Practices and Innovations in Public Governance Award for its web-based tax management system, which aided in making tax compliance easier and less costly for taxpayers. The site has also won several other awards, including the "Technology Innovation Award" from the Chilean IT Association, a Management Innovation Award from the Chilean government, and the award for the best public institution website in the country from readers of *El Diario* newspaper. SII data show 155 million visitors to the website annually.

The SII website performs two key functions: 1) it enables taxpayers to communicate directly with the tax administration online; and 2) it serves as a channel for providing an array of information. The information available can be grouped into the following categories:

- Informative: Provides taxpayer (general and specific) information relative to tax regulations, personal information contained in the SII databases, opinion studies, news, etc.
- Transactional, oriented towards compliance: Facilitates business registration, tax declarations filing, deregistration at end of business activity, the issue of electronic tax documents, and tax payment of all types.
- Transactional, auditing: Allows the taxpayer to provide and/or correct information.
- Tax portal for foreign investors: Provides information on investing in Chile.

[104] Inter-American Center of Tax Administrations (CIAT) et al. (2012), section 6.5.

- Tax portal for micro, small, and medium businesses: Allows micro, small, and medium-sized enterprises to obtain electronic tax documents, at no cost to them, directly from the website.
- Tax education portal: In conjunction with the Ministry of Education, SII has made a Portal of Tax Education available to teachers and children, with a focus on educating children about taxes and the social benefits they produce.
- Pre-populated returns: Contains electronically pre-populated returns based upon information received from third-party sources.

LAC taxpayer assistance programs should generally be placed in the second level of the maturity model above, noting of course, that there are differences, including some countries that are much further along. The approaches utilized to enhance service delivery in LAC are centered on the following key areas:

- Information services: The most common tools include advertising campaigns, informational brochures, letters, and practical handbooks, instructions, and guides.
    - Advertising campaigns: This is the principal tool used by the tax administrations to offer assistance services or raise tax awareness around issues of special interest and significance for compliance.
    - Informational brochures: These are designed to provide taxpayer specific information on a range of topics impacting voluntary compliance, while also making the public aware of services provided.
    - Letters: Letters are mailed to groups of taxpayers as reminder notices or to make them aware of changes that impact them.
    - Practical handbooks, instruction, and guides: These guidelines are developed to assist taxpayers in preparing their own tax returns.
- Assistance services: Telephone and face-to-face channels are the primary methods made available to taxpayers to facilitate their compliance with tax obligations through assistance on preparing tax returns, explanations relative to technical aspects of the law, information on procedural requirements, etc.
- Information technology: As noted above, there have been increased efforts to provide online taxpayer services. Available online services include those for general and restricted use, as described below:
    - General use: Through these services, any taxpayer can have access to general information, such as forms, brochures, frequently asked questions, etc.
    - Restricted use: These require some form of secured login to file returns and make payments, inquire about taxpayers' account status, etc. These uses are typically at the early stages of development in LAC.

Quality taxpayer service is a main goal in the strategies of many LAC tax administrations. In Belize, the tax administration's strategic plan calls for improving and providing service and education in the pursuit of voluntary compliance through available information, quality service, an accurate taxpayer register, communication programs, the development of the capacity of staff, and a pilot one-stop shop.[105] Ecuador has conceptualized a "model citizen service" approach based on establishing the proper processes, opening assistance channels, and developing the appropriate culture of tax administration.[106] A recent CIAT study[107], however, notes that, while such goals may be comprehensive and there has been some improvement, implementation lags in certain areas. For example, while taxpayer satisfaction surveys are common, allowing taxpayers the ability to view their records is largely non-existent. While it is possible to file through the web in all Latin American countries, seven do not allow online payments.

6.5. Key Benchmarks and Guidelines

Once an administration has implemented a taxpayer service program, performance indicators will help define and measure progress towards established goals and objectives.

Taxpayer service performance measures generally center on the level of service provided in terms of timeliness and quality. The table below reflects common performance activities along with international standard benchmarks as reflected in OECD Comparative Information Series (2010). As the taxpayer service program progresses through the maturity model, the time expended should be reduced accordingly.

Figure 6.5. Benchmark standards in taxpayer services

Performance activities	Benchmark standards
1. Responding to written correspondence: electronic or paper	15 – 30 days
2. Handling face-to-face inquires	10 – 15 minutes
3. Answering telephone inquiries	2 – 5 minutes
4. Resolving taxpayers complaints	15 – 30 days

Other types of activities related to taxpayer service, which are often tracked in conjunction with the performance activities reflected above, are as follows:

1. Total number of taxpayers assisted: face-to-face / telephone;
2. Total amount of correspondence received and responded to: paper / electronic;
3. Total number of electronic hits: Internet / kiosks;
4. Total number of advisory visits made;
5. Total number of educational seminars conducted; and
6. Total number of media coverage received.

The ultimate performance measures, however, are used to determine how the service provided impacted voluntary compliance. For example:

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[105] Belize Department of General Sales Tax (n.d.), p. 9.
[106] Servicio de Rentas Internas Ecuador (2012), p. 3.
[107] Inter-American Center of Tax Administrations (CIAT) et al. (2012), section 6.5.

1. What was the percentage reduction in inquiries following an educational or outreach effort?
2. Was there a spike in self corrections of previously filed returns?
3. Was there a spike in voluntary filings?
4. Was there a spike in voluntary payments?
5. Was there a difference in the compliance level of taxpayers who received assistance as compared with those who did not?
6. Was there a difference in the compliance level of taxpayers who attended educational or outreach events as compared with those who did not?

Once the tax administration has established the appropriate measures, it must communicate them to all stakeholders and put in place a regular reporting mechanism to gauge progress. At a minimum, results should be evaluated monthly and appropriate action taken to continuously improve performance.

Chapter 7. Filing and Payment

David Crawford

This chapter is intended as a tax administrator's guide to filing and payments and provides observations on some of the more frequently encountered problems and insight on approaches to resolving them. Filing and payment processing is not an end on its own, but is an essential part of the chain of events that results in obtaining and storing information that is used for other functions, such as collections, audit, revenue reports, and tax analysis.

7.1. Leading Practice

With respect to filing and payment, the tax administration has two primary concerns. First, taxpayer filings and payments require significant processing and must be done efficiently, at minimal cost, so that the tax administration can use its resources for other activities. Second, the tax administration must work to ensure that taxpayers comply with filing and payment requirements. Since filing and payment are the two primary obligations of taxpayers, compliance, including appropriate sanctions when a taxpayer fails to comply, is addressed at length in this chapter.

Throughout this chapter, a "compliant" taxpayer is one that:

1. Registers for tax purposes;
2. Files tax returns, including information returns, by the date required in the law;
3. Correctly reports tax liabilities; and
4. Pays the tax by the date required in the law.

The requirement to make tax payments based on some form of liability has been a fact of life since before biblical times. The administration of taxes slowly evolved over the past couple of millennia, but the pace quickened during the latter part of the 20th century through the introduction of self-assessment, improvements in management and organizational structures, an improved legal framework, and, most importantly, the introduction of better working tools – namely, automation, coupled with advances in communication and banking. With these changes tax administrations have been able to both rapidly process returns and identify non-compliant taxpayers.

7.1.1. Self-Assessment

Before beginning a discussion on filing returns and how to best gain compliance, a brief discussion concerning the main underpinning principle of modern tax policy and tax administration is worthwhile. Most modern tax administrations are based on a self-assessment system[108]. In recent decades, there were major changes that tax administrations had to cope with: the general population was growing,

[108] Self-assessment is also briefly discussed in Chapter 3.

economies were changing, small and medium-sized taxpayers were becoming more prolific, and tax law was becoming more complex.

Tax administrations found they were trying to cope with organizational structures and work methods that were developed when the tax legislation was not as complex during an era when they were dealing with much smaller workloads. Under these old methods of administration, a tax officer would often be assigned to specific taxpayers. This tax officer was responsible for the all-inclusive administration of the tax law as it pertained to "his/her" group of assigned taxpayers. This responsibility included the delivery of tax returns to these taxpayers, responding to taxpayer questions, mathematical verification of tax liability, collection of accounts in arrears, obtaining returns from non-compliant taxpayers, and auditing their assigned group of taxpayers. The strategy of assigning specific taxpayers to specific tax officers and involving these officers in preparing or checking each tax return at the time it was submitted, plus all other administrative activities, necessitated constantly increasing staff levels as the number of taxpayers increased. This became impractical, as most tax administrations did not have sufficient funds to continually grow, and caused tax administrations to instead reduce the time spent on enforcement activities.

It became evident that the processes surrounding tax return filing, tax payments, and the collection of tax arrears required significant changes, with or without the existence of a self-assessment system. To a large extent, administrative pressures and progressive management thinking led to the concept that the taxpayer ultimately knows more about their tax affairs than anyone else, including the tax officer. If a taxpayer is provided clear information, simple procedures, and sufficient encouragement, then he/she can calculate and remit the correct amount of tax without assistance from either the tax administrator or commercial tax preparers.

This is the **self-assessment system** – taxpayers are provided with information that gives them sufficient understanding of their tax obligations and rights and enables them to calculate their own tax liabilities, to complete their tax returns, and to remit the correct amount of tax at the time required by the law. There is no intervention by a tax official in this process to check that each return is correct. Although the tax administration reserves the right to audit returns, it does so selectively and at a later stage.

Self-assessment has become one of the basic strategies that permit tax administrations to effectively administer the country's tax laws. It places more responsibility on the taxpayer, because each tax return must now be prepared without the direct assistance and confirmation of a tax administrator. A self-assessment system is much more efficient for the taxpayers, as well as for tax administrators. Taxpayers no longer have to spend hours in long lines each month waiting to have "their" tax administrator accept the tax return, or come back repeatedly if their tax administrator is unavailable. Tax administrations can introduce greater specialization in their operations by organizing staff to specialize in particular functions. This organizational change allows taxpayers to direct questions to a team of tax information experts, without having to locate or wait for their particular tax administrator.

Self-assessment is a system within which taxpayers have a duty to:

- Report the facts on which their liability for tax is computed;
- Compute their liability for tax;
- File a tax return showing the result of that computation; and
- Pay the tax (usually the filing date and payment dates coincide) owed at the time of filing.

As discussed in this and other chapters, the general conditions necessary for a properly functioning self-assessment system are:

- Stable tax law;
- Taxpayer services;
- Simple filing and payment procedures;
- Effective non-compliance detection and enforcement;
- Selective risk-based audit programs;
- Fairly applied sanctions; and
- Fair and timely dispute resolution.

7.1.2. Legal Framework

Modern tax administrations have the responsibility to collect the proper amount of tax at the least cost. This begins with the legal framework. It is important that the legal provisions contain the tools to require taxpayers to correctly file returns and remit the proper amount. Tax laws should contain provisions for:

- Who is required to file a return;
- The time at which a return is required to be filed;
- How returns can be amended;
- Where the return must be filed;
- What information must be provided (form[109]);
- Authority to demand a return that has not been filed;
- What tax is to be paid, whom it is payable to, and where it is to be paid; and
- Appropriate sanctions that will be applied where a taxpayer fails to comply.

As discussed in Chapter 3, some tax administrations place the general rules relating to returns (e.g., who is required to sign the return and other procedural matters) in a general tax administration law and leave a separate, tax-specific law to determine who is required to file the return and the filing deadline. In other countries, the substantive law may be self-contained, having all the necessary provisions for its administration within the one law for a specific tax. Still another approach is for all the (national) tax laws to be organized into a single law or tax code. In keeping with the principles of self-assessment and making it as easy as possible for the taxpayer to comply, consolidating all the provisions into as few laws

[109] Forms, depending on the country's legal system may be: 1) required to form part of the primary law as a schedule that can only be amended through the legislative process; 2) prescribed by subordinate legislation such as by regulation; 3) may be prescribed by the tax administration with appropriate notice being published. This latter system of administratively determining the content of forms makes it easier to amend forms when necessary.

as possible is the preferred approach. A tax code, being the ideal situation, removes the potential for conflicts and confusion that can develop when provisions are scattered across more than one law.

The requirement to file the tax return generally specifies that all persons who are taxpayers are required to file a return and remit the tax imposed by that law to the government. The law broadly defines who is a taxpayer and requires that they file a return, including, for example, anyone who exceeds a certain threshold or is engaged in a certain type of activity, regardless of whether they had come forward and registered or not.[110] This construction eliminates the need for additional provisions that describe the need for filing returns and paying tax by taxpayers, who have failed to register.

In addition to the requirement to file a return, there should not be confusion about the requirement to sign a return. In the absence of an e-file provision in the tax law or an all-encompassing e-commerce law, tax administrations require original signatures signed in ink. In most tax jurisdictions, the general assumption is that the signature on the return is presumed to be valid unless the person claims the signature was not theirs and proves it. In many jurisdictions, the law or regulations provide for tax preparers to sign original returns in a special block on the return that indicates it was prepared by a person who was paid to prepare the return. Of particular importance are the provisions relating to corporations. The legal norm is that returns are signed by an officer of the company, which would normally include the president, vice president, treasurer, chief accountant, or any other person, who is authorized to sign. Similar to other returns, a paid preparer, such as an accounting firm, can sign the returns for a corporation. It is important to note that, although the preparer may have been engaged by the corporation to file the return, unless there is a valid designation authorizing the tax administration to communicate with the preparer, such communication would be prohibited under the secrecy provisions of most tax laws.[111]

Notable and typical shortcomings to providing a sound legal basis to file tax returns and remit the required amount of tax in some countries include:

- The law requires a return to be filed, but fails to specify the form. Countries should require that forms be published in one of the following ways: (a) as part of the substantive law, which requires approval by the legislature; (b) as part of a regulation, which, within the regulatory process, may or may not require approval by the legislature depending on the legal system; or (c) as part of an administrative action, which only requires approval by the head of the tax administration and some form of public notification. Failing to specify the form can have the unintended result that a letter or anything submitted has to be considered a return. Such submissions are difficult to computerize. In some jurisdictions, the failure to specify the return form renders the requirement to submit a return void until such time a form is specified;

[110] In the case of VAT, it is common for the law to state that all registered persons and *those required to be registered* are required file a return and remit the tax.

[111] There are other instances where returns are submitted on behalf of a taxpayer. These include the final income tax return filed by the trustee on behalf of a deceased person and, in the case of financial insolvency, a return filed by a receiver or trustee in bankruptcy. In these situations, the returns would be accepted when accompanied by proof that the signatory has the legal capacity to file the return.

- Requiring a return to be filed, but failing to specify where the return is filed such that returns submitted to any tax office, including the most remote one, are acceptable;
- Returns are considered filed if postmarked on the due date, even though an inefficient postal system can take several days or even weeks to get the return to the addressee; or
- Provisions for electronic filing of returns are either non-existent or are outdated due to technological advances.

The following few subsections describe specific areas of the legal framework that are of paramount importance to filing and payment and deserve additional attention: tax policy simplification, form design, withholding taxes, and sanctions.

7.1.3. Tax Policy Simplification

Tax administrations exist for the purpose of ensuring taxpayers' compliance with the tax laws and the exercise of good tax policy choices by the political leadership directly impacts tax administration and compliance. This said, "tax administration is tax policy" – a statement often attributed to Milka Casanegra de Jantscher, head of the IMF Fiscal Policy Division in the 1980s. She had concluded that, however finely tuned the design of the tax policy might be, it is the manner of interpretation and implementation of the law by the tax administration that counts. The tax laws can contain a large amount of complexity and, if combined with the tax administration not having appropriate staff to interpret and implement the law, cause the actual burden of the tax to be very different from the original objective. Complexity in the law also leaves latitude for "interpretation," and, hence, rent-seeking can easily take hold to supplement what are perceived to be low salaries in many tax administrations.

It is not a surprise that increases in the complexity of a tax causes more persons to use the services of tax practitioners, but, interestingly, the average level of non-compliance is higher for tax returns prepared by persons who were paid for this assistance.[112]

7.1.4. Form Design – An Important Consideration

The tax system starts with the tax return. This is often an overlooked, yet critical element in the process of encouraging tax compliance. There are some basic guidelines that contribute to overall compliance: (a) the return should be kept as simple and self-explanatory as possible; (b) it should present a series of logical steps to calculate the amount of tax owed for the tax period; (c) it must provide sufficient information in a logical format for the tax administration to be able to verify the proper calculation of the taxpayer’s tax liability and be able to run various background validation tests; (d) where necessary, a guide to properly completing the return should also be produced in an effort to reduce taxpayer

[112] Alm (1999), p. 21.

errors,[113] which will reduce processing costs and time and assist with efforts to rapidly identify non-compliance; and (e) the professional appearance is as important as the design.

Designing forms is a specialized field that is beyond the scope of this document. There are, however, a few basic guidelines:

- All forms should have a consistent look as part of a corporate identity, and certain information blocks should be standardized;
- Information requested should be consistent across the whole series of tax returns and other documents. For example, the taxpayer name, address, and taxpayer identification number (TIN) should be consistent across all forms in the same position, typeface, spacing, etc. This presents a professional appearance;
- All forms should have a form number and a revision date;
- Form making software is available and should be used to prepare all forms in order to provide a professional appearance.[114] A quick internet search will result in a multitude of software that can build professional looking forms;
- If forms are completed by hand, the response areas should provide sufficient space to accommodate a large script;
- Lines and cells in forms should be numbered. This makes references in instructions easy to follow and navigation in the form simpler. In addition, when cells in paper forms are numbered, data entry becomes simpler, as the data entry operator can simply type the cell number and the value submitted by the taxpayer for that particular cell;
- In forms that will be processed manually, the tax administration should consider including a check digit[115] in the line number as in the example below. The operator will have to enter the number of the cell, the value submitted by the taxpayer, and the check digit. This process minimizes a frequent error, where operators capture cell number and values of a line above or below the actual line that is being processed;
- Questions and response areas should follow in a logical progression;
- Statutory references should be totally absent, or should be included as footnotes to any explanatory notes or instructions;
- All forms should be on a standardized paper size, i.e., A4 or Letter;
- All forms that are available to the public should be available online through the tax administration website, either for download or to be filled online and submitted;
- Clear instructions with examples should be provided;

[113] For example, the tax administration of India began publishing, in all indigenous languages, a pamphlet entitled *How to Compute Your Taxable Income*. Two years after the first publication, computational mistakes had dropped from about 22 percent to 3.5 percent. This reduction in computational errors produced savings in administrative costs.
[114] One of the industry standards is Adobe, due to its ability to build forms that can be completed online and complemented by the other services that Adobe can offer.
[115] This digit is computed from the remaining digits entered. If the system computation results in a check digit that is different than the one included in the line, then there is an error in the entry.

- In cases where minimal information is captured and a large amount of forms need to be processed, the tax administration should consider the use of forms that can be processed using optical character recognition (OCR) technology. OCR technology has evolved to become a reliable data capture technology. OCR technology should be limited to forms that contain mostly numeric information. It can be considered an expensive solution since special equipment is required to capture process and review forms;
- Some tax administrations have implemented pre-printed forms, where some information, mainly identification information, is printed on forms that are sent to taxpayers. This process relies on a well-established mailing infrastructure; and
- With the increase in the amount of electronic data being collected for audit and other purposes, tax administrations have the ability to pre-populate tax forms for taxpayers in some cases. For example, in the case of income tax withholding for employees, the tax administration requires companies to report the withheld amount for each employee. This information can be used at the end of the year to prepare a "suggested" or pre-populated individual income tax return that the taxpayer can access on the internet and modify or simply submit with his/her concurrence.[116] Similarly, the use of electronic invoices and information from Customs facilitates the preparation of a pre-populated form for the monthly VAT filing.

Figure 7.1. Sample section of a VAT form[117]

6	Capital Gains	(attach schedule)	+	**100**		9
7	Rental Income	(attach schedule)	+	**105**		4
8	Interest Income		+	**110**		8
9	Other Revenues	(attach schedule)	+	**115**		3

7.1.5. Withholding Tax

An appropriate legal framework should ensure that the number of taxpayers is reasonable when considering the tax administration's budget, staffing levels, and infrastructure. This means that, for example, when designing a VAT, the threshold requiring registration should keep the number of estimated taxpayers within the bounds of the tax administration's capability. It can also mean that the number of persons required to file a personal income tax return should be kept small by setting a minimum taxable income, below which persons are exempted from filing a return. In addition, where a person's sole source of income is subject to PAYE (pay-as-you-earn) and tax is withheld by the employer, this can be treated as a final tax whereby the employee is not required to file a return. This rationale for withholding goes to economies of scale, where the tax administration has to deal with a considerably

[116] According to CIAT, Argentina, Chile, the Dominican Republic, Mexico, and Peru already have pre-printed or pre-populated returns. The study notes that the number of tax administrations that implement these will grow as the service becomes better known and improves in quality, which requires working continuously to improve the updating and accuracy of the tax information (Inter-American Center of Tax Administrations (CIAT) et al. (2012), p. 53.).

[117] Note that each data cell is numbered and a check digit for data entry purposes has been added at the right hand side of the cell.

smaller number of larger remitters of PAYE – employers – who have the sophisticated record-keeping and accounting systems to simplify the process of tax remittance and information reporting. Source withholding increases tax compliance as long as the tax administration closely monitors the withholding agent for compliance. This is easier with a single employer than with many employees. Withholding taxes also act as a safeguard, ensuring that some tax is remitted even when the statutory bearer (e.g., the employee) of the tax fails to file a return or otherwise disregards their tax obligations. A properly functioning withholding system reduces the cost of administration: there are less files / returns to deal with, requiring less staff, less physical space and other infrastructure, and less personal interaction with small taxpayers.

In the OECD countries,[118] income-related taxes, for example, account for approximately 62 percent of total tax revenue.

- 28 of 30 OECD countries apply withholding taxes on employment income; and
- 23 of 30 OECD countries routinely apply withholding to payments of dividend and interest income.

Given the large contribution of these taxes to a government's revenue, it is worthwhile to design administrative mechanisms such as withholding tax at source to ensure compliance.

When designing a withholding regime, electronic reporting should be a requirement for larger businesses and government, while web-based reporting solutions should be developed for smaller taxpayers. This may involve upgrading the tax administration's information technology (IT) systems and working with taxpayers to develop an appropriate interface between taxpayer systems and the reporting requirements. Moreover, Scandinavian countries are piloting the use of information reports submitted for withholding to pre-fill the tax returns for some individuals. The concept is that these pre-filled tax returns will eliminate most of the effort required by taxpayers to complete their annual tax returns. By doing this, the compliance rate should increase.

The below table is illustrative of some of the withholding and reporting systems in use in selected OECD countries.

Figure 7.2. Withholding and information reporting regimes of selected OECD countries[119]

Country	Name of regime	Nature of regime	Industries targeted	Year begun
Canada	Contract Payments Reporting System (CPRS)	Reporting only	Construction & all goods & services provided on a contractual basis to Federal Government Bodies	1999
Ireland	Relevant Contracts Tax (RCT)	Reporting (withholding sanction)	Construction, meat processing & forestry	1970
	Professional Services	Withholding &	Professional services (as	1987

[118] OECD (August 2009), p. 6.
[119] Ibid., p. 14.

Country	Name of regime	Nature of regime	Industries targeted	Year begun
	Withholding Tax (PSWT)	reporting	defined)	
	Third Party Returns (TPR)	Reporting only	Very broad coverage prescribed in law	1992
Japan	Statutory With-holding and Reporting (SWR)	Withholding & reporting	Specific categories of remuneration & fees prescribed in laws (not captured by 'employment' income)	1899
New Zealand	Schedular Payments (SCH)	Withholding & reporting	Very broad coverage prescribed in law	1979
Norway	Withholding tax-fishermen (WTF)	Withholding & reporting	Fishing	1956
United Kingdom	Construction Industry Scheme (CIS)	Withholding & reporting	Construction	1972
United States	Information Returns Program (IRP) and backup withholding	Reporting & withholding	Very broad coverage prescribed in law	1954, 1984, 2011

Although withholding reduces the costs to the administration, it imposes additional costs on businesses that should be considered when deciding on a withholding regime. These costs include:

- Training costs for the human resources (HR) and payroll department, as well as the costs of making those who will have PAYE deducted informed about how the system works;
- The cost of obtaining information required from payees;
- The costs of adjusting the payroll/accounting system and maintaining records for possible future audit verification;
- Accounting for any taxes that must be withheld from payments made;
- Preparing information returns for the tax administration;
- The costs of preparing PAYE information slips on amounts withheld;
- The costs associated with inquiries/ audits by the tax administration; and
- Personnel costs.

Finally, there are new costs that the tax administration should bear, including:

- Preparation of guides and other explanatory materials;
- Enhancements to the IT system;
- Processing costs related to the additional workload for returns and payments;
- Additional staff for dealing with information requests; and
- Enforcement costs to deal with the additional workload for non-filers, stop-filers and failure to pay cases for PAYE.

7.1.6. Sanctions

Effective penal provisions in the legal framework are necessary to encourage taxpayers to comply, and there is a considerable body of research into penalties for non-compliance. It should be noted, first, that not all taxpayers deliberately set out to be non-compliant. There are unintended errors and honest mistakes, and sometimes taxpayers simply do not understand how the law applies. As a result, non-compliance can be divided into two categories. The first category comprises taxpayers who are non-compliant, but would probably comply voluntarily if conditions were different. For example:

- They lack sufficient information on how to comply;
- The effort to be compliant is too expensive. That is, they cannot spare the time or afford an accountant; or
- It is too difficult to comply. Many hours are spent in a queue waiting for a tax official to accept the return.

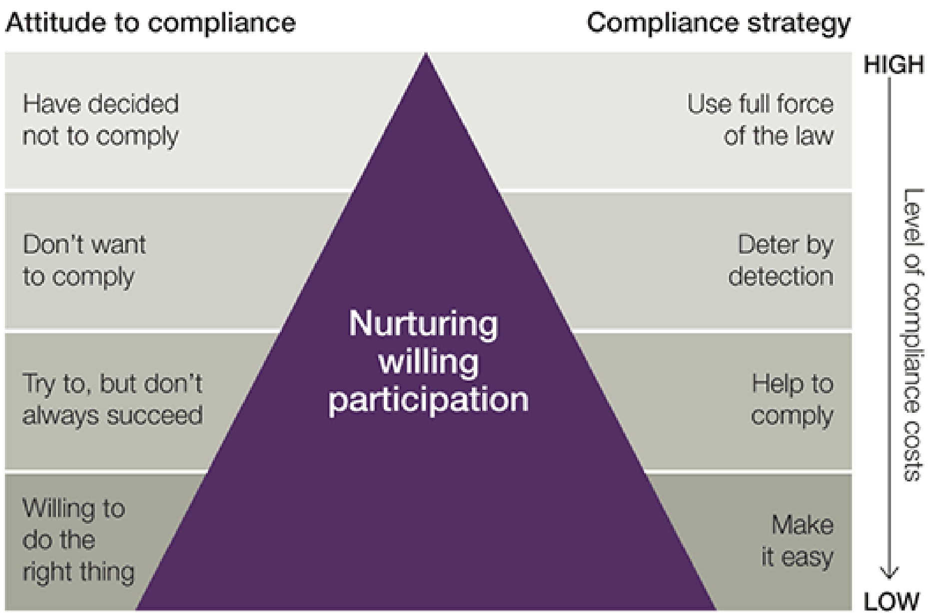
The second category consists of the taxpayers that willfully decide not to comply. These taxpayers may:

- Make an economic decision to evade paying tax, where the costs and risk of detection are less than the perceived benefit of non-compliance;
- Fundamentally disagree with paying tax. They may disagree with the government's policies; or
- Avoid paying tax through overly aggressive tax planning.[120]

The below diagram illustrates the results of research into tax compliance by the Australian Tax Office. Similar to all countries there are a very small number of taxpayers who for a variety of reasons make a conscious decision to be non-compliant. This small group requires the tax administration to expend considerable resources and apply the law to its fullest extent in order to obtain compliance. This is contrasted by the large majority of taxpayers who are generally compliant where it may only be necessary for the tax administration to send the taxpayer a low-cost reminder notice to assist them in complying.

[120] Aggressive tax planning consists in taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability.

Figure 7.3. Australian compliance model[121]



The taxpayer's perception of the risk of being detected, combined with the taxpayer's perception whether the sanction will actually be imposed, is important. For example, the government willingness to impose sanctions and pursue cases in the courts, where necessary, is a factor in attaining compliance.[122] Thus, when taxpayers know or perceive that their likelihood of being prosecuted in court is negligible, these sanctions become ineffective. The situation can worsen if taxpayers believe that non-compliance is relatively common and goes unpunished. An attitude of "everyone does it, so I will too" may develop, or what is sometimes referred to as "the crowd mentality" may emerge, resulting in the quasi- legitimization of non-compliance. This type of non-compliance is difficult to turn around.

When designing a sanction scheme, there are other factors to consider.

- Although the rationale for sanctions may seem obvious, governments should not lose sight of the fact that their purpose is to correct or deter non-compliance. Financial penalties should not be viewed as an important source of revenue. It is inadvisable, for example, to split a portion of the penalties with the revenue administration, as this will become an incentive to apply penalties as frequently as possible. Dependence on penalty revenue can also be a source of discontent and resentment by taxpayers, and the sanctions can lose their deterrent effect.
- Including imprisonment in the sanctions as an alternative to a monetary penalty can have fiscal implications for governments, and there may also be legal limitations on its use. Prison terms cost the government for facilities, incremental costs for each prisoner, trial costs, etc., and may result in increased expenditures that affect the budget. In addition, the ability to use

[121] Australian Taxation Office, Compliance Program 2011-12, http://www.ato.gov.au/corporate/content.aspx?menuid=0&doc=/content/00284023.htm&page=5&H5.
[122] Examples are discussed in Chapter 9.

imprisonment as a sanction is often reserved for the most severe economic crime of criminal fraud. Including imprisonment for failing to simply file a tax return and pay taxes does not fit the scheme of the sanction being proportionate with the offense.

- Financial penalties may be inconsequential to some taxpayers, such as those with a high overall net worth or, conversely, those that lack the resources to pay the penalty. In other situations, where there is inflation, the effect of the sanction could be nullified if payment can legally be delayed long enough. Even well-crafted financial penalties, such as those that are proportionate to the amount due or that increase for subsequent offenses, may still be ineffective. In this circumstance, possibly imprisonment as an alternative penalty would be more effective or even the temporary closure of the business could be considered but their use would be under exceptional circumstances.[123]
- The effect of sanctions being compounded is an important consideration. Sanctions that continue to compound into an exorbitant amount that cannot be paid could be viewed as unjust and confiscatory. Some countries have been accused of using the tax system and these severe sanctions to silence their opposition, or to sell the assets of a successful business at "fire sale" prices to their friends. If sanctions are enforced largely against the less powerful, and the wealthy or currently connected persons are seen to be above the reach of the law, then it is reasonable that the public's perception of justice is weakened. This also has the potential to lessen tax compliance. Thus compounding sanctions should be capped at a reasonable amount that can be paid.

While they may be well-intentioned when initially drafted, severe sanctions provide the possibility for abuse. This is also particularly important where there is corruption in the tax administration. Situations can quickly develop where administrative powers are selectively applied by corrupt tax officials to extract additional personal income. The general guidance when considering a sanctions scheme, and its accompanying administrative guidelines, would be to deal with non-compliance by imposing moderate sanctions more frequently than by creating an elaborate scheme of sanctions containing some provisions that are so severe that they are intended to be rarely applied.

Even well-intentioned administrative action to reserve the sanction for punishing presumably rare and severe cases of non-compliance can also be perceived as arbitrary. Thus, when designing sanctions as a deterrent, it is better to ensure that they are relatively light and have programs to detect non-compliance rapidly, as opposed to having severe sanctions that are applied infrequently. If severe sanctions must be included (often as a result of religion and history), they should be subject to oversight and an independent appeal process.

The above considerations are important when designing sanctions for non-compliance with the law. In particular, in cases of delayed payment, charging interest on penalties for non-compliance serves to

[123] Financial penalties should be "appropriate," which cannot easily be described in legislation and the purpose of the paragraph above is to note some of the potential pitfalls. In addition, imprisonment should likely remain reserved for offences such as fraud, as discussed in Chapter 9.

protect the real value of the government's revenue, and the penalty itself is meant to discourage non-compliance.

Interest

Late payments should automatically be assessed interest since interest reflects the time value of money. The application of interest should never be waived. The common practice is for interest to accrue at a market rate rather than some arbitrary rate that is either too low to fairly reflect the actual cost of the use of unpaid taxes by the taxpayer, or so much higher than market rates that it becomes a penalty. The rate of interest is typically set by regulation or some other mechanism where it can be periodically adjusted without requiring legislative approval for each change. The most common method of determining the rate is by reference to the Central Bank rate plus a certain percentage to approximate the rate of interest a business would be charged if it borrowed money from a commercial lender. In determining the surcharge on the Central Bank rate, it is presumed that a defaulting taxpayer would be charged a higher rate by a commercial lender than it would charge to one of its best customers. This higher rate further discourages defaulting taxpayers from cheaply "borrowing" from the government.

Bank rates can change frequently, so to avoid administrative costs that would result if the rate were to change every few days, it is more convenient to establish specific dates on which the rate is set. Some countries may specify in the tax law that the Central Bank rate on the first day of each calendar quarter will serve as the base rate (plus pre-determined surcharge) to be charged on late tax payments for that calendar quarter. Other countries adjust their rate less frequently, but at a minimum the rate should be adjusted annually to account for changing global economic conditions.

Penalty

The purpose of imposing a penalty for the failure to file a return or make a payment is to deter non-compliance. Usually, there are separate penalties for failure to file a tax return and failure to pay tax on time, as each of these acts is a separate form of non-compliance. There are some fundamental issues to consider when determining the size of a penalty. First, the amount of the penalty should be fair. For example, the tax administration must consider whether the penalty for the failure to file an information return should be equal to the penalty for failing to file an annual income tax return or a monthly VAT return.

The penalty should have a reasonable chance of being paid. For example, if a taxpayer is struggling to pay the tax, it may not be reasonable that a penalty for failure to pay should continue to compound to become ten times the original amount owing. If an imposing a large penalty due to compounding has no reasonable chance of being collected, it should not be imposed. Large penalties can distort the government's potential revenue and have an impact on government budgets. Large penalties are likely to become uncollectible and, thus, will need to be written-off at a later date.

As previously mentioned, penalties are often structured to take into account varying degrees of culpability. For example, tax laws generally contain considerably more severe sanctions for cases of fraud, such as financial penalties that are twice as large as normal. Where the payment is late, the usual approach is to calculate the penalty as a percentage of the amount of tax that is due. In this manner, the penalty is proportionate to the amount of tax that is not paid. Penalties of this type can, however, become excessive, and ultimately uncollectible, if the taxpayer does not pay quickly and the penalty amount continues to grow over time. As a result, the common practice is to limit the penalty to a maximum, thus retaining a reasonable chance the penalty imposed can be collected.

A sample penalty regime could be: a penalty for the first month of 5 percent of the unpaid amount, which would decrease to 2 percent for each subsequent month up to a maximum penalty of 25 percent or 50 percent for deliberate underpayment. The penalty is further increased by an additional 10 percent (of the amount due) in the case of negligence (which is defined as any underpayment greater than 30 percent of the amount owed). In cases where the taxpayer is found guilty of fraud by the court, the civil penalty is double the amount that would have been applied if the taxpayer had been negligent, but a criminal sanction may also be applied such as an additional financial penalty or even imprisonment. It is also worth noting that in cases were the late payment is a trivial amount, some countries do not apply a penalty, recognizing that small amounts cost more to collect than the amount owed. In Canada, penalties on amounts of less than one dollar are not applied.

Failure to file a tax return is generally subject to a fixed penalty, rather than a proportion of the amount due. A proportional penalty for late filing leads to difficulties in situations where only a small amount of tax is due, as the small resultant penalty does not have a deterrent effect. Another difficulty with the proportional approach is that there would be no penalty in cases of "nil" returns and information returns. Furthermore, filing a tax return is a key document that is relied upon by tax administrations for determining other actions, such as risk analysis, audit selection, and statistical analysis of the tax base. For these reasons, a specified minimum sanction that applies in all cases regardless of the amount of tax that may be declared is preferable.

As a final note concerning the size of the penalty, some countries that are experiencing relatively high inflation have found it useful to index the penalty amounts for inflation. Penalties could be expressed in terms of generic penalty units in the legislation, with the value of the penalty unit determined by a regulation at specified intervals.

Special Circumstances - Personal Liability for Penalty

Another issue that arises is with respect to legal persons. An example would be a company that is required to file and remit VAT but has insufficient funds to meet all the company obligations. The Chief Financial Officer (CFO) directs that salaries and trade accounts are paid instead of remitting the VAT. In this situation, the company, as the taxpayer, would incur both interest and the penalty for failure to pay, but the physical person (CFO) who is responsible for the company’s tax position is not subjected to any sanction. Not remitting VAT is particularly important, since in most countries the VAT is collected by the taxpayer on behalf of the government and this money is legally regarded as "trust funds." In this example, the person who suffers the penalty is the owner of the company and not the physical person who was responsible. Some countries have tried to address this situation by including a penalty for the "responsible physical person." Such a penalty provision is usually restricted to specified circumstances, such as in the United States where the penalty applies only in the case of failure to withhold the appropriate amount of taxes on payments to third parties and on failure to remit employee withholding (PAYE). In this situation, the legal person and the "responsible physical person" are considered to be jointly and severally liable for a penalty that is equal to the amount of tax withheld but not remitted or the amount of tax that is underpaid to a third party.

Rapid Detection of Stop-Filers

The more rapidly non-compliance can be detected the more effective the sanction will be as a deterrent. It is human nature for people to discuss, at least in broad terms, how the tax system has treated them or to sometimes boast about how they got away with something. Thus, if non-compliance is detected quickly and sanctions are applied, others in the community will become aware of the efficiency in detecting non-compliance through word of mouth. Identifying non-compliance quickly also affects the taxpayer’s subsequent behavior. For example, if a taxpayer fails to file a monthly VAT return and they are notified shortly after the due date that it was not received and an automatic penalty has been applied, this has a higher probability of correcting their behavior for the next monthly VAT return. Secondly, if the failure to file the return was not an honest error and it was not dealt with quickly, there is a greater likelihood that the taxpayer’s non-compliant behavior could be repeated, testing other taxes the next time, in addition to repeating the original VAT non-compliance.

Similarly, it is also human nature to dislike paying a penalty, no matter how small. People may accept a penalty more easily if the rules are clear and known, but they will still take action to avoid being penalized. For example, when a parked vehicle on a public street remains past the allotted metered time, people are accepting of the parking ticket as they know the consequence. There are usually many stories circulating about the efficiency of the police in ticketing vehicles, so they have the perception of a high probability of receiving a parking ticket. As a result, people will hurry back to their vehicle to avoid receiving a ticket. The same generality applies to taxes.

The most important administrative action that can be taken is to design processes and procedures that will assist in the rapid detection of non-compliance when it occurs, the application of automatic sanctions, and swift notification of the taxpayer. The simplest method of applying a sanction, in the case of failure to remit tax when due, is to automatically apply a percentage calculation to the amount of tax due but unpaid. To introduce an element of fairness into the application of automatically applied sanctions, in situations where the taxpayer can prove that they could not comply due to circumstances that were beyond their control or some other defined reason, the tax administration would, following defined and published guidelines, have the ability to remit the amount of penalty that had been automatically applied. This is a proven, effective method of deterring subsequent non-compliance.

As a component of clear and understandable tax laws, sanctions should be uniformly the same across the various laws, if they are not contained in a single statute. In this manner, taxpayers can understand sanctions more easily. Furthermore, beyond simplifying the law, uniformity also makes it easier for the tax administration to apply sanctions. Finally, taxpayers should not be faced with the imposition of multiple penalties for the same offense, nor should there be non-compliant behavior for which there are no penalties.

Frequent Problems with Sanctions

Some of the more common problems with sanctions can be:

- Penalties that are specific amounts in the substantive law. Over time, with inflation, the deterrent effect of the penalty is lessened to the point where it becomes a meaningless amount. Legislators are sometimes hesitant to revise these amounts, as revisions to a tax law must usually follow the legislative process which can be time consuming. As part of this legislative process, there is the risk that penalties would be subject to possible debate where proposed changes could be altered or even rejected. Some countries have created the application of penalty units, with the amount of a unit being determined by a regulation, Ministerial decree, or some other mechanism that does not require returning to the legislature. The rationale being that a regulation is easier and quicker to change.
- Laws that impose penalties regardless of the amount can unintentionally create small residual amounts on a taxpayer account that must be collected. These small amounts can become an administrative headache to collect, aggravating the taxpayer, and often costing more to notify the taxpayer and collect that the original amount. For this reason, tax laws often have a de minimis amount, below which interest and penalty is not applied.
- Overly complex sanctions that try to define various circumstances with a variation of the sanction to each circumstance. While the original intent is to provide a graduated system of sanctions depending on severity, these complexities can lead to a lack of clarity, issues of interpretation, and, ultimately, disputes.
- Compounding can initially be a compelling reason to settle tax arrears, but, in the absence of an upper limitation, it becomes an amount that cannot be reasonably repaid.
- Sanctions that are overly severe as to result in the business ultimately being closed and its assets sold under the arrears collections provisions of the law. Severe sanctions can be abused as a negotiation point to extort bribes or as a means to silence political adversaries.

Partial Payments

Taxpayers often misunderstand how their payments will be applied to any amounts that they may owe, including if the amount paid is insufficient to cover current arrears. In most countries, partial payments are applied first to penalties and interest in the order in which the penalties and interest became payable, and second, to taxes, fees, and charges in the order in which they became payable. The law should be clear on how payments will be applied to a taxpayer's account.

7.1.7. Organization and Procedures

As with most aspects of tax administration, there is no single perfect way of conducting business. There are, however, some general guidelines that will assist in designing an organization that is efficient, effective, and less costly than other alternatives.

Large Taxpayers

Some administrations have placed responsibility for large taxpayers solely within the Large Taxpayer Office (LTO)[124]. Although the definition of who qualifies as large taxpayer varies between countries, there are general characteristics they have in common, including:

- Multiple operating entities;
- High volume of transactions in day-to-day business activities;
- Large number of employees;
- International business dealings;
- Unique industry characteristics (such as banking or oil and gas);
- Complicated issues (involving complex tax law and accounting principles);
- Complex financing and business structures; and
- Their own tax department to manage the tax affairs of the company.

Large taxpayers generally have a tax compliance function within their organization and designated person(s) responsible for the various tax returns, but large taxpayers sometimes fail to file returns or remit taxes.

Box 7.1. Compliance of large taxpayers in Bangladesh

In Bangladesh, a study of large corporate taxpayers[125] found that 84.4 percent of them file returns on time, but when reporting income their compliance drops to 53.9 percent. In paying taxes on reported income, their compliance was 75.3 percent. Interestingly, the study found that only about one-third (37 percent) of the large corporate taxpayers were simultaneously compliant with filing, reporting, and payment obligations. Conversely, 63 percent of large taxpayers were non-compliant at any given time in meeting their filing, income reporting, and/or payment obligations.

Large taxpayers as a small, select group are responsible for a high portion of tax revenue. Large taxpayers are critically important to a country's revenue, as this group usually comprises less than 5 percent of the total number of taxpayers but can account for 75 percent to 85 percent of the revenue. One late return or late payment can have a material impact on a government's revenue. This said, an LTO is responsible for a relatively small number of taxpayers, and these taxpayers are generally compliant for the purposes of timely filing and payment. Thus, the staff in the LTO that is responsible for tax arrears are also assigned the task of obtaining compliance for outstanding returns and current tax. Clearly, with the majority of the revenue for a country concentrated in relatively few taxpayers, the

[124] LTOs are discussed in Chapter 4.
[125] Akhand (n.d.), p. 11.

default by only a few on meeting their filing and payment obligations requires swift action. Strategies to do so are examined later in this chapter. From the tax administration's operational level, the most important element is being able to rapidly detect when a return is overdue or a payment is missing or short. Modern tax administrations rely heavily on computerization and the underlying procedures for this task.

What should be the appropriate target for large taxpayer compliance in timely filing and payment? Both the ideal situation and the reality should be a target of 100 percent compliance. The accounting systems for large taxpayers are almost always fully computerized and can produce the information required to complete a tax return very shortly after the close of the tax period. Thus, large taxpayers should be required to e-file their returns. Similarly, large taxpayers, in most cases, already have systems to pay their employees and suppliers directly into their bank accounts. This should also be the case for paying taxes. In this manner, a non-compliance report can be produced the day after the close of any tax period. Such a report will accurately reflect the compliance of this group of taxpayers and appropriate action can be taken immediately.

Small and Medium Taxpayers

Small and medium taxpayers are different from large taxpayers. First, they are numerous, but make up a small percentage of the government revenues. Their business organization may be both poor and inefficient and, unlike large taxpayers, they may not have highly qualified accountants on staff.

Small and medium-sized enterprises (SMEs) are perceived by most tax administrations as part of a hard to control segment of the tax base. This has resulted in special legislation applicable to only select subsets of these taxpayers. In some countries, there is a presumptive tax[126] for select groups of taxpayers. Various countries, for example, have "simplified" methods of calculating the VAT liability of different categories of small VAT payers. The purpose of these simplified methods is to include a large number of taxpayers, who are usually self-employed or have a minimal number of employees, whose tax compliance has traditionally been hard to control, and who have low income levels and little impact in terms of revenue collection in the VAT base. These approaches have been adopted to facilitate small and medium taxpayer compliance by reducing their compliance costs. This is accomplished by simplifying formalities for record keeping, tax reporting, and tax payment. This is also logical, as the administration's resources are limited and higher skilled employees are allocated to control large taxpayers.

Administrative tasks toward the smallest taxpayers normally include verifying that they are correctly classified in the proper tax bracket (by revenue) or segment (i.e., market stall, taxi, barber, etc.) and ensuring that a periodic return and payment is made. In many countries the requirement for a return has either been removed or simplified to only a couple of information items. Periodic payment, of course, is required.

[126] In a presumptive tax regime, tax liability is computed using means other than the usual taxpayer accounting rules. This is usually done to simplify tax computations for small taxpayers or taxpayers in specific sectors. For example, a presumptive income tax could be computed as a fixed percent of estimated gross receipts or net worth.

Almost all tax administrations in the world operate their small taxpayer programs on a voluntary basis. Taxpayers will register after self-classifying or self-categorizing their activity. A minimal amount of documentation is submitted and the tax administration usually does not verify the information. As previously mentioned, the only variable to classify the taxpayer is gross income, which is a parameter that is difficult for the tax administration to verify. Taxpayers will tend to register in the lowest tax brackets or categories. Thus, while they appear to be observing their tax obligations, they are benefiting from tax savings without running any risk, since no controls are exercised after registration. If controls are attempted, they are inefficient.

Presumptive and simplified regimes should not be skewed to collecting minimal information for the sake of expediency, if this will result in lack of compliance. As described below, presumptive and simplified regimes have flaws.

- One of the basic flaws is that these regimes initially prioritize attracting as many taxpayers as possible and the corresponding public campaign focuses on "selling" the benefits of joining the formal sector. Thus, many of the normal checks and verification are eliminated or administratively ignored. Crucial information about many taxpayers is questionable at best, with incomplete and invalid basic contact information, such as an address or telephone number. After a period of time, these errors become a problem and countries attempted to take corrective measures, but, by this time, the number of registrations is overwhelming and, often, tax staff assigned to the problem is poorly trained, with a lack of supervision and inefficient verification procedures.
- A problem with attempting to cleanse the information is that most tax administrations use business turnover for classification, which is very difficult to control, especially since the cleanup of the data is usually done from the confines of a tax office (i.e., without seeing the taxpayer’s premises to try to verify, even visually, their statement of turnover).
- Another problem with cleanup of the tax filing and payment system, as it applies to presumptive taxpayers, is dealing with those who joined the system but understated their income so as to receive more preferential tax treatment. As previously noted, the determination of these taxpayers’ actual income is very difficult and no prior action has been taken to verify whether they were properly classified. Even if this group was correctly classified, their revenue impact would be minimal, at best, and the tax administration would be left to deal with numerous complaints, bad relations, negative press, and possible political intervention since small taxpayers represent a large voting bloc.

These factors result in attempts to control the situation and encourage compliance by enacting a penalty regime that is ineffective given the minimal resources that the tax administration has available and the possible political problems with penalizing the smallest taxpayers. One option is for tax administrations to use matching computer databases to attempt to identify non-compliant taxpayers. Proxies of income, such as electricity consumption, water bills, cell phones, and third party sales, among others, are possible areas to examine. Undoubtedly, this exercise will identify non-compliance, but the tax administration must ensure that adequately trained and qualified persons are utilized. Otherwise, the same problems that developed with the initial registration will recur.

In summary, these special tax regimes that were designed to help small and medium-sized taxpayers to cope with transitioning from the underground economy to the formal sector were intended for a very large number of small taxpayers conducting low-income generating and hard-to-control business activities. Given their low incomes, they would have a negligible impact on total tax revenue. Rather than the regimes described above, simplicity of the tax system should prevail over revenue considerations. Thus, any formal obligations that this category of taxpayers must meet have to be considerably simplified. As a result, various tax obligations are usually replaced by a single, regular payment which discharges all tax obligations.

Addressing Small and Medium Taxpayer Compliance

The problems created by a weak registration program should be addressed through a more robust screening of the initial registration information to verify to the extent possible.

- Addresses (where there is a formalized address system) are verified against the property tax database;
- Cell phone numbers are verified (although people often change numbers, and on prepaid phones this validation is generally non-productive);
- National Identity numbers (if in use in the country) are checked against the database;
- Passport number (although most small taxpayers do not have a passport); and
- Bank account information is required, which can be a problem with the smallest taxpayers, as banks may not allow them to open accounts.

Tax payment must be convenient, simple, and quick, including, for example:

- Payment accepted at any bank, without charge to the taxpayer; and
- A short payment form completed by the taxpayer which shows the TIN and current contact information (i.e., telephone(s), address). This basic information could be entered online by the bank and serve to update the contact information on file at the tax administration.

Mobile phones have also become an important additional electronic service delivery channel for this purpose that has grown rapidly over the past 5-10 years. The OECD previously reported that just over half of surveyed revenue bodies revealed the use of taxpayers' mobile phones for taxpayer service-related purposes. For the most part, the services offered were fairly limited and the volumes quite low.[127]

Invoices issued by small taxpayers operating under the presumptive tax regime cannot be used by VAT registered persons to obtain a credit for tax paid. This is designed to encourage small taxpayers to progress to the next level in the tax system and leave the special tax regime. This measure also reduces

[127] OECD (March 2010), p. 56.

the problem of invoices being used to conduct VAT fraud. All persons importing goods through Customs must have a valid tax clearance certificate[128]. As discussed in Chapter 10, this action must be thoroughly planned and coordinated with Customs.

Finally, all persons supplying the government with goods or services must:

- Be registered as a taxpayer; and
- Submit a current tax clearance certificate.

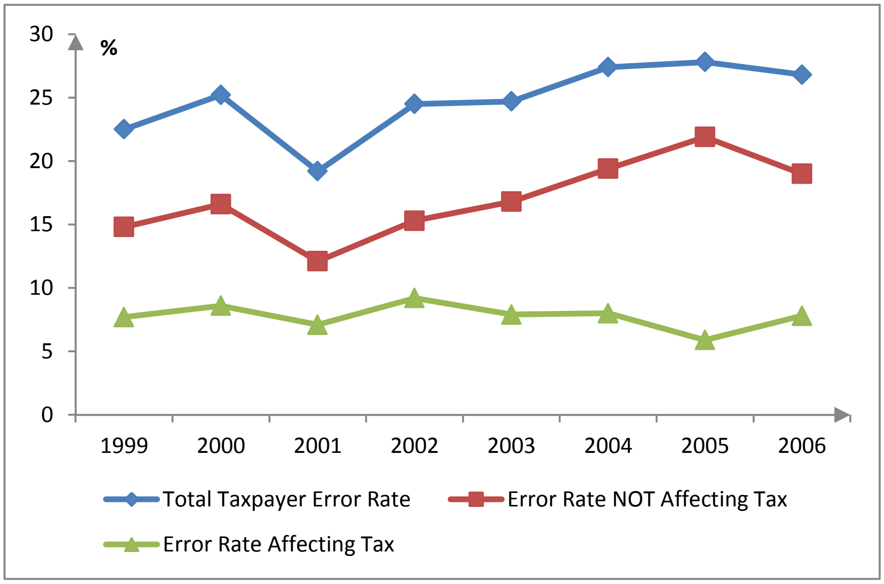
7.1.8. Getting the Tax Return from the Taxpayer to the Tax Administration

The first step in the filing process is getting the tax return from the taxpayer to the tax administration. Various methods are in use, ranging from using the traditional method of completing a hard copy and using either mail or hand delivery, to online completion with digital signatures and instant transmission, to tax software that interactively guides the taxpayer through the process and, where internet is available, transmits the completed return to the administration.

There are costs and problems associated with manual returns and archaic payment systems. Tax administrations spend large amounts of time and financial resources to print blank return forms and fold and stuff these forms in envelopes (in many instances, temporary staff are recruited). The process is delayed as the mail system in many countries can be slow. Paper returns must be entered manually. This is a slow process that can contain data entry errors and introduce inaccuracies into the taxpayer account. Data entry for individual tax returns can take several months and, in some cases, considerably longer, as the administration re-enters and reviews all the returns to try and resolve both taxpayer and data entry errors. Irrespective of the reviews, unspotted data entry errors can remain, which can be irritants to taxpayers. At the end of the process the paper returns must be physically filed, requiring staff and space. Manual filing systems are also prone to errors with returns being misfiled. Another weakness with hardcopy files is they can sometimes be made to "disappear" when crucially required as evidence in legal proceedings. Often countries require the tax files to be retained for anywhere from 6 to 10 years which requires secure space.

[128] Tax clearance certificates are discussed in Chapter 10.

Figure 7.4. Canada Revenue Agency error rate on personal income tax returns[129]



7.1.9. Data Entry

It is important to note that the process of getting information from the return into the IT system should take advantage of as much automation as feasible (prefilling forms, barcodes, online fillable forms, etc.), and internal processes should be simplified and standardized across all taxes to the extent possible to decrease administrative costs, as well as to detect non-compliance as early as possible. This said, in cases where paper returns still exist, these returns have to be entered into the system manually.

Tax administrations may have a central data processing unit or may operate in a decentralized manner, with district offices responsible for the input of their taxpayers, and the LTO responsible for its own taxpayers. On receipt of the tax return, there are basically two divergent philosophies to posting a return to a taxpayer's account. Simply stated, the return is either:

- Subjected to a review process, where it will not be accepted as a completed tax return, unless it is correct; or
- Posted to the taxpayer account "as-is" and the computer identifies errors for subsequent correction.

There are variations of either approach. For example, the taxpayer is provided with a receipt acknowledging a return has been filed, but the details of the return are held in suspense when an error is detected during data entry into the computer system and remain in suspense until the error is corrected. In this scenario, the system might be able to indicate there is a return filed, but the details may not be available. There are advantages and disadvantages to any system, but posting returns "as-

[129] Canada Revenue Agency (2007), p. 23.

is" becomes preferable when following the initial premise that non-compliance should be rapidly detected and addressed.

Returns should be captured electronically as soon as possible. Experience has shown that problems occur if data from returns are set aside for error correction rather than being captured immediately. The most common difficulty is the return is misplaced and cannot be located. This may necessitate contacting the taxpayer and, although there may be a record of it being filed, there is embarrassment that it has been lost. The second frequently occurring problem is the return is set aside for error correction, but other priorities and workload cause significant processing delays which then lead to the inevitable question about the efficiency of the administration. If a significant number of returns are held in suspense, efforts to conduct tax analysis and risk assessment could be adversely affected.

Tax returns containing errors must be corrected. Tax administrations have approached this in a variety of ways within their organizations. Approaches range from:

- Data entry operators setting aside the return when the computer system detects an error to attempt to resolve the error by contacting the taxpayer by telephone. Unresolved returns that cannot be resolved by the data entry section are forwarded, depending on the organization, to other functional areas, such as a dedicated return resolution unit, taxpayer services, collections, or audit;
- Returns rejected during data entry are automatically referred to an error resolution unit. This unit may be variously organized as part of taxpayer services, collections, audit, or revenue accounting. Depending on how the unit is organized, it may contain either clerical level staff, or it may require some higher level employees if its mandate is to resolve all issues, with the exception of the most complex situations; and
- Serious problems that cannot be resolved on the telephone, depending on the organization, are referred to audit, collections, or taxpayer services. The predominant preference of most tax administrations is to refer the return to the audit function.

Organizations have found that having data entry operators stop production to phone taxpayers is the least desirable process. Production suffers and, often, data entry personnel cannot answer any questions that may arise during the telephone contact.

Ergonomics of Data Entry

Countries are moving toward e-filing as a means of reducing their costs and increasing the accuracy of the information as it eliminates data entry errors by the tax administration but for the foreseeable future there will remain the need for some data entry. As a result, modernization of the data entry work environment is an area that is also often overlooked, but significant gains in both output and quality can be obtained with minimal cost. The more efficient data entry processes have staff dedicated solely to this function, and the workplace is conducive to data entry as a production line process with ergonomically correct desks and chairs. The data entry work environment must be properly designed and adjusted to optimize the comfort, safety, and health of operators to ensure quality and productive output. For example:

- Computer entry tasks are best performed without arm rests. Arm rests can cause restricted forearm movement, pressure points, and stressful shoulder postures;
- Operators should be seated so that they can maintain a straight wrist—good neutral wrist posture—to avoid soreness often caused by working long periods with hands bent upward or downward and that can contribute to operators developing carpal tunnel;
- Proper positioning of the computer monitor and angling of the screen helps avoid screen glare and maintain relaxed neck and back postures. The monitor position should not require operators to tilt their head forward to view the text;
- Proper lighting is important. Windows, overhead lighting, and reflections from shiny surfaces can create glare and reflections causing eye strain. For example, a bright wall behind a dark computer screen can cause eye strain, because an operator's eyes must repeatedly adjust from the bright surroundings to the dark near-field of view of the computer screen;
- A document holder or copy stand that is properly positioned can make data entry less stressful, increase efficiency, improve posture, and allow operators to work more comfortably. A document holder that is placed close to the monitor reduces the head twisting to create less stressful eye movements;
- Data entry requires operators to constantly enter data into the computer using their keyboard and source document. For this arrangement, the keyboard and source document should be placed directly in front of the operator with the display off to the side. Documents should be the same height as the display;
- Excessive noise, uncomfortable temperatures, glare, and poor lighting affect operator comfort and productivity, as well as cause distractions. Too high or low light levels, or flickering overhead lights, cause fatigue; and
- Traffic in the work area, or operations near the data entry workstations, can sometimes cause distractions. The movement can distract the eye, decrease visual attention or concentration, and create fatigue.

7.1.10. E-Filing

Electronic filing (e-filing) is the transmission of tax return information directly from the taxpayer to the tax administration using the Internet.[130] E-filing options include completing returns online as either a self-prepared return, using a personal computer or tax preparation software.

As the IT systems operated by tax administrations are modernized, provisions are being made for e-filing. In addition, some administrations have introduced more sophisticated online tax filing systems that are interactive. These systems have mathematical checks and other prompts that replace the former manual checks that the tax administration performed during the vetting process. This

[130] Dowe (2008), p. 6.

modernization reduces the number of staff required for error correction and makes the system more efficient as the number of taxpayers to utilized electronic filing increases.

Box 7.2. E-filing in the United States

> The processing of individual income tax returns by the Internal Revenue Service (IRS) of the United States during the 2009 filing season saw e-filing increase by 6.1 percent compared to the same period in 2008. The largest part of this increase was taxpayers e-filing from their home computers, which increased by 19.9 percent[131]. For the 2010 filing season, the IRS received nearly 61.3 million tax returns. Of those, 51.6 million were e-filed, and nearly 9.7 million were filed on paper (a decrease of almost 20 percent from the previous year). The IRS received nearly 60.5 million personal tax returns for the 2011 tax filing season – 53.9 million (89 percent) were e-filed and nearly 6.7 million (11 percent) were filed on paper.[132] The IRS received more than 63 million tax returns in the 2012 filing season: 57 million (90 percent) were e-filed and nearly 6.3 million (10 percent) were filed on paper.[133]

E-filing and e-payment (which is discussed below) have many benefits, including:

- Convenience – returns can accommodate the taxpayer's schedule and be filed at any time – day or night;
- Saves time, as returns do not require taxpayers making a trip to get a physical return from an office or waiting for the return to arrive by mail;
- Increased taxpayer/client satisfaction;
- Certainty of delivery and quick confirmation of receipt, as tax administrations can provide an email confirmation that returns have been received;
- Fast refunds – allows taxpayers receiving refunds to get them sooner;
- Assures taxpayer privacy and security;
- Online help facilities and user guides;
- Use of online commercial tax preparation software;
- Eliminates data entry errors and improves data quality; and
- Reduces tax administration operational costs by eliminating the cost of handling paper returns, and staff requirements for data entry and file maintenance can be reduced.

E-services require the underpinnings of enabling policy and legislation, and technical infrastructure. The electronic representation of a document should be recognized as equivalent to paper in court proceedings, and the authentication of both parties and non-repudiation of electronic transactions, as well as message integrity and confidentiality, should be legally recognized.

7.1.11. Assessment of Returns

Once a taxpayer has registered, filed a return that is entered in the computer system, and paid tax, most tax administrations pursue the accurate and efficient assessing of returns. The assessment process,

[131] Treasury Inspector General for Tax Administration (2009), p. 2.
[132] Treasury Inspector General for Tax Administration (2011), n.a.
[133] Treasury Inspector General for Tax Administration (2012), n.a.

more typical of the income tax due to its inherent complexity, checks returns for errors and produces notices of assessments (acceptance of the return as filed or with changes in tax due) to let the taxpayer know whether they have properly filed their return and how much tax they may owe, along with conducting a limited verification of items on the return. With the increasing number of taxpayers, this is usually done with the help of computer systems. At the same, time the cash area will ensure that the taxpayer's payment is recorded in the right account and for the right year and that a receipt is issued. Having an efficient system in this area is critical.

7.1.12. Payments

Many tax administrations have yet to accommodate electronic payments, and, therefore, taxpayers make payments at the tax office, government treasuries, and sometimes at the banks. The payments in tax offices and treasuries often result in long queues near payment due dates and the need for larger public service areas and additional cashiers to receive and process payments. When checks are returned by the banks, staff must be assigned to resolve returned checks with taxpayers.

With these challenges, many countries have adopted a system for taxpayers to make their payments at a bank. The payment is subsequently transferred to the government accounts in the Central Bank. One of the primary reasons for this change is to remove the tax administration from handling tax payments and reduce the opportunity for irregularities. Another major reason is the flow of tax revenues to the government is more reliable using the banking system, as most banks can electronically transfer or wire transfer the funds immediately after collection (such as on a daily basis) to the government tax revenue accounts. This system also makes the accounting for tax revenues more accurate and timely.

Benefits of the Bank Payment System

The following are the benefits to the taxpayer of making payment at a bank:

- Convenient – the taxpayer can make payment at bank anytime during banking hours;
- Easy – the taxpayer can go to a nearby bank;
- Efficient – there is no waiting in lines at a tax office to file the return and make payments to a cashier, which is often a two-step process, where both steps require waiting in queues;
- Safe – the taxpayer can arrange with the bank for a transfer of funds from the taxpayer's bank account to make the tax deposit, reducing the need to travel with cash; and
- Accurate – the taxpayer has a bank receipt showing the amount and date of payment.

The following are the benefits to banks:

- More deposits and use of funds due to "float" time when funds are in the bank prior to payment and transfer to the tax administration;
- Taxpayers may deposit funds in their bank accounts prior to direct payment being made to tax administration;

- New customer potential, as taxpayers use banks more frequently for direct deposit of tax payments; and
- Potential for additional loans, credit lines, or similar transactions with customers making tax payments directly through the bank.

There are also numerous benefits to the tax administration:

- Better compliance with tax payment requirements;
- Generates more timely payment to the government;
- Accelerates the flow of tax funds into interest-paying accounts of the government;
- Better taxpayer relations, as payment of tax obligations is more convenient through banks;
- Better workload management, as number of "clerical" type transactions with taxpayers are reduced and more time is available for substantive tax compliance issues;
- Greater efficiency, effectiveness, and accuracy of tax payments, contributing to improved tax accounting;
- Automated (computerized) system for transfer of tax payments from taxpayers to the government treasury reduces errors in transposition of figures and other data entry problems;
- Provides the foundation for centralized filing in regional computerized service centers;
- Computerized systems are able to generate more accurate and more timely management information reports regarding tax revenue collection and payment;
- Reduces the need for maintaining a cashier function, or reduces the staffing level for handling cash and check transactions;
- Increases the ability of the tax administration to concentrate more on the accuracy and timeliness of return filing, thereby generating improvements in the self-assessment system; and
- More stable tax revenue as taxpayers increasingly file more accurate returns and amending returns and subsequent tax adjustments are reduced.

Bank Payment System Risks

Four of the basic categories of risks in the payments process are liquidity risk, operational risks, security risks, and legal risk.

- Liquidity risk arises from the possibility that the sending party (the taxpayer or the taxpayer's financial institution) may fail to meet its payment obligation on the due date because of an unforeseen shortfall in available funds. Liquidity risk involves a loss to the receiving party (government), which must now implement the arrears collection process against the taxpayer. Of course, this could be a problem even when taxpayers make payments directly to the tax administration's cash office. However, since a single bank handles multiple taxpayers, the problem is more serious if the financial institution fails to meet the payment obligation. However, assuming the Central Bank (or another entity in charge of bank supervision) is conducting appropriate and effective monitoring of the financial system, it should be aware of the insolvency of a financial institution long before the problem and be able take appropriate action;

- Operational risks arise with the possibility of human error, equipment malfunctions, natural disasters, or system design flaws that can result in payment errors or incompletion of the transaction;
- Security risks, such as the risk of fraud, can leave a party subject to financial loss. Security risks include the risk to privacy if the system is hacked and the perpetrator gains access to confidential payment information that can be used to exploit the financial information; and
- Finally, there is also a legal risk. Given that there is a third party involved (the banks), it may not always be clear who the liable party is when something goes wrong.

To mitigate some of the tax administration's risk, various safeguards should be implemented, such as:

- Strong internal and data processing controls on all programs;
- Written agreements establishing procedures and risks; and
- Implementation and periodic review of internal controls that address access control, confidentiality of data, integrity of data, and other information security issues, as appropriate.

As an example, many of Canada's municipal governments have introduced a Tax Installment Pre-Payment Plan (TIPP). This is a monthly tax installment payment plan that allows property and business owners to make consecutive monthly payments for taxes, rather than an annual payment or semi-annual payment. TIPP is an automated program that taxpayers establish with their local government, and it automatically withdraws payments from their designated bank account. The system is set for payments to be made on a specified day each month by automatic withdrawal from the designated bank account, with the number of installment periods chosen by either the municipality or the taxpayer. Installment plans can be flexible with, for example, property tax installment periods between 7 and 12 months, and business tax periods between 6 and 10 months. The monthly payment is calculated by dividing the previous year's tax levy by the number of installments chosen for the calendar year, plus any applicable charges that the municipality may add. Frequently, the municipality does not add any charges to encourage taxpayers to use this system, as there is a net benefit to the municipality when taxes are automatically deposited. At the time of the annual tax billing, taxpayers will be notified of the total amount of installments paid to date and the calculation of the new installment amounts for the remaining payments in that year.

Bank Compensation

Prior to implementing a bank payment system, the tax administration should first consider the costs associated with implementing online procedures and services. Many of these costs will be associated with the financial institutions and the online services that they can provide. The financial institution will require financial compensation. A tax administration should determine if the change is financially feasible and whether the taxpayers will accept the new system.

Banks are normally compensated in one of three ways:

- Negotiation of a certain number of days that the bank is allowed to retain the tax payments (float), with no fees payable;
- A flat rate per tax payment, which is deducted daily, and the net amount is deposited to the government accounts no later than the close of each business day; or
- A percentage of the tax payment is negotiated, which is deducted by the bank from the total amount deposited to the government accounts, no later than the close of each business day.

The compensation from country to country varies widely. It depends on the anticipated volume of transactions, with a small country paying what can be a high fee relative to a country with a large number of transactions. For example, the negotiated fee charged by banks typically ranges from 0.75 percent to 2.5 percent of the amount of the tax payment. "Float" time alone (i.e., that banks can use the money before transmitting payments to the government) is often sufficient and acceptable compensation to banks.

7.1.13. E-Payments

An e-payment is the transfer of money from a taxpayer's bank account to the tax administration's bank account using the Internet. E-payments can be made online, at any time (during and after banking hours), and from any location. In comparison to a bank payment system, e-payments offer the following additional benefits:

- Convenience – e-payments can be made at any time and can also be scheduled for a later date;
- Reduced payment cost to taxpayers – replaces the use of checks, and many banks provide free online payment services;
- Increased taxpayer/client satisfaction;
- Speedy revenue collections;
- Reduced check handling costs for tax administrations – not having to deal with checks backed by non-sufficient funds; and
- Timely information on payments to aid in reconciliation and revenue reporting.

7.1.14. Implementing E-Services

Successful implementation of e-filing and e-payment systems requires: (1) reliable and accessible internet service; (2) cooperative financial institutions that have the IT infrastructure to support e-payment; (3) IT literate taxpayers; and (4) adequate financing to set up the appropriate infrastructure in the tax administration. An e-filing and e-payment system should form part of a larger comprehensive IT strategy. This topic is discussed in Chapter 12.

Issues for E-Services

One of the biggest issues for most tax administrations is the difficulty they have in retaining sufficient IT expertise. Other concerns include:

- E-commerce – in particular, the use of digital signatures and data encryption may require legislative amendments to support e-filing;[134]
- Information security issues surrounding the transfer of information, integrity, and confidentiality;
- Possible fraud risks through false taxpayer identification, refunds, etc.;
- The ability to address taxpayers' concerns (given that interactions between the taxpayer and the tax administration are limited); and
- Staff concerns about job security (given that e-services may replace traditional positions).

Many countries have gradually introduced e-filing and e-payment, first making it voluntary for a select few taxpayers, such as those in the LTO, to allow for live testing of systems and procedures. After testing is complete, e-filing becomes mandatory for certain taxpayers, and voluntary e-filing and e-payment is extended to the general taxpayer base.

Many countries continue to limit e-filing to only certain taxes or where returns are below thresholds. The tax administration always has the legal right to question any tax return, request supporting documents, or audit any tax period (within statutory time limits). Where there are strong e-commerce laws and e-file provisions are supported by the law, although there may be some administrative reason for retaining an insistence for paper returns, there is presumably no legal barrier. Other administrations have taken a relaxed position, with certain caveats. For example, professional accountants and tax agents, who have been certified by the tax administration, may file almost all returns online with few exceptions. One of those exceptions is the final income tax return for a deceased person, where many jurisdictions require court documents attesting to the legal capacity of the executor of the estate.

During the implementation of e-filing, some of the commonly encountered taxpayer questions the tax administration must anticipate in advance are:

- How do e-filing and e-payment work?
- What are the benefits of e-filing and e-payment?
- Am I eligible to e-file?
- How can I e-file and e-pay?
- Is it safe and secure to e-file and e-pay?
- Can a third party e-file for me?
- What if I owe money when I e-file - how do I pay?
- Can I set-up a special account to e-pay?
- Is there a fee to e-file or e-pay?
- How do I know if my e-filed return has been received?

[134] In the United States, the Internal Revenue Service (IRS) uses a "self-select personal identification number (PIN)" as one method of signing income tax returns electronically by taxpayers. The self-select PIN method requires taxpayers to provide their prior year income amount or prior year PIN for use by the IRS to authenticate the taxpayers. Taxpayers may also authorize their professional tax practitioner to enter PINs on their behalf, in which case the taxpayers must review and sign a completed signature authorization form after reviewing the return.

- Do I need to submit any paperwork or supporting documentation if I e-file?
- How do I sign my electronic return?
- How do I amend my e-filed return?

In addition, banks may not be equipped to offer these services; the service fees proposed by financial institutions may be too high; there may be no inter-bank clearing service in the country; and the public key infrastructure that would provide optimal facilities may not have been developed.

Lessons Learned Implementing E-Service

Important lessons learned from implementing e-services include:

- A good public awareness program is absolutely necessary to achieve high e-filing take-up rates. This awareness program should be well researched, as much depends on what is workable in the each individual country. For example, direct telephone calls to taxpayers and practitioners worked very well for the authorities in Denmark. Some countries realized increased participation in the program as a result of explanatory information provided to taxpayers, tax forums, and education seminars;
- Based on the type of questions received during the initial pilot stage, countries found that it was important to address the needs of taxpayers in a well-developed plan before the general implementation phase and once into the implementation phase it was important to provide adequate and timely information to stimulate take up by taxpayers; and
- Relationship building with other interest groups during the implementation process is critical. The development of an e-payment system must be done in conjunction with local financial institutions. Countries that have partnered with financial institutions, tax practitioners, and other organizations have seen greater acceptance and use of the system and higher satisfaction levels. An especially important aspect is the face-to-face interviews with tax practitioners in the early stages of the development of the system. It was these tax practitioners that, once convinced of the benefits, assisted the tax administrations to promote e-filing and e-payment.

7.1.15. Refunds

Refunds arise naturally in many tax systems. In both income tax and PAYE, there will be taxpayers that have overpaid their tax and be eligible for refunds. In some countries, the PAYE tables that employers use to calculate the amount to be withheld from an employee may deliberately cause slightly more tax being withheld than is required, with the result that an employee must file an income tax refund return to recover this overpayment. In other countries, the design of the system may have advance payments of income tax applied to various types of transactions, such as on imports of goods through Customs, which requires reconciliation on the annual income tax return and can result in a refund. The level of VAT refunds depends on the value added of exported goods, the extent of the zero-rating provisions, and the use of multiple rates.

A frequently asked question is whether the level of refunds being paid as a percentage of gross revenue for any particular country is "normal." The results of an OECD survey of tax administrations are shown below. Refunds vary widely, due primarily to the tax system design features of each country.

Figure 7.5. Percent of gross tax collections refunded to taxpayers in 2007[135]

Country	Personal income tax	Corporate income / profits tax	Value added tax	All taxes
Australia	14.5	10.8	46.1	20.1
Canada	13.2	20.4	n/a	21.6
Hungary	6.4	13.5	42.8	17.4
Ireland	19.1	12.8	24.6	13.9
Japan	4.3	1.6	6.5	12.6
N. Zealand	4.3	3.0	46.1	16.7
Korea	3.6	10.3	41.6	18.9
Slovenia	11.0	9.1	38.1	-
Spain (2006)	14.7	11.2	31.0	18.0
Sweden (2006)	5.0	-	41.0	-
UK	-	-	40.8	13.3
USA	18.2	6.8	n/a	11.0

Paying Refunds

Many countries are concerned with paying refunds promptly, since payment of a refund within a certain period can be a legislative requirement. Additionally, if a refund is not paid within the allotted time, the tax administration must pay interest to the taxpayer. It is important that refunds are paid promptly since this money is legally due to the taxpayer. When governments fail to honor a taxpayer’s entitlement to a refund it can adversely affect tax compliance as taxpayers will find other means to recover their entitlement such as netting refunds against liability and reporting only the net amount, or less.

Refund Fraud

A primary reason for many administrations' delays in paying refunds is the potential of fraud, especially as related to VAT. Frauds exploiting the VAT system are large. In Europe, a 2007 study by the European Commission estimated that VAT fraud costs the member states an estimated Euro 60 billion annually[136] in just one type of fraud scheme.

The focus of tax administrations on the processing of all claims with speed and the time constraints placed on them generally leaves little time for any substantive investigation and no time or available resources to conduct an audit at the taxpayer’s premises. Processing refunds becomes a desk-based review that is largely a mechanical operation ensuring all documentation is present. These operational "gaps" that leave the refund system susceptible to refund fraud are, as many countries are finding, often exploited, with sometimes huge amounts being paid to the perpetrators of these frauds. Worse,

135 OECD (January 2009), p. 100.
136 Financial Action Task Force (2007), p. 3.

because of weaknesses in the registration system, the perpetrators of the fraud sometimes cannot be subsequently located.

Tax refund fraud is on the rise in many countries, as it is relatively easy to commit due to the lack of adequate detection tools used by most countries and, in many cases, the inability of tax authorities to cooperate with police because of the secrecy provisions in the tax laws that prevent disclosure to other agencies. As shown in the table below, the number of refund frauds that were identified in the United States increased in 3 years from about 457 thousand to over 2 million.

Figure 7.6. Fraudulent returns and refunds in the United States in 2009-2011[137]

Processing Year	Number of Fraudulent Refund Returns Identified	Number of Fraudulent Refund Returns Stopped	Amount of Fraudulent Refund Returns Identified	Amount of Fraudulent Refund Returns Stopped
2009	457,369	369,257	$2,988,945,590	$2,517,094,116
2010	971,511	881,303	$7,300,996,194	$6,931,931,314
2011	2,176,657	1,756,242	$16,186,395,218	$14,353,795,007

European tax administrations not only have a problem with income tax fraud, but also a considerably larger problem with VAT "carousel fraud." In this type of fraud, goods are imported VAT-free from another country in the EU, but are not sold for consumption in the home market. The goods are sold through a series of companies, each liable to VAT, before being exported, possibly even back to the original seller. In carousel fraud, the first link in the chain of businesses goes missing without accounting for the VAT. The final link in the chain reclaims the VAT it has paid from the government before disappearing. This type of fraud generates high returns over a short period of time; it is difficult to detect, and it is difficult to prove. VAT refund fraud is addressed in further detail in Appendix 7.A.

Risk-Based Refund Management

Tax administrations are attempting to tighten up the refund system, but also trying to maintain an acceptable turnaround time in processing refunds. Part of the solution is implementing risk management. This entails categorizing refund applications by risk indicators and quickly processing those that are low risk. By processing the low risk refunds with minimal scrutiny, the tax administration can devote extra resources and time to those that are high risk.

In the absence of a formalized program to determine risk indicators, and as an interim step until a risk management program is instituted, a rudimentary three-level risk categorization could be used. For example, in the case of VAT refunds, including those tax returns where there is an abnormally large credit that is to be absorbed by future returns, the following risk categories can be used:

- Category "A" claimants could be those where there is minimal risk. Claimants in this category could be those who are traded on a stock exchange, have audited financial statements by a major firm, are compliant with all taxes, and have had a tax audit within the last 2 years. These

[137] Electronic Tax Administration Advisory Committee (2012), p. 24.

claimants/taxpayers should be treated as valued "customers," should not be subjected to frustrating delays, and should be issued prompt refunds.

- Category "B" claimants could be those with a medium risk. These claimants would have audited financial statements, but not necessarily by a major firm. They have been registered for more than 2 years, have a history of reasonable compliance (although some returns may be late), have had a tax audit where the auditor visited the claimant's premises, and the suppliers to the claimant on which the refund is based are known and are also reasonably compliant. These claimants/taxpayers are also valued "customers," should not be subjected to frustrating delays, and should be issued prompt refunds. Of course, post-refund audits can be conducted, if subsequent information should trigger such action.
- Category "C" claimants are high risk. These claimants would not necessarily have audited financial statements, would have a history of non-compliance or "nil" returns, and may have recently registered. They have not had a tax audit, or there may have been an audit, but the auditor did not actually visit the premises (desk audit). In addition, the suppliers to the claimant may either be non-compliant or the tax claimed based on the documentation is in excess of the tax returns that have been filed by these suppliers. Claims of these taxpayers should be subject to pre-refund audit.

VAT offers distinctive opportunities for evasion and fraud, especially through abuse of the credit and refund mechanism. In many tax systems, refunds are processed through desk audits where copies of supporting documents may be examined. These supporting documents can be easily "created" using a computer to generate false invoices or even by simply altering a photocopy. It is important that the tax administration take a more holistic approach to refunds, by examining the credibility of the supplier, as well as the refund claimant.

It is especially important where registered persons have not been previously audited that the tax auditor be aware of potential signs of fraud.[138] Where a visit to the claimant's premises is warranted, an attempt should be made to assess the likely future trading pattern of the business. This information would be noted in the audit case record as an aid to the verification of future refunds.

There may be cases where it is difficult to contact the VAT refund claimant. This may be an indication that the business is not genuine, particularly if the business has not been previously visited. Where contact with the claimant cannot be easily made, it is important to check the existence of a genuine business at the address provided.

7.1.16. Stop-Filer Detection

The early detection of stop-filers and corresponding action are essential. Stop-filers are defined as taxpayers who have registered with the tax administration and been issued a TIN at some time in the past, but have stopped filing tax returns.

[138] The audit process and techniques are discussed in Chapter 8.

How does a taxpayer become a "stop-filer"?

- If a registered taxpayer does not submit a monthly VAT or PAYE return (or any other return by the due date), then the taxpayer will become a stop-filer for that tax period. Each registered taxpayer must file a VAT or PAYE tax return for each tax period (in most countries VAT and PAYE are filed monthly, with possibly exceptions for small businesses and seasonality)
- If a registered taxpayer decides to submit a "consolidated return" (a return that would combine one or more tax periods), then the taxpayer will become a stop-filer for those periods (e.g., a taxpayer does not submit a return for June, July, and August, but in September files a consolidated return for the three months – in this case, the taxpayer would be a stop-filer for June, July, and August). Taxpayers need to be informed that consolidated returns will not be accepted – a separate return is required for each month.
- If a registered taxpayer does not file a monthly return because there are no taxable transactions, the taxpayer will become a stop-filer. Taxpayers must be informed that they must submit a monthly return even if there are no taxable transactions.
- If a registered taxpayer fails to notify the tax administration that the business is no longer in operation, then the taxpayer becomes a stop-filer.

The following are reasons to promptly deal with stop-filers:

- If a taxpayer does not file, the taxpayer is not remitting tax, which has an impact on revenue collections.
- VAT/PAYE stop-filers should receive priority attention, because the taxpayer has collected the tax from customers. In the case of PAYE, this is tax that has been deducted from employees. The taxpayer has no legal right to retain the amount collected – these are payments in trust.
- A level playing field should be created for all taxpayers, as every taxpayer should be subject to the same rules -- if taxpayers believe others are not filing, they themselves may stop complying.
- Prompt collection of arrears is considered essential, as the chance of success is higher if the arrears are collected before the amount reaches an uncollectible amount. It is essential that the amount of these arrears is known as quickly as possible by ensuring that taxpayers submit their tax returns.

The quick processing of returns, preferably in an automated system, is essential for the quick detection of stop-filers. As an example, e-filed returns should be posted to taxpayer accounts within 2 working days of receipt,[139] and the bulk of the data from all paper-filed returns should be entered within 5 - 10 working days[140] from the filing due date. At this point the computer system should be able to indicate

[139] This assumes there is an online system with interactive prompts to detect basic math errors and prompt the taxpayer to correct the issue.

[140] A lot depends on the data entry system employed and the volume of tax returns. In smaller countries with centralized processing, the time frame is realistic. In some situations, the LTO is responsible for their own data entry and are dealing with very small numbers of taxpayers where, for instance, all VAT returns can be posted within only a couple of days. LTO operations should have a goal of all tax returns being e-filed with returns posted the following day.

that a return has been received, and, conversely, should be able to produce an accurate report of taxpayers that filed in previous years, but not in this year – stop-filers.

The stop-filer report should also rank the taxpayers based on the estimated revenue at risk using historical data and any other risk factors that may be applied by the computer system, to allow the tax administration to address stop-filers with highest risk to revenue first. The supervisor responsible for stop-filers would then assign the non-compliant taxpayers to the tax officers responsible for obtaining the delinquent returns. The tax officers would use the risk ranking to determine their priority in contacting the taxpayer. In a fully automated system, the stop-filers would be assigned to individual tax officers by the supervisor on the system (or automatically by the system). An administration that does not have such capability should provide tax officers with a manually prepared assignment list.

In the United States, the IRS uses three phases for collecting unpaid tax liabilities in an "assembly line" approach for collection cases. The cases flow through each of the below phases until they are determined to be uncollectible, collected, or otherwise resolved:

- Notice stream: The IRS sends a series of balance due notices to the taxpayer to prompt a reply or payment by the taxpayer. Statutory requirements provide that the IRS send one notice of deficiency for each assessment to the taxpayer. Accordingly, the notice stream begins with the issuance of the statutory notice, which is generated by the Master File, followed by reminder notices, which are generated by the Integrated Data Retrieval System.
- Telephone contact: IRS employees attempt telephone contact with the taxpayer to prompt a payment or take enforcement action that may include levying financial assets or filing a lien against property.
- In-person contact: Revenue officers contact the taxpayer to prompt a payment or take enforcement action, including levies, liens, and seizures of property.

Tax administrations have been trialing alternatives to making the first contact with stop-filers by telephone. Many tax administrations have stopped routine mass mailings[141] using the post office due to the high cost and, in some countries, the inefficiencies of the mail system. Stop-filers would be contacted by telephone; however, this is labor-intensive, and call-backs are often necessary in order to speak directly with the non-compliant taxpayer. Due to confidentiality issues, messages cannot be left with other persons. In the context of an LTO, telephone calls are the preferred method since taxpayers assigned to the LTO should be close to 100 percent compliant, and the number of calls to be placed is very small.

In a study by the U.S. Treasury Inspector General for Tax Administration[142], it was discovered that the first notice that was sent to the taxpayer resulted in 2.79 times more closures than all other notices

[141] In the United States for example, approximately 20 percent of all taxpayers change addresses during the year thus mailing notices has a high rate of non-delivery.
[142] Treasury Inspector General for Tax Administration (2011), p. 2.

combined. This first notice also collected 1.84 times more dollars than all other notices combined and generated 2.02 times more taxpayer responses than all other notices combined.

Project Approach to Stop-Filers

A stop-filer project is a separate component within a tax administration designed to increase the compliance of large taxpayers. By focusing on only large taxpayers, it will prevent the staff assigned from being overwhelmed by unmanageably high numbers of low tax liability taxpayers. This project is concerned only with obtaining the tax returns of stop-filers.

The project is initially focused on taxes which are trust funds (VAT and PAYE) and are collected on behalf of the government by large taxpayers. After addressing these taxes and being satisfied that systems and procedures are sound, the scope of the special project should be enlarged to include the other taxes.

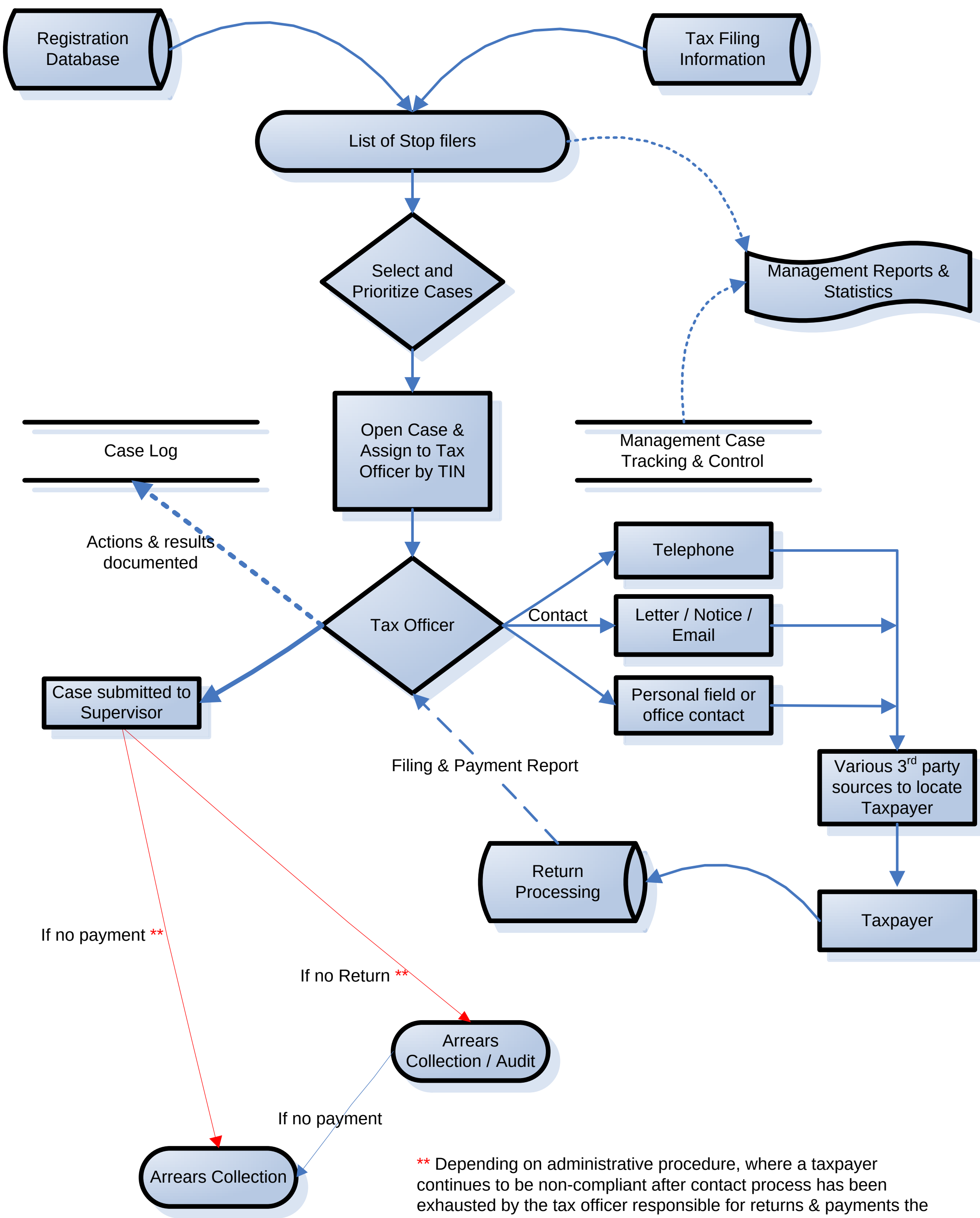
Implementing the stop-filer project is a major undertaking. It will be one of the most visible components of the tax administration, but, unlike other functions in a tax administration, such as enforced collection or audit, it should not be socially and politically sensitive, since it is only concerned with obtaining a tax return and associated payment.

Stop-Filer Process – An Overview

This is a general outline of the steps taken when a taxpayer fails to file their return. The description of how the team would work on stop-filer cases is only indicative and would vary significantly depending on the capability of the computerized tax system, the front-end data processing timeframes, country infrastructure (such as telecommunications), and the organizational structure of the tax administration. The flow of work is illustrated on the below flow chart.[143]

[143] Source: Previous work of author.

Figure 7.7. Stop filer process flow



** Depending on administrative procedure, where a taxpayer continues to be non-compliant after contact process has been exhausted by the tax officer responsible for returns & payments the case may be referred either directly by the tax officer or a recommendation may be made by the tax officer to the supervisor to transfer the case to either Arrears Collection or Audit for action.

The procedures described below are guidelines and are not intended to be a list of the sequential steps that an officer must follow. The team supervisor will need to determine when it is effective and appropriate to use the different steps and actions. The following is a summary of the possible procedures and steps:

Step 1. Generate list of Stop-Filers

The team supervisor should use the computer system to print a list of stop-filers. In some systems, this is already a pre-defined report that can be run at any time. In other countries, the computer system may have limitations and it may be necessary to work with the IT section to run a custom report. The stop-filer list should be produced approximately 7 to 10 days after the VAT / PAYE return due date.

At the outset of this project, the number of stop-filers can be large. Using the previously cited case of large taxpayers in Bangladesh, less than 40 percent were completely compliant. The list should be ranked or prioritized. The longer the time period that has elapsed since a tax return was required to be filed, the lower the likelihood that stop-filers case actions will be quickly resolved. For example, a large taxpayer who ceased to file all VAT and PAYE returns for the previous six months may be in financial difficulty and could already even be in bankruptcy. Alternatively, the staff member responsible for the returns may have left the business, and the new replacement may not be keeping the required records or even be aware of the requirement to file returns.

Step 2. Team supervisor considers sending an automatic "Stop-Filer Reminder Letter"

The supervisor may elect that a reminder letter be sent to each taxpayer who has failed to file a return. The taxpayer may have simply forgotten to file the return, and, therefore, the letter may serve as a timely reminder to file.

Step 3. Supervisor creates and assigns stop-filer cases to team members

The supervisor will open a case and assign it to a tax officer. In some computerized systems, cases can be assigned on the computer system to employees and also tracked on the system by the supervisor. The system may also have a "case log" (diary) where the actions taken are recorded by the tax officer in chronological order. The case log where the actions of the tax administration are recorded and the taxpayer responses are also entered can be an important document should the case should go to court. Other countries may not have as sophisticated a computer system. In this situation, it becomes necessary to use the manual procedures that were in use before computerization. Handwritten case logs that document the action taken on a taxpayer file must be kept. Similarly, manual control must be maintained by the supervisor.

Step 4. Complete the taxpayer profile

In manual systems, taxpayer files are often unreliable, out-of-date, and incomplete. For this reason, a standardized taxpayer profile form should be created. It should be completed and, when the taxpayer is first contacted, the information should be reviewed with the taxpayer to ensure it is accurate. This is an opportune time to capture detailed contact information such as FAX numbers, e-mail addresses, and cell phone numbers, as these can all be used if it is difficult to reach the taxpayer by telephone, or should the administration begin a project to routinely contact non-compliant taxpayers in this manner.

The review of information is also important in the event of legal proceedings or fraud cases. Where the taxpayer is a partnership, the members of the partnership should be reviewed with the taxpayer to ensure there have been no changes. If the taxpayer is incorporated, a copy of the corporation's registration should be available in the file. If it cannot be located, a copy should be requested from the taxpayer.

Step 5. Examine previous history of non-filing

The team member should check to see if the taxpayer has any previous history of non-filing. At this point, there are two possible outcomes:

- It is determined that the taxpayer's tax return filings are up-to-date. The team member will make the corresponding entries in the case log and return it to the supervisor; or
- It is determined that there is a problem with the taxpayer's information on file, or there is a problem with the tax returns.
    - Where returns are in the computer system or the appropriate ledger, but a hard copy is not on the tax file, the taxpayer should be asked to provide a copy of the return;
    - Where a return is on the file but not on the computer system or the appropriate ledger, this will be referred to the supervisor to request the correction of the situation through the data entry section; and
    - Where there is no record of a return, the taxpayer will be requested to file it (with payment).

Step 6. Contact the taxpayer by telephone

The taxpayer is contacted by telephone to find out why the return(s) has not been filed.

- If the taxpayer indicates the return has been filed, then ask the taxpayer to submit proof that the return has been filed;
- If the return has not been filed, the taxpayer should be informed of the penalties and interest that will accrue until the return is received;
- If the taxpayer indicates there are no taxable transactions in the case of VAT, or no employees to withhold tax from, then explain that the taxpayer must submit a "nil" return immediately;
- If the taxpayer needs assistance, then an appointment should be made for the taxpayer to visit the taxpayer services section. In some countries, this may be the responsibility of another section, such as either the collections or audit function to explain the proper filing of returns and assist the taxpayer.

This first call is very important, as it provides the opportunity to review and update, if necessary, contact information and to provide taxpayers with a positive impression of the tax administration. Every effort should be made during this telephone call to secure agreement from the taxpayer that the missing return(s) are submitted to the tax administration within one week.

When the call to the taxpayer is completed:

- The details of the call are to be entered by the team member in the taxpayer case log, and, if contact details have changed, this should also be changed on the computer system.
- The team member will enter the taxpayer return submission date in the "bring-forward"[144] diary in the computer system to check to determine if the taxpayer has submitted the return. If the computer system does not have a "bring-forward" feature, then a manual diary system will be necessary.
- Where the taxpayer has indicated they require a tax return form and it is not available for download from the tax website, a form should be either e-mailed or faxed to the taxpayer. This action would also be recorded in the case log.[145]

Step 7. Reminder to the taxpayer

Although not always a step in the stop-filer process, the taxpayer is contacted on the "bring-forward" date as a "gentle" reminder that a return submission date was agreed to. This would be done where the tax officer assigned to the case performs a quick search of the computer system and it does not show any change to the taxpayer account (a return or payment). This action may be by e-mail, telephone, or text message. This action is also recorded in the taxpayer log.

Step 8. Visit the taxpayer to secure the return

Within a few days following the agreed return submission date, the team member will check records to ensure the return(s) have been submitted. When this is done depends on the tax administration’s systems and procedures. Where the procedure is to acknowledge on the system that a return has been received on the day it is submitted, or if returns can be accepted electronically and posted to the taxpayer account as they are received, then the team member should check the system the day after the taxpayer committed to filing the return. In technologically advanced systems, this check is automated and the "bring-forward" will either be cancelled or it will be noted that the return has been received, and a notation in the case log will be automatically entered.

If the initial telephone contact has not worked, the officer may consider two alternatives:

[144] A diary or calendar where an action by the tax officer is to be taken at a future (forward) date is entered. In most situations, this is an electronic diary that will remind the tax officer at the beginning of the work day of actions that had previously been entered that are now due when organizing the daily workload.
[145] An example collection case log is provided in Chapter 10. Stop-filer case logs will largely mirror the collection case log section dedicated to recording actions taken to contact the taxpayer.

- A repeat telephone call, but with a "stronger tone" requesting compliance. Where a telephone call is made, it will be confirmed with the taxpayer by email. The email will be printed and retained in the taxpayer file, and an electronic copy will also be retained. In this situation, the reasons for non-compliance with the agreed submission date will be noted in the contact log. A new submission date will be agreed with the taxpayer, and, where possible, this new agreement should not extend beyond 2 weeks. An earlier date is preferable, if the taxpayer will agree.
- Visiting the taxpayer or making an appointment for the taxpayer to attend a meeting at the tax office with the objective of helping the taxpayer prepare the return. The following are some guidelines and tips:
  - There may not be enough resources to visit each taxpayer; therefore, with assistance from the supervisor, it will be necessary to prioritize the taxpayers that should be visited
  - The largest taxpayers that have not filed should be visited, as this could have an important revenue implication. It is important if a visit is to be conducted that there is coordination with other areas in the tax administration to determine if, for example, there is an audit visit scheduled, so that the taxpayer does not receive multiple visits.

7.1.17. Public Perceptions and Compliance

The public's perception of the tax system depends on a number of factors, including the extent to which the public views the government as legitimate and whether the public perceives that funds are being misappropriated through corruption, wasted, or misdirected to projects that do not address public priorities or needs. If people generally support the government and have a positive view of the government's spending of "their" tax contribution, then it stands to reason that they are more likely to comply with the tax laws. The more the public perceives that funds are being misappropriated through corruption, the higher the rate of non-compliance.[146] It is critical, as part of the equation on gaining tax compliance, that a government is seen to be wisely spending. Even where funds are being spent wisely, the government needs to communicate that people are receiving the benefits of paying tax. The government should use opportunities, such as the opening of a new school or medical clinic, or the completion of roadwork, to demonstrate to the public that tax revenue is supporting critical investments and public services.

Public perceptions will change, if the public has a better understanding of why taxes are imposed. This understanding will also improve the concept of the legitimacy of the tax regime. Possibly tax administrations and government should consider taking a long-term view on achieving change by, for example, taking part in financial literacy courses taught in schools, colleges, and universities. The more the public understands that non-compliance with the tax system has a cost and that the general public

[146] See: Odd-HelgeFjeldstad (2004), Trust in Public Finance: Citizen's Views on Taxation by Local Authorities in Tanzania, Project Brief LRG 12. The study supported the hypothesis that the rate of contribution to services is affected by factors such as citizens' trust in others and the trustworthiness of the government. Respondents agreed (51 percent) that people should refuse to pay taxes until the services delivered by government improved. A paper by Cummings, Ronald G. Jorge Martinez-Vazquez, Michael McKee, and Benno Torgler (2005), "Effects of Tax Morale on Tax Compliance: Experimental and Survey Evidence" found support for the hypothesis that tax compliance increases with individual perceptions that the tax system is fair and that the government is providing valued goods and services with the revenue.

must bear this cost, the more likely the tax administration will succeed in raising compliance levels. Over the long term, financial literacy can change attitudes and potentially contribute to a new tax culture that makes it socially unacceptable to evade taxes.

Box 7.3. Lessons from CRA research involving younger citizens[147]

The Canada Revenue Agency (CRA) was interested in better understanding youth's levels of awareness about and attitudes towards taxation, and to identify any knowledge gaps relative to the subject. In addition, the CRA wanted to gain insight into potentially key messages that resonate with this segment of the population and the best vehicles for conveying taxation information to it. This study was conducted with youth aged 16 to 22 years old. To meet the research objectives, a total of twelve focus groups were conducted.

Findings suggested that youth have minimal awareness and understanding of income tax-related terminology. Youth also expressed limited knowledge of the requirements and processes involved in filing an income tax return. The findings highlighted the importance of informing and reassuring youth. Most importantly, youth need to be aware that they can potentially get overpaid tax refunded if they file a return, as this was deemed to be the greatest motivator. Parents, the Internet, and the telephone were considered the most useful means of accessing governmental information, while in-school presentations and print advertisement were deemed the most effective means of communicating simple tax information to youth.

7.2. Common Trends

Tax administrations are increasingly devoting resources to behavioral research, re-examining proven approaches to gaining compliance through the use of compliance certificates, and applying technology such as data mining that is being used to combat fraud in other areas of government and successfully adapting it to detect tax refund fraud.

7.2.1. Setting the Level of Sanctions

There is a considerable body of research into penalties for non-compliance. Theories concerning compliance can be categorized into three broad groups: 1) those that are based on economic theories which emphasize incentives; 2) those that are based on psychology theories; and 3) those that have a basis in sociology. Broadly, and rather simplistically, economic theory into tax non-compliance holds that, where a rational person sets out to be non-compliant, he/she will calculate the benefit to be derived against the marginal cost, plus the likelihood (risk) of being detected. Thus, the economic response, also simplistically summarized, is that the goal of imposing a sanction is that the threat, whether financial or otherwise, deters non-compliant behavior. Unfortunately, people are not always rational (in the context of economics), and the other theories place a more emphasis on psychological and sociological factors. These theories include the role of ethical, personal, moral, and social norms, as well as justice or fairness considerations, as strong determinants of taxpayer behavior.

This research into taxpayer behavior is a relatively new field. There is only a body of research[148] that spans about the past three decades. As such, tax administrations are still at the early stages of learning

[147] OECD (2010), p. 34.
[148] Australian Tax Office (n.d.), "Literature review: measuring compliance effectiveness 2007", http://www.ato.gov.au/corporate/content.aspx?menuid=39508&doc=/content/00105122.htm&page=1&H1.

and applying new approaches, and there is the tendency to use the more traditional and direct approach of sanctions when seeking increased compliance. So far with this body of research, there is not a conclusive approach to designing measures that will ensure that taxpayers will comply. Most studies and papers conclude that people are complex, and what may work for one set of persons in one circumstance does not work for others. Thus, a mix of approaches is necessary.

Where a tax reform is contemplated, compliance issues are usually cited as one of the reasons for the reform. In some situations, there is considerable pressure for the reform program to show results. New sanctions are rushed into law as a political response to poor compliance or to a specific situation that the electorate finds unacceptable. For example, the electorate may be incensed about a couple of large corruption cases, leading to a rushed amendment to confiscate all properties acquired with money through corrupt practices. The problem is, in the haste to draft the provision, assets that were purchased with money that was co-mingled with legitimate funds was not contemplated. Legitimate investors who had the misfortune of receiving some money from another investor who was found guilty of tax fraud had their investments seized. In this case, the sanction was overturned by the courts. In other situations, the sanctions could follow the traditional norms of a conservative group which may not be in step with modern practices. For example, look at the demographics of the country where a large percentage of the population is under the age of 25, while those preparing the law and sanctions are considerably older and may hold different values. One of the acceptable approaches when proposing new sanctions is to review the provisions of other laws in the country and also nearby countries to ensure that the proposed sanctions regime is synchronized, to a large degree, with the norms of these other laws. If it is radically different, then it may not be socially or politically acceptable, and it may not pass judicial review.

7.2.2. Tax Compliance Certificates

Other civil sanctions that are used in some countries are the temporary suspension of business licenses to operate or the suspension of an accountant or other professional to represent clients in tax matters. This prohibition could be extended to doing business with the government or the ability to import goods through Customs. This latter sanction is generally used in conjunction with a tax compliance certificate scheme where importers must have a certificate from the tax administration to clear goods. The certificate generally must be renewed quarterly or at least semi-annually. A certificate would not be issued if there was an outstanding tax return or tax arrears.

There are disadvantages to suspending a license to operate or import. It is analogous to the former British system of debtors' prison, where people that could not pay were imprisoned until they could pay, but being imprisoned prevented them from earning the money to pay their debts. While the suspension is intended to be a deterrent, it may have the unintended effect of causing unemployment, damaging the economy, and further reducing the ability to the taxpayer to pay the original tax debt, while interest and penalty accumulates.

7.2.3. Refund Management Initiatives

Tax administrations have traditionally used computerization to identify non-compliance after a transaction has been completed. In many countries that have less sophisticated revenue systems, they rely on examining historical refund data to identify fraud cases for investigation after the refunds have been paid. In this scenario, tax administrations are using their scarce resources to chase frauds after they have been paid. These are cases that should never have been paid in the first place. Tax administrations should use the same databases to build models that are predictive and work in real time, to detect non-compliance before the refund is approved and payment is made.

Fraud, of course, is not unique to taxes. Other areas of government have recognized that fraud is becoming more sophisticated and that sophisticated tools to discover fraud are needed.

> *"As fraud schemes become more sophisticated and migratory, access to real time data and the use of advanced data analysis to monitor claims and provider characteristics are critically important."*
>
> Daniel R. Levinson, Inspector General, Office of the Inspector General, U.S. Department of Health and Human Services[149]

Advancements in data mining techniques present possibilities for quickly detecting unusual refunds that should be candidates for further investigation. Data mining to detect anomalies is different than modeling methods. Modeling is rule-based, where known frauds are examined to determine a set of rules which are stored, and the patterns of various refunds are compared to these rules to detect any similarities. Anomaly detection models store information on what normal behavior looks like, which makes it possible to identify deviations, even if they do not conform to any known pattern under the modeling method.

Another example of using data in real time is the use of sophisticated algorithms to predict an outcome, which is used very successfully by stock market investors in high frequency trading. A similar concept can be applied to identifying refunds that are suspect.

7.2.4. Automating Taxpayer Contact

Technology provides low cost options to fully automate the taxpayer contact process by, for example, sending text messages and e-mails directly to non-compliant taxpayers. The initial contact by text message and/or e-mail is brief and polite, but also gives a deadline for when the return is expected to be filed. This deadline would normally be about 5 working days. Taxpayers who are not covered by the LTO, but who have high risk or high revenue returns, are contacted after a suitable waiting time to allow for returns to be posted in the computer system (about 2 weeks). If the delinquent return has not materialized, then the case is escalated to the assigned tax officer to initiate telephone contact with the taxpayer. In the automated system, a log (diary) detailing dates and actions taken is maintained on the

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[149] http://www.hhs.gov/asl/testify/2009/06/t20090625a.html.

computer system. When the tax officer contacts the taxpayer by telephone, the date, time, the name of whom was spoken to, what was requested of the taxpayer, and the taxpayer response is recorded in this log.[150]

Tax administrations with the technological capability are also experimenting with web-based self-service solutions. In addition to being able to file a return online and make payments on their tax accounts, taxpayers can also view their tax account transactions and balance and view prior tax returns, and their registration information.

7.3. Tax Administration Maturity

Filing and Payment: Maturity Level 1

Key word: "Unfocused"

- Return forms use templates that vary by type of tax and contain insufficient information to determine liability. Returns are manually posted to ledgers and archived, but not otherwise analyzed (except when needed for other functions, such as audit). Only paper returns are used. Payments are accepted only at tax offices. Refunds are delayed and require budgetary appropriations.
- Complete tax return information is not captured electronically and cannot be used for analysis.
- There is no return verification (other than during audit).
- Filing, payment, and refund arrangements are separate for each type of tax and there is no standard.
- There are separate taxpayer accounts for each type of tax.
- There may be separate TINs issued by tax type.
- Electronic data if it does exist is unreliable. There are no guarantees of paper archive security as tax employees have unrestricted access to files.
- There is no stop-filer program.
- What few penalty provisions exist in the separate laws are vague or incomplete (e.g., penalties, but no interest).

Filing and Payment: Maturity Level 2

Key word: "Burdened by processing"

- Returns contain sufficient information to determine liability, but continue to use templates that vary by type of tax. Returns are subject to an extensive annual review before it can be accepted as files and then sent for data capture and archived. Only paper returns are used. Payments through banks are allowed. Refunds are delayed and require budgetary appropriations.

[150] When implementing an automated system similar to a log maintained on the computer system it is important that legal issues concerning the admissibility of the log in court are addressed in the event the taxpayer is prosecuted.

- Limited information is captured electronically (not enough to determine liability). Information is not captured as soon as practical (i.e., before computational verifications, audits, etc.) and there are inadequate system checks to ensure data integrity.
- Filing, payment, and refund arrangements are separate for each type of tax, and there is no standard.
- Although combined into a single revenue accounting system, taxpayer accounts continue to be separate for each type of tax with no coordination.
- There are some measures of security for paper archives, but measures for electronic data protection and disaster recovery are deficient.
- There is still no stop-filer program.
- There is a set of financial penalty provisions for various delinquencies, but they are insufficient and differ across taxes.

Filing and Payment: Maturity Level 3

Key word: "Process-driven"

- Returns contain sufficient information to determine liability and use a standard template. Returns are verified, captured electronically, and archived. E-filing is allowed. Payments through banks are allowed. Refunds do not require budgetary appropriations, but are still delayed.
- Information sufficient to determine liability is captured electronically as soon as practical (i.e., before computational verifications, audits, etc.).
- Although standardized, filing, payment, and refund arrangements continue to be separate for each type of tax.
- Although combined into a single taxpayer accounting system, taxpayer accounts continue to be separate for each type of tax.
- Security of taxpayer data (both electronic and paper) is ensured.
- Stop-filers are identified and pursued, but in an ad hoc fashion as other priorities permit.
- There is a set of consistent financial penalty provisions, set at appropriate levels and covering all delinquencies.

Filing and Payment: Maturity Level 4

Key word: "Program-driven"

- Returns and payments are standardized, expedited, and, where possible, e-filing and e-payment exist and are mandatory for large taxpayers. Returns are captured electronically, verified, and archived. Refunds are expedited through the use of a risk assessment process.
- Information sufficient to determine liability and support tax analysis is captured electronically as soon as practical.
- Taxpayers are offered a consolidated view of their tax account, combining all payments and returns into a single balance with the ability to offset refunds against other tax liabilities.

- Security of taxpayer data (both electronic and paper) is ensured.
- Stop-filers are systematically identified and pursued according to a well-defined stop-filer program.
- There is a set of consistent penalty provisions for all types of delinquencies (non-filing, non-registration, late filing, non-payment, late payment, etc.). These are set at sufficient levels to promote compliant behavior by taxpayers.

7.4. Latin America and the Caribbean

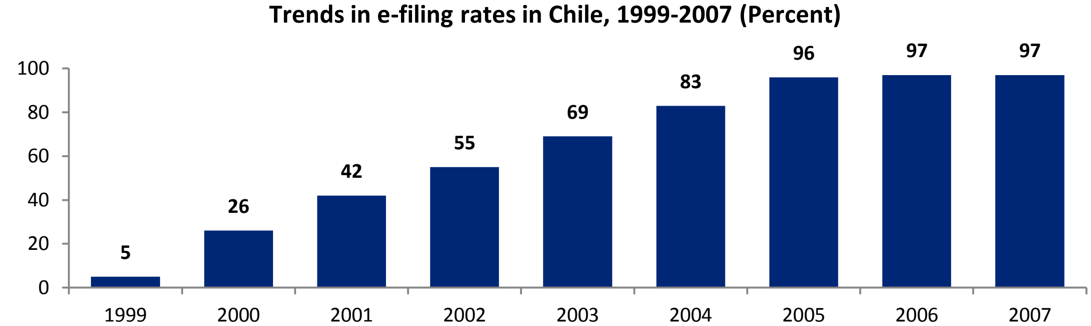
There has been substantial progress made in recent decades with regards to filing and payment systems in Latin America and the Caribbean (LAC). Standardized forms have been complemented with electronic filing and payment and information provided to the taxpayer to determine liability and assist in completing the forms. On average, tax returns filed through the Internet have grown rapidly and, in some specific cases, the Internet is the most reliable and accessible way to obtain forms and file returns. In countries such as Argentina, Brazil, Chile, Colombia[151], Dominican Republic, Ecuador, Mexico, and Peru, electronic filing is virtually the only form of filing.

Box 7.4. Over 97 percent e-filing in Chile[152]

The rapid growth of technology and internet services worldwide in the past decade has had a huge impact in terms of tax administrations providing e-filing services to taxpayers, but countries seeking to achieve 100 percent e-filing rates face several obstacles along the way.

Within LAC, the two leading countries in e-filing rates are Brazil and Chile. In the late 1990's, spurred by the technology boom and the Internet, Chile launched an effort to boost e-filing rates through large-scale investments in user-friendly systems, simplification of forms, and innovative initiatives to overcome connectivity issues. By 2007, the new public-private network established to combat sparse connectivity and costs accounted for nearly half of new e-filings. Aggressive marketing and awareness campaigns, combined with incentives to file online, significantly increased the e-filing rate in the country. E-filing was also made easier by improving access through agreements with internet cafes to allow taxpayers to file online at no cost, mobile units with computers, tax agents, and training operators.

Trends in e-filing rates in Chile, 1999-2007 (Percent)



[151] Colombia established mandatory electronic filing and payment for major taxes, including corporate income tax and value added tax (International Finance Corporation (n.d.), p. 6).
[152] Dohrmann et al., p. 14.

Progress has also been achieved in detecting and addressing delinquencies. In the area of stop-filing, computerization has allowed tax administrations in most LAC countries to improve control of stop-filers.[153] In some countries, tax administrations are working with police to combat refund fraud.[154]

Many LAC countries should be placed in the third or fourth level of the maturity model above. Nonetheless, many countries in LAC continue to struggle with cumbersome legislative frameworks, resulting in difficult compliance requirements.[155] Several countries have taken steps to overcome this challenge. In Brazil, a tax simplification scheme for microenterprises consolidated several taxes, reducing taxpayer costs and resulting in an increase in registrations with the tax authority.[156] According to the World Bank's 2012 Doing Business report, Mexico continued to reduce the administrative burden on businesses by eliminating some filing requirements for firms, including the obligation to file yearly value added tax returns, and Colombia allows the consolidated filing and payment of taxes levied on salaries.[157]

7.5. Key Benchmarks and Guidelines

Throughout the discussion of filing and payments presented in this chapter, several important topics and benchmarks have surfaced that should serve as key takeaways. The below list, while not exhaustive, attempts to summarize five major benchmarks and guidelines for filing and payments in the realm of tax administration.

- **Ensuring that the tax law, subordinate legislation, and penalty structure are sound public policy instruments.** This can be roughly gauged by the frequency of amendments to the returns and payments provisions of the law. Frequent amendments can be indicative of compliance issues that may be legal and/or administrative in nature (e.g., organization, process, procedural). Monthly statistics should be examined, as legislative problems will often be identified by tax officials during this general discussion. Both sanctions and interest should be automatic, with no discretion on whether they are applied, except in cases of hardship, where administrative discretion may be used on applications to reduce or waive sanctions.
- **Self-assessment is critical and can only function effectively if the taxpayer has sufficient information to accurately determine their correct tax liability.** A quick guide is to determine when the last amendment was made to a provision that affects either filing a return or paying tax and to locate the publication(s) that deal with these changes. The publication(s) should have

[153] Tanzi (2000), p. 35.
[154] Brazil has taken significant steps to dismantle and publicize fraud. In March 2013, a nine-year-long investigation resulted in 31 incarcerations and the freezing of the assets of 195 companies and 62 individuals (Latin American Herald Tribune (2013), para. 13)). In February 2013, the Brazilian Federal Police in the state of Piauí issued five warrants to dismantle a criminal organization specializing in fraudulent individual income tax statements for obtaining refunds abuse. (Comunicação Social da PF no Piauí (2013), para. 1).
[155] In October 2012, the Latin Business Chronicle, after producing a Latin Tax Index based on World Bank, KPMG, and Heritage Foundation data, called a number of countries "small nightmares" and placed Brazil last (Latin Business Chronicle (2012)).
[156] Fajnzybler et al. (2011), p. 76.
[157] International Finance Corporation (n.d.), p. 5-7.

been modified to reflect the change in legislation shortly after the legal amendment. The tax administration should have a website with all current forms and publications available.

- **Filing and payment of returns should require minimal or preferably no contact with a tax official.** Ideally, payments should be made through the financial system and returns filed electronically.
- **There should be a unit dedicated to identifying and contacting stop-filers.** This may be further delineated by taxpayer size, with a special group dedicated to large taxpayers, although large taxpayers should ideally be 100 percent compliant when returns and payments are due.
- **There should be monthly statistics on returns and payments.** At a minimum, all large taxpayer stop-filers should be contacted within 14 days of the return becoming overdue. An aged report of receivables should be system generated each month, with the highest risk-to-revenue cases being allocated for action. A monthly management report should be produced by tax type that differentiates between large taxpayers and others and outlines the opening balance, intake of cases, resolved cases, and the ending balance for the period. The report should also have a brief, non-statistical analysis of events affecting compliance.

Chapter 8. Audit

Colin Lethbridge

The purpose of this chapter is to define "audit" and to discuss the important role that audit plays in tax administration. Audit is a core function of the tax administration and is essential to help the tax administration carry out the task of monitoring tax compliance and thus collect the total tax liabilities due to the government.

Audits examine the declarations of taxpayers to not only test the accuracy of the declaration and the accounting systems that produce the declared liability, but also evaluate the credibility of the declared or assessed tax liability. The taxpayer's anticipation of such actions has preventive and deterrent effects. The deterrent effect is the extent to which audit actions discover and stop taxpayers from continuing to under-declare or manipulate their liability. The preventive effect is the extent to which enterprises decide not to evade tax, because they are aware of audit activity and fear detection.

An effective audit program generally results in the discovery of under-declared liabilities either by omission, error, or deliberate deception. The amount of additional revenue raised obviously depends not only on the level of compliance within the taxpayer community, but also on the effectiveness of the Inspectors and the audit program planning and implementation. An efficient and effective audit division will assist the government in its pursuit of increasing taxpayer voluntary compliance and facilitate the tax administration's aim of getting "the right tax at the right time."

It is important to remember that the role and responsibility of the audit function is to control registered taxpayers. It must not be expected to also take on non-filers or the gray economy, which is usually the responsibilities of other divisions in the tax administration, such as registration and fraud investigations.

8.1. Leading Practice

The following are known leading practices on how the audit function actually works in terms of its legal framework, organization, management, staffing, process flow, and monitoring and reporting, etc.

8.1.1. Legal Framework

The legal framework that covers the tasks of the tax administration is discussed in Chapter 3. For the purposes of audit, it is important to note that a rigid legal framework has the tendency to make the audit task more difficult, as it makes it easier for taxpayers to appeal assessment and other powers claiming technical misuse of the law, which may result in long delays in the judicial appeal processes. Primary legislation regarding the carrying out of audits should be set in general terms of powers of access to all books and records of the taxpayer and powers to inspect the operating activities of the taxpayer. Detailed procedures of audit should be set out in the regulations of the tax administration to enable the administration to make changes to procedures without amendments to the law as trends in business activity or accounting practices may change.

In addition, the roles and responsibilities of the Ministry of Finance (MOF) and the tax administration should be clearly defined and separate. The MOF should restrict its role to one of setting tax policy and allow the tax administration to administer and implement that policy. Otherwise, the task of auditing can be impeded by decisions taken by the MOF that fail to recognize the effect on the audit process. The MOF will, of course, have powers to review the administration of the laws to ensure these policies are being implemented correctly.

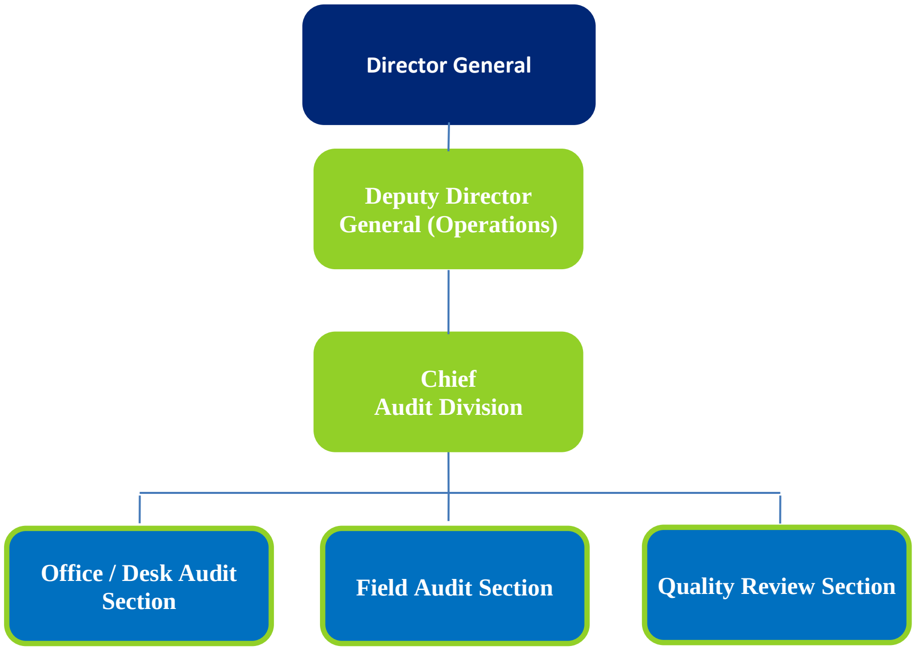
8.1.2. Structure and Management

Modern tax administrations divide responsibilities for the audit function between headquarters and district/field offices. The main responsibilities of headquarters relate to policy and management, while district/field offices are responsible for ensuring that policy decisions are implemented in a consistent way and that any problems encountered during implementation are referred to headquarters for central consideration and resolution. This division of responsibilities is also an accountability measure, since policy and operational tasks are not carried out by the same personnel. Another benefit of separating the two functions is that it helps to fight conflicts of interest and any perceptions of corruption by auditors, as it prevents the "strategic" targeting of taxpayers (i.e., based on their potential for making side payments or as a means to protect corrupt taxpayers from audits). Independent case selection will also help the tax administration respond to any allegations of political bias in audit selection, as the independence of case selection will be demonstrable. Both factors will contribute to taxpayers' perceptions about the fairness of the audit program.

The Role of Headquarters

In the tax administration, as described in Chapter 4, the functional divisions of headquarters, including the audit division, set and review policy, make forecasts, develop processes and procedures for management of the functions at district/field offices, monitor performance, and consider new concepts.

Figure 8.1. Organizational structure of the audit function at headquarters[158]



In the audit function, headquarters monitors the law to ensure that the authority and powers of the auditors are transparent, fair, and equitable. It must make sure the laws do not inhibit the conduct of an audit, but must also be sure that audit powers do not exceed the rights of the taxpayer. Headquarters makes policy decisions on how the audit task will be implemented, including but not limited to the number and type of audits to be done, the resource allocations to be made, audit techniques, risk criteria to be used, staff training needed, etc. They develop processes and procedures to be used by the district/field offices to carry out the various tasks associated with audits. Headquarters also monitors performance and carries out management checks to ensure correct implementation of the law(s) and instructions. Specifically, headquarters:

- Develops and continually updates all programs, policies, guidelines, procedures, and manuals for the district/field audit functions;
- Designs and implements risk analysis scoring systems (preferably computerized), categories, and standards for risk-based selection of cases for examination;
- Develops consolidated strategic and annual audit work plans and for all district/field offices;
- Classifies, selects, and assigns cases for examination based on annual work plans;
- Allocates audit resources to district/field offices;
- Evaluates the district/field office audit programs through reviews of periodic reports and on-site field visitations, including on-site reviews of the quality of work district/field offices;

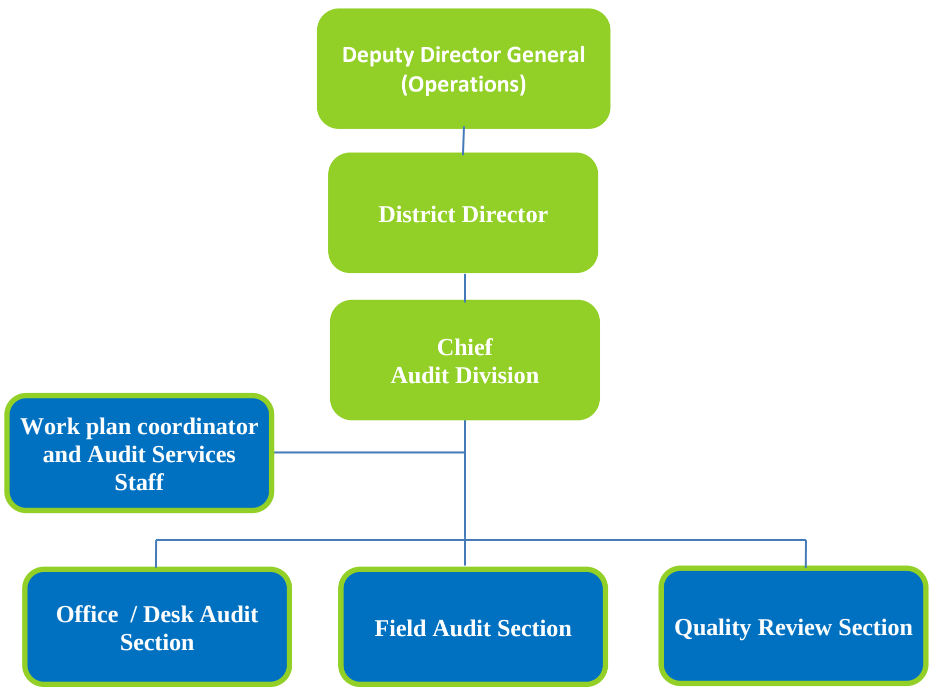
[158] The organizational structure of headquarters mirrors the organizational structure of district / field offices. The specific responsibilities of each section are described below. Of course, the role of the sections at headquarters is to plan, monitor, and evaluate, whereas the role of the district / field office sections is to implement.

- Designs controls and programs to accurately account for all assigned and closed cases;
- Determines the training needs of audit staff in all district/field offices; and
- Develops employee evaluation standards for the performance of audit staff.

The Role of the District/Field Offices

The district/field office is the primary point of contact between the tax administration and the taxpayer community. The audit manager in the district/field office undertakes the responsibilities delegated from the headquarters audit division, ensuring all planned audits are carried out in the manner laid down by procedures developed by headquarters and that the auditors have enough training to carry out their work. Of course, the audit manager and auditors have support from the administrative staff of the district/field office for clerical, information technology (IT), and other duties. The audit manager oversees the performance of audits, including the allocation of cases to auditors, the quality of work, and the achievement of the targets set by headquarters.

Figure 8.2. Organizational structure of the audit function at the district / field offices



The principal role of the Chief, Audit Division and his staff of district/field offices is to execute the annual audit work plans developed by the audit division at headquarters.

The Work Plan Coordinator and Audit Services Staff are the centralized control point of all work that flows in and out of the audit division. They assist the Chief of the Audit Division to coordinate with headquarters to ensure that only the cases most in the need of office/desk and field audit are selected, that the scope of the work plan is implemented throughout the district/field office to give full geographic coverage to compliance-enforcement efforts, and that consideration is given to audits of all types of taxes. They also make case assignments throughout the year promptly, upon request by the audit sub-units.

The Office / Desk Audit Section has staff assigned to groups of 10-12, each with a supervisor, that handles less technically difficult or lower revenue risk in-office audit cases. They contact taxpayers by correspondence or telephone and schedule in-office desk audits of issues pre-identified as questionable and advise the taxpayer to bring to the audit conference the documentation required to substantiate income, deductions, credit, or other issues in question. In conducting the audits, the office/desk auditor follows the processes described below.

The auditors of the Field Audit Section are assigned to groups, usually of 10-12, each with a supervisor. Experienced field auditors conduct in-depth examinations of books and records and should be given broad legal and administrative authority to take any and all actions permitted by the tax code/tax laws to conduct the full scope of the audit until conclusion of the case without seeking supervisory approval. In conducting audits, the field auditor follows the processes described below.

The Quality Review Section is comprised of experienced auditors specifically selected for their technical expertise. On an ongoing basis, the staff selects samples of completed and ongoing cases to determine if auditors are conducting their audits in conformance with the tax legislation and the policies and procedures established by the headquarters staff in manuals or other documents. In addition to communicating uncovered discrepancies to specific auditors and their respective supervisors, the staff periodically issues "alerts" to all audit staff about common issues and discrepancies noted during their reviews and provides guidance for corrective actions.

8.1.3. Audit Function Staffing

The deployment and organization of the audit staff should be decided by the audit division at headquarters and international experience has found that many different organizational structures exist, due to the varying maturity of the administration and the culture of the taxpayers they seek to control. The more mature organizations will have taken into account such elements as the number of taxes involved, type of taxpayer activity, size of taxpayer, compliance of taxpayer, etc. to decide on how best to organize the resources available. These range from teams of specialist auditors for large or complicated taxpayers, e.g., auditors with high level of expertise on transfer pricing of multi-national corporations[159], to single generalist auditors operating in remote areas and dealing with all aspects of taxation for small or medium taxpayers.

Staffing of the audit function has always been the subject of debate. The elements for staffing are always affected by political agreements regarding the budget for the tax administration and the audit directorate’s share, estimated revenue lost by lack of or underperforming auditors, savings to be made across the national budget, overall tax administration needs and expenditures, and the audit function’s desire to do as many audits as possible.

[159] Transfer pricing issues are discussed in Chapter 3.

Planning resources in an audit function will be an ongoing task from the day the budget allocations are made until the next budget exercise. The annual audit plan will take account the number of available auditors, the average days for performing various types of audit and the corresponding number of personnel-days of support staff needed, allowances for training, annual holidays, sickness, etc. The plan will be monitored to ensure targets are being met and adjusted as necessary as events unfold.

8.1.4. Overview of the Audit Process

At a high level, the audit function should have three elements as follows: 1) taxpayers are selected for audit during audit planning; 2) audits are conducted; and 3) the quality of audits is continually monitored. These are described in detail in subsequent sections. Frist, however, given that it is impossible to audit all taxpayers, especially in one and the same way, a critical aspect to consider is that the first two elements of the audit function use some form of case selection.

During audit planning, risk analysis to test the credibility of the taxpayer has become a highly specialized undertaking for most tax administrations, and the actions become more and more intense as taxpayer compliance is tested. Modern risk systems will move from simple completion and correctness checks, through to checks that apply hundreds of criteria, comparisons, or standards in order to identify whether cases: (a) require no action and should be accepted as compliant; (b) leave room for some doubt and may require some review or audit action; or (c) are not credible and require action. Depending on the complexity and sophistication of the risk analysis program, the three classifications above will be subdivided many times to identify the cases that are most likely to produce additional revenue or where revenue is at high risk (e.g., VAT refunds). The tax administration will use this information or risk score to set categories for the selection of cases. The audit division at headquarters will set the score categories in order to produce a detailed annual audit plan, indicating the number of taxpayers to be targeted for each type of audit.

Whether or not only certain returns are selected for audit, it is always preferred that various types of audit are developed by the audit division. Modern tax administrations have designed procedures for comprehensive audit vs. single tax audit, desk audit vs. a field audit, monitor audit used to check the selection process, and other audits to be able to use staff more effectively.[160] In any of these cases, during the conducting of the audit as described below, the tax administration has the flexibility to expand or contract the scope of audit as it deems necessary, according to findings and based on potential of the audit case to produce results.

Audits are a complex undertaking and, during the whole audit process, the audit function must aim to have a system in place that enables both headquarters and district/field office managers to be able to control and monitor each of their responsibilities. The head of the audit division needs to be able to see the status of all the plans and yearly targets on a national and local level to be able to correct, adjust, or take specific action when the process flow reports indicate either national or local problems. This same

[160] Desk and field audits are defined above. A "monitor" audit is an audit that is performed not because the taxpayer necessarily should be audited, but to check whether the tax administration should, in the future, audit types of taxpayers for audit other than the ones it has selected. Audit selection is described in detail below.

system must deliver appropriate reports to each manager down the management chain in order for them to take action even before headquarters has identified problems.

8.1.5. Types of Audit

The audit division at headquarters must set the policy for classification of audit types and the expected time to be spent on each case. They will use historical data and the administration's experience to separate the relative risks of the various sizes and classifications of entities.

The audit types can vary from simple checks to in-depth inspections at taxpayers' premises. This depends on the calculated risk, based on compliance, size of turnover, previous inspections results, time since the last audit, and credibility of declarations, etc. Many tax administrations take advantage of the well used 80/20 theory (20 percent of taxpayers pay 80 percent of tax collected) and exclude the top 20 percent of the highest turnover taxpayers from any plan or risk selection program and monitor them individually. While this policy has many advantages, it should not be carried out at the cost of omitting high risk, lower turnover taxpayers.

Most tax administrations will have a classification procedure for audit types going from a simple audit of one item identified as risky by the risk-based selection system to a full, comprehensive field audit for high risk scoring taxpayers. In between these will be single tax audits, refund audits, special exercise audits, and system monitoring audits. Each tax administration will need to identify which types of audit they need and how they will be classified, plus the expected time each type of audit should take. Once the policy for audit classification is developed, work on the annual audit plan and selection procedures can progress.

8.1.6. Annual Audit Plan

This annual audit plan sets out the overall number of audit case targets for the year. It takes into account the total number of registered taxpayers, set against the total available resources, and the types of audit considered necessary by the audit division at headquarters. As the plan is developed, the targets will be purely numerical and will be used for case selection after the risk-based selection program has been run. At this stage of the exercise, headquarters will have decided on average times to be taken for the various types of audit they have chosen.[161] If headquarters has set up special and separate measures for high turnover taxpayers, the resources for implementing these measures must be taken out of the main calculations for the annual audit plan.

The annual audit plan includes input from various sources. Headquarters provides the audit objectives for the year (e.g., number of audit files, a forecast of assessed revenue, etc.). Other sources may include:

[161] For example, while a simple desk review may take up to a couple of days, a comprehensive field audit may span an average of several months.

- Previous experience and area specific knowledge from auditors (i.e., knowledge of large taxpayers or specific industries);
- Audit area indicating a compliance need;
- Recommended overall taxpayer classification (size, industry type, other);
- Type of business (industrial, commercial, professional, construction);
- Reasons for the recommendation (i.e., source of compliance concern, such as prior substantial audit findings, comments from taxpayers and/or representatives, feedback from speaking engagements, etc.);
- Application of risk-based selection as described below;
- Anticipated staff levels in the audit function and the net available time for direct audit work;
- Outcomes from the previous year(s) audit plan; and
- Estimates of potential revenue (per return or per hour).

The audit division at headquarters must have optimum targets for the various audit types and amount of additional tax discovered when preparing the annual audit plan, but this will be adjusted during consideration of the resources available and discussions with the district/field office managers. Matching resources to audit targets is a skilled task and requires cooperation from headquarters and a bottom-up information flow from the district/field offices regarding their estimates of the year's available resources for completion of the various types of audit. When this is done, both headquarters and the district/field offices will have their targets for the year and be ready to assign audit cases from the risk selection when it is run.

8.1.7. Risk-Based Audit Selection System

The overall objective of the audit division must be to have in place a system that will identify the most risky returns/declarations or non-compliant taxpayers for audit and then allocate these, in priority risk order, to the available resources. Since it is impossible to control and check every single taxpayer, risk management is an important element of effective and efficient audit programs. Tax administrations, where laws require universal filing, will likely audit 10 percent or less of the total taxpayer population each year. Tax administrations, where laws prescribe only 'business' filers, may audit up to 30 percent of the total taxpayer population each year. However, with proper selection, audit will cover up to 90 percent of the revenue and provide for a sufficient number of audits to effectively deter non-compliance. This said, it is unnecessary to waste scarce enforcement resources on routinely examining low-risk, compliant taxpayers. The objective of the audit program, including the file selection process, is to allocate examination resources to areas that have the most potential for generating additional revenue. Tax administrations use methods that focus on high risk taxpayers to select files for audits. This targeted approach will result in higher revenue from audit activities than an unstructured approach.

To select taxpayers for audit, tax administrations use criteria – risk criteria – that measure at least those elements of a taxpayer's compliance that can be measured within tax returns and within the historical performance of their responsibilities. A number of risk criteria will be used on each taxpayer and combined into a "risk scoring algorithm" – an algorithm to quantify and compute risk for each taxpayer.[162] Sophisticated risk scoring algorithms may also include criteria to do comparisons with industry averages and norms, such as margins, mark-ups and profitability ratios, matching of third-party data, etc. The main goal of the risk scoring algorithm is to identify the taxpayers with the highest risk to revenues and the highest probable additional liability that will be discovered by audit.

The risk-based audit selection system is not possible without automation, if risk is to be calculated for all taxpayers. This said, many developing tax administrations do not have the available information – both electronic information from tax returns and historical information on successful audits – to do more than a very simple risk analysis. A simple automated risk analysis, however, is still better than an attempt to audit all returns received or to manually identify the most risky taxpayer. The number of criteria and the quantifying mechanism used can be augmented and developed over time.

The efficiency of an automated risk-based selection system depends largely on the quality and the number of the risk criteria used. The more accurate they are, the better the taxpayer's credibility will be assessed by each criterion and the more effective the system will function as a whole. Hence, the selection of the criteria and their continuous adjustment over the years are vitally important. Thus, as described below, it is also necessary that headquarters has, as a precondition to an automated risk selection system, audit monitoring and assessment activities. The individual prioritizing and scoring of criteria can have major effects on the final risk score, and only constant monitoring and testing will produce lasting good results. Over or underweighting scores on individual risk scoring criteria can result, in the following effects, among others:

- Compliant taxpayers may appear in the high risk taxpayers' group if they had mechanical errors in their tax returns;
- Not all taxpayers who underreport their tax liabilities will immediately appear in the high risk score bracket; and
- The lack of filed returns could cause non-compliant taxpayers to receive lower scores in the system.

The selection program should be run (and the audit plan updated) on a regular basis during the tax year, not just once, as this ensures late filers are included in the overall risk assessment and scored accordingly. This also gives the district/field offices a current list of high risk taxpayers, ensuring a better allocation of audits during the year. Many tax administrations in emerging countries run the program just once a year shortly after the filing due date, but this is not good policy. Not only does it miss the late filers, but it probably means that the district/field office will carry out a complete distribution to individual auditors for the whole year. This not only stops the flow as far as management information is concerned, but is inefficient, encourages 'cherry picking' of cases, and distorts the production of accurate achievement reports against the annual audit plan.

[162] An example list of criteria and a simple risk scoring algorithm are provided in Appendix 8.A.

With the use of a risk-based audit selection system, taxpayers should be satisfied that they are being audited due to a procedure that was completely automated and governed by a fair and automatic process that selects cases based on predetermined criteria that are tested against all taxpayers.

Box 8.1. Case Selection Management System in El Salvador

The case selection management system introduced in El Salvador during 2009-2010 by USAID's Tax Policy and Administration Reform project selects cases for audit automatically based on the quantified risk to revenue of each taxpayer and distributes audit cases automatically rather than leaving these to the discretion of tax officials. It also allows for the monitoring of progress along audit cases and effectively standardizes audit procedures and workflow. The introduction of the system yielded an increase of audit assessments to an estimated 6 percent of national revenue in 2010 from 1.8 percent in 2009.[163]

8.1.8. Conducting Audits

The audit is a powerful tool to be used by the tax administration to control the tax register, and it must be well planned, with well-trained and professional auditors. As stated earlier, the type of audit will be stipulated by the policy laid down by the audit division at headquarters, and the procedures to be carried out during the audit should be available for all staff involved in the audit task.

Modern tax administrations have intensive training programs and detailed audit manuals for their auditors, giving them not only knowledge and skills for effective 'revenue' audits, but insight into the activities of the taxpayer. There may well be special manuals developed for businesses or activities that have particular difficulties or problems and need specific audit methods outside the general principles described below.[164] In all cases, it is understood that the "revenue audit" is not the same as the "financial audit" carried out by the accounting profession, and great care is taken to ensure that the auditors look behind the accounting books, records, and operating processes to establish the credibility of returns and declarations. They are looking for under-declarations of tax caused by deliberate omissions or incorrect application of the law, not simply accounting errors of posting or arithmetic.

In developing tax administrations, this is not always the case. Recruitment of Inspectors is generally geared to graduates with accounting or economic degrees, and little training is given. More emphasis is placed on checking arithmetic accuracy or looking for technical bookkeeping errors that produce fines or penalties. This produces a less than effective deterrent, as the taxpayer views the Inspector as nothing more than a clerk who understands little of the businesses processes of the activity.

The use of the risk-based selection system must be used by the audit division at headquarters to introduce a modern case management process that will place responsibility at the correct level and do away with bureaucratic multilevel approvals prior to audits being commenced and completed. The system can give managers at each level the taxpayers to be audited and specify which type of audit

[163] Murdoch et al. (2012), p. 9.

[164] In much of this section we focus on the audit of "businesses." The steps to be taken in auditing personal income tax returns are similar. Furthermore, in many countries, a business, such as a sole proprietorship or a partnership is not taxed on income, but its owners are instead taxed on their income through the personal income tax.

should be used. In this way, the managers overseeing the audit function can concentrate on performance against the plan at each stage and the quality of the results. With established reporting lines and clearly defined management roles and responsibilities, along with managers that accept accountability, there should be no reason for multilevel approvals of decisions.

The conduct of each type of audit must be carried out using a set of guidelines, usually in the form of a manual, developed by the audit division at headquarters. The various types of audits considered necessary by the tax administration will range from the in-depth comprehensive audit and single tax audit, through to the less detailed desk audit (cameral), specific audit, and system monitor audit, but all will have specific areas identified to be checked, backed up by the selection system's previous risk assessment information.

The methods used during an audit are detailed and must be developed by the audit division at headquarters. The tax administration should have procedures, manuals, and guidelines in place setting out the best practices to be followed. These documents can run to hundreds of pages, but for the purposes of this chapter the main stages required for a comprehensive audit are illustrated below. These stages represent accepted international leading practice, and all tax administrations should aim to have all their auditors trained in and using these techniques.

Although the mechanics of audit are set by procedures, manuals, and guidelines, the task of conducting the audit should not be mechanical or routine. The procedures below provide guidance on how best to approach the analysis and assessment of the taxpayer under audit. This said, the auditor's judgment is paramount – not all of the information sources will be reliable or accurate. By its very nature, audit involves continuous development of the picture as inquiries are pursued and observations made and an ongoing review of information to focus the auditor on areas of potential problems. Developing an understanding of the taxpayer and its industry will assist the auditor to identify where tax risk areas are most likely to exist. The better appreciation the auditor has for the taxpayer and its industry, and for the external and internal factors that affect the taxpayer, the easier it will be for the auditor to assess whether there is significant distortion in the taxpayer's tax reporting.

Stage 1. Pre-visit Planning

Once a case has been allocated, the auditor must collate as much information as is available to have reliable background about the taxpayer. The details from the risk selection system will have given the results of the criteria scores and the taxpayer file will give standard profile information. Any third-party details available within the department should also be obtained. The auditor will analyze these data to decide which areas will need specific attention, how the audit will be conducted, and how the auditor will make sure the audit is completed within the time allowed. Unless there are indications that warning of a visit would prejudice the availability of books and records, the auditor or a support team should contact the taxpayer, make an appointment for the visit and list the books and records that the Inspector will need to examine.

The auditor also uses this stage to develop an audit work plan. It is unlikely that a comprehensive audit work plan could be developed based only on pre-contact analysis, as there are many things that may not become clear to an auditor until after he or she has had the opportunity to observe the taxpayer's operations directly. The auditor must continually exercise judgment throughout the audit process to expand or contract the scope as needed with appropriate approval (even changing the type of audit from office to field). A critical consideration here is that the auditor is not bound by the scope of audit that is determined at this (or any other) stage of the audit. This said, the principles of risk-based audit require the auditor to have a clear idea of how the audit should evolve from the pre-contact analysis, based on potential risks that have been identified. If subsequent inquiries suggest that the initial risk assessment was incorrect or incomplete, the auditor is expected to review the scope of the audit to take any relevant new information into consideration.

Stage 2. Interview with Taxpayer or Representative and Inspection of Premises

This initial contact with the taxpayer is very important and it is critical that the auditor uses the interview to establish how the business is organized and how the books and records are prepared. The auditor may well feel all the facts are already in the taxpayer file, but it is essential to confirm them again and get the taxpayer to agree the facts are current. By getting the taxpayer to set out all relevant processes, the normal procedures will be reviewed to enable the auditor to identify any irregularities. The pricing policies and profit margins should also be confirmed at this time for use during the conclusion of the audit. Likewise, an inspection of the premises will enable the auditor to confirm that the activity revealed by the books and records is consistent with the physical activity observed in the operational part of the premises. The taxpayer's compliance and any lapses in meeting deadlines will be discussed.

Stage 3. Basic Checks of Books and Records

The basic checks will test the system and methodology the taxpayer has described to calculate their liability. The type of tax will of course have various measures within the accounting procedures to produce the liabilities, but initially the check should be to examine one return for each tax and trace some items of the accounting events through to the final declared amount. Once the system has been proved or otherwise, the Inspector can decide how to proceed. Provided there is an audit trail found from the primary documents through to the final declaration, the decision as to how many returns and which element of the process should be examined can be made. Using the information gained from this stage, plus the risk assessment system and other data from the administration, it will become clearer as to whether the fundamental accounting procedure is generally sound.

Stage 4. Further Checks

The stage is used to follow up on any details that give concern during the previous stages. If any inconsistency is revealed by the information held, the basic checks, or large variations in what should be a regular activity, these will need to be investigated. The subsidiary records must be examined to test the main accounting records and these can include purchase invoices, sales invoices, production records, cutting records, credits received and given, delivery notes and goods received notes. This list is not all inclusive and the auditor must make decisions depending on the facts and circumstances of the current audit. The examinations must be sufficient so that there is satisfaction that the routines do produce consistent accuracy for the overall results to be credible.

It is typically at this stage where it will be decided whether with the steps taken so far, the audit can be considered to have demonstrated that, on the balance of probabilities, the accounting records of the taxpayer produce credible liability declarations. This is important, because if the Inspector is satisfied with the bookkeeping records and the operational records relating to them, the audit can be concluded and the taxpayer status considered up to date. Only if new information comes to light can the taxpayer be re-audited. This is a crucial decision as it will not only affect the taxpayer status within the risk selection system but it will contribute to the cost effectiveness of the audit plan. By not continuing to the final stage, the allotted time will be shortened and returned to the resource pool.

Stage 5. In-depth and Credibility Checks

When this stage is reached, it is because the Inspector is not satisfied that the accounting system described by the taxpayer at the interview, and that applied checks indicate that the liability declared is not correct. This being the case, further actions must be taken to prove all the tax due has been declared.

At its simplest, in-depth checks can be established by using the basic records that are outside the recognized accounting system and mentioned earlier, e.g., delivery notes, cutting records, production records, etc., and checking that the all transactions are captured by the prime records.

In depth checks are not achieved by comparing invoices to 'daybooks' or 'sales books,' as this only tests the credibility of the clerk transcribing the information. The Inspector must look for other ways of checking all transactions are accounted for and concentrate on full checking of particular aspects. For example, if the profit margin appears low or purchase to sales ratio appears low the auditor must investigate whether all sales are being recorded, whether there are there cash sales or factory door sales where the details are not recorded. It is also necessary to understand the taxpayer accounts, so that accountants' adjustments and other accountancy protocols are investigated.

Another method of establishing the accuracy of declarations, when the basic checking has not been sufficient, is the credibility or indirect method. This is a technique that uses any of the various known facts or figures discovered during the audit and test or extrapolate the facts against the declared results producing the tax liability. The types of credibility check will depend on the activity, the accounting records, and laws in force. The types of credibility checks include gross profit ratio, parts/labor ratio, food drink/drink ratio, cash reconciliation, invigilation, component check and mark up exercise. Life style and net worth are exercises that must also be considered.

It is essential that the indirect methods of calculating an assessed tax liability has the force of law and is clearly written in the statute. When the books and records of the taxpayer do not appear credible or are not produced, the auditor must be able to demonstrate that on the balance of probabilities with the information provided by the Taxpayer the real liability should have been different to that declared.

There is no exhaustive list of in-depth checks and it is up to the skill and expertise of the auditor to identify the possibilities that could exist for the unsatisfactory prior checks. The type of activity and the findings at the time of the audit will dictate the in-depth checks to make.

Audit Report

Once the auditor is satisfied with the compliance of the taxpayer or that the errors discovered do reflect the true liability, the audit must be concluded with the report written up and the assessments issued where necessary. The auditor compiles the audit report without undue delay and while the auditor is still familiar with the case.

The audit report is a summary of the audit findings and is an important part of the audit process as it explains the legal and procedural basis for any conclusions that the auditor may reach on the taxpayer`s liability. If a taxpayer appeals an assessment, the audit report represents the key evidence on which the appeal body will base its conclusion. The audit report is also important to help evaluate the effectiveness of the auditing approach and risk-based selection criteria. The results of audits will be reviewed as part of a continuous cycle, so that the audit program becomes increasingly more effective over time. The auditor prepares an audit report on every audit, whether or not measures regarding taxation are proposed.

In order to create an effective audit report, the auditor employs a process of continuous documentation. The auditor writes up the procedures and finding as soon as they occur throughout the audit, including the pre-contact stage and the actual audit. The auditor also prepares any notes or working papers in a manner such that another auditor with no background to this specific audit can review these notes or working papers and understand what procedures have been performed and what the data in various working papers represent.

An audit report contains a written draft of the audit that the auditor carried out, all relevant information on the basis (legal and procedural) for any conclusions the auditor reaches on the taxpayer's liability, and the proposed measures to be taken because of these conclusions.[165] An audit report contains suitable details on the following:

- Information on the taxpayer company and general information on its business, including the business sector or industry, and business scope;
- Information on the audit, including the date and time, places of business audited, interviews with the taxpayer, whether notification was given to the taxpayer, and whether there was cooperation with other authorities;
- A description of the taxpayer´s accounting and other related systems;

[165] An example template for the audit report is shown in Appendix 8.G.

- A listing of audited accounting records, tax records, and other materials audited, and an indication of the period of time that the audit is concerned with;
- The assessment measures proposed by the auditor on the basis of the audit and a separate justification for each measure, including justification for not proposing any measures;
- The contents of the legislation, regulations, instructions, legal cases, and taxation practice relevant to the audit and the content of any expert conclusion that the audit relied upon when justifying assessment measures;
- Calculation of the penalty and interest payable, if any;
- Any other facts, evidence, and justifications that were of material importance when determining the tax liability of the taxpayer;
- Any issues that may be relevant to future audits;
- Names and signatures of the auditors that carried out the audit; and
- Copies of any necessary details that provide clarification on the issues at hand should be enclosed in the audit report as appendices and numbered so that their connection with the issues presented in the audit report can be found without difficulty.

The audit report and any assessment calculations must be checked by an auditor or manager with the appropriate level of authority before issuance and final closure. This should be the only authorization required, but line management roles and responsibilities around performance and quality monitoring will serve as further control.

Audit Closing

After checks by an auditor or manager, the auditor enters the results of the proposed assessment (if any) in the tax administration IT system[166], sends a notice to the taxpayer that there is a proposed assessment, and returns the file to archives.

The taxpayer or representative is usually given some time (e.g., 30 days) to send a letter that he or she does not agree with the notice of proposed assessment, stating their reasons in a clear and concise manner.[167] If the taxpayer responds with such a rebuttal, the file is reviewed by a manager and any collection action that may have been initiated is suspended. The manager prepares and sends a response (e.g., within 15 days) to the objection. Where the taxpayer does not agree with this response or where the tax administration did not respond within the period, the taxpayer should be allowed to file an appeal.

[166] This should trigger a collection action.

[167] Typically, if the taxpayer is correct, no assessment is ever made and hence the assessment above is only "proposed." A related leading practice is that the actual assessments are then made by a centralized group of select auditors in a "central assessment unit" that would also review the audit and ensure that multiple erroneous assessments are not continually being entered into the system.

8.1.9. Audit Plan and Case Management

As audits are carried out and completed, cases should be tracked and monitored at the individual level, but also with attention to how each case contributes to the overall national targets. In this regard, both headquarters and district/field offices have roles and responsibilities. Headquarters must ensure that the audit case selection system is producing the best results, and district/field offices must implement the annual audit plan, with auditors carrying out their work in a timely and effective manner.

It is essential that the audit division has in place a clear set of roles and responsibilities for every aspect of the workflow process. Together with this, there must be acceptance of managerial and personal accountability at every level. In international leading practice, all staff involved in administering and implementing the audit function have a clear understanding of their roles and responsibilities and how they fit into the operation of the division. Depending on their level, each staff member will know how they must monitor their own performance, how their performance will be monitored by others, and their level of responsibility for monitoring other staff members' performance.

The audit division of headquarters must regularly analyze all factors that contribute to the national audit function. The section responsible for the annual audit plan must regularly monitor the results of each target and take action when and where targets are missed. Headquarters will also review the criteria and scoring that govern the selection of cases for audit to ensure that they are producing the optimal results. The section responsible for audit processes and procedures must monitor whether those are still appropriate and being applied correctly. All sections will undergo review and inspection to confirm that they are performing all of their tasks and responsibilities at a high standard.

Likewise, the district/field offices must conduct regular analysis of their performance with regard to the audit function, both in terms of individual contributions and from the point of view of overall performance against set targets. In turn, the chain of authority as described below will analyze and review the results to gauge performance at the office, team, and individual levels and confirm that performance at each level conforms to high standards.

8.1.10. Monitoring and Reporting

Ideally, the whole audit process from planning to case closure should be closely monitored with regular reports produced. Unless each stage of the audit process is managed effectively and the progress and results reported regularly, the targets and objectives of the audit division cannot be reviewed and adjusted or updated as necessary.

The tax administration must have a robust management information system in place that will give regular (weekly, monthly, etc., as necessary) reports that will inform managers of the performance and progress within their responsibilities. In the audit function the reports must include the number of audits completed, the amount of additional tax discovered, the time taken, the number of appeals against assessments, etc., so that both headquarters and district/field office managers can quickly take action when indications or trends show signs of lack of progress or deviation from the plan.

To determine whether the basic audit objectives are being met, certain measurement criteria are applied to the audit results. Those measurement criteria can be categorized as follows:

- Quantity – The quantity of the audits produced is important primarily because a minimum amount of "audit coverage" is necessary to obtain effective enforcement of the tax laws. Audit coverage is the percentage of the total taxpayer population subject to audit in a given year. By tracking the number of audits completed each year, with its available resources, the tax administration can determine whether it is meeting its audit coverage goals. However, quantity of audits must never override high-quality audits as the primary objective of the tax administration.
- Revenue – The amount of revenue assessed is important because it helps to target the taxpayers who have underpaid or misallocated the largest amount of taxes. Since audit coverage is limited, it is crucial the taxpayers selected for audit are those responsible for the largest amounts of underreporting. By measuring the revenue generated by audits over a period of time, the tax administration can determine whether it is meeting its audit revenue goals.
- Quality – Generally, quality can be determined from the number and type of review comments generated by supervisors and internal review processes, the number and type of protests received, and the percentage of collection recovery on audit assessments. By promoting high quality standards, the tax administration can assure that resources are used productively, provide taxpayer education, and maintain a high collectability rate.

Such reports highlight the results and will also explain variances to the plan. Audit results are also used to measure the effectiveness of the current audit file selection process and to inform the future year's audit selection process.

One of the key elements of the accomplishment of the annual audit plan is the time spent by auditors in completing the audits included in the annual audit plan. A time reporting system must provide the details of all direct audit time spent by auditors, as well as time spent on indirect activities. The monitoring of such time enables audit management to ensure that resources are used as planned and in accordance with the overall goals and objectives. The monitoring of time also provides the ability to recognize and make necessary changes to redirect audit activity to meet plan objectives.

8.1.11. Audit Review and Quality Control

In general, completed audits should go through a two-stage quality review, as follows: (1) all should be subject to a supervisor review, and (2) a sample should be selected for a strategic review. The purpose of both reviews is to appraise whether auditors are following all audit manual guidelines, technical and policy memorandums, rulings, regulations, statutes, and procedures. However, the strategic review will also review the audit for viability. This means the review is performed similarly to a taxpayer filing a protest and will look for lapses in documentation, discrepancies, contradictions, errors, or any other problems that might jeopardize the tax administration's position. It will also review whether the result of the audit justified the time spent by the auditor conducting the audit. Finally, the strategic review is also used to determine if the tax administration is being equitable in its administration. Sometimes, audits identify the need for additional regulations, changes in policy, or additional training.

Supervisor Review

During the course of the audit, supervisors must discuss with the auditor procedures and methods for conducting and documenting the audit and monitor each auditor's progress. Auditors are required to keep supervisors informed about their audits, but both auditors and supervisors are responsible for audits being done correctly and efficiently.

The supervisor reviews and discusses all phases of the audit with the auditor to the extent the supervisor considers necessary to ensure that the auditor followed all audit manual guidelines, technical and policy memorandums, rulings, regulations, statutes, and procedures.

The supervisor should treat all employees equitably in the monitoring process so every auditor is given the opportunity to learn from feedback. At the same time, supervisors should expect better audits from auditors who are more experienced or are in a higher classification. Supervisors should determine the appropriate balance of monitoring based on individual auditor needs. The supervisor should also recognize the training potential of the review process and discuss with the auditor what could have been done differently, based on their experience.

Notwithstanding this basic management responsibility of the supervisor, it is not possible, given the volume of audit throughput, to check and discuss in detail every audit with every auditor. This is where the strategic review comes in.

Strategic Review

A sample of files (perhaps up to 10 percent) is selected for quality review from the taxpayer files that have been audited during the previous month or quarter. Although this selection should be as random as possible, it is preferable that the list includes files from across all segments of taxpayers, including large, medium, and small, and perhaps from various industries and taxpayer types. The strategic review is conducted to determine the substantially correct tax at the least cost and in a manner that promotes public confidence in the tax administration. Through the use of quality standards, such conduct is identified and defined as an expectation for all tax administration audit staff. The strategic review:

- Reviews each selected file, focusing on the file documents to support the auditor's technical conclusions;
- Ensures accurate tax and penalty computations;
- Ensures proper completion of all procedural requirements;
- Ensures proper managerial involvement; and
- Ensures that taxpayer rights have been protected.

The recommended process to be followed in the performance of an audit review, including the standards and attributes of a ‘quality’ review, as well as a reviewer’s checklist and report are in

Appendix 8.F. The corresponding form is provided in Appendix 8.H. On completion of the review, the reviewer documents his/her findings in the report which in turn provides feedback to the auditors.

8.2. Common Trends

Throughout this chapter, comparisons between modern and developing tax administrations have been made during the description of various elements of the audit function, and they have been collated here together with other areas where there is generally still no commonly accepted approach.

8.2.1. Specialization

Over the last 10-15 years, modern tax administrations have extended the training of their auditors so that they can use new techniques and software to increase the professionalism and effectiveness of the audit function. As the task of controlling the tax register has become more complex and difficult, tax administrations have had to ensure their Inspectors understand international accounting standards, the work and role of the accounting profession, and the latest trends in tax avoidance and evasion. They have used both internal and external training opportunities. Internal national training institutions have been set up with highly qualified tutors engaged, and staff has been sent to universities and other bodies for specialized training.

There has been no standard approach to the use of specialist auditors mainly because of the expense, availability of suitable candidates, size of the taxpayer register, and the culture of the tax administration. Approaches have ranged from recruiting specialist fraud recognition accountants direct from the profession to comprehensive, in-house training courses being developed.

In between has come a gradual evolution of the pool of expertise within the audit division and individual Inspectors becoming the recognized ‘expert’ within a particular field. The team concept has also developed due to the big increase in customized computer accounting systems. Depending on the size of the taxpayer, the team could consist of activity expert auditors, tax specific auditors, global accounting experts, and computer program/forensics experts to complete a comprehensive audit. Each of these specialist Inspectors should be used in the specialist role as much as possible, but they can also take part in basic audits as well. The computer program expert will be able to check that the accounting program does, in fact, produce accurate results leading to correct declaration of tax liability and nothing is diverted to external accounts. He/she will also be able to use auditing software to test and validate checks requested by the Inspectors. The global accounting expert will be able to assist the Inspectors in interpreting the accounts and transfer pricing when multinational business is recorded. The computer expert and the global accounting expert will be used other departmental tasks when not needed on audits.

The use of the specialist for audits is so diverse that the developing audit division will need to train and develop specialist auditors as and when the budget allows. The cost of training and purchase of auditing software is high and each administration must decide on priorities, but, suffice to say, the use of more and more sophisticated accounting programs puts the computer program auditing task high on the list.

The use of contract experts is also a controversial topic. Many modern tax administrations use consultants to assist in improving many aspects of various divisions, but, when it comes to audits, opinions are divided. Many civil servants argue that using consultants to do revenue audits creates a conflict of interest for the consultant, who may be required to carry out special audit techniques designed by the tax administration, giving them information that could be of use to their private clients when having contracts with them. Others argue that all departmental techniques should be published and, therefore, no conflict exists.

8.2.2. Publishing Auditing Procedures and Techniques

Both modern and emerging audit divisions argue about revealing the procedures used during an audit. Whereas some administrations publish their entire auditing policy and methods, others insist on complete secrecy arguing that this gives far too much information to the taxpayers, enabling them to avoid some liabilities. Again, the tax culture of the country has to be taken into consideration, but, today, with generally more openness in government, the trend is to less secrecy. Countries have had to deal with freedom of information laws and calls for transparency for years, which have led to much of what used to be internal instructions and procedures being available to the general public via the government's websites.

8.3. Tax Administration Maturity

Four levels of maturity of the audit program of tax administrations are presented below to help interested officials make determinations about the level of maturity of the program and as rules of thumb to make self-assessments about strengths and weaknesses.

Audit: Maturity Level 1

Key word: "Unfocused"

- There is no audit policy regarding where, when, and how audits are conducted, or how to control the tax register, other than to audit all return/declarations received.
- Direction from tax administration headquarters to district/field offices is confused, contradictory, and short-term.
- The lack of a management information system minimizes performance monitoring at any level.
- There is no audit strategy or annual audit plan.
- No audit manuals are ever prepared and auditors are always in a state of confusion and subject to whatever interpretations are made by their local managers.
- Lack of standardized processes and procedures and the absence of an audit manual cause poor quality audits and chaotic case management.
- The audit target is still set at 100 percent of all returns/declarations filed, causing massive backlogs.

- No risk analysis selection system is in place. Rather, selections are more influenced by tax collection performance, set against the budget estimates, usually ignoring actual declared tax and estimated liabilities.
- Auditors are aggressive and concentrate on identifying misdemeanors for the imposition of fines and penalties, instead of the credibility of returns and declarations.
- No use is made of indirect methods during audits or to reach assessed liability.
- The inconsistencies in interpreting the law contribute to many appeals or delays in finalizing cases.
- Auditor recruitment, training, and retention policy ignores real needs and concentrates on economy and law graduates with little specialized in-house training.

Audit: Maturity Level 2

Key word: "Looking to improve"

- The functional managerial responsibility and accountability start to be considered with a review of the current status compared to leading international practice.
- There is recognition that the policy of 100 percent audit of returns/declarations must be changed if self-assessment and voluntary compliance are to be encouraged. Various actions for different types of audit are being proposed, and even a risk analysis selection program is being considered.
- An audit strategy and plans are prepared, but without top management ownership, and commitment to implementation is lacking.
- Managers prepare their own records to try to have some level of control, but little central information is available.
- A review of written regulations, instructions, processes, and procedures produces recommendations for all to be updated and improved. In view of the results, an audit manual is still not considered necessary.
- Auditors are encouraged to be more helpful to taxpayers, but at the same time start checking the credibility of declared liabilities, looking for under-declared tax rather than just misdemeanors.
- Depending on the law, the audit function takes steps either to urge clarification of the powers of indirect methods of assessment, or, if they are clear, then to train and instruct auditors on the use of these techniques.

Audit: Maturity Level 3

Key word: "Focused"

- With roles and responsibilities understood, a management structure is set up with delegation of powers and authority levels established to facilitate a more effective and efficient implementation of the modernization being undertaken.

- A clear audit policy is written that identifies various types of audit and provides guidance on how to carry out each type. The policy also indicates that audit selection must be targeted to cases where there is a high potential risk of lost revenue.
- Recognition that the methods of communication within the audit function are not sufficient to meet the needs of the staff leads to a complete review and significant improvements.
- Moves are made to create a computerized, risk-based audit selection system based on the new policies. The system accounts for the types of audit indicated in the policy, as well as the steps required to undertake different types of audit and the resources available.
- An audit strategy is now being written using the new policy, and top management is taking ownership. Commitment to the strategy is displayed by management monitoring and adjusting resources and actions when necessary.
- An annual audit plan is produced that takes the strategy and audit policy into account and gives weight and information to a (computerized) selection system.
- More management information reports are available, but they tend to be on a ‘one off’ or ‘on request’ basis, and many managers are unaware of what reports can be generated or are available. Little consideration is given to a true Management Information System as the IT department does not understand its purpose is to serve, not dictate operations.
- The recommendations made for rewriting regulations, instructions, processes, and procedures are implemented and the new documents issued. Lack of training for the staff and little management support makes the impact less than desired.
- An audit manual is commissioned and gradually being introduced.
- Auditors are producing better quality audits using their new techniques, producing more under-declared tax, and contributing to the self-assessment and voluntary compliance effort.
- Large taxpayers are being identified for special controls, but no national plan is in place.
- The improvements and changes noted above have created a substantial increase in staff training needs. The audit function is ensuring that short-term needs are met, while also reviewing the long-term needs of a modern department.
- The recruitment policy for auditors is reviewed and more appropriate criteria are proposed.

Audit: Maturity Level 4

Key word: "Strategic"

- The tax administration’s drive for taxpayer voluntary compliance and self-assessment is at the center of all the audit function’s plans and actions.
- The audit function recognizes its role and responsibilities and accepts accountability for the implementation of the law, as well as instructions, policies, processes, and procedures set out by the tax administration, including the audit division at headquarters.
- The management structure within the audit function is clear and well defined. Top management has taken ownership of the delegation and authority levels ensuring checks and balances are in place at each stage of the process.

- The roles and responsibilities of the management structure within the function are clearly defined. All managers understand their delegated powers and level of authority and implement their tasks correctly.
- The communication and information flows of the audit function give clear and concise directions and advice to all levels of staff.
- The audit strategy, annual audit plan, and audit policy are all operating well. The targets set are achievable and relevant to available resources, estimated liability due, complexity and perceived risk of taxpayers, and a management that is dedicated to encouraging effective processes and procedures in all tasks. Monitoring, reviews, and development are all part of the ongoing tasks undertaken by dedicated sections.
- A five-year audit strategy is developed, and senior managers accept ownership, ensuring regular monitoring, updating, and communication to staff.
- Preparation of the annual audit plan is now a routine process and the division uses expertise and experience to target the highest risk taxpayers and continually improve the criteria used in the targeting process. Control of the largest taxpayers has become specialized.
- An audit manual has been developed setting the best practice for each type of audit and explaining special techniques where the auditor experiences difficulties in verification of accounts or declarations.
- The well-written regulations, instructions, processes, and procedures of the audit function are implemented in an effective manner and are constantly monitored and developed by a dedicated section.
- Audit managers and auditors focus on establishing actual liabilities of taxpayers and getting the right tax at the right time.
- Audit techniques detailed in the audit manual, including indirect methods, are being used more, and the quality of audits is becoming much more professional.
- A fully automated, risk-based audit selection system is in place, incorporating a case tracking procedure that informs the annual audit plan and management information reports.
- The management of large traders is routinely monitored and the appropriate regimes put in place to ensure best practice control is maintained.
- A full Management Information System is in place, giving regular, routine reports of all areas of audit function’s activities, from national down to individual performance. Using the reports, a system of monitoring and inspection is developed to enable managers at each level to ensure fulfillment of their tasks. The reports are used intelligently to adjust focus or methods to improve results.
- The managers, auditors, and audit support staff of the audit function are given the necessary training that enables them to implement the processes and procedures of their tasks and use audit manual techniques. Further dedicated training is also obtained for specialist areas, such as computer auditing, international accounting standards, and transfer pricing, etc.
- The recruitment and retention policy incorporates a specification underlining the need for individuals with good interpersonal skills who are able to deal with confrontational situations, not just individuals with a degree in law or economics.

8.4. Latin America and the Caribbean

In 2003, the Inter-American Center of Tax Administrations (CIAT) developed an Examination Handbook[168] to assist in the formulation of audit procedures across Latin American and Caribbean (LAC) tax administrations. In its foreword, the book states that examination in many countries is poorly developed in comparison with other functions and its introductory "justification" states that there are large cultural, organizational, and statutory differences between administrations.[169] Other sources cite audit as weak, outdated, and underfunded.[170] In general:

- Audits are few in number, amounting to 0.2 percent of active taxpayers subject to field audits and 8.5 percent for basic checks;[171]
- A heavy presence of informal activity leaves less room for sophisticated taxes and requires more reporting by taxpayers and more complex auditing by tax administrators;[172]
- Although manuals are present, they are not updated often; and
- Although the administrations rely on risk scoring, there is a need for better automation to develop audit plans that focus on different types of audits (e.g., to include quicker and less intensive audits)[173] or on specialization within economic sectors. Auditors have too much influence on the selection of cases.

These sources also highlight that there is lack of legislation regarding exchange of information between government departments, which inhibits the data available for risk selection systems, that many tax administrations fail to automate the basic checks on receipts, and that protective assessments are not automatically issued for stop-filers, indicating that LAC administrations fail to demonstrate to the taxpayer that the tax administrations are proactive in seeking to identify errors or liabilities that are not credible.

On a positive note, most tax administrations have a formal approach to audit planning, subject audit plans to continual review and update, and have standardized audit procedures. A number of countries provide auditors with compliance data warehouses and/or software to perform verifications.[174] These characteristics would place LAC countries in the third level of the maturity model above. It is likely that with additional focus on specialization and data exchange, along with proper funding, the audit function of the tax administrations in LAC countries could progress quickly to international leading practice.

168 Inter-American Center of Tax Administrations (CIAT) (2003).
169 Ibid., p. viii-ix.
170 Alm et al. (2007), p. 10.
171 Inter-American Center of Tax Administrations (CIAT) et al. (2012), p. 48.
172 Alm et al. (2007), p. 36.
173 Ibid., p. 55.
174 Inter-American Center of Tax Administrations (CIAT) et al. (2012), p. 44.

8.5. Key Benchmarks and Guidelines

Four key questions to maximize the effectiveness of audit are presented in the European Commission's Fiscal Blueprint[175].

Figure 8.3. The European Commission's key audit indicators

Strategic objectives	Key indicators
1. A sound legislative basis for tax audit, including access to data in taxpayers' computer-based systems	Is there a clear and consistent legal basis for tax audits? Does the legislation require the taxpayer to provide access to data in computer-based systems? Does the legislation achieve a sound and appropriate balance between the rights and responsibilities of taxpayers and the tax administration?
2. A risk-based tax audit strategy that determines and prioritizes audits according to agreed risk factors, such as the (size) and complexity of taxpayers and their compliance record	Does the administration have a risk-based tax audit strategy? Has the taxpayer population been appropriately categorized according to relative revenue risk? Does the risk-based system used for selecting taxpayers for audits draw on a wide range of information sources (e.g., register of incorporated companies, banks or financial institutions) and provide an overall evaluation based on all relevant tax types?
3. Use of the most appropriate and modern tax audit tools and techniques to control taxpayers' accounting systems, including the computerized ones	Have tax auditors been provided with sufficient training, information, and logistical support to undertake effective audits? Are the auditors routinely provided with specialist technical information and support for the latest auditing software approved for use in their jurisdiction?
4. Regular monitoring and evaluation of the performance and outputs of tax audits	Does the tax administration have clear rules and procedures that require the prompt and accurate recording of all tax audits undertaken? Is the tax audit information regularly and routinely analyzed (e.g., number of audits undertaken, additional tax liability identified, ratio of additional revenue to audit resources deployed)? Are the results or outcomes from tax audits used to inform and update the strategic risk model?

175 European Commission (2007), p. 35.

Strategic objectives	Key indicators
	Are the results or outcomes from tax audits used to keep the tax administration aware of anti-fraud or tax avoidance strategies? In terms of results, has the tax administration achieved the correct balance between audits at taxpayers' premises and desk audits at offices of the tax administration?

In addition, the following are specific quantitative benchmarks based on OECD and other country experience.

- Audit coverage will depend on the resources of the tax administration and the size of the filing population, among other factors. OECD countries audit from less than 1 percent of taxpayers (e.g., Austria) to 5-10 percent of taxpayers (e.g., Australia, Netherlands). Countries in which filing is not universal (i.e., not all businesses and persons file) audit a larger portion of returns.
- 100 percent of large taxpayers should be audited;[176]
- Approximately 30-50 percent of the staff time of the whole tax administration should be devoted to audit and fraud investigations;[177]
- Approximately 2-8 percent of net revenues should come from assessments; and
- There should be at least about 70 percent success (positive assessments) in risk-based audits (i.e., positive assessment).

Other important performance measures for the audit function are listed below, but the actual percentage or measure set must depend on local circumstances and the stage of development of the particular tax administration.

- Operating costs of the audit division set against the revenue collected;
- Total number of registrants to total number of auditors;
- Number of auditors compared to total staff;
- Completion of an annual audit plan;
- Average time spent per field/desk audit carried out set against additional liability discovered; and
- Effective field/desk auditing: Comparison between total number of audits carried out and total number of audit adjustments made.

The list is not exhaustive but gives the basis for information that can be used to set benchmarks and then monitor and analyze the performance of audits.

The number of tax administration staff employed per taxpayer can vary from 1 staff member to 1,000+ taxpayers to 1 staff member to as little as 20 taxpayers. The different staffing levels across country

[176] See, for example, OECD (March 2011), p. 52, 111.
[177] See OECD (March 2011), p. 163.

imply differences in government employment policies, as well as audit policies. Due to a drive for efficiency and cost-cutting, modern tax administrations are likelier to have the high 1 to over 1,000 ratios. In developing tax administrations, where the government may well be the largest employer, the drive for improved efficiency will not mean less staff but redeployment and rearrangement of processes, so the ratios are likely to be much lower. The ratio of tax administration staff per taxpayer will have a major effect on the audit policy in terms of how many audits of each type to undertake and how long they will take to complete.

All tax administrations must aim to reduce the burden of intervention and administration for the taxpayer. In order to do so, they must develop an audit policy that makes the best use of the resources available by concentrating on the riskiest taxpayers, but not without limits on the time expended on individual cases or to the exclusion of other important risks. Chapter 3 discusses the rights of taxpayers selected for audit that should be clearly listed as part of the legal framework.

When reviewing the benchmarks set, it is important that the tax culture is understood before the quality of the benchmarks are assessed. The audit function must be able to justify the percentages of taxpayer audits set, the average time set for each audit, the time spent on large taxpayers, and the percentage of desk and special audits set. They must also be able to demonstrate that their monitoring systems are sufficient to give them assurance that the targets are SMART (specific, measurable, achievable, realistic, and time-targeted).

Chapter 9. Fraud Investigations

Arturo Jacobs

The term "tax fraud" refers to cases involving taxpayers who knowingly underreport substantial amounts of taxable income and/or overstate substantial amounts of deductions in their tax declarations to fraudulently minimize tax payments. "Tax evasion" refers to the premeditated failure to register with the tax authorities, as required by law, or failure to pay owed taxes. The tax administration's fraud investigation department or division investigates both types of violations.

The purpose of this chapter is to describe tax fraud investigations in tax administrations around the world and to discuss the vital role tax fraud investigation staff play in promoting voluntary compliance with the country's tax laws. The following aspects of fraud investigation work are addressed in this chapter:

- The main mission and organization of the fraud investigation function;
- The key legal provisions for effective fraud investigation work;
- Staff qualifications, training, and differences between fraud investigations and audit;
- The role of the audit and collection functions in detecting potential tax fraud and evasion and in developing fraud cases jointly with the fraud investigations staff;
- The importance of communications from third-party informants as sources of potential tax fraud/evasion cases;
- The criteria that should be considered when selecting cases for full-scale fraud investigation, based on international leading practice;
- The importance of information technology for case development and management;
- The role of the legal staff of the tax administration in fraud investigations;
- The relationships between fraud investigators and the police, other law enforcement agencies, and members of the judiciary before whom fraud and evasion cases are prosecuted; and
- The fraud deterrent role of widespread publicity about convictions, particularly those convictions with sentences of incarceration and/or substantial civil fraud penalties.

9.1. Leading Practice

By international leading practice, the fraud investigation function is an integral part of the compliance and enforcement "tools" of the tax administration, alongside the collection of delinquent tax accounts, securing delinquent tax returns, fiscal inspections, and fiscal audits. In other words, fraud investigations are a vital feature of the overall risk-driven compliance strategy of a tax administration. **Tax fraud investigators** are the financial experts that identify and investigate complex financial crimes by taxpayers.

The primary mission of the fraud investigations division is to identify, target, investigate, and recommend for prosecution significant perpetrators of tax fraud and evasion. The division's highly trained and skilled investigators conduct in-depth investigations of tax fraud and evasion cases, gather all necessary evidence, select and forward those cases deemed worthy to the legal staff of the tax administration for review, and participate as expert witnesses in judicial proceedings on cases that the legal staff of the tax administration submit for prosecution. The focus of the fraud investigation division is on the selection of the most serious cases, where the tax administration can pursue the most severe punishment, for investigation and possible prosecution. If successful, the tax administration can publicize these cases to give taxpayers a clear understanding of the high risks and consequences for non-compliance.

Although the role of tax auditors and fraud investigators may seem similar, there are substantial differences. In effect, tax auditors use accounting and business skills in examining financial records, transactions, assets, etc. to detect irregularities by taxpayers. Fraud investigators' skills include accounting as well, but fraud investigators also rely heavily on investigative techniques, information gathering, use of direct and indirect methods of proof, and detection and gathering of evidence to prove criminal violations of tax laws.

9.1.1. Key Legal Provisions Required

To discourage tax fraud and evasion, a country's tax laws must first contain provisions with serious consequences for violations, including substantial civil fraud penalties and possible incarceration. Second, legal provisions must grant fraud investigators sufficient power to conduct their investigations effectively and efficiently. Among the most important legal provisions, already discussed in Chapter 3 are:

- Provisions that require banks or other third parties to regularly provide information on payments to taxpayers to the tax administration for matching with its master file;
- Provisions for sanctions, including possible imprisonment, for tax fraud and evasion and the authority to publicize convictions and prison sentences; and
- Provisions that give administrative authority to the compliance staff of the tax administration to legally summons persons and any case-related documents necessary.

For fraud investigators, the legal authority to administratively subpoena or summons persons and documents, compel persons to testify, and record all questioning are indispensable investigative tools. Fraud investigators also require the use of various kinds of investigative equipment, including firearms and the authority to enter premises that contain books and records, or that are otherwise deemed pertinent to their investigations.

Perhaps, however, one of the most important legal provisions of fraud and evasion investigators is the authority to use circumstantial evidence to determine the proper tax due when books and records are absent. Circumstantial evidence enables the fraud investigator to develop presumptive assessments and includes the type and nature of the business activities of the taxpayer, analysis of businesses similarly situated, the movement of funds through the taxpayer's accounts with a bank or other financial institution, the comparison of the taxpayer's expenditures with the taxpayer's income, and other information.

9.1.2. Qualifications and Training for Fraud Investigators

To qualify for fraud investigator positions in the tax administration, candidates should be required to have a graduate degree in accounting, or at least some post-secondary schooling on accounting, because much of their work involves investigating and/or reconstructing financial records to prove that taxpayers have committed financial crimes. Candidates should also have excellent physical health and fitness, because their assignments include rigorous undercover and surveillance work that requires physical stamina. Candidates also are required to have firearms training and must qualify periodically in the proper use of firearms. Generally, training courses for fraud investigators include the following topics:

- Accounting principles and techniques;
- Applicable criminal laws, rules of criminal procedure, and relevant constitutional and statutory laws;
- Revenue administration functions and jurisdictions of the Ministry of Finance, and other governmental ministries and their subdivisions;
- Investigative policies and prescribed investigative techniques, such as undercover, surveillance, and interrogations;
- The use of investigative equipment authorized by statutes, including firearms;
- Relevant computer applications to assist in conducting criminal investigations, information gathering, and case development activities;
- Information gathering and the detection and gathering of evidence;
- The use of direct and indirect methods of proof;
- Investigative report writing;
- Interviewing techniques;
- Money laundering statutes; and
- Domestic and international banking.

The training program goals are to give the fraud investigator the knowledge and a basis to acquire the skills to:

- Conduct interviews and interrogations effectively;
- Identify, explore, and exploit leads;
- Reconstruct books and records from incomplete data;
- Analyze and interpret available evidence;
- Prepare fair, accurate, complete, uniform, concise, and logical reports; and
- Testify in legal, quasi-legal, or administrative proceedings.

Fraud investigator training is highly specialized. For many years now, all new fraud investigators of the U.S. Internal Revenue Service (IRS) have attended the Department of Homeland Security's Federal Law Enforcement Training Center's (FLETC) Criminal Investigation Training Program (CITP) – an interagency law enforcement training organization for 91 Federal agencies. The training topics include interviewing, surveillance, criminal case management, legal provisions, physical techniques and conditioning, tactical training, firearms, vehicle handling skills, physical evidence, and other courses that provide the essential knowledge, skills, and abilities needed by the Federal criminal investigator. The FLETC provides services to international law enforcement agencies as well, including to fraud investigation divisions in LAC. In fact, the FLETC has oversight and program management responsibilities at the International Law Enforcement Academies (ILEA) in Gaborone, Botswana and Bangkok, Thailand. The FLETC also supports training at other ILEAs in Hungary and El Salvador.

9.1.3. Implementing a Fraud Referral Program

One of the best sources of fraud investigations is referral of potential fraud cases from tax auditors or staff of the collection function. Many suspected fraud cases are initially detected with the use of accounting and collection skills during the examination of financial records, transactions, etc., while performing what start out as routine audits or other compliance activities.

Fraud Referral

To develop a robust fraud referral program, staff of the audit and collection functions should be trained to recognize the so-called "badges of fraud"[178] in the cases they handle. Classroom and on-the-job, "badges-of-fraud" training courses focus on indirect methods, such as examining wealth, high value assets, and business transactions observed or uncovered during routine audit and collection activities and not reflected on tax declarations, and other methods. "Badges of fraud" for VAT/consumption tax cases include the nature of the business, such as enterprises which conduct a substantial volume of cash business and taxpayers who claim repeated, large refunds. It is the responsibility of the headquarters office staff of the fraud investigation function, in coordination with their audit and collection counterparts at headquarters, to develop internal policies and procedures for the referral of such cases from the audit and collection divisions to the fraud investigation division.

If, during the course of a routine tax audit or other compliance activity, a tax auditor or other enforcement official detects "badges of fraud", the compliance officer should immediately notify his or her manager. The facts and circumstances should be further reviewed, with management involvement, to a point where there is a reasonable indication that tax fraud exists. At that point, and without going any further, the case should be referred to the fraud investigation division, whose investigators are specially trained in criminal laws and in techniques to conduct criminal investigations. Auditors and other compliance staff, who continue their activities beyond this point in such cases, often unknowingly take actions that harm the government's cases in subsequent criminal court proceedings, because they are not trained in criminal laws and criminal investigation techniques.

[178] "Badges of fraud" are the facts or circumstances that indicate the intent to hinder or defraud. Badges of fraud can include excessive false or fraudulent expenses, unreported income, or returns not filed.

A criminal offense referral report is usually completed when the tax auditor or other compliance officer is reasonably certain that "badges of fraud" exist and when his or her supervisor concurs. This report contains a narrative summary of the facts and circumstances that is reviewed, along with all tax returns, schedules, and documentation, for approval by the referring officer's supervisor and, ultimately, by the respective head of the audit or collection division, prior to its referral to the fraud investigation division and its intelligence branch head.

Communications from Informants

Communications from informants are very important sources of fraud investigations. Many third parties, particularly former or current business partners, accountants, and spouses, often have "inside" information not readily obvious and/or available to others about tax fraud and evasion schemes and associated details. They may even have documents/records to substantiate their allegations. The staff of the information and analysis section should develop, widely publicize, and maintain an effective informant communication program. Generally, a direct telephone line is dedicated to receiving communications from informants, and a special address is provided for anyone wishing to submit information about possible tax fraud and evasion. The telephone number and address are widely and continually publicized. Anonymity, for those who wish it, is guaranteed. Furthermore, a financial reward based on the amount of tax, penalties, and interest recovered is given to the informant, as provided by law.

Box 9.1. Informant cases in the United States

In the United States, by law, the IRS must pay 15 to 30 percent of the amount of taxes, penalties and interest collected to informants, as a result of the information that they provide. An informant case in the United States that received much publicity around the world in 2012 involved Bradley Birkenfeld, a former insider at Swiss Bank UBS. Mr. Birkenfeld provided valuable information to the IRS regarding a tax fraud scheme of his former employer, Swiss Bank UBS. He received a record-setting $104 million reward from the IRS, after UBS paid $780 million to settle civil fraud charges, and turned over records to help the IRS purse many others, who participated in the tax fraud scheme. Other Swiss financial institutions, formerly in a bank secrecy jurisdiction, also turned over names and bank account numbers to the IRS. As negotiations with Switzerland for disclosure of information were ongoing, the IRS also implemented and publicized a "voluntary disclosure program" for unreported income in tax haven countries, resulting in $ 5.5 billion in collections from 2009-2011, according to various media reports. The media also reported that the large awards granted in 2012 prompted an avalanche of calls to the IRS from potential informants.

In 2012, public media also reported that two awards for $38 million and $2 million were paid by the IRS to anonymous informants. No details were provided about the $38 million award. As reported by the media, the $2 million award was the third seven-figure reward for the same informant, a Wall-Street insider, who wanted to remain anonymous.

9.1.4. Organizational Makeup and Placement of the Fraud Investigations Component

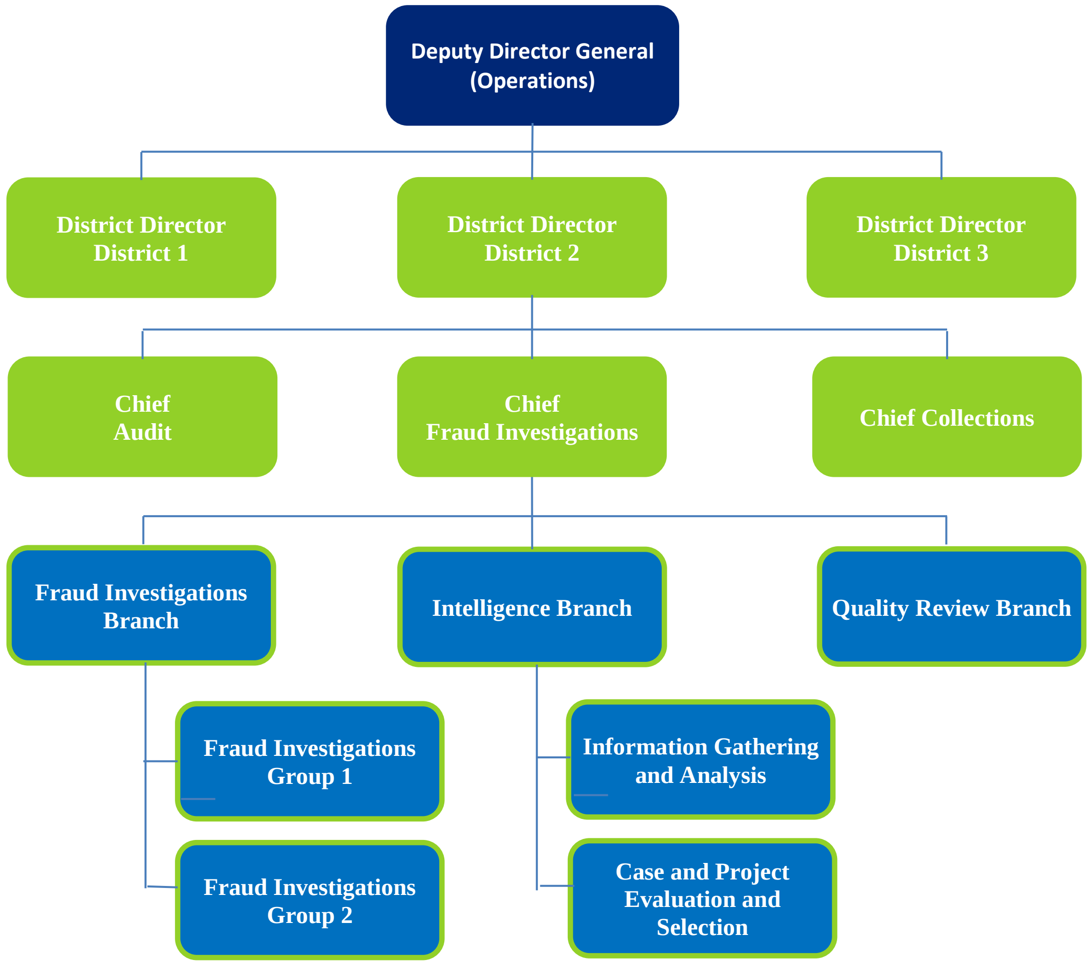
In a large tax administration, with headquarters, regional, and district/field levels, and a substantial volume of ongoing and potential cases, fraud investigations are typically conducted by investigators assigned to various district/field offices. In medium and small tax administrations, with only headquarters and district/field offices, and only a small volume of fraud cases, the fraud investigations operations may be centralized in one or two key district/field offices, in a division under a District Director, who reports to the Deputy Director General (Operations), as discussed in Chapter 3. In several developing countries, where the fraud investigation function is relatively new in the tax administration, the function can be conducted from the headquarters level, under the Deputy Director for Operations. This way, top-level officials can monitor the fraud investigation function, given that it embodies considerable powers and can be a conduit for abuse and corruption.

As discussed in Chapter 4, the normative, planning, monitoring, and evaluation roles of headquarters and the operational role of regional, district, and local offices, respectively, must be practiced. The staff of the fraud investigation division at headquarters should perform the following roles:

- Develop an objective case/project selection system with a uniform method to select cases for investigation;
- Develop annual work plans and objectives in line with strategic plans;
- Establish policies, procedures, and guidelines regarding coordination with prosecutors on prosecution cases;
- Monitor and provide functional guidance to the tax fraud investigation divisions in field offices;
- Develop and maintain information regarding taxpayer fraud and evasion by occupational, business, and geographic sectors;
- Develop guidelines and procedures for the referral of potential fraud cases by the audit and collection functions;
- Develop guidelines and procedures for the joint investigation of cases referred by the audit or collection functions and accepted for fraud investigations; and
- Coordinate with other law enforcement agencies at the national level in the development of information regarding tax fraud and evasion.

At the operations level in the field, there should be three main organizational units in the functional structure of a fraud investigation division: (1) intelligence, (2) investigations, and (3) quality review. The role of the intelligence unit is covered in the next subsection. The work of the fraud investigation staff is self-explanatory. The quality review staff should consist of highly trained, skilled, and experienced investigators, who review completed fraud investigation cases to ensure that all evidentiary standards are met before these cases are referred to the legal services division of the tax administration for prosecution. The following organizational chart depicts the structure at the district/field office level.

Figure 9.1. Typical structure of a fraud investigation division in the field



Role of the Intelligence Branch

Potential fraud cases arise mainly from three sources –communications from informants, referrals from the audit and collection functions, and cases developed from information gathering. The intelligence branch plays a key role in all three scenarios. Referrals of potential fraud cases from the audit or collection divisions, and from third-party informants, are assigned to the intelligence branch for further analysis. The intelligence branch provides a recommendation for full-scale investigation or a recommendation for discontinuance if further development determines the case does not meet selection criteria and standards. Through its own information gathering, supplemented with information shared by its counterpart headquarters office staff, the intelligence branch not only identifies and develops individual targets for investigation, but also looks at groups of taxpayers for analysis of potential compliance. There are two staff sections that perform the work of the intelligence branch: (1) an information and analysis section, and (2) a case evaluation and selection section, as shown in the organization chart above.

Roles of the Information and Analysis Section: The information and analysis section of the intelligence branch is responsible for gathering and matching data from all possible sources for the preliminary analysis and classification of possible cases for investigation starting with any related tax returns, including cases referred by audit and collection staff or by informants. To do their jobs effectively, the staff of the section must have access to the computerized systems of the tax administration that accurately collect information on all payments and liabilities, land and building ownership and taxation, customs transactions, motor vehicle registration, etc. Experiences in many countries that have the ability to make such queries and compare such data continually confirm or reveal many incidences of potential tax fraud and evasion. For example, audits of taxpayers who paid relatively little income tax, but were identified in related computerized systems by the information and analysis staff as owners of several profitable companies and one or more expensive automobiles, often revealed substantial underreporting of income and led to prosecution.

To secure other pertinent data for comparative purposes, other activities of the information and analysis section can include the scanning of information in industry and trade registrations, electric company lists of high wattage users, lists of passport holders, data on membership in professional associations (doctors, lawyers, etc.), publications for new business announcements, import/export documents, and other sources. Even aerial photography to locate large houses and unregistered businesses can be explored. With these matching exercises, the staff of the information and analysis section fully develops and analyzes potential fraud and evasion cases to determine those that should be discontinued and those that should be recommended for full-scale investigation. Either recommendation is fully documented.

However, the cross-checking of information can only be effective with the complete storage of accurate information on most or all taxes for each taxpayer, which is impossible to accomplish with manual systems. As taxpayers become aware that the tax authority has the ability to cross-check information with computerized systems on a routine basis, there is a positive and significant impact on controlling tax evasion.

Roles of the Case Evaluation and Selection Section: The staff of the case evaluation and selection section is responsible for evaluating referrals from the information and analysis section and recommending for criminal investigation only those cases where there is a strong likelihood that the evidence required for prosecution can be assembled through investigative means. "Case selection criteria" in international leading practice include some, if not all, of the following considerations:

- The amount of tax evasion;
- Broad geographical and occupational coverage;
- Type of industry;
- Flagrancy of the violation (to prove intent, willfulness);
- Establishment of a criminal pattern over time;
- Notoriety of the taxpayer or enterprise;
- Collusion with others;

- Education level of the taxpayer and/or his/her presumed knowledge of tax laws;
- Whether the taxpayer is in an industry or geographic area identified in strategic and/or annual work plans where non-compliance is particularly high;
- Availability of records or evidence;
- Associations of the taxpayers involved; and
- Lifestyle and/or wealth.

The cases selected for fraud investigation should have both geographical and occupational coverage based on market segment analysis. By analyzing geographical areas of the country and occupational groups, the staff determines pockets of non-compliance by comparing return information (or the lack of tax returns filed) with other forms of financial information. Once a group has been analyzed, the few individual targets with the greatest criminal prosecution potential are selected for full-scale investigations by fraud investigators in the investigations branch. The most promising targets follow the developmental and selection processes described above.

A fraud investigator with the case evaluation and selection section ultimately writes an intelligence referral report recommending full-scale investigation, or a criminal withdrawal report to close files or to refer them to the audit or collection function if there are still civil tax consequences. Intelligence referral reports recommending full-scale investigations are reviewed by the head of the intelligence branch and, if approved, forwarded to the investigations branch for assignment to fraud investigators.

Fraud Investigation Case Development

If the development phase indicates that insufficient criminal prosecution potential exists, the appropriate fraud investigator will write a criminal withdrawal report outlining the reasons for the discontinuance. The investigation, after concurrence by the head of the intelligence branch and the head of the fraud investigations division, is closed and referred back to audit or collection functions, along with the criminal withdrawal report, for resolution of the civil issues (e.g., additional tax assessments, interest, penalties). As the person responsible for inter-division relationships, the head of the division reviews rejection of referral cases to insure that rejection is the proper decision. Referrals are a very important source of fraud cases and future referrals must be encouraged. If potentially good fraud cases are rejected, inter-division relationships will be negatively affected. On the other hand, if too many referrals are rejected for just cause, the head of the fraud investigations division is required to offer assistance to audit and collection counterparts for refresher training on "badges of fraud" for auditors and compliance staff.

If the development phase indicates sufficient potential for criminal prosecution, the fraud investigator prepares an intelligence referral report outlining the findings of the case development effort and recommending full-scale investigation. After review by the head of the intelligence branch the case is transferred to the fraud investigation branch for assignment to a fraud investigator.

Income tax cases recommended for full-scale investigation may include those cases, in which indirect methods have shown substantial changes in the taxpayer’s net worth each year for the last three years;

total expenditures substantially exceed gross income for the last two years; there are unidentified sources of income, as alleged in an informant's communication; the quality and accuracy of the taxpayer's books and records are poor; the taxpayer principal business is cash-based; or combinations of all the above. VAT cases recommended for full-scale investigation may include taxpayers with unexpected large or repeated refund claims; large deficiencies in prior audits; owner-operated cash businesses, service industries, or businesses with a low ratio of input tax to output tax, such as restaurants; informant's communications; history of late filing and late payment; or combinations of all of the above.

Roles of Fraud Investigations Branch

When a full-scale investigation is opened, the tax auditor or collection officer who referred the case is automatically included as part of the investigation. Furthermore, the tax auditor or collection officer stays involved in the examination of the taxpayer for civil settlement purposes – the assessment and collection of additional taxes, penalties, and interest – long after the criminal aspects of the case – are completed.

Early in any criminal investigation – whether the source of referral is an audit case, a collection case, an informant's communication, or information gathering by the intelligence branch - the taxpayer and/or representative is contacted by the fraud investigator and advised of the investigation. Cooperation for both testimony and documentation is solicited. At the conclusion of the investigative phase, the taxpayer and/or representative is also invited to an investigation closing conference (a meeting), where the case and recommendation are summarized. At this meeting, the taxpayer is given an opportunity to present any final information or testimony prior to submission of the case for prosecution or final resolution.

The combination of options and tools used to reconstruct a taxpayer's taxable income are referred to as indirect methods, and generally fall into the following six categories:

1. **Cash transactions** – matching cash expenditures to cash receipts. Also known as the "T" Account method, this is the simplest of the indirect methods. It is usually performed as a quick test of the reasonableness of reported income.
2. **Source and application of funds** – a more advanced computation of the above method. The key aspect is the fraud investigator's or auditor's ability to trace the use of money by the taxpayer. This requires competent investigative and analytic skills to identify, corroborate, and document each expense.
3. **Net worth** – compares the increase in a taxpayer's net worth from year to year. This method requires examination of more than one consecutive tax year.
4. **Bank deposit** – monitors the flow of funds through bank accounts. This method is applicable only if the taxpayer's income and expenditures are primarily transacted through bank accounts.
5. **Percentage computation** – determination of gross income using percentages or ratios considered typical to the business or item under inspection.
6. **Markup/unit volume** – estimation of gross income based on specific business transactions and the normal volume and average prices of the items or services sold. Generally, this method is the most difficult for the taxpayer to refute.

Indirect methods, done correctly, have been recognized by courts in developed countries throughout the world as sustainable, legal assessments by tax administration officials, where the taxpayer has few or no records or refuses to cooperate with tax officials. Assessments using indirect methods have been upheld as admissible evidence, not only in civil court proceedings, but also as proof of fraud and evasion in criminal proceedings.

Closing Fraud Investigations

Once all of the facts and circumstances of the tax crime have been fully documented, it is the responsibility of the assigned fraud investigator to prepare the final investigation report summarizing the evidence. The report will contain, for example, identification, location, sources and amount of unreported income uncovered during the investigation, location and legal description of real estate purchased for cash at prices, which greatly exceed gross income reported for tax purposes, and similar items. At the conclusion of the investigation, the head of the investigation branch, the quality review staff, and the head of the fraud investigation division perform formal reviews of the fraud investigation report, with related exhibits, prior to submission for legal counsel's review. Even though the fraud investigator participates in the pre-court proceedings, the head of the fraud investigation division is the official representative of the division with the Legal Services Division and should therefore be familiar with the technical aspects of the case.

As is readily obvious from all the above steps, fraud investigations consume a lot of resources. Therefore, only the most egregious cases which have the best potential for prosecution, conviction, and publicity should be selected for investigation to serve as clear examples for all taxpayers that there are significant consequences for non-compliance.

9.1.5. The Role of the Legal Services Division

The legal services staff of the tax administration is involved in the investigation process by performing legal reviews of cases in progress with the assigned investigators at least quarterly. Upon the completion of the investigation, the legal staff also perform an in-depth, formal legal review of the final investigation report and related exhibits. The Legal Services Division submits a brief report in writing to the Deputy Director General (Operations) concerning the review and legal recommendations for prosecution. If the Deputy Director General (Operations) concurs, the case is forwarded to the Director General for review and approval. If approved, the Director General refers the case for prosecution to the litigation unit of the tax administration's legal services division.

The main responsibilities of the attorneys of the criminal litigation section are to:

- Prepare the final legal reports for cases which will involve criminal litigation, with assistance from those members of the advisory services unit staff already involved with the investigation;
- Provide legal advocacy during judicial proceedings for the tax administration's criminal cases in judicial venues of the Ministry of Justice; and

- Liaise with counterparts of the Ministry of Justice, Ministry of National Security, the national police agency, and other national officials involved with public prosecutions in all aspects of duties requiring criminal litigation.

9.1.6. Relationships with the Ministry of Justice, Police Agencies, and Others

Fraud investigators, auditors, and other compliance staff involved in the development and investigation of cases serve as expert witnesses in the judicial proceedings, as required by attorneys of the criminal litigation section. It is important that representatives of the fraud investigation function and legal services staff demonstrate high levels of courtesy, professionalism, and expertise on such occasions. In fact, it is the responsibility of all the staff, particularly top-level staff of the fraud investigation division, to develop and maintain positive relationships with the judiciary and other Ministry officials involved in the prosecution of tax fraud and evasion cases. Coordination and collaboration with these officials is essential to insure that all tax cases referred for prosecution are handled timely and effectively. In its efforts to develop positive relationships, in some cases, the tax administration is able to offer and provide tax law training and other services to judges and other Ministry officials.

There are other public institutions with which the fraud investigations function must develop and maintain positive relationships. National and local police agencies are examples. In some cases, when information summoned from the taxpayer and/or representative is not forthcoming, fraud investigators may be required to enter business premises to seize documents, computer equipment, and other materials necessary for the ongoing investigation. In these cases, the presence and collaboration of police officers is often necessary. Occasionally, fraud investigators, who are authorized to carry firearms, are required to assist in the protection of auditors and other compliance officers in cases where there is the threat or risk of assault. Often, the presence and collaboration of police officers is also sought in these cases. In some countries, fraud investigators and the police collaborate to conduct joint vehicle searches periodically for evidence or contraband at checkpoints on roads, highways, and railways in cases that involve known or potential violations of laws, including tax laws.

Furthermore, many countries are establishing law enforcement entities with broad authority to prevent, investigate, and prosecute "economic crimes," such as corruption, money laundering, and even terrorist financing. For example, the Center for Combating Economic Crimes and Corruption (CCECC), established recently in Moldova, is a law enforcement entity aimed primarily at detecting and investigating economic crimes, including tax evasion. A similar institution was also established in Jordan very recently.

It is generally agreed that, in many countries, the various government agencies involved in one way or another with tax fraud and evasion issues typically have difficulty communicating and coordinating, and often even have competing interests. This is an international problem that must be solved through forced collaboration. It is essential that the fraud investigation division of the tax administration take the lead on a regular basis in bringing these parties together to share mutual interests and problems that relate to legislation, work processing, common procedures, overlapping authorities, information sharing, etc. After all, one of the significant differences between the fraud investigation and other tax compliance components of the tax administration is that the ultimate results of prosecutions, convictions, and fines are dependent on a multitude of governmental bodies working cooperatively to achieve a high degree of voluntary compliance with the country's tax laws and higher tax revenues.

9.2. Common Trends

9.2.1. Large Taxpayer Tax Fraud

There seems to be a general perception in the tax administrations of many developing countries that tax fraud should not be a major concern with large taxpayers, because they invariably have effective accounting controls, skilled legal assistance, sound management practices, and internal and external, independent auditors. Experience indicates otherwise. International tax administration experts in the field of tax fraud and evasion quickly point out that some large enterprises frequently employ tax lawyers, skilled accountants, and information technology experts to avoid paying taxes. Oftentimes, these businesses intentionally create complex accounting systems and transactions so that it is difficult, if not impossible, for less sophisticated auditors and investigators to detect tax evasion. For example, transfer pricing[179] creates issues that are extremely difficult to unravel.

Global automation by businesses has created tremendous opportunities for enterprises to hide financial transactions. Undoubtedly, tax administrations need to develop strategies to combat international tax evasion. Tax administrations around the world now train their large case auditors and fraud investigators in industry specialized courses, such as telecommunications, banking, energy, and mining, to be able to perform effectively in the large enterprise world.

Box 9.2. The case of Enron

In the international arena, many large corporations have been involved in multi-million dollar tax evasion schemes. Enron Corporation, the seventh largest U.S. corporation in 2000, is an example of this trend. More than 30 people were charged with various crimes as a result of their illegal business practices. More than 20 people, including Enron's chairman, president, and chief financial officer, were convicted of or pleaded guilty to fraud, conspiracy, and other crimes. Arthur Andersen, a top accounting firm and provider of accounting services to Enron, came under investigation for its role in Enron's collapse and received a conviction for obstruction of justice in 2001.

9.2.2. Computerization

Large taxpayers are not the only ones that use technology. International estimates suggest that 70 percent to 80 percent of taxpayers use computers to document and store financial data once maintained in manual ledgers. Tax administration officials, who seek to recover critical financial information for their audit or investigative work, face difficult challenges. The employment of skilled programmers by some involved in tax fraud and evasion schemes to create programs designed to hide

[179] Transfer pricing is the practice by which divisions of a company set prices for transactions with each other. These transactions can be between a parent company and a subsidiary, or two subsidiaries controlled by a common parent.

and, in some cases, destroy information when outsiders attempt to access their computers or networks compounds the problem.

There is a strong trend in tax administrations of developed countries to hire and train computer forensic experts, provide them with equipment for forensic data mining, and enable them to clone hard drives, retrieve required accounting data, and analyze such information. This is particularly true if tax authorities agree to investigate major enterprises to prove tax evasion by recreating critical information for the presentation of evidence in court.

Many developed countries now use automated, risk-based techniques to select those taxpayers for audit cases that have the highest probability to produce audit assessments. The collection division is also embracing computerized formulae for priority selection of the cases with the highest risk to revenue. The latest trend is for the fraud investigation division to also design computerized systems for case selection with the input of numerous external and internal databases. The output of these systems, with the application of automated ratios and mathematical formulae, targets cases with high potential for fraud, of which, those with the highest potential are selected for investigation. The remaining cases, which always constitute the majority of cases, do not meet the case selection standards, but may reveal civil tax violations, in which case they are referred to the audit or collection divisions for necessary action.

Adding skilled information technology staff to the traditional fraud investigation division is a recent trend in tax administrations around the world. These staff help develop computerized systems unique to the fraud and evasion function, such as automated case tracking systems and automated management information systems, and assist in case investigations that involve computer seizures and forensic analysis. Information technology staff is usually placed in the intelligence branch and/or as staff to the head of the fraud investigation division to serve all fraud investigation functions.

9.2.3. Tax Fraud Investigation of Corruption, Money Laundering, and Narcotics Trafficking

In collaboration with drug enforcement agencies in various countries, the fraud investigation functions of many tax administrations have been dedicating significant time and effort in recent years to the tax fraud and evasion implications of narcotics traffickers. While the tax administration does not enforce drug laws, the enormous, untaxed profits of those engaged in these illegal activities are definitely within the scope of the tax administration's jurisdiction. Through circumstantial evidence and indirect methods, fraud investigators of some tax administrations have been able to prove tax fraud and evasion of very large sums by narcotics traffickers and have seized impressive amounts of cash and valuable property on many occasions through presumptive tax assessments.

However, narcotics trafficking cases are very time consuming and require extensive surveillance activities, joint activities with other law enforcement agencies, and evidentiary challenges in judicial proceedings. While publicity about prosecutions, convictions, and funds and property seized by the tax administration is certainly worthwhile, taxpayers do not associate such cases with the consequences of non-compliance with the tax laws, which is one of the primary objectives of fraud investigations.

Therefore, to avoid taking too much time from the main missions of the tax fraud and evasion function, the number of narcotics trafficking cases selected and ongoing at any given time should be small.

9.3. Tax Administration Maturity

Maturity levels of tax administrations with respect to the investigation of tax fraud and evasion are described below.

Fraud Investigations: Maturity Level 1

Key word: "Absent"

- The country's separate tax laws for the various types of taxes either have no provisions for tax crimes or have only vague provisions about civil fraud penalties for tax fraud and evasion.
- There are no provisions in the tax laws that require financial and other institutions to report to the tax administration on any of the various payments made by taxpayers through these institutions or that give tax officials the authority to subpoena or summon persons or documents or to use circumstantial evidence for presumptive assessments to determine unreported tax.
- The Ministry of Justice is in charge of investigating and prosecuting all economic crimes, is understaffed, doesn't have the capacity to discuss tax, and rarely handles even the civil fraud violations referred directly to them by informants.
- Without statutory authority, a fraud investigation component is totally absent from any of the organizational structures of the various tax administrations.
- The various tax administrations are in the business of collecting as much revenue as possible and are not interested in making examples of tax evaders other than for the large amounts of taxes, penalties, and interest collected from them.
- There is no coordination among the various tax administrations, and each tax administration is passive in developing positive relationships with other institutions involved with law enforcement.

Fraud Investigations: Maturity Level 2

Key word: "Junior Partner"

- The country's separate tax laws for the various types of taxes have a few provisions for tax fraud and evasion, particularly for VAT – civil fraud penalties, especially for repeat violations, and even incarceration for egregious repeat offenders – that give limited authority to tax administrators to investigate tax fraud and evasion.
- There is one tax administration for all taxes, and the audit and collection divisions in the organizational structure have a junior partner – a small fraud investigation component at the headquarters level reporting to the Director General, consisting of a somewhat isolated supervisor, administrative staff, a few investigators, and using little information technology.

- Fraud Investigators and their supervisor in the new unit are former, experienced auditors, but most do not have post-secondary schooling in accounting, none has special fraud-investigation training, and they are not skilled in the basic skills required to conduct professional tax fraud investigations, such as indirect methods, investigative techniques, evidentiary requirements, etc.
- Under the tax laws, fraud investigators have limited authority to subpoena and summon persons or documents and to use circumstantial evidence for presumptive assessments to determine unreported tax, mostly in the legal VAT framework, and have limited access to financial information of taxpayers from third parties.
- Fraud investigators concentrate wholly on cases of fraud and evasion of VAT by small and a few medium taxpayers, which are much easier to determine and prove than cases of income tax fraud and evasion. Investigators select these cases manually, and there are no defined criteria for the selection of VAT or income tax cases and no written manuals, policies, or procedures for investigators developed by headquarters.
- VAT fraud and evasion cases are successful in producing revenue from civil fraud penalties, including substantial revenue from repeat second and third-time offenders, but no one has ever been sentenced to prison for tax fraud or evasion.
- The tax administration's legal services staff has minimal involvement in the review of completed tax fraud and evasion cases, except in cases where the taxpayer does not agree with the findings of investigators.
- There is an informal, word-of-mouth fraud referral program for audit and collection staff, which has very limited success.
- Most of the cases selected for full-scale investigation by the fraud investigation division come from informal informant communications received throughout the tax administration, of which only some are referred to the fraud investigation unit. Others are either erroneously referred directly to the audit division, or are ignored.
- The fraud investigation staff has good relationships with Customs and police agencies, but is making no effort to cultivate positive relationships with the judiciary or with Ministry of Justice officials.

Fraud Investigations: Maturity Level 3

Key word: "Partner"

- The country's tax code or tax procedures code has strong provisions and sanctions for tax fraud and evasion, including substantial civil fraud penalties and possible incarceration.
- The legal framework provides for a functional organizational structure for the single tax administration, including a fraud investigation component, and gives specific authority to the tax administration to investigate tax fraud and evasion.
- The tax administration's fraud investigation component is now a partner and an integral part of the compliance and enforcement "toolbox," along with audit and collections.

- The fraud investigations function in headquarters and the district/field divisions is organized and performed according to international leading practice, with intelligence, investigations, and quality review branches, and all are equipped with fairly modern computerization equipment and systems.
- Fraud investigators and their supervisors, mostly former, experienced auditors, have post-secondary degrees in accounting and most, except for those recruited in the last two to three years, have attended a locally designed criminal investigation training course and have adequate skills in the application of indirect methods, investigative techniques, evidentiary requirements, etc.
- Under the law, fraud investigators have full authority to subpoena and summon persons or documents and to use circumstantial evidence for presumptive assessments to determine unreported tax. Investigators also have access to taxpayer financial information, in documents received periodically from financial institutions and others, and good computerized equipment and systems for matching data.
- A written, formal fraud referral program designed for the audit and collection divisions produces many good cases accepted for full-scale investigation. However, too many other referred cases are rejected, because work on civil issues by audit or collection staff, who have no key fraud indicator training, compromised the investigation.
- A well-designed and administered informant communication program, managed by the intelligence staff of the fraud investigation function, yields notable fraud prosecution cases, including convictions and prison sentences that are widely publicized.
- With defined case selection criteria for the manual selection of cases, and policy and procedural manuals for case investigations, fraud investigators successfully prosecute medium and a few large taxpayers for VAT fraud and evasion, leading to convictions and prison sentences that are widely publicized.
- Although lesser in number, there are successes with prosecuting medium taxpayers for individual and corporate income tax fraud and evasion, including convictions and prison sentences that are widely publicized. However, investigators have never developed similar cases against large taxpayers.
- The tax administration's legal services staff has full involvement in tax fraud and evasion cases during the investigation phase and also after completion.
- The fraud investigation staff has good relationships with the Ministry of Justice, the judiciary, Customs, and police agencies, and participates actively with other agencies on some important investigations of economic crimes, including drug trafficking. Occasionally, however, there is confusion about jurisdiction.

Fraud Investigations: Maturity Level 4

Key word: "Key Partner"

- The country's tax code or tax procedures code has strong provisions and sanctions for tax fraud and evasion, including substantial civil fraud penalties and possible incarceration.

- The legal framework provides for a functional organizational structure for the single tax administration, including a fraud investigation component, and gives specific authority to the tax administration to investigate tax fraud and evasion.
- For several years, the tax administration's fraud investigation component has been a full partner and an integral component of the compliance and enforcement "toolbox," along with the audit and collections. In fact, fraud investigation is now considered the key partner, due to its success in investigating and prosecuting income tax and VAT fraud and evasion by many medium and large taxpayers throughout the country, including securing convictions and prison sentences that have been widely publicized.
- The fraud investigations function in headquarters and the district/field divisions is organized and performed according to international leading practice, with intelligence, investigations, and quality review branches, all of which are well equipped with the latest computerization equipment and systems. Additionally, information technology staff are present as staff assistants at the division-head level to assist the entire division on IT needs.
- The fraud investigation function counts on computerized systems unique to the function, such as automated case tracking systems and automated management information systems, to assist in case investigations that involve computer seizures and forensic analysis.
- Fraud investigators and their supervisors, mostly former, experienced auditors, have post-secondary degrees in accounting and have all attended an excellent criminal investigation training course, designed on one of the international models for criminal investigators. This course is updated periodically, and fraud investigators also attend continuing professional education training courses periodically. All but the newest recruits have expert skills in the application of indirect methods, investigative techniques, evidentiary requirements, etc.
- Under the law, fraud investigators have full authority to subpoena and summon persons or documents and to use circumstantial evidence for presumptive assessments to determine unreported tax. Investigators also have access to taxpayer financial information, in documents received periodically from financial institutions and others, and modern computerized equipment and systems for matching data.
- Most experienced auditors and collection staff have attended a "badges-of-fraud" course, designed and conducted by staff of the fraud investigation function, and a written, formal fraud referral program, designed for the audit and collection functions, continually produces many good cases accepted for full-scale investigation.
- A well-designed and administered informant communications program, managed by the intelligence staff of the fraud investigation function, has yielded several notable fraud prosecution cases, including convictions and prison sentences that have been widely publicized. The tax administration has paid all informants timely awards based on the recovery of tax, penalties, and interest that stems from the information they provide.
- With defined case selection criteria for the computerized selection of cases, and policy and procedural manuals for case investigations, fraud investigators successfully prosecute many medium and several large taxpayers for both income tax and VAT fraud and evasion, including convictions and prison sentences that are widely publicized.

- The tax administration's legal services staff has full involvement in tax fraud and evasion cases during the investigation phase, and also after completion.
- The fraud investigation staff has excellent relationships with the Ministry of Justice, the judiciary, Customs, and police agencies, and participates actively with other agencies, all acting within their respective jurisdictional boundaries, on important investigations of economic crimes, including drug trafficking.

9.4. Latin America and the Caribbean

As noted above, one of the most important legal provisions underpinning an effective fraud investigations function is the authority for tax investigators to access taxpayers' bank information in the conduct of their investigations. A second set of indispensable legal provisions to discourage tax fraud and evasion provides serious consequences for violations, including substantial civil fraud penalties and possible incarceration.

Generally, in LAC countries, tax administrations do not benefit from either of these legal provisions. According to a recent report, "practically all countries (in Latin America) affirm that they have bank secrecy laws which limit their access to information necessary to perform their responsibilities."[180] Furthermore, "the information…shows that sanctions and penalties for tax violations imposed by Tax Administrations of Latin America are very low…..in general it can be affirmed that the Tax Administrations do not apply sanctions/penalties frequently nor vigorously and therefore sanctions/penalties are not disincentives to taxpayers for noncompliance."[181]

In fact, a very recent study confirms that tax evasion in Latin America is very high.[182] VAT evasion rates from 2001-2006 ranged from 11 percent in Chile to 38.1 percent in Nicaragua and averaged around 27 percent. Rates of non-compliance with the income tax ranged from 41.6 percent in Mexico and 47.4 percent in Chile to 63.8 percent in Ecuador for an average of 51.4 percent. Evasion of the corporate income tax was more extensive in most of the countries than evasion of taxes on income of physical persons, ranging from 48.4 percent in Chile to 65.3 percent in Ecuador for an average of 54.1 percent for the six countries with estimates available.[183]

The majority of LAC countries are in the second level of maturity described above, with a fraud investigation function that is only a "junior partner" of the audit and collection functions in their respective tax administrations and very high VAT and income tax evasion rates.

External weaknesses in the execution of effective fraud investigation activities and operations include:

[180] Inter-American Center of Tax Administrations (CIAT) et al. (2012), p. 33.
[181] Ibid., p. 36
[182] Gómez Sabaini et al. (2012), p. 7.
[183] Ibid., p. 34.

- A few countries still have separate tax laws which have very few provisions for investigation of tax fraud and evasion, except perhaps for VAT, and the laws in those countries provide few, if any serious sanctions – definitely no incarceration - for fraud;
- In countries that do have serious sanctions, including incarceration, they are rarely, if ever applied;
- Lawmakers are not usually inclined to enact provisions that give powerful investigative authority to the tax administration, which they think can be abused;
- Under some countries' laws, tax fraud and evasion are not investigated and prosecuted by the tax administration, but are the responsibility of other government institutions, such as agencies under the Ministry of Justice;
- Lawmakers often establish multiple national commissions or agencies to investigate financial crimes with authorities and jurisdictions which conflict with existing bodies or agencies;
- Bank and other financial secrecy laws prevail, so there is no third-party information available to the tax administration for matching documents for possible unreported or underreported income or overstated expenses;
- What little authority fraud investigators may have under the law to summon persons or documents is rarely, if ever, enforced with legal proceedings in cases of non-compliance; and
- Prosecution cases that rely on circumstantial evidence or indirect methods are seldom, if ever, successful in the courts because of the vagueness of laws and the inexperience of judges.

Internal weaknesses in the execution of effective fraud investigation activities and operations include:

- Many fraud investigators do not have post-secondary schooling in accounting, which itself is not a required qualification for the job, and so the cadres of fraud investigators throughout LAC countries are generally not well qualified;
- Training courses specifically for fraud investigators are non-existent or inadequate, and so cadres of fraud investigators throughout LAC countries are not well trained;
- The exclusive normative and program execution roles of the headquarters and field offices, respectively, are neither clearly defined nor practiced, and there is always some degree of confusion of roles at both levels. There is also confusion amongst the taxpayers involved in fraud investigations and/or their representatives;
- There are few, if any, procedural manuals and few clear, written policies for fraud investigators to follow. Case selection criteria are not well defined, so case selection is usually a manual, ad-hoc process;
- The organizational structures of the fraud investigation function and the roles of staff do not follow international leading practice. For example, there is a lack of units dedicated to intelligence gathering, case development, and quality control;
- There is no formal fraud referral program, and there is no "badges of fraud" training offered to auditors or other compliance staff;
- Within the Large Taxpayer Offices (LTOs), the audit function is understaffed, and both auditors and fraud investigators lack expertise on issues related to multinational corporations, such as

transfer pricing, and on other issues related to complex industries. As a result, potential fraud and evasion cases involving large taxpayers are often neither referred nor developed;

- There is no formal informant communications program and such communications are treated on an ad-hoc basis;
- There is a strong focus on VAT fraud prosecution cases, with little focus on income tax, and cases referred to courts languish interminably. No one is sentenced to prison for tax fraud and evasion, even if the tax laws provide for it;
- Annual budgets consistently prove inadequate to finance much needed computer equipment and systems or the hiring of increased numbers of qualified fraud investigators and legal service attorneys, who review and prosecute fraud cases;
- Relationships with Customs and police agencies are fair, but relationships with the Ministry of Justice and other institutions or commissions also involved with financial crimes are poor or non-existent; and
- The overall results of the tax administrations' fraud and evasion operations are mediocre.

Box 9.3. Tax fraud and evasion investigation Guatemala

Guatemala's situation with regard to tax fraud and evasion about 10 years ago is a good example of the situation in many LAC countries. In 2000, it was estimated that tax evasion of VAT in Guatemala was 33.9 percent, and that the rate of income tax fraud and evasion was even higher.[184] Yet, Guatemala's tax administration, the Superintendent of Tax Administration (SAT), had no legal authority to investigate tax fraud and evasion. Instead, auditors and other compliance staff of the SAT who suspected fraud and evasion by any taxpayer they were auditing, or on whom they were conducting other compliance checks, were required to submit an information/complaint report through their Legal Services Department to the Ministry of Justice's Prosecutor of Corruption Cases (Fiscalía Contra la Corrupción), which had received 2,350 cases from April 2000 through July 2001 (including 890 Customs and 123 tax cases). Unfortunately, the office of the Prosecutor was severely understaffed, and its small staff of attorneys was unfamiliar with tax laws and issues. The majority of tax fraud cases were invariably discontinued or ignored and lapsed. Of those actually processed and discontinued, the main cause cited was that the SAT's auditors had gone too far on civil tax issues to introduce criminal charges. As noted by Gallagher in his benchmarking methodology study in 2004, Guatemala's tax fraud law enacted in the mid 1990's had not been applied even once.[185]

The jurisdictions of national agencies became even more complicated and confusing, when lawmakers established a National Commission to Combat Fraud and Smuggling in 2000. In many other LAC countries there are usually multiple national commissions or national institutions with jurisdiction over financial crimes, which always causes confusion about "turf," and often results in inaction, clashes between agencies, and minimal prosecutions and convictions.

The lack of effective tax fraud and evasion detection, investigations, prosecutions, convictions, and publicity contributes to a situation whereby taxpayers realize that there are no serious consequences for non-compliance, even in cases of egregious tax fraud or evasion. As a result, tax administrations in many LAC countries are faced with low levels of voluntary compliance among taxpayers. The threat is that even the current, mediocre levels of voluntary compliance will erode further, leading to increased leakage of tax revenue, which countries can ill afford.

[184] Jacobs (2002), p. 3.
[185] Gallagher (2004), p. 18.

The greatest threats, however, are with the large taxpayer segment. With chronic understaffing, auditors that lack expertise on complex multinational tax issues, and insufficient or inadequate information technology equipment and systems, LTO auditors in most LAC countries are likely to have an annual audit rate of 5 percent or less of all taxpayers, which is not even close to the international audit norm of 30 percent. Given this inexperience and low audit rate, coupled with ambiguous or no fraud referral programs and training, fraud detections and referrals by LTO auditors for investigation are unlikely to reach a meaningful number. Therefore, there are ever-increasing opportunities for large taxpayers in LAC countries to underreport their tax liabilities, with less risk of detection and investigation. With impunity over the long term, large taxpayers are likely to become bolder. If so, the threat of serious, persistent revenue leakage from this taxpayer segment, which now contributes 60-75 percent of the governments' tax revenues, would be catastrophic.

There are some encouraging trends in the LAC region. For example, in Jamaica, a Fraud Investigation Unit was established as part of the Tax Administration Jamaica's (TAJ) Audit function more than 10 years ago. An IMF report of April 2010 states that "25 fraud investigations were conducted and 10 cases were referred for prosecution to the courts."[186] Unfortunately one top level official under the Ministry of Finance also "observed that fraud cases referred for prosecution stay in the courts for years and that no one has ever been incarcerated in Jamaica for tax or customs fraud."[187] In April of 2012, TAJ was considering proposing to the MOF and Parliament a tax procedures code, which had already been drafted, and which contains provisions that would significantly strengthen sanctions against fraud and evasion. Tax administrations in most LAC countries recognize the need to have tax legislation that gives sufficient authorities for effective fraud and evasion investigation and are currently exploring options.

As members of the Inter-American Center of Tax Administrations (CIAT), tax administrations in LAC have opportunities to provide modern training, based on international leading practice, to their fraud investigators that may not be available to tax administrations of other developing countries. The U.S. IRS is a member of CIAT as well, and through the U.S. Treasury's Office of Technical Assistance (OTA) and CIAT sponsorship, IRS experts have conducted numerous technical training courses over the years for LAC countries' tax administration staff. Another opportunity for professional fraud investigation training might be the Criminal Investigation Training Program of the Federal Law Enforcement Training Center's (FLETC) International Law Enforcement Academy (ILEA) in El Salvador.

9.5. Key Benchmarks and Guidelines

Any attempt by tax administration officials to measure criminal tax fraud or evasion results in terms of tax assessed or collected will destroy the primary focus on the identification and investigation of major offenders. Rather than dedicating significant time and expertise to complicated and significant tax offenses, fraud investigators will be focused on the generation of revenue, which includes components beyond just tax (e.g., penalties and interest).

[186] Jacobs et al. (2012), p. 32.
[187] Ibid., p. 32.

The amount of staffing devoted to the fraud investigation function varies. It is not unusual to see as much as 5 percent of the total tax administration's total staff dedicated to this function, as long as the function is both efficient and effective in controlling overall tax fraud and evasion activities by applying strict case selection criteria and producing high quality, and widely publicized, prosecutions and convictions, with corresponding consequences. These consequences are most frequently measured by the application of appropriate civil and criminal fines and penalties and criminal convictions, resulting in prison terms for the most flagrant offenders. If the consequences are appropriately applied by the judiciary, overall tax compliance will improve and tax revenues will increase.

Some more specific key indicators of performance of the fraud and evasion function drawn from international leading practice are:

- 60-70 percent of fraud investigators' total time is spent on investigations (the rest is spent on administrative, training, overhead). In the first two years of operation of the division, approximately 60 percent of total time would be a reasonable objective;
- 60-70 percent of total time of the intelligence branch's staff is spent on case development and information gathering activities;
- Discontinued investigations do not exceed 10 percent of investigations initiated;
- The prosecution rate exceeds 90 percent (the number of cases recommended for prosecution divided by the number of cases placed under investigation for the year);
- The conviction rate exceeds 75 percent (the number of cases successfully prosecuted divided by the number of cases recommended for prosecution); and
- Senior investigators complete an average of one complex investigation in the first two years of operations, and an average of two cases per year thereafter. Journeyman investigators complete an average of two, less complex investigations per year in the first two years of operations, and an average of three per year thereafter.

In addition to the benchmarks described above, key questions to measure the performance of the tax administration in its tax fraud and evasion function and to pinpoint areas for improvement are:

1. Is there an effective effort that focuses on the investigation of high-income and/or prominent criminal tax fraud offenders and on achieving meaningful convictions and civil consequences?
2. Are preventive measures effective in reducing overall tax fraud and evasion?
3. Does the performance system measure the number and quality of convictions or civil actions achieved that result in improving overall tax compliance and revenues?
4. Do the country's tax laws and the tax administration allow for maximum publicity when offenders are prosecuted to ensure that the public is well informed of the offense and the resultant punishment?
5. Are indirect methods of proving income authorized by law and applied in the identification of major tax offenders and during the investigation process to provide quality evidence?
6. Are the audit and fraud investigation staff selected, trained, and developed in both financial investigations and tax control (audit) techniques to adequately detect and investigate violators?

7. Are "selective means" (as discussed in section 2.2.1) being applied in identifying the most important targets?

Chapter 10. Collections

David Crawford

This chapter contains an overview of collections and examples of legislation, tax collection procedures and processes, and suggested ways to measure the various outputs for purposes of performance management and evaluating the collections function of a tax administration. This chapter attempts to provide general operational suggestions to assist tax administrations in discussing relevant aspects of collections and developing their own tax collection policies. In addition, it contains an outline of the roles and responsibilities of tax officials connected with tax arrears collection efforts and general comments on organizational structure.

While this chapter also contains references to the applicable "legislative authority," this reference is broad and examples of legislation are a composite drawn from a number of countries. These references are intended to assist those who may not have particular provisions in their own legislation, or where a provision may not be performing as well as intended.

10.1. Leading Practice

Governments are increasingly under pressure to find sufficient funds to meet their budgetary requirements and their attention often turns to the stock of tax arrears – the tax administration's "accounts receivable."

10.1.1. Introduction

When viewed from 20,000 feet, tax collection appears to be a relatively simple task, but this initial impression is deceiving. In fact, tax collection is a complex and difficult task. It involves collecting money from tax debtors in often stressful and occasionally confrontational circumstances. For example, in Russia, "in 1996, twenty-six tax collectors were murdered, seventy-four were injured, and six were kidnapped while eighteen Russian tax offices were 'shot up.'"[188] More recently, and in various countries, there have been frequent reports of tax collectors being injured on the job while trying to seize taxpayer assets.

Approaching debt collection in a professional manner and using a series of predictable and progressively stronger measures can maximize collection results while minimizing risks of confrontation. There are some basic steps to collecting tax debts that are common to any tax organization. These basic steps are:

- Rapid identification of arrears;
- Assigning priority to cases of arrears (i.e., risk, amount, etc.);
- Increasing severity in each of a series of requests for payment; and

[188] Franklin (1997), p. 136.

- Taking action using the provisions of the law to collect.

The collection policy of any tax administration is determined by the culture of the country, political environment, business practices, judicial policies, and previous taxation experience. The above basic steps will be defined through these influences and further elaborated in the operating guidelines and procedures for the tax collection function. This chapter details the legal actions that are commonly used to collect tax debts. It outlines in sufficient detail the steps involved with each action so that a tax administration that is encountering difficulty with their particular provisions may be able to adapt these steps to achieve a solution within the bounds of their particular collection policy.

Tax Arrears Defined

Tax arrears are those liabilities that have been legally assessed through:

- Self-assessment;
- An administrative action based on objective criteria; or
- An audit of the taxpayer's records

but are not paid by the legal deadline. Arrears include: (a) outstanding tax liability; (b) penalties; (c) interest accrued, and; (d) other legally imposed amounts.[189] Interest is usually charged from the date the balance owing is due and extends until the date the amount is paid. The accrual of interest is a matter of statute and is a form of compensation to the government for the cost of using funds to which the government is legally entitled. As discussed in Chapter 7, the rate at which interest is charged should be reviewed regularly and reset where necessary. Interest is generally charged on the full balance, including penalties and previously charged interest, and may be compounded on a daily basis.

Modern tax administrations have a civil penalty system to ensure that taxpayers are encouraged to follow through on their obligations on a timely basis. The penalties vary in amount or severity depending on the defaulted obligation or the number of times it is repeated. Those who do not follow through may be charged a penalty for various lapses, including late filing of a tax return, late payment, not meeting deadlines for registering with a tax office, and/or not responding to a demand for information.

Depending on the legislation, refunds for overpayment of tax liability may be applied against a debt of the same tax in another year or to any taxes administered by the tax administration. Certain credits, as specified by the legislation, can become refunds and may also be applied against debt.

Where tax liability is not paid on time, the tax administration usually issues a series of warning letters that escalate in severity and normally applies a procedure of enforced arrears collection. A number of debt management powers are typical across tax administrations, including powers to:

- Grant extensions of time to pay;

[189] Sanctions, including penalties and interest, are discussed in Chapter 7.

- Offset taxpayers' tax debts against credits arising under other taxes;
- Formulate payment arrangements;
- Collect tax debts through third parties who owe money to a taxpayer;
- Demand payment from the bank accounts of persons with tax arrears;
- Initiate seizure action; and
- Initiate bankruptcy/ liquidation action.

Designing a Tax Collection Policy

It is important to recognize that not all of the procedures and available legal remedies to collect tax arrears are necessary or appropriate in every tax arrears case. The decision of how best to proceed is generally based on an evaluation of the risks involved in collecting the tax debt and the most cost-effective method of collecting that tax debt. The tax collection policy should be one whose procedures and policies are:

- **Selective:** It is not practical to pursue every taxpayer, as there is usually a large number of small amounts and old arrears that that, if pursued with every means at the disposal of the tax administration, would overwhelm the available staff. There is simply too much non-compliance for the tax administration to address with its limited resources. Instead, the tax administration should employ a focused approach to identify and devote collection efforts to the most significant and high-risk non-compliance.
- **Inexpensive:** Tax administrations do not have unlimited budgets. Low-cost alternatives are preferable where they are available. This requires a balance between the costs of taking various actions and the expected return. The continuation of collection action cannot be justified where the costs exceed the expected benefits.
- **Prompt:** The tax administration should identify non-compliance and begin collection action as quickly as possible; and
- **Proactive/Curative:** The focus on non-compliance should, wherever possible, be to prevent future non-compliance by a taxpayer and to address the cause of the non-compliance.

Since the tax administration's resources are limited, it is important to adopt a simple, understandable collection policy with procedures that are easy to automate and use. The policy must provide guidance on which cases to pursue, as well as decide which cases to ignore.

A clearly defined and routine business process should be developed and the tax administration's management should ensure that it is, in fact, followed. Once a taxpayer is identified as being in arrears, this process should ensure that the taxpayer/debtor is notified as soon as possible. Delays in notifying a debtor result in lost revenues, as the probability of realizing the amount decreases over time. According to the Collectability Curve[190] from the U.S. Internal Revenue Service (IRS), as a tax debt ages, the probability of recovery after it has been outstanding 36 months becomes negligible.

Figure 10.1. IRS collectability curve – probability of collecting $1 of debt

Current	1 Month Past Due	3 Months Past Due	6 Months Past Due	9 Months Past Due	12 Months Past Due	24 Months Past Due	36 Months Past Due
$1.00	.97c	.72c	.53c	.43c	.28c	.13c	.0c

These statistics are from a tax jurisdiction that has all the necessary legal tools and a modern administration aided by significant automation and a properly functioning postal service. The situation in many countries could be far worse than this.

There are a number of factors that can cause a poor recovery of tax arrears. These factors can be summarized as follows:

- The legal framework is often identified as the largest impediment;
- Internal organization and coordination within the tax administration may be lacking;
- Clearly defined policies, procedures, and responsibilities, as well as sufficient oversight, may be lacking; and
- Operational resources, ranging from qualified staff to logistical support from computers, telephones, and transport, may be inadequate.

Of particular interest is the current status of the aged arrears of selected countries in Latin America and the Caribbean (LAC) in the table below. The aged arrears are shown as percent of the total outstanding arrears. Some of these may be legitimately delayed due to court appeals. However, the probability of collecting all arrears is significantly reduced as accounts continue to age. This table suggests that most countries in the LAC region would benefit from a reform of current collection law and practices. Additionally, accounts that are uncollectible should be prepared for write-off to avoid the revenue potential being presented is distorted.

Figure 10.2. Aged uncollected taxes as percent of total arrears[191]

	Less than 1 year old	Older than 1 year but less than 2 years	Older than 2 years but less than 5 years	Older than 5 years
Argentina	12.30	9.66	20.73	57.31
Chile	11.93	12.44	29.59	46.01

[190] Internal Revenue Service (2002), p. 12. This IRS assessment of diminishing returns with the passage of time reflects the experience with private collection agencies. The Commercial Collection Agency Section of the Commercial Law League of America published the results of a survey of its members in July, 2001, indicating that on average only 10¢ of every dollar is collectible after the expiration of two years. A similar affirmation is a presentation by Nina E. Olson, National Taxpayer Advocate before the Subcommittee on Oversight Committee on Ways and Means U.S. House of Representative hearing on Tax Compliance Challenges Facing Financially Struggling Taxpayers on February 26, 2009.

[191] Inter-American Center of Tax Administrations (CIAT) et al. (2012), page 50. The average is for all reporting LAC countries, whereas the table shows only selected countries.

	Less than 1 year old	Older than 1 year but less than 2 years	Older than 2 years but less than 5 years	Older than 5 years
Colombia	22.83	27.91	17.88	31.38
Costa Rica	19.81	25.94	29.85	24.40
Ecuador	42.86	25.61	11.90	19.62
Honduras	46.44	5.59	4.10	43.87
Mexico	36.31	21.58	26.16	15.95
Peru	0.89	1.62	11.86	86.32
Average for LAC countries	21.2	15.83	27.20	42.37

Organizational Risk

It is neither feasible nor cost-effective to work all tax arrears accounts simultaneously, as there simply are not enough resources available. The tax administration should apply risk principles to efficiently allocate staff to collections accounts (organizational risk) and to focus on those taxpayers that may have the largest impact on collections (compliance risk).

Organizational risk can be addressed, first, by ensuring that the hiring of collectors is appropriate to the tasks, that collectors receive the proper training, and that there is enough experienced staff available to adequately respond to the workload. In addition, the tax administration should continuously monitor workload and should produce regular reports that track:

- The number and value of accounts that come into arrears status (i.e., the 'intake' of cases);
- The number and value of arrears accounts that are collected or closed (i.e., the 'production' of cases); and
- The number and value of arrears accounts that remain in inventory.

The number and value of accounts that come into arrears status at any one time are considered the new 'intake' for a period. Normally the period would be a calendar month. New intake needs to be addressed as soon as possible while the information about the debt is still new and the taxpayer is still in a position to pay or borrow to pay the tax debt. As could be seen from the IRS experience, with each month that passes, the probability of full recovery steadily diminishes. If the debt is large, the taxpayer may be in the early stages of difficulty with the result that the assets available to recover the tax debt are diminishing as other creditors also make payment demands. As discussed earlier, compliance risk is less with new accounts, particularly if this is the first time the taxpayer is in debt. The collector still has the opportunity to change the behavior of the taxpayer and a relatively easy task of receiving full payment for the debt. Examining the composition of the intake is important.

Analyzing intake should be the role of a supervisor. It is this analysis that may assist in recognizing possible developing trends and effectively allocating staff. The supervisor should be looking for:

- Whether more accounts than usual are coming in at any one time;
- Whether there is a group of accounts that are businesses related by ownership;

- Whether accounts from any particular business sector are going into arrears (e.g., hotels, high-end retailers, construction industry);
- Whether more "Best of Judgments" (BoJ)[192] are coming into debt status at a time; and
- Whether one type of tax is more prevalent (e.g., corporate income tax).

Depending on this intake analysis the supervisor may have to consider whether to:

- Request additional staff;
- Arrange for specific training;
- Reorganize staff so that some are dedicated to specific sectors or types of tax;
- Determine how audit assessed the BoJs to better collect them; and
- Prioritize accounts by not taking action on some small value accounts.

The number of accounts collected or closed is the 'production' for the period. The analysis of the production helps the supervisor determine how efficient or effective collectors are and what training or other corrective action, if any, is required. Tracking how long it takes to collect or close an account helps the supervisor determine how many large or small accounts a collector can work at any one time (e.g., a week, month, quarter). In this manner, the supervisor can determine how many accounts to assign to each staff member.

With experience and a base of statistics, the supervisor will be able to determine standard times for various activities and types of tax debts, such as the time required to collect an active account, close (write-off) an account which is no longer collectible, close an account when seizure of assets is initiated, collect a large account or a small account, as well as the success rate in achieving full collection for various taxpayers when they are notified within a certain number of days of entering into arrears. All of this can be considered when determining how many collectors are needed and what accounts should be prioritized. Analyzing how accounts are collected or closed can also help determine the more effective methods of achieving compliance. For example, automated notices, followed by telephone calls, are the least expensive, while visiting the taxpayer at their place of business and following enforcement procedures is considerably more costly.

Analyzing the inventory of casework is also necessary to determine the age of accounts and/or whether they are even still collectible. If IRS experience is representative, accounts older than three years should be prepared for write-off.

Finally, supervisors should select and review samples of accounts on a regular basis to determine how well the accounts are being worked. The more common types of samples of work that should be reviewed include:

- Individual collectors' inventory, particularly larger accounts;

[192] A "best of judgment" assessment is one in which the tax administration has reasons to believe that the statements and accounts presented by the taxpayer are not sufficient enough to assess liability. These are also called "indirect assessments."

- Different tax types in inventory, such as value added tax (VAT), pay as you earn (PAYE), personal income tax, property tax, or corporate income tax;
- Accounts over a certain age, such as ones that are more than 1 year old or ones that are within 6 months of being statute barred[193] and for which there has been not account action taken; and
- Accounts identified as uncollectible.

Compliance Risk

The above factors can also indicate if there is 'compliance risk' among various tax types, such as increased number of BoJ's in one tax type or increased numbers of large debts in any particular tax type. Collections staff should also be aware of the need to react appropriately, from a compliance perspective, to different types of accounts. For example, taxpayers who are habitually in arrears and are not forthcoming with financial information should not be allowed to continually make payment arrangements. In these cases, progressively stronger enforcement action is required.

Understanding compliance profiles and risk characteristics of certain taxpayers can assist collectors. The OECD model below illustrates factors that a tax administration might consider and approaches it may use to foster compliance among various groups of taxpayers.

Figure 10.3. OECD compliance model applied to collections accounts[194]

Percent of taxpayers	Taxpayer attitude to compliance	Compliance strategy to be used	Percent of compliance used	Application to collections of tax arrears (Examples)
Least	Have decided not to comply	Use the full force of the law	Greatest	Collector must use full enforcement provision, such as garnishment[195], liens, seizure and or sale of property
Lesser	Do not want to comply, but will if the tax administration pays attention	Deter by detection	Less	Collector may need to call, send reminders, and try a long-term payment arrangement and/or one garnishment, before a payment is made and the taxpayer starts to comply
Less	Try to, but do not always succeed	Assist to comply	Lesser	Collector may need to call the taxpayer and determine ability to pay for a longer-term payment arrangement
Greatest	Willing to do the right thing	Make it easy by providing written material or a website for taxpayer to understand their	Least	Collector may make one call and the taxpayer will make own arrangements or very short-term arrangements to pay debt

[193] No longer subject to legal action due to statute of limitations.
[194] Adapted from OECD (2004), p. 41.
[195] A garnishment is legal procedure by which a tax administration can collect what a tax debtor owes by attaching the debtor's property, when it is in the hands of someone other than the tax debtor. Typically this is money owed to the tax debtor and reflected in the tax debtor's records as a trade account receivable, or it is money belonging to the tax debtor that is on deposit at a financial institution. .

Percent of taxpayers	Taxpayer attitude to compliance	Compliance strategy to be used	Percent of compliance used	Application to collections of tax arrears (Examples)
		responsibilities		

Allocating Accounts for Collection

All large new accounts (intake) should be regularly identified by the supervisor and allocated to collectors. Ideally, the information technology (IT) system should provide reports on new intake, which the supervisor can allocate to staff on the computer system. Where the system is not capable of allocating accounts and tracking progress, the supervisor will need to develop a manual system. When allocating workload, new accounts should be ranked in value order, from largest to smallest, and any new unassigned accounts should be reviewed to determine compliance risk. It should be noted that larger value accounts[196] can take longer on average to resolve, and thus fewer accounts would be allocated to a collector for action. No more than 20 large accounts should be initially allocated to establish a time baseline. As a general guide, it will take at least one day to address each large account and 20 large accounts would constitute a month of work.

Once a baseline for handling accounts has been established, it may be determined that, for example, three times as many personal income tax accounts could be distributed to collectors than corporate accounts. It is the responsibility of the supervisor to determine the taxes that comprise the largest percentage of the tax arrears. For most national tax administrations, the largest taxes will include corporate income taxes, VAT, PAYE, and personal income taxes. These taxes are handled by collections teams for each type of tax. Some taxes may be combined under one collections team. For example, as PAYE and VAT are both trust funds[197] and generally a high priority, they may be combined under the same team. Other taxes are normally worked on a project basis, as described below. In some tax administrations, collectors are responsible for a number of taxes belonging to one taxpayer. This is recommended to minimize confusion both for taxpayers and the tax administration. In addition, when a collector is responsible for all tax debts, it is advisable to either align all the collections provisions that may be scattered across several laws or to consolidate them into a single law.

Allocated work, new, and aged accounts should be distributed in order of the potential of the account to generate value (e.g., the actual value of the debt multiplied by the probability of collection, which is a function of age, among other factors). To ensure fairness in the distribution and better tracking of these accounts, only supervisors should allocate taxpayer accounts for collection. This said, in most organizations new collectors are allocated smaller value accounts until they have demonstrated that they are comfortable with the different taxes and interacting with professionals, such as accountants and lawyers.

[196] The 80/20 rule can be used to define 'large accounts'. That is, 80 percent of the tax arrears are usually generated by 20 percent or less of accounts.
[197] These taxes are not paid by the taxpayer directly, but are rather remitted on behalf of the taxpayer. For example, the VAT is collected and remitted to the tax administration by the seller on behalf of the purchaser.

10.1.2. An Action Plan at the Production Level – the Tax Collector

The most effective system or plan for tax collectors to manage their workload involves a three-stage process: 1) analyze; 2) prioritize; and 3) act.

Analyze

Collectors should analyze their assigned casework inventory to determine their priorities to ensure the maximum recovery and the most efficient use of their time. Collectors must determine which files they will work and which files they will have to set aside. In order to manage the casework inventory, the collector must concentrate on files that give tangible results and/or require action on an urgent basis.

Other important planning principles, which a collector should keep in mind, are:

- Taking every opportunity to collect an account in full;
- Always working on the largest value file, unless there is an immediate danger of loss;
- Taking the most cost-effective action within the circumstances of the account; and
- Recommending "write-off" for an account when all avenues to collect have been exhausted.

Due to the level of effort required to collect some accounts, it may not be financially viable to continue with a collection action if the potential amount of money recoverable is relatively small. Although telephone calls are inexpensive, continually calling without results is not cost-effective.

As part of a systematic approach to working an entire assigned inventory, the collector should have a realistic "to do" list for the day, which places the emphasis on higher payback and more essential cases. This is usually a plan that is developed by the collector each day. The plan needs to be flexible, as new high priorities may intervene at any time. This list includes the high priority cases, the daily "bring forward" list[198], incoming correspondence, telephone messages, or walk-in taxpayers.

Prioritize

To properly prioritize the work for the day, a collector must be aware of specific priorities established by management and must be able to analyze files to determine risk of loss. Management priorities can change due to circumstances, but will usually include:

- Ministerial/senior management inquiries (as a result of taxpayer complaints);
- Attorney/Solicitor General or court requirements;
- Remission requests;[199]
- New intake;
- Aged accounts;
- Financial difficulty accounts;

198 Unhandled cases left over from previous days.

199 Requests to reduce or cancel interest and/or penalties, which the tax administration can do if it deems that it is fair and reasonable to do so, usually because of taxpayer hardship or other extraordinary circumstances.

- Write-offs; and
- Small accounts and special projects.

Inquiries: In modern tax administrations, taxpayers are provided the opportunity to query their accounts. It is common for taxpayers and/or their legal representatives to request account information when there is impending collection action. These requests are often made to search for reasons to challenge the impending collection action. Such requests require considerable work to ensure that all appropriate steps have been taken to collect the account and that the taxpayer has been treated fairly and professionally. To ensure that these inquiries are dealt with openly and transparently, the taxpayer file[200] should contain the following information:

- Complete reports that provide an account summary of:
    - all financial information about the taxpayer, including an analysis of ability to pay;
    - all collections and compliance efforts taken; and
    - all efforts or non-efforts by the taxpayer to comply;
- Recommendations by the collector as to the next legal action to be taken or if there is undue hardship in paying the arrears;
- Any final decisions on action that have been approved by management; and
- Communications of supervisor decisions to the collector.

Requests from the Attorney/Solicitor General for information for court cases require the same documentation as indicated above.

Aged accounts: There are often many accounts that are old, the accrued penalty and interest on which outweigh the original tax, and for which the likelihood of realizing payment is very low. These accounts should be considered separately. If the collection case is complex and includes legal issues that are not a routine collection matter, but the case is still within the statutory time limit for collection, the case should be referred to a specialist to further examine the substantive issues and make recommendations on how best to proceed. Other routine old accounts should have their balances verified and collection action begun to prevent them from entering statutory time limitations. All accounts that are over the time limit for collection should be considered uncollectible and prepared for immediate write-off.

Write-offs and remissions: Most governments provide legislation in their financial administration acts to allow the write-off of any government debt that cannot be collected. When an account is submitted for write-off, the tax administration has made a business decision not to continue with further collection action. It is important to note that a write-off does not "extinguish" the debt and if the taxpayer is in a position to settle the debt at some future time then the tax administration can collect the debt at this later date.

[200] Depending on the tax administration, there can be multiple taxpayer files for registration, audit, and collection or for each tax type. Alternatively and preferable, all documents may be in a single repository.

A "remission" is legally different. A remission is a written request from the taxpayer requesting relief because of financial hardship or other extraordinary circumstances. A remission will permanently extinguish interest, penalty, and/or tax.

Small balance accounts: Small accounts are most often worked on a project basis, by grouping accounts with similar characteristics and assigning such accounts to specific collectors. The benefit of this is that it can be done quickly and a certain critical mass of expertise may be developed by one or more collectors. The approach to small value accounts can also often be done by less experienced staff with a simpler policy, such as one that requires three telephone contacts within a certain period and no further action. If an account remains dormant for a certain period after the last contact and there is no indication that there is economic activity, then it would automatically be prepared for write-off. Often, the IT system can write off very small value accounts in batches and thereby reduce costs of collection for the tax administration.

Danger of loss accounts: These are accounts where the taxpayer is trying to put assets or income out of the tax administration's reach. Not taking expedient action may mean losing the account. The collection action may come under the jeopardy provisions of the tax law[201], or it may be necessary to accelerate issuing garnishment, special assessments, or even asset seizure.

Act

The collectors should first review the account to determine what actions have been taken to date, and the results of those actions, before deciding on the next steps required to resolve the account. For most accounts, the collector will:

- Review the account to confirm:
    - the amount of the debt, the details about the assessment, and whether any portion of the debt is under dispute because of an appeal;
    - the taxpayer's previous payment history;
    - the reason for an assessment (e.g., unreported income, insufficient installment amount, salary remittances not made);
    - the potential for the debt to increase (e.g., no salary withholding or potential audit assessment);
    - the requirements for an audit for outstanding periods or amounts;
    - the need for a legal warning and/or the potential result of any legal action (e.g., undue hardship for the tax debtor); and/or
    - if applicable, the need to cross reference the account to any related account, such as family members or business partners.
- Contact the tax taxpayer by telephone to:

[201] Under 'jeopardy provisions' the tax administration will accelerate assessment (e.g., before the due date) and attempt to collect revenue that the tax administration believes is jeopardy, because the taxpayer is about to leave the tax jurisdiction, the taxpayer is about to dispose of property, or other reasons.

    - request payment in full and/or obtain details of any payment made, including date of payment, name of financial institution, address of financial institution, method of payment;
    - obtain additional information to update the account (e.g., current address, employment status, etc.);
    - make a payment arrangement, where full payment is not possible, based on a complete review of ability to pay;
    - obtain the necessary information to raise an assessment of any remittances that are past due;
    - advise the taxpayer of his/her rights and obligations and/or the possibility of legal action, if payment is not received.
- Where telephone contact is not possible, either:
    - send the appropriate collection letter to request payment; or
    - complete further investigation to determine the best way to contact the taxpayer (e.g., a visit).

When a collector follows up cases in an organized way, this reinforces the taxpayer's perception that the collector is professional, committed and will take the necessary and appropriate actions. Where the taxpayer has this perception, he/she is more likely to make an effort to voluntarily comply. The collector must ensure that all contacts with the taxpayer are documented in a collection log and exact dates, times, consequences, and anything agreed to, are recorded. The collector must ensure that a deadline or "brought forward" date is also recorded.

In order to ensure that accounts are worked in an efficient manner and that the taxpayer gets consistent information, some accounts will need to be associated and worked as part of a group of accounts. Accounts may be related in some way, such as when a corporation owns a number of subsidiary corporations with separate tax accounts. In such cases, one collector will take responsibility for all of the accounts, though it may be necessary for the collector to ask for assistance in complex situations.

10.1.3. Case Management

It is a management responsibility to systematically review accounts to ensure the quality and effectiveness of a collector’s work. Reviewing work minimizes organizational risks. For example, poorly trained collectors can be coached and/or trained. Monitoring may also reveal whether changes or improvements are required to operational policy or procedures.

To assist in this review, the supervisor should develop a quality review checklist that follows the procedures for collecting an account. The supervisor should then conduct a workshop to explain this form to staff, and collectors could use this same form as a checklist to ensure that they have completed all necessary steps when working the account. The supervisor should review the checklist with individual collectors during meetings to discuss concerns and provide feedback. The supervisor would also use this checklist and any notes made on it as both a record of quality review and to document the performance of the collector.

Management Reports

A number of management reports should be prepared on a regular basis. Tracking the components of a debt arrears inventory, such as intake and production, is critical in measuring collection performance in order to be able to make appropriate strategic and operational decisions.

Ending inventory report at month, quarter, or year end: This report quantifies the arrears inventories by tax type relative to the total inventory. Recording the ending inventory and watching its progress from month to month is one way to determine if the inventory is decreasing. If the inventory is increasing, then the supervisor must also track intake and production to determine whether there is too much new debt or whether there is too little production by the collectors.

The ending arrears can also be compared to the projected revenue for the year to determine how much can be collected from arrears and how much is collected from current revenue.

Figure 10.4. Sample ending inventory report

Ending Tax Arrears Inventory as of Quarter 1 End								
Tax Type	Month 1		Month 2		Month 3		Percent of total	
	#	$	#	$	#	$	#	$
Corporate income tax (CIT)								
CIT – opening arrears								
Plus CIT new accounts/amounts								
Less CIT closed accounts/ collected								
CIT ending inventory								
Personal income tax (PIT)								
PIT – opening arrears								
Plus PIT new accounts/amounts								
Less PIT closed/collected								
PIT ending inventory								
Pay as you earn (PAYE)								
PAYE – opening arrears								
Plus PAYE new accounts/ amounts								
Less PAYE closed/collected								
PAYE ending inventory								
Value added tax (VAT)								
VAT – opening arrears								
Plus VAT new accounts/ amounts								
Less closed/collected								
VAT ending inventory								
Other taxes								
…								

Ending Tax Arrears Inventory as of Quarter 1 End								
Tax Type	Month 1		Month 2		Month 3		Percent of total	
	#	$	#	$	#	$	#	$
Total							100%	

Intake report: The value and number of accounts added during the period allows a supervisor to know if too many accounts are defaulting. If this is the case, the supervisor can:

- Determine how many can be worked and put aside some;
- Determine if a different method of contact should be used (e.g., send notices for all and only react to those large accounts where there is no answer);
- Obtain additional staff;
- Work only on a particular non-compliant sector; and/or
- Determine how many are BoJ's and speak to the audit division about what can be done.

Aging of inventory report: This report helps determine how many accounts there are in inventory and their various ages and value. With this report, the supervisor can determine if the oldest and largest accounts have been allocated to staff and are being addressed. Since the accounts are stratified by value, the supervisor can decide whether certain groups of accounts can be considered for batch write-offs or for other actions.

Figure 10.5. Sample aging of inventory report

Ending Inventory Summarized by Age and Value												
Amount of Arrears	1-90 days		91-180 days		181-360 days		361-720 days		Over 720 days		Total	
	#	$	#	$	#	$	#	$	#	$	#	$
0-500												
500-5,000												
5,000-10,000												
10,000-50,000												
50,000-100,000												
100,000-500,000												
500,000-1,000,000												
Over 1,000,000												
Total												

Total production report: This report shows the total collected on arrears accounts. It is critical to know, at a minimum, how many accounts are being closed and or collected by the collectors. To ensure that the inventory does not increase, the supervisor must ensure at least that as many accounts are closed or collected as become new intake. To prevent an inventory increase, supervisors must determine the cause, such as whether collectors:

- Have good working habits and are effective in their collection practices;
- Are being assigned too much non-collection work;
- Require training; and/or
- Are often on leave.

Tracking how accounts are either closed (e.g., written off) or collected allows management to determine the effectiveness of collectors in taking enforcement action and addressing old accounts. For example, if few enforcement actions are taken but the inventory keeps increasing, the supervisor must determine why this is happening.

The sample report below can be adapted to track the production of individual collectors. It can be combined across the team to also reflect the team performance. To determine the efficiency of collectors, the supervisor can divide the various totals on the form by the number of collectors performing the work and determine the average dollars collected for any one of those actions. This type of information can be used when preparing a business case to demonstrate what can be achieved and justify, for example, requests for additional staff.

Figure 10.6. Sample production report

Analysis of Production														
Collected or Closed By (date) Name of Collector ------- - -														
Tax Type	Demand / Notice		Installment/ Arrangement		Remission / Hardship		Garnish-ment		Other Enforcement		Write-offs		Total	
	#	$	#	$	#	#	#	$	#	$	#	$	#	$
Tax 1														
Tax 2														
Tax 3														
Tax 4														
Total														
Analysis	Pre-enforcement						Enforcement				Administrative			

Write-off and remission production report: This report provides an analysis of write-offs and remissions. The intention again is to determine how many accounts are written off and/or remitted and their reasons during a reporting period. This type of report is usually required by a Ministry of Finance since most Financial Administration Acts contain a disclosure requirement.

Figure 10.7. Sample write-off report

Summary of Accounts "Written off" as "Uncollectible"										
Uncollectible	Tax 1		Tax 2		Tax 3		Tax 4		Total	
	#	$(000)	#	$(000)	#	$(000)	#	$(000)	#	$(000)
Debtor is deceased										
Debtor is no longer resident										
Debtor cannot be located										
Debtor is incapable of paying debt (indigent)										
Debtor is bankrupt										
Debtor is an inoperative/ wound-up corporation										
Cost of collections not justified										
Total										

Figure 10.8. Sample remission report

Summary of Accounts 'Remitted'								
Reason for Remission	Tax 1		Tax 2		Tax 3		Total	
Description	#	$(000)	#	$(000)	#	$(000)	#	$(000)
Financial Hardship								
Tax Administration Delay/Error								
Extraordinary Circumstances – Natural Disasters								
Extraordinary Circumstances – Accident /Illness/Death								
Extraordinary Circumstances- Civil Disturbances								
Extraordinary Circumstances - Other								
Total								

Accurate management reports similar to the above are usually the core reports for managing a debt arrears program. The sooner a tax administration can identify changes in noncompliance, the faster it can respond. Frequent and accurate reports can assist with identifying emerging revenue risks, identify internal problems, and provide management and the government advance warning to coordinate and develop an appropriate response, if necessary.

10.1.4. Tax Collection – An Organization

In order to efficiently utilize the powers provided in the tax law to collect tax arrears, an organizational framework is necessary. Most tax administrations are organized along functional lines.[202] In addition to

[202] The organization of the tax administration is discussed in Chapter 4.

organizing along functional lines, another recent trend is to further organize the tax administration by taxpayer size (small, medium, large).

In designing and staffing collection divisions, there are variables that affect the design and number of employees that are required including:

- Anticipated workload per employee;
- Number of taxes to be collected;
- Level of automation;
- Reliability and integrity of account information;
- Legal framework (separate and differing provisions for each tax versus a tax code);
- Supporting infrastructure;
- Cost;
- General level of taxpayer compliance; and
- Additional duties assigned to the division.

In addition to debt collection, some countries have given collection divisions responsibility for the identification of non-filers (those who should be registered for tax purposes but have failed to do so); stop-filers (those who are registered but have failed to file returns); account balance inquiries; error resolution for tax returns identified with errors during data entry; and taxpayer registration. As a result, there is no uniformity to point to when it comes to the design and indicative staffing numbers, as illustrated in the table below.

Figure 10.9. Staffing of enforced collections in the OECD[203]

Country	Total staff usage in 2007 (FTEs), or year end employees /1	Enforced debt collection and related functions	Percent of total
	#	#	%
Australia	20,877	2,620	12.5
Austria	7,993	853	10.7
Belgium	17,322	2,194	12.7
Canada	36,717	7,375	20.1
Czech Rep.	14,679	973	6.6
Denmark	8,026	908	11.3
Finland /2	5,913	276	4.7
Germany	111,988	12,000	10.7
Greece	12,566	-	-
Hungary	13,567	2,367	17.4
Iceland /2	78	-	-
Ireland /2	6,656	333	5.0
Italy /2	54,619	-	-
Japan /2	56,159	8,043	14.3

[203] Adapted from OECD (January 2009), p. 92.

Country	Total staff usage in 2007 (FTEs), or year end employees /1	Enforced debt collection and related functions	Percent of total
Korea /2	17,179	824	4.8
Mexico /2	21,119	6,031	28.6
Netherlands /2	25,500	1,000	3.9
N. Zealand /2	5,944	583	9.8
Norway	5,849	377	6.5
Portugal /2	11,463	1,852	16.2
Slovak Rep.	5,144	323	6.3
Spain	27,153	4,452	16.4
Sweden /2	8,650	350	4.0
Switzerland	935	65	7.0
Turkey	41,525	11,112	26.8
UK /2	88,934	6,706	7.5
USA	92,017	31,793	34.5

/1. The data on distribution of resources should be treated with caution owing to differences in interpretation between countries on the functional split described and organizational arrangements in place.

/2. **Australia**—provision of written advice, marketing, education, Australian Valuation Office and others; **Finland** – Customs is not included; **Germany**—Taxpayer account management functions are included in audits and verification functions; **Iceland**—number of staff only in headquarter; **Ireland**—Figures for Staff numbers are the average for 2007, and include all serving staff who are paid for a particular period. Figures include temporary staff.; **Italy**—data for Revenue Agency and 1/3 staffs of GDF, not including outsourced debt collection function; **Japan**—inseparable from the audit, investigation and other verification function and debt collection function; **Korea**—staff in taxpayer account management and verification functions are also engaged in the work of debt collection; **Mexico**—Number of staff as of December 31st, 2007; **Netherlands**—data exclude customs and benefit division; **New Zealand**—includes components of non-tax functions that can't be isolated; **Portugal**—number of year-end employees; **Spain**—includes 3,644 staff in Customs; **Sweden**—data exclude EA staffs (around 1,850) which carries out enforced tax debt collection functions; **UK**—data includes Customs.

Nevertheless, the appendices of Chapter 4 draw on international leading practice to devise a typical structure for the collection division of functionally organized small/medium and large tax administrations. As discussed in Chapter 4, the staff of the administration's headquarters should provide planning, support, and normative guidance for all field operations, but should not actually carry out operations (should not deal directly with taxpayers). The principal role of the collections staff of district/field offices is to execute the annual collections work plans developed by the collections headquarters office. Appendix 10.A of this chapter expands on the information provided in Chapter 4 and provides additional detail on the roles and responsibilities of the typical sections in the collection division.

Effectively managing tax accounts in arrears is a shared responsibility between management and the collections staff. Both have specific responsibilities. Management must ensure that accounts are reviewed and analyzed and that accounts are properly allocated. Management must also ensure that collectors are properly trained and have a good understanding of the organization, policy, and procedures.

Collections staff must ensure that all parts of the collection process are carried out with professional and judicious care. They must ensure that they plan, organize, and act on their accounts in a timely manner.

The specific roles and responsibilities of each staff member in the processing of accounts are summarized below.

All collections staff should not only be knowledgeable about the law, policy, and procedures in collections, but should also have an understanding of the tax administration's organization. This will enable the collector to better assist any taxpayer not only in resolving their tax debt, but also in other tax issues. Collectors should be trained on recovery legislation, policy, and procedures and should also have exposure to information from and about other work areas that impact collection activities. General organization knowledge will assist the collector in directing the taxpayer to the right source for further resolution of their tax matters.

Collector

Some tax administrations may differentiate collection responsibilities by the complexity and knowledge required to perform some of the actions required in collecting debts. This provides a career path within the collections organization. They may, for example, have a senior or complex collector(s) that deals with bankruptcy, seizure, receiverships, and other situations that can require specialized knowledge. Routine collection cases may include arrangements to pay, garnishment, and liens, while a clerical level position may include routine telephone contacts. Other administrations do not necessarily divide work in this manner, and collectors are expected to follow through with a case, once assigned, from start to completion.

Most of the procedures related to conducting an investigation, preparing an investigation summary, communicating with the taxpayer, and enforcing the collections provisions of the law are the responsibility of the collector. The collector is the primary person responsible for collecting arrears on any account by following approved processes and procedures and documenting the information required. Often, the collector is also the one serving documents and generally being at the frontline of relations with the taxpayer. The collector is responsible for being aware of all policies and procedures and for keeping up to date with any changes. The collector's responsibilities are:

- Reviewing assigned accounts on a daily basis and ensuring that accounts in danger of loss are given priority;
- Reviewing all information on the file and/or other tax files, if information is lacking in the collections file, when first assigned a new account. All applicable information about the taxpayer's location, sources of income, and assets should be in the IT system. In the absence of appropriate IT support, a manually completed form that provides a "snapshot" of the taxpayer's finances and other basic information should be completed;
- Requesting information from the taxpayer or third parties, when the collector determines that he/she needs this information. This information will be obtained by telephone, letters, demands, visits to other government offices, and/or field calls to the taxpayer's premises;
- Ensuring that all compliance actions have been reviewed, such as whether all returns have been filed, whether additional tax will be owed, or whether the client cooperated in any previous collection arrangement;

- Determining the taxpayer's ability to pay or borrow;
- Developing an action plan to collect the debt, once all the above information has been reviewed and analyzed; and
- Putting the collections steps in place, after all recommendations are approved by the supervisor, and ensuring that there is an effective "bring forward" system in place to follow up on all actions.

Collectors need to have a general understanding of how the collection processes fit in the context of a self-assessment system and with the general organization where they work. For the collector, this means having knowledge about the components of tax debt, such as the types of taxes, penalty and interest, and the impact of refunds and credits on the debt owed, as well as how the taxpayer account works on the IT system and how non-compliant taxpayers are identified.

An understanding of the compliance process – encouraging taxpayers to file returns and enforcing collections through a progressive series of steps – also helps the collector in determining how this impacts on collections. Taxpayers who do not file returns often do not pay taxes. This can reinforce why enforcement procedures are required and how they ensure that the self-assessment system works across programs.

The collector must have an understanding of various financial records, including financial statements, accounting records, various sub ledgers, bank records, etc. A collector cannot confirm a taxpayer's financial position without being able to adequately review these documents. The tax administration should encourage collectors as much as possible to take courses and get other training in furthering their understanding of accounting and business practices. This understanding is critical for the collector to calculate a taxpayer's ability to pay or borrow and to identify what assets could be attached[204] or seized and sold to cover an outstanding debt.

Supervisor

The supervisor is responsible for managing subordinate staff and their workload. The supervisor is concerned with work quality and is required to ensure that the staff receives any necessary training. Depending on the size of the office, this position may also be responsible for ensuring that procedures are kept updated and in electronic format.

The supervisor is also responsible for ensuring that the collection workload is properly managed on a regular basis by:

- Reviewing all new accounts and allocating them on a risk basis, assigning the riskiest accounts (e.g., the largest and oldest) to the most experienced collectors;
- Assigning accounts to collectors;

[204] An "attachment" in this context is usually the process, by which a property is transferred to the tax administration or sold for the benefit of the tax administration, by a court order. The term "attachment" can also mean simply a "lien" or a "seizure" depending on the jurisdiction.

- Reviewing accounts regularly for quality;
- Coaching and/or training collectors on new or changed procedures;
- Tracking and reviewing production and ending inventory on a regular basis;
- Consulting with IT staff on the validity of information required for the management reports;
- Consulting with other work areas if their programs impact on collections; and
- Regularly discussing program results with senior management and staff.

Senior Manager

The senior manager may be responsible for a number of collection teams and should ensure that the procedures are kept updated and regular management reports are prepared. The senior manager is usually also responsible for workload management and for good communication with the IT staff so that various reports and taxpayer information are available. The senior manager is responsible for:

- Ensuring collections policies and procedures are in writing, kept up to date, and are readily available to all staff;
- Ensuring that forms are consistent with the legislation and with the standards of the tax administration, public forms are available on the website, and internal forms are available on the tax administration's internal system;
- Reviewing management reports monthly with the supervisor and making operational decisions for improvement;
- Validating information regularly with the supervisor and IT; and
- Ensuring that supervisors perform their duties.

Notification Procedures

There are certain actions that should be completed before an account is referred to a collector for follow-up and possible enforcement. The extent of these actions depends on the type and size of the account, but, in all cases, the taxpayer should be notified of pending actions. The number of possible statements or notices can include the following:

Notice of Assessment: In the general scheme of modern tax laws, with the exception of VAT and PAYE, which are trust funds, all taxpayers should initially receive a notice of assessment as soon as a tax return has been filed and assessed. For most tax administrations, this will be a computerized notice provided to the taxpayer that confirms:

- The amount of tax assessed and whether there was any change in the amount;
- Any tax owed;
- When payment is expected (i.e., payment is requested for the balance); and
- Whether penalty and/or interest have been or will be charged.

First Reminder: Depending on the administrative policy and available resources, a collection letter or reminder should be sent within 30 to 90 days after the notice of assessment to advise the taxpayer of the amount outstanding that is due. This should be done automatically by the IT system. To allow the tax administration to address large-risk accounts first, this reminder should also be risk-based. For example, if the account is of small value and risk, the reminder may be sent within 60-90 days. If the amount owed is very small, a notice may not be sent until 90 days after the notice of assessment. If the amount is large, both a reminder should be sent and the account should be referred to a collector for follow-up.

Subsequent Notices: Subsequent to the above, if payment has not been received, there may be other notices or demands for payment. These could include a warning outlining the provisions of the law. In most countries, established collection policy requires that a tax debtor be given legal warning (by letter or by telephone contact, etc.) before legal action may begin. This warning ensures that the taxpayer is being treated as fairly as the circumstance allows and that the taxpayer has been made fully aware of the actions than can occur during collection. Depending on the size of the debt and the risk, the delivery of this notice may be accelerated. For example, for a large taxpayer covered by the large taxpayer office (LTO), the policy may require sending the notice within 15 to 30 days and also immediately referring the case to a collector.

In the general scheme of progressive and escalating actions, before an account is sent to a collector, there is an attempt to secure the missing return(s) and payment of the associated tax. In larger tax administrations, this activity is normally conducted by a special unit dedicated to getting taxpayers to file and pay outstanding current tax.[205]

Reviewing Books and Records

Collectors will often have to review a taxpayer's financial books and records to confirm a number of issues. These can include:

- An analysis of ability to pay or borrow sufficient money to pay the tax debt, support a longer-term payment arrangement, or possibly to confirm hardship when remission is requested; and/or
- A review of bank records and the accounts receivable of a business for the purposes of determining where a garnishment can be sent or collection enforcement action can be taken.

As much as possible the collector should obtain all the financial information that is necessary from the taxpayer to be able to determine the ability of the taxpayer to pay or borrow. Information about assets is important, as it allows the collector to determine the amount of equity a taxpayer has and how much could conceivably be recovered, if seized and sold. The liabilities note who the other creditors are and

[205] Taxpayers are required to submit a return for each tax reporting period (month, quarter, or year). A taxpayer who submitted returns in the past, but did not submit one in the current period, becomes a "stop-filer" for the current period. Stop-filer procedures are discussed in Chapter 7. In general, the tax administration (a tax compliance officer in the collections division or other divisions responsible for stop-filers) will attempt to obtain a return from stop-filers through notices, telephone calls, etc. If a return or sufficient information to determine liability cannot be obtained, the account is referred to an auditor, who will attempt to estimate the amount of tax arrears a "best of judgment" assessment.

their potential priority, but can also indicate how rapidly unpaid amounts are increasing, which affects the ability to pay the tax debt. The income sources are carefully noted for potential garnishment. The comparison of the assets and liabilities can also help establish a taxpayer's net worth for purposes of calculating "ability to pay" and estimating the taxpayer's ability to borrow. Financial information about assets, liabilities, sources of income, principal customers, etc., should be extracted to a standardized form that is applicable to all tax arrears collection cases.

At times the taxpayer will not cooperate, and it becomes necessary to contact the taxpayer's financial institution directly to obtain information. A financial institution has a responsibility to keep its clients' affairs confidential or it can be subject to legal action from its clients. Financial institutions usually do not respond to informal requests for information from a collector. However, tax laws should contain a provision to issue a legal demand to third parties for information.

Personal Security

The personal security of the collector is always a concern. Collectors must always be cautious and look for any indication of the taxpayer's past attitude and or behavior, such as whether the taxpayer has been cooperative, or whether there is a history of avoidance or confrontation. If the file indicates any past problem, two collectors should be assigned to a field visit. The collector should also:

- Discuss any concern about safety with the supervisor before meeting with a taxpayer;
- Schedule meetings during business hours and not in the evening;
- Make sure someone in the office knows his or her whereabouts;
- Take another tax officer to any meeting if either the location or person is considered high risk; and
- Carry a fully charged cell phone before leaving for a meeting.

In the extreme event that a taxpayer abuses, threatens, or assaults a collector, the collector should take the following actions, in the priority order shown below:

- Immediately vacate the premises;
- Seek medical attention, if necessary, and call the police[206] if in danger;
- Report the incident to the supervisor and/or a security officer so that the appropriate action can be undertaken by the tax administration as soon as possible; and
- Record the circumstances in the taxpayer's file.

This will allow any other tax officer assigned to the file to be aware of the potential danger and to plan and act accordingly in any dealings with that taxpayer. The collector should describe the events and refrain from injecting any personal feelings about the taxpayer.

[206] Most tax laws contain provisions where the police are required to assist if there is an indication of confrontation.

Time Limitations

The ability to take collection action should have time limitations set by the law, during which certain actions can be done. This means that a collection action must have been started within a specified time limit, which can range anywhere from 4 to 6 years, depending on the specifics of the legislation, usually after the date of the notice of assessment and, in some cases, from the date the tax first became payable. An aged accounts receivable report is critical to ensure that these time limitations do not bar a collection action.

Objections and Appeals

The tax acts will usually have provisions that allow a taxpayer to object to or appeal an assessment, reassessment, or an administrative process, such as garnishment.[207] Often, the legislative provisions will direct the tax administration not to take any action on the amount in dispute. In some jurisdictions, the taxpayer may be required to post security for amounts that are unpaid and objected until the objection is resolved. However, in the majority of countries, security is not required and no action may be taken to collect disputed amounts once the notice of objection or appeal has been filed.

It is important to note that accounts under objection or appeal are usually large, and the collections organization needs to review these accounts on a regular basis. If there is any indication that the taxpayer's financial circumstances are significantly deteriorating, the collector needs to determine whether any jeopardy collection action should be considered and whether it can be accomplished under the legal framework.

10.1.5. Payment Arrangements

Collection cases are created when taxpayers fail to meet their payment obligations. The addition of penalty and interest to the debt owed creates an incentive for taxpayers to find funding to pay their tax arrears, including by obtaining a loan from a financial institution. In some cases, however, a taxpayer cannot find the funds to make an immediate payment. While the task of the tax administration is to obtain immediate payment in full without creating undue hardship for the taxpayer, this is not always possible and a payment arrangement proposal can be considered. Tax administrations will usually have the latitude to negotiate a payment arrangement that allows the taxpayer to pay a tax debt without causing unnecessary financial hardship, provided there is not a danger of default on the arrangement and the taxpayer's continued compliance is not a concern. The arrangement is a written agreement between the taxpayer and the tax administration to pay the tax debt over a specified period of time. The taxpayer's ability to pay is determined by a review of such factors as income, expenses, and capacity to borrow at a commercial lender.

Most tax laws do not make specific reference to payment arrangements. Arrangements are a matter of administrative policy and are an action to facilitate the taxpayer in paying their tax liability over a period of time. Any arrangement will be based on the circumstances of the particular situation of each

[207] Objections and appeals are discussed in Chapter 10.

taxpayer. The process of reviewing and/or accepting a payment arrangement proposal by the tax administration is similar to a bank providing a loan to a client. Like a bank, the tax administration has the responsibility to obtain all the financial information necessary to enable an "informed" decision on whether or not to extend a payment arrangement, as they are in effect lending the taxpayer money. Before granting a payment arrangement, the taxpayer should be expected to demonstrate that a loan from a financial institution to clear the outstanding taxes has been turned down.

The acceptability of a payment proposal is normally based on the taxpayer's ability to pay. If the taxpayer has the ability to pay in full, the taxpayer should be requested to do so. Where this is not possible, an arrangement which pays off the entire outstanding debt in the shortest time possible and at the least cost to the tax administration may be considered. The least cost consideration also requires the taxpayer to pay the established monthly amounts without any unnecessary intervention or follow-up by tax administration staff.

The arrangement should be aimed at paying the entire outstanding debt in the shortest time possible. An arrangement to pay does not normally stop interest from accruing on the outstanding balance and requires the taxpayer to remain current with all future tax returns.

Arrangements Shorter than Six Months

In some jurisdictions, payment arrangements can be established shortly after the tax has been assessed. Often, when there has been a large audit assessment, the amount cannot be paid in a single payment and the taxpayer will ask for a payment arrangement. If a proposed arrangement will pay off the outstanding debt within a few months (e.g., six months) or before the filing due date for the next return, then it may be eligible for approval under administrative policy without a review of the taxpayer's finances.

Commonly, the proposal must also meet the following conditions:

- There is no prior history of payment non-compliance;
- There is no evidence to suggest that the tax administration's interests are at risk by accepting the proposal (i.e., there is no danger of loss);
- The amount of the debt is not large (depending on the historic levels of income on the individual's account and tax authority guidelines); and/or
- The proposal is not a balloon payment arrangement (i.e., the largest payment being the last in a series of payments).

Acceptance of proposals for individual income tax accounts is established for the sake of practicality, recognizing that the individual has accepted the responsibility to pay in a reasonable period of time.

Arrangements Longer than Six Months

When considering the acceptability of a proposal over six months, generally:

- Any negotiation starts with the tax administration asking for payment in full of all arrears;
- Any proposed payment terms accurately reflect the taxpayer's ability to pay or borrow;
- The taxpayer is requested to file any outstanding returns;
- The full arrears – interest, penalty, and taxes – are included in the arrangement;
- Where possible, a down payment is taken into consideration;
- Where electronically possible, direct debit is considered;
- The maximum repayment amount and the minimum repayment period are sought; and
- Current taxes are paid at all times.

Where arrangements extend over a period of time, the tax administration's IT system should be able to calculate the expected monthly payments, record the receipt of payments, and flag those payments that do not match the required monthly payment or are not received on a timely basis. Whether the system is electronic or manual, the tax administration must follow up immediately when a taxpayer defaults on an arrangement. Often, the situation can be rectified and payments can continue. Where this is not the case, the collector must again review the case to determine the course of action.

The IT system should also assist in preparing management reports that show the effectiveness of the payment arrangement process. The data should include the following:

- Arrangement start and end dates determine the efficiency of time to collect the debt;
- The number of arrangements accepted and broken indicate how effective the arrangements are; and
- Comparing the total amount collected under a payment arrangement to the total taxes collected in any period confirms the percentage of debt collected in this manner.

During the agreement the taxpayer may request minor variation(s) in the payment schedule. For example, due to cash flow difficulties, the taxpayer might ask that a payment be delayed a few days until money is in the account, or that a particular payment be reduced, with the balance paid at a later date. A decision to agree to this variance will depend on the individual circumstances of the case. Minor variations are generally acceptable if the arrangement has otherwise been working satisfactorily and the debt is continuing to decrease.

10.1.6. Sequencing Collection Enforcement Actions

The general approach to collections enforcement is a series of steps that are taken after attempts at getting the taxpayer to voluntarily pay have not yielded results. The usual steps that are most often followed in order are:

- Offset of any refunds due;
- Garnishment on bank accounts or wages;
- Issuance of demands on accounts receivable;
- Court action for seizure of assets:
    - Movable property, and

  - Immovable property;
- Notice of public auction;
- Auction or redemption of property;
- Disposition of proceeds[208]; and
- Write-off of uncollectible amounts.

10.1.7. Offsets

Most tax administrations will set up a process with the central financial government agency to "set-off" a government payment to a tax debtor and pay the amount instead to the tax administration. An internal set-off form will usually contain the following information:

- The correct name, address, and account number of the taxpayer, where the correct name is the legally registered name of the taxpayer. Although the trade name may also be indicated, usually preceded by "Known as" or "Trading as," it is important to correctly indicate the legal name; otherwise, the offset may be invalid. The address of the taxpayer is where the head office is located. This address should be the complete address as known to the tax administration;
- The correct amount of tax owed;
- The name of the government department and account from which the money is being set-off; and
- The discharge of the original liability of the government department to the taxpayer.

In all cases where a set-off is made, the taxpayer must be informed. This varies from sending the taxpayer a letter to using a multi-purpose set-off form that can also serve as a notice to the taxpayer.

In some countries, such as the United States, federal law[209] indicates how a tax refund payment will be applied when a taxpayer has debts with multiple agencies. The tax refund payment will be reduced and applied to a taxpayer's debts in the following order of priority:

- IRS income tax liabilities;
- Past-due child support assigned to a state;
- Any past-due, legally enforceable debt owed to a federal agency;
- Past-due child support not assigned to a state; and
- State tax liabilities.

In other countries, the law may not be as clear, but there are workaround solutions. The taxpayer may be requested to sign an assignment of the refund, or other payment to the tax administration, authorizing the offset. Alternatively, garnishment may be sent internally to the Ministry of Finance, if there is a central payment function, or to the other government agency directly, if it is a decentralized system.

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[208] If money remains after tax, penalties, interest, and costs, such as storage, security, etc., this amount is returned to the taxpayer.
[209] Payment priorities are mandated by Title 26, U.S. Code §6402(e).

10.1.8. Garnishment

Garnishment is an administrative process requiring a third party, who owes money to a tax debtor, to instead pay the money to satisfy a tax debt to the tax administration. The third party is served with a garnishment[210] to pay funds to the tax administration. For simplicity, the term 'garnishment' is used here and below. Terms used in other jurisdictions include lien, third-party demand, offset, and/or judgment. In exercising the power to garnish a payment, reasonable care (due diligence) must be exercised to avoid harm to other persons or property.

Most tax laws make provision for garnishment proceedings where all efforts have been made to collect unpaid taxes voluntarily but the tax debtor has not complied or cooperated. The power to use garnishment is usually vested with the head of the tax administration, and it may be a delegated authority in some countries where subordinate staff can be authorized to exercise this authority.

Garnishment provides the legal ability of the tax administration to intercept funds a third party owes or will owe to a non-compliant tax debtor and to pay that money toward the tax debt. The provision will indemnify the third party so that they will no longer owe the tax debtor to the extent of the money that was paid to the tax administration. In the event that the third party does not cooperate, the provision will usually make the third party liable for the debt. The third party has a responsibility to pay over to the tax administration what would have been owed to the tax debtor. In some cases, the third party will not cooperate and the collector must determine the reason. Where the third party is purposefully not cooperating, most tax legislation provides a penalty that requires the tax administration to assess the third party for the amount, and the assessment becomes collectible as though it was tax owed by the third party. This assessment can then be collected using all the collection powers in the tax law.

A properly prepared and timely garnishment is one of the most important and effective tools in the tax collection process. A garnishment can be either a legal document issued by the court to collect debts from judgment debtors, or, in some countries, it can be issued directly by the tax administration without the necessity of using the court. A garnishment issued by the tax administration has the same legal authority and effect as a court issued garnishment order or judgment.

The decision to use a garnishment must be carefully considered since the existence of a garnishment should not be public information. Other creditors could interpret the garnishment as financial difficulty, making it difficult for the taxpayer to borrow money to pay their tax arrears or to continue to operate their business.

The garnishment of third party funds is an involuntary act, meaning it does not require tax debtor approval. The collector must ensure that a number of factors have been investigated, considered, and adequately documented. Improper processing of the garnishment can result in embarrassment to the tax debtor and/or the tax administration.

[210] Garnishment is the form used to attach to funds held by a third party (the garnishee) a requirement to pay the tax administration.

All of the above steps must be documented in either electronic and/or paper format to support the execution of a garnishment. If the file cannot prove that these points have been investigated, the request for a garnishment should not be approved.[211] Full documentation is an integral part of the process and in most jurisdictions, where a court must issue a garnishment, proof of process is required. The same level of proof should be required where the tax administration itself has the ability to issue a garnishment.

Salaries, bank accounts and various investment incomes, cash value of insurance policies, rental income, accounts receivables of a business, government payments, and any other payment determined to be owing to the tax debtor may all be garnished. There may be different procedures that would apply to the different sources of income, and the collector must be aware of these. The collector must ensure that no more than the amount of the debt is garnished from these sources, as collecting excessive amounts can lead to investigations of abuse of power.

Some income sources, such as alimony or pensions, must be carefully reviewed as they may cause distress if garnished, and they may also be legally out of bounds. The tax debtors and the courts may object if the tax administration is overly zealous with this power.

Garnishment Process

To properly complete the garnishment process, collectors must ensure that:

- The correct amount of debt due and payable has been established and no other taxes, for which the tax administration is responsible, are also in arrears – it will be necessary to coordinate efforts with another collector, where different collectors are assigned to other taxes;
- There are no payment arrangements in place;
- The ability to pay has been determined, the tax debtor is not bankrupt and the taxpayer's financial condition, i.e., analysis of ability to pay, has been investigated and reviewed, should the garnishment involve the interception of wages or periodic payments from other sources. Where a tax debtor is a business, the collector has visited the business premises of the taxpayer to determine the severity of the financial problem first-hand. (The outcome of this visit will determine whether other actions in addition to garnishment may be warranted);
- Audit has been contacted to confirm if there is any audit in progress that could alter the taxpayer's liability and the account is not under appeal or objection that would affect part or the entire outstanding amount that is being prepared for garnishment;
- The appropriate legal amount of time, within which to pay the debt, has been provided;
- Most importantly, all voluntary collections efforts have been exhausted, all information has been investigated, and a log of action, organized in chronological order, of steps taken from the

[211] Collectors at journeyman-level or above (i.e., those who have completed all training, have had two or more years of field experience, and have been certified by their supervisors as being able to operate independently) should be delegated written authority to execute garnishments under their own signatures. This, of course, depends on the level of potential publicity. In smaller countries, approvals may be needed even from the head of the tax administration, since the potential publicity could be nationwide.

inception of the debt to the request for garnishment has been completed, an account report has been prepared by the collector and reviewed for quality by the supervisor;

- All actions to locate the tax debtor, assets, and/or income have been carefully documented so the correct source can be garnished;
- The tax debtor has been notified at appropriate times and all notices to advise the tax debtor and or representatives have been mailed or otherwise delivered to the correct addresses of last standing;
- The garnishment forms have been carefully prepared by the collector and then signed by the delegated authority or processed by the court, as may be applicable;
- The garnishment form has been properly served;
- Follow-up procedures for receipt of the payment have been set up;
- Non-compliant third parties have been addressed;
- The garnishment form has been withdrawn as appropriate; and
- Management has reported on the number and dollar value of accounts garnished.

It is important to note that a lack of case preparation and documentation that all steps have been exhausted to get the tax debtor to pay voluntarily is often a cause for governments to suspend or place further restrictions on this power. Evidence to support previously undertaken collection efforts is an absolute necessity, as well as confirmation that the amount is legally collectible. In confirming facts, it is necessary that a record of telephone conversations is kept which, at a minimum, records the date, time, person spoken to, and details of the conversation.

Some tax administration IT systems have the ability to record the various steps in a 'collection log' or diary. Information is entered on the collection log each time there is contact with the tax debtor (e.g., returned notices or other documents that indicate the tax debtor is not responding and/or cooperating are also indicated in the log). In the absence of a computerized recording of the actions taken, a manual log listing actions in chronological order is necessary. In more sophisticated systems the actual telephone conversation can be recorded and recalled as part of the collection log.

In jurisdictions where a judgment must be obtained in court before the garnishment can be issued, the court may request to review the evidence or supporting documentation. The continuity of possession of original documentation becomes critical in the event an action is later challenged in court. It is therefore important that original documents are secure.[212] Often, the court will accept copies of the original documentation provided that the copies are certified as true copies of the original documents. In some jurisdictions, this may require an amendment to the evidence provisions of the applicable tax law. By producing copies of documents for court examination, continuity of possession of the original documentation is retained with the tax administration. Retention of the original file by the tax administration should, at least in theory, also reduce the risk that a file can become inadvertently lost while not in their possession.

[212] It is important that tax administrations review the security measures for tax files. Where continuity of possession can be challenged due to lax access procedures for tax files, a taxpayer may be successful in an appeal against a garnishment.

Current and up-to-date information on the source of funds to be garnished is critical. Incorrect information can cause a garnishment form to be sent to a third party and cause the inappropriate disclosure of tax debtor information. The collector should obtain correct information as follows:

- **Wages and employment:** These are usually the best source for tax debtors who are employees. The exact name and address of the employer must be obtained.
- **Bank accounts:** The collector must ensure that the correct bank and/or account type and/or account number have been obtained. Banks will often reject a form if any information is incorrect. The use of garnishment on a bank is the best and quickest source of obtaining money. If the taxpayer has funds in the bank at the time the garnishment is served, then the bank must pay the funds demanded by the garnishment and must treat the garnishment as a claim for money at the moment it is served. The bank may claim to honor a competing claim when the garnishment is served, as other checks or withdrawals, or claim an offset against a loan that the bank may have with the taxpayer. The tax collector must ensure that the bank does not impose its own internal rules to circumvent the purpose of the garnishment. The collector must follow up with the bank if it fails to remit the funds that were on deposit in the taxpayer's account at the time the garnishment was served.
- **Rental income:** The name and address of the individual and/or corporation paying rent to the tax debtor must be confirmed.
- **Government payments:** The exact name and address of the employer and/or department or ministry issuing the payment should be confirmed. The collector must know which agency is responsible for payment and whether an internal form or offset process has been established;
- **Accounts receivable:** Tax collectors must be particularly careful when issuing garnishment on this source of funds. Collectors must establish the amount due at the time of service of the garnishment and obtain a commitment from the "payer" when the funds demanded by the garnishee will be paid. When reviewing the accounts receivable, it is important to select only "quality" receivables that are current. Garnishment issued on receivables that are old or in dispute is unlikely to result in success. Furthermore, the tax administration is put in the position of attempting to collect amounts that the tax debtor may have been already having a problem collecting.
- **Prepaid accounts with supplier:** If the tax debtor is a business, the collector should establish if any such accounts exist with suppliers.

The garnishment can take many forms, but, most importantly, it should contain the legal information from the tax act and accurate information about the tax debtor and third party, including:

- The correct name, address, and account number of the tax debtor. As with offsets, trade names may be indicated in addition to the legally registered name;
- The correct amount of tax owed;
- The name of the third party and address. Every effort should be made to determine the legal name of the third party, although the trade name may also be cited. Otherwise, the

garnishment could be invalidated. Where the third party is also a taxpayer, the tax file should be referenced to determine the correct name;

- Declaration of agency[213] of the third party, if the act calls for this;
- The time frame within which to pay and a due date which does not fall on a date or dates when banks or other financial institutions do not operate;
- The discharge of the original liability of the third party's debt to the tax debtor; and
- Liability of the third party, if payment is not made.

Garnishment is normally personally served. In some tax administrations, there is a staff member who is dedicated to serving documents (i.e., bailiff). In others, this is the responsibility of the collector. Prior to serving the garnishment, information concerning the tax administration's action should be treated as confidential since a leak of information may cause the tax debtor and/or third party to take actions to put the funds out of reach of the tax administration. If a tax debtor becomes aware that garnishment action may be taken, funds may be removed from their bank accounts and deposited in institutions outside the country, or they may assign rental payments or accounts receivables elsewhere.

Serving a third party demand to pay is a legal process, and it is important that the service of the garnishment be properly executed and that the person serving the demand be able to recall the event, should this come into question in a court case. The following steps are necessary to ensure that the garnishment remains valid if challenged in the courts:

- The person serving the garnishment should have identification as an employee of the tax administration.
- The garnishment can only be served on the person to whom it is directed. The collector must establish that the person being served is a "legal" representative of the business being served. Ideally, the person being served should be the owner, officer of the company, or other senior employee. The garnishment should not be served to a clerk, assistant, etc.
- The person(s) being served must understand what is required and the implications and seriousness of non-compliance. The collector must emphasize that the garnishment must be complied with by the specified date.
- No extension for compliance should be granted under any circumstances.
- Should the person wish to comply immediately, they must be given the opportunity.
- The due date for a garnishment should not fall on a Saturday, Sunday, or legal holiday.
- The garnishment form should provide room for the third party to sign receipt on the day, month, and year served and for the signature of the collector serving the garnishment.
- If the person being served refuses to sign the receipt, the collector should put a notation on the tax administration copy to this effect and note the person's name and time of service.
- When service of the garnishment has been completed, or as soon as reasonably possible, the collector should complete a report, since the collector may be called upon to testify in court. The report should be factual, complete, and include the following: a physical description of the

[213] Any declaration that the third party is an "agent" for someone else (a "principal").

person served; the date, time, and exact location of the service; the degree of cooperation of the persons served; and a summary of any verbal communication.

- Depending on the jurisdiction, the collector may also be required to complete an Affidavit of Service – a notarized and signed testimony with the time, date, manner of service, identity of the person served, and other information.

Upon returning to the office, the collector should ensure that a receipted signed copy of the garnishment is securely filed and that the garnishment details are entered in a log for follow-up action. The day following the service of the garnishment form, the collector should contact the third party to determine when payment will be received.

In those cases where garnishment is issued to employers or sources that will result in payments over a period of time, there should be an internal system, preferably electronic, which calculates the expected periodic payments, records the receipt of payments, and flags those payments which do not match the required payment or are not received on a timely basis.

Sample Legal Provision for Garnishment

The section of the tax law that allows for demanding payment from third parties should include provisions that:

- Give the head of the tax administration the authority to demand payment;
- Allow the head of the tax authority to declare or identify a third party as an agent or representative of the tax debtor;
- Demand that the third party pay to the tax administration the amount that it currently owes or will owe to the tax debtor;
- Specify a time frame within which the third party will pay the amount required;
- Identify the types of funds which could be garnished;
- Indemnify the third party from any legal action by the tax debtor for not paying the amount to the latter;
- Allow the tax administration to state to the third party the name of the tax debtor and the amount owed by the tax debtor, including the rate of interest thereon;
- Require the third party to continue to pay until the amount due from the tax debtor is satisfied; and
- Make the third party liable for the amount, if for some reason they do not pay as demanded.

10.1.9. Liens

A lien is an encumbrance on property, which can include real and personal property and rights to property, to secure a debt the property owner owes to the person placing the lien. A judgment lien issued by a court can affect all real and personal property of a person who fails to pay a debt. A lien can carry with it the right of the creditor to sell property, if necessary, to obtain the money.[214]

The use of liens to obtain settlement is not widely understood in some tax administrations.[215] Where a tax debtor has not paid outstanding tax debts, the tax administration may either administratively, or through the courts, register a lien in the appropriate government registry or registries on all property, whether movable or immovable, belonging to the tax debtor. The amount of the lien would include the outstanding tax and any interest and/or penalty, together with any other cost that may accrue. This is normally done after all other efforts to collect, including garnishment, have failed to secure settlement. The lien is usually taken before, or in anticipation of, a seizure and sale of property[216] and should generally remain in force until the tax debt is paid. In many cases, the act of placing a lien on property is sufficient to motivate the taxpayer into finding a way to settle the debt rather than having the tax administration seize and sell the property.

Where the tax law provides specific recovery legislation to file a lien, the collector will be expected to follow the steps of the law. Where there is no specific lien provision in the tax law, a process must be determined with the Attorney/Solicitor General so that the general provision of suing for a debt through any court of competent jurisdiction can be used. In this case, it would be necessary to obtain a judgment lien against the property from the court.

Similar to garnishment, the decision to file a tax lien must be carefully considered, as with the lien the taxpayer may not be able to borrow the funds with which to pay the delinquent tax liability or to continue to run the business. The intention of the lien is to encourage the taxpayer to settle the tax debt – it is a warning that further action to settle the debt is possible. The last resort is to actually seize and sell property, since this is a time consuming process and not without problems.

When a lien is registered on an immovable property, this lien becomes a public document that is available to anyone searching the property title. Some tax laws may give the tax administration priority over other creditors. Filing a lien is protection for the government's existing claim for the amount of the tax debt, but the collector must first ensure that all efforts have been made to collect the debt voluntarily and that all investigations have been completed before recommending the placement of a lien. The recommendation will be reviewed by the supervisor for quality of investigation, particularly of the assets and/or property owned by the tax debtor. The supervisor will also review the quality of the report, which will then be approved by the person with the delegated authority under the tax law to place a lien. A lien is a legal document and the forms must be reviewed for accuracy.

The basic content of a lien is similar to garnishment: it properly identifies the taxpayer, the outstanding liability, the property involved, and the government's authority for making the claim. The taxpayer's name should agree with that shown on the tax records, whereas the property identification should be

[214] A mortgage is also a lien. It allows the creditor to sell the mortgaged property, if mortgage payments are not made.
[215] A "lien" is largely a common law construct.
[216] A lien is a claim on the property that would usually prevent the taxpayer from selling the property him or herself.

the legal description and should, in the case of vehicles, boats, aircraft, and equipment, contain serial number(s). Deficiencies in documentation can lead to it being invalid.

The lien should, where possible, be against all taxpayer property or, at a minimum, placed on those title registers identifying property with a significant value. In some jurisdictions, the tax law can make the directors of a company jointly and severally liable for the tax debts of the company. It may also allow for liens against principle residences, which is useful in the case of a proprietorship and partnership. Normally a tax administration will not act on the lien on a principle residence, and there may be a debtor's law that prevents seizing a place of residence, but the existence of a lien may be sufficient warning to encourage the taxpayer to resolve the tax debt.

A taxpayer should have the right to appeal the filing of a lien. This would be an administrative procedure intended to correct erroneous filings, but not to challenge the validity of the underlying tax liability. Once the tax debt has been paid, or an appeal has established that it was incorrectly filed, it is incumbent on the tax administration to remove the lien as quickly as possible.

Sample Legal Provision for Liens

The legislation should contain provisions for the circumstances and creation of the lien, such as:

- The lien shall arise from the failure of the taxpayer to pay a debt by the due date;
- The lien shall be for the amount of tax liability, penalties, interest, and the cost of collection and shall take precedence over the claims of other creditors;
- The head of the tax administration should authorize the lien and have it placed in the approved government registrar and/or court registry;
- The administrative lien should have the same force as a judgment lien delivered by the court;
- The length of time the lien will stay in existence should be specified (e.g., "until the liability is satisfied");
- Any limitations should be laid out (e.g., the lien is not valid against anyone who has had a legal interest in any property before the lien was realized);
- The head of the tax administration should be required to serve a copy of the lien to the tax debtor within a stipulated time frame (e.g., 10 calendar days), and the lien should specify the time for the tax debtor to pay and have the notice removed;
- The fact that an affected person may appeal the imposition of the lien and/or apply for a release should be indicated; and
- Regulations should be developed for the filing of the notice of lien and may prescribe categories of interests against which the lien shall or shall not be valid.

Where there is no specific legislation on liens, the tax administration would usually have a provision allowing it to sue for any debt in any court of competent jurisdiction.

10.1.10. Seizure and Sale of Property

Seizure and sale of a tax debtor's asset(s) is a last resort effort in the process of escalating measures that a tax administration would use to collect a debt. It should only be used after all other efforts to collect, including garnishment and/or liens, have failed. As always, the case history must be well documented with all actions that have been taken in order to show the justification for seizing a taxpayer's assets. The decision to seize must be based on the specific facts and circumstances of each case, and the collector must follow all legal and procedural guidelines.

The seized property is sold to cover the outstanding tax, interest, and/or penalty, together with any other costs incurred by the tax administration that may have accrued, such as storage charges, maintenance, etc. In many cases, seizing a tax debtor's property will cause the taxpayer to settle the debt before the sale commences. A tax debtor should be given every opportunity to settle right up to the time before the auction begins, since the intent is to achieve a settlement rather than being in the business of selling seized property. Once the property is sold, any excess from the sale will be returned to the tax debtor.

Prior to the seizure, the collector will review the case thoroughly with the supervisor. This review provides a means of ensuring that all reasonable efforts have been made to collect the delinquent taxes before initiating seizure. The supervisor should review the entire file to ensure the quality of investigation, particularly of the assets and/or property owned by the tax debtor, and preparation of reports.

It is important to carefully research all the assets of the tax debtor and ensure that there is sufficient equity to cover the outstanding tax, penalty, interest, and the estimated other costs incurred to sell the property. A seizure should not be made if the estimated expense of the seizure and sale is more than the forced sale value of the property to be seized.

Seizing perishable goods is normally not recommended as they quickly depreciate. In many jurisdictions, a person's principle residence cannot be seized, or the legal hurdles due to other laws make it extremely difficult. In addition, most countries have specific prohibitions against seizing certain assets, such as a workman's tools and specified personal possessions.

Where the supervisor agrees with seizure, since this process has the potential to seriously damage an individual's financial abilities and may cause loss of employment, the collector would normally inform the tax debtor of the impending action and provide another opportunity to settle (in the case of property that cannot be easily moved and hidden). If there is no settlement, all paperwork, including notices of levy and/or warrants to bailiffs or other officers of the court or the tax administration to seize and sell property and/or notices of seizure and sale, are then prepared. The entire file would then be forwarded to the head of the tax administration (or other person with the delegated authority) for final approval to seize the taxpayer's property.

The seizure is a two part process. It consists, first, of a levy on the property and, second, its subsequent actual seizure of the property. This is a legal process that removes property from the possession and use of a taxpayer and it requires documentation to prove that the decision to seize property can be legally defended if challenged in the courts. As this process can have legal repercussions, the file should be reviewed by legal counsel to ensure that all forms are properly completed. Other tax administrations may have slightly different processes, but the final approval to proceed is usually with the head of the tax administration or a delegated person or group of persons. As an additional check, there is usually another review of the documents to ensure that they are correct.

The intention of seizing a taxpayer's property is to create a situation where the tax debtor will expedite efforts to resolve the outstanding tax debt. In many cases, tax debtors are able to find sufficient funds, whether from previously undetected sources, family members, or business associates, to pay the tax debt. Should the tax debtor not react, the tax administration must be prepared to sell the property.

Once the taxpayer's property has been secured, the next step in the process is to provide public notice. Public notice may include the Government Gazette or posting at the Court House, newspapers, websites, etc. to ensure that the public has the opportunity to purchase the property.

It is also critical that current and up-to-date information be available on the property owned by the tax debtor. Incorrect information can cause the seizure action to be "unenforceable" or returned "nulla bona" (no property found). The collector must determine title to the property, the book and/or potential market value, any encumbrances or liabilities, and the correct address where the property is situated and/or held. Property can include:

- Business chattels (e.g., furnishings, equipment, inventory, livestock, computer equipment);
- Exclusive rights (e.g., copyrights, patents, exploration rights);
- Licenses and/or permits (e.g., fishing rights, timber license, taxi license);
- Personal property (e.g., works of art, jewelry, antique furniture, cars, boats, recreation vehicles);
- Cash, guaranteed investment certificates, notes receivable, mortgages, bonds, safety deposit box contents, bank accounts.
- Real estate, including building and/or land, interest in property, leases, personal residence;
- Business/company;
- Joint interests/interest in partnerships; and
- Trusts.

Levy

A levy is an administrative document issued by the tax administration advising the tax debtor and other parties that the tax administration has a right to seize any property and rights to property belonging to the tax debtor. The levy can take many forms, but most importantly, it should contain the legal information from the act authorizing the administration to carry out the act of levying and accurate information about the tax debtor and debt. Where possible, the levy and other documents should be personally served.

Delegation of Authority

Most tax laws provide the head of the tax administration[217] the authority to issue:

- Levies, which publicly advise that the tax debtor has not paid their debt and actions will be taken to seize property;
- Warrants to an authorized party, such as a designated collection staff member, an outside party, such as a bailiff, or another person to seize and sell goods and other property, usually by public auction;
- Notices of seizure, which will advise that the property has been seized and will then be sold by public auction;
- Notices of sale, which advise interested parties of the properties which have been seized and can be bought; and
- Notices of release, which will only be issued if the taxpayer pays the debt in full with secured funds.

Seizure of Moveable Property

If moveable property is to be seized, arrangements must be made ahead of time for secure storage. Depending on the circumstances, the tax administration may make the following arrangements:

- Obtain its own premises to store and secure goods;
- Arrange with other departments, such as Customs, a government warehouse, the bailiff, local police, or an auctioning firm for the temporary storage of goods;
- Arrange to keep property secure;
- Mark and tag property appropriately; and
- Arrange if necessary, for towing, transportation, and/or refrigeration.

Goods under seizure are usually required to be kept for a certain number of days, either at the premises at which the seizure was levied or at such place as considered appropriate, at the cost of the taxpayer from whom the goods were seized. Thirty days would be appropriate and would allow sufficient time to advertise the sale and for the taxpayer to redeem the goods under seizure. The legislation (either in the act or regulations) may also stipulate when the seizure takes place, usually during daytime hours, and who should accompany the "authorized person," usually a member of the police force. It may advise whether a property can be broken into. It will also advise the collector on his or her rights and/or obligations should the tax debtor or other person become confrontational.

[217] As stated in Chapter 4, in the most successful tax administrations, tax officials in headquarters offices, regional offices, and district/field offices are given sufficient authority by law and delegated by the head of the tax administration to make and carry out technical and administrative decisions with a high level of independence, while being held fully accountable for their organization's performance. Modern functional tax administrations rely heavily on a system of cascading delegations of authority.

If goods are to be seized, then a list should be prepared ahead of time. If this is not possible a form similar to an inventory sheet should be taken and then completed as items are taken. The taxpayer would be asked to sign the document, if present. A copy would be provided to the taxpayer. This information would be included in the notice of seizure. The taxpayer is entitled to a copy of the notice of seizure at the earliest possible time. In all cases, the description should include the legal information, including address, type of structure, and approximate size of structure. The intended usage and other information, if useful, can also be included. The same description should be included in the notice of sale.

At the end of the seizure process, the tax debtor should be advised as to the next steps, such as storage and/or sale of property. The taxpayer should also be advised of their rights, including that they can address their concerns to the court for a judicial review of the process.[218] Where possible, the taxpayer should be provided with a written statement to this effect.

The notice of sale should be issued within the number of days required by the law or regulations, and any deviation from the stipulated time should be documented in the collection file.

At the beginning of the public auction, the collector or an authorized person will advise all present of the details of the information as stated in the levy, warrant, and/or seizure documents. All other costs (e.g., bailiff fees, advertisement cost, and other incidental costs of sale) are also made clear and included in the disclosure.

The items being sold should be offered "as is" and "where is" without recourse against the tax administration, with no guaranty or warranty, expressed or implied, as to the validity of title, quality, quantity, size, weight, or condition of any of the property or its fitness for any use or purpose.

The proceeds of the sale are first applied towards the cost of taking, keeping, and selling the goods and chattels under seizure, including fees for a sheriff or bailiff, and then towards the tax, penalty, and interest, with any remaining proceeds paid to the taxpayer from whom the goods were seized. The seizure process continues until the liability for the tax debt is satisfied or becomes unenforceable for other reasons. However, if the debt is paid, a notice of release should be prepared and provided to the taxpayer.

Sample Legal Provision for Seizure and Sale

The following are example provisions of tax recovery legislation dealing with the seizure of property:

- Reference throughout would be to "property," as it encompasses both movable (goods and chattel) and immovable property (e.g., real estate);
- The legislation would allow the tax administration to administratively carry out a seizure. The head of the tax administration would be able to levy on the property of the taxpayer rather than

[218] That is, the taxpayer is able to claim irregularities in the processes, but not challenge the right of the tax administration to seize, store and sell the property.

going to court to obtain a judgment. The levy would have the same force as a court issued judgment;

- By issuing a warrant, the head of the tax administration shall direct an "authorized person" to carry out the seizure. An authorized person may be designated staff within the tax administration or an arrangement with an external bailiff or sheriff or other authorized body who would carry out the seizure.
- The warrant would have the same force as a court issued judgment;
- Reference should be made to the circumstances leading to the seizure (e.g., failure of the tax debtor to pay a debt by the due date);
- If the tax debtor does not pay the debt within a stipulated time frame, the property would be seized to be sold by public auction, and a notice of seizure would be issued and published in the Gazette or other public notice that may be stipulated;
- Every sale would be held at such time and place as the head of the tax administration would direct, and notice of the sale would be published in the Gazette and/or other public places;
- Any excess from the sale would be returned to the taxpayer;
- The taxes and any other costs to carry out the seizure and sale would be charged to the tax debtor;
- The head of the tax administration would be required to serve a copy of the warrant, levy, or any other notice referred to in the provisions to the tax debtor within a stipulated time frame, which would also provide time for the tax debtor to pay and have the notice removed. This would be applicable at all stages, except when the final sale is made;
- An affected person may appeal the process within a given period of time; and
- Regulations should be developed for the filing of each levy, warrant, and/or notice. The regulations may also stipulate other parts of the process that need more detail than the tax law provides (e.g., who accompanies the "authorized officer" during the seizure and how it is carried out).

Where there is no specific legislation on seizures, the tax administration will usually have a provision allowing it to sue for any debt in a court of competent jurisdiction. The process would then be carried out through the court as is allowed any other creditor.

10.1.11. Other Tax Collection Powers

There are extreme circumstances where tax administrations may need legal counsel in order to resolve tax debts. For example, where taxpayers are trying to leave the county without paying their debts or where taxpayers are trying to make themselves judgment-proof and avoid paying their taxes. In these cases, tax collectors would work with counsel to prepare statements of facts, risk analyses, affidavits, and other briefs for counsel to be able to make an "ex-parte" application[219] in court to get remedies that may not be available under the tax legislation.

[219] An application made by one party to a proceeding in the absence of the other party.

Legal Counsel

Some cases may be time sensitive if the taxpayer is taking steps to put assets out of the reach of the tax administration and legislation is either limited or restrictive. Collection officers and management must work more closely with their legal counsel in order to be able to effectively recover delinquent taxes. This requires experienced collection staff and management to be aware of the following:

- The relationship with legal counsel;
- Those provisions that require involvement of counsel;
- Recovering taxes from tax debtors leaving the country;
- Recovering taxes in jeopardy situations;
- Other legal means; and
- Management reporting of these cases.

For the purpose of this discussion, and depending on the jurisdiction, counsel may be lawyers or solicitors in a Ministry of Justice, Legal Affairs, the Attorney or Solicitor General's Office, or, in some countries, lawyers or solicitors hired under contract. In the exercise of the authority to place garnishment, levy, seizure, etc., it may be possible for the tax administration not to utilize the services of counsel. However, it is advisable to use counsel, at least initially, when determining the process and forms. Cases of jeopardy are usually not handled without the use of counsel, as the normal provisions of the law, including the taxpayer's right of an appeal, are typically suspended.

Most tax laws provide for the treatment of a tax debt as a debt due to the government and it can be pursued in a court of competent jurisdiction. There can be circumstances where the only means to collect is through the court. For example, a collections organization may not have legal powers to directly place liens, instead requiring that legal counsel go to court and obtain a judgment and/or order that allows the placement of a lien. In other situations, a tax debtor may be trying to make herself/himself judgment-proof by selling or transferring assets, or even by fleeing the country. This situation is normally provided for in tax law as a "jeopardy" provision. This may require counsel taking the case to court and having liens placed against assets or immediately seizing assets.

Evidence

For any case to be successful in court, collectors must understand what evidence means in a legal context and how to obtain and preserve evidence so it is acceptable for court purposes. 'Evidence' is any species of proof, or probative matter, legally presented at the trial of an issue by the act of the parties and through the medium of witnesses, records, documents, exhibits, concrete objects, etc., for the purpose of inducing belief in the minds of the court or jury as to their contention.

Collectors, as part of their normal routine, gather evidence to support any legal enforcement action that may be taken. There can be circumstances when the tax legislation does not provide an avenue to collect, but legal counsel may suggest, based on precedence or remedies available to creditors at large, that a legal action in court for recovery of tax debt is possible. Collectors must then be aware of the more stringent requirements of evidence for purposes of presentation in the courts. A collector may require evidence to prove that:

- All legal enforcement avenues have been taken and no further payment was received;
- The tax debtor has assets for which others are nominees[220];
- There is a danger of loss to the government; and/or
- There is no other tax legislation that allows an option to seize and/or sell these assets.

Assistance from Legal Counsel in Jeopardy Cases

Most frequently, counsel will assist in two common jeopardy collections circumstances: (1) where taxpayers are trying to leave the country without paying; and (2) where they are attempting to liquidate assets or make themselves judgment-proof, and time is of the essence to avoid a danger of loss.

In the context of tax collection, "jeopardy" is synonymous with a loss anticipated to take place if collection action is delayed. If assets, from which to collect, have already been liquidated or removed, the loss has already occurred and the account would not meet the concept of "jeopardy." However, if an investigation reveals assets that may be used to effect collections, and if any collection restrictions under the tax acts may impede the ability to collect the account immediately, regardless of the taxpayer's intent, the tax administration may consider the need for jeopardy collection action and apply to the court for assistance.

Taxpayer Flight

Most tax legislation will account for situations where the tax administration suspects or believes that a taxpayer has left or is about to leave the country. In these cases, before the day otherwise fixed for payment, the head of the tax administration may issue a written notice, usually served personally to the taxpayer, to demand payment of the amount of all taxes, interest, and penalties for which the taxpayer is or would be liable if the time for payment had arrived. The amount is usually expected to be paid "forthwith" by the taxpayer.

Generally, where it is suspected that a taxpayer is about to flee the country, the collector would first gather evidence and prepare a report requesting legal assistance and approval for a notice to be delivered to the taxpayer, requiring payment of the tax debt. It is time sensitive for legal counsel to review the case and help with any steps to be taken after the notice is served.

Although legislation refers only to circumstances when a taxpayer may be leaving or fleeing the country, the actions described are a form of jeopardy collection action. They allow the tax administration to act without being restricted by usual time frames for collection action. These provisions vary depending on the jurisdiction. In some jurisdictions, the taxpayer may be able to post security for any tax, interest, or penalties demanded under this section. In some jurisdictions, legislation may make reference to the

[220] A "nominee" is someone who is given limited authority to act on behalf of the owner.

denial of an exit certificate[221] as the remedy for non-payment of tax. However, the difficulty in administering this certificate requirement, and the challenges to exit certificates within the court system, often does not make this a viable solution. Sometimes legislation will instead advise that, if the payment is not made, action will be taken to collect immediately, usually through the court, and direction may be given to seize and sell without regard to the usual time frames stipulated in the legislation. Where the tax administration has concerns about how collection can be effected and the legislation does not provide clear direction, legal counsel can help clarify the situation.

Some indicators that a tax debtor is in the process of leaving the country and not intending to pay the tax debt may include:

- The tax debtor's home is sold or being sold, sometimes below market value;
- Other assets are or have been liquidated or transferred (often in non-arm's length transactions to nominees);
- Assets have been purchased secretly in other countries;
- The tax debtor is dealing with a financial institution located in another country with respect to loans and investments;
- Substantial monetary amounts are being transferred out of country;
- The taxpayer's children are or will going to school in another country;
- The tax debtor indicates a reluctance to resolve issues pertaining to present or future tax liabilities;
- Substantial income amounts have not been reported; and/or
- There has been a request for exit/clearance certificates.

If information is available that the taxpayer has income or assets which can be attached, the collector should immediately prepare garnishment and warrants or levies for seizing any property or chattels.

Jeopardy Cases of Placing Assets beyond Jurisdictions

Normally, collectors would attempt to use the legislation "as is" to collect tax debts and follow the general provisions for levy and seizure. However, if there is the potential that a taxpayer is listing a large property and the rules for seizure and sale have time requirements for giving notice, such that the property could be sold and funds transferred beyond reach before the tax administration can take action, then it may be possible to use the jeopardy provision. An alternative would be to have legal counsel use the regular court system and rules to stop the transaction or have the money redirected to the tax administration by proving danger of loss in a civil suit. Aspects of such a court order would be similar to a "Mareva Injunction," which would stop a tax debtor from dissipating his or her assets. The Mareva injunction, known also as a freezing order, Mareva order, or Mareva regime in Commonwealth jurisdictions, is a court order which freezes assets so that a defendant to an action cannot dissipate their

[221] In Bangladesh a tax clearance certificate was required in 2003 to board an international flight. The desk was located after clearing security, but often the person responsible was on break or so occupied with the overwhelming crowd that travelers would walk past without reporting. Other times the administration of the requirement appeared to be arbitrary and certificates were randomly required at certain times or only for some flights.

assets[222] from beyond the jurisdiction of a court so as to frustrate a judgment. The Mareva injunction may be supported by legislation that states that all taxes, penalties, interest, costs, or other amounts payable under any act administered by the [head of tax administration] are debts due to the Government and recoverable as such in any court of competent jurisdiction or in any other manner provided by this Act.

Once an application has been granted and documents are served, it is important to only dispose of seized assets after confirmation that an appeal or judicial review is not pending. If jeopardy legislation exists, the taxpayer may be offered objections or appeal rights. If this is not available, the tax debtor will usually have the right to a judicial review.

Bankruptcy, Public Identification, and Imprisonment

In very rare cases, particularly where taxpayers have been blatant in their non-compliance and have shown that they will pay other creditors but ignore settling tax debts, consideration may be given to actions that are aimed at "embarrassing" the taxpayer and letting other taxpayers know that non-compliance will be addressed to the fullest extent of the law. This may entail putting a taxpayer into bankruptcy, publicly identifying the taxpayer, and imprisonment. If imprisonment is used, it should not be in lieu of settling the debt.

10.1.12. Non-Filer Identification

'Non-filers' are taxpayers who have tax liability, but are not registered with the tax administration and do not file tax returns. Sometimes, these people are not aware of their tax obligations. More often, they have made a conscious decision to remain outside of the tax regime. One of the biggest difficulties with most non-filers is that they are "hidden" and many, when identified, have poor books and records which makes the task of ascertaining the extent of their unreported income and sales in the case of VAT a time-consuming and expensive process for the tax administration. Even if tax, penalty, and interest are assessed, they may be difficult to collect, as many of these can be small, marginal operations that do not have sufficient funds to repay a large accumulation of arrears.

Box 10.1. Non-filers in the United States

In the United States, in a 2005 report,[223] the Inspector General for Tax Administration extrapolated from data to measure the tax gap and found that, in a three-year period from 1998 to 2001, the non-filer tax group grew by one third.

In California, it is estimated that 86 percent of persons voluntarily comply with filing their state income tax and 3 percent are discovered through compliance initiatives, which leaves a sizable 11 percent continuing to work in the underground economy.[224]

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[222] Dispose of, transfer, or otherwise use the assets not in the usual course of business or due to a "necessity of life."
[223] Internal Revenue Service (2005), p. 2.
[224] California Franchise Tax Board (2006), p. 4.

A recent OECD report[225] indicated that non-filers are an area that is not getting sufficient attention from tax administrations. One possible reason is that the number of persons participating in the underground economy is large, while the revenue to be gained from each successful identification of a new taxpayer is very small. Another problem with many tax administrations is that they have just as much difficulty retaining compliant taxpayers. Although identified, taxpayers can easily slip back into the underground, as the tax administration is slow to respond to non-compliance and may not have sufficient information on file to easily find a taxpayer again. This may the result of a business decision, since the costs of aggressively pursuing small taxpayers outweigh the revenue to be gained. Survey responses also revealed that many revenue bodies do not have a comprehensive strategy for addressing their respective underground economies, suggesting that this area of non-compliance may not be receiving adequate attention.

Approaches to Discovering Non-Filers

Prior to computerization, the discovery of non-filers was a manual operation that would generally consist of scouring trade directories, telephone books, newspaper advertisements, and even walking the streets to identify persons who should be registered and paying taxes. Most tax administrations now have progressed to, at a minimum, a "matching operation" between various databases. For example, the taxpayer registration database of the tax administration can be compared (matched) to the business registration database of, for example, the Ministry of Industry and Trade, to identify businesses that are registered with the Ministry but not with the tax administration. In addition, all OECD countries have communications programs aimed at raising awareness of the tax system and of the consequences of non-compliance. Additionally, all OECD countries have data matching programs which accumulate and match data from a variety of sources. The purpose of data matching is both to detect those that are not registered, as well as those taxpayers who are registered and file tax returns, but who have not fully reported their income, sales, etc.

The cost of obtaining any information must always be considered. Less costly but effective sources of information will be government departments or agencies which hold information of value in their databases. If confidentiality provisions or cost become issues, the tax administration should attempt to negotiate written agreements to receive and/or exchange information, if legally permitted. As much as possible, electronic means of receiving information should be sought, as any data entry would have a significant cost. Where information is only available in hard copy, scanning it into a usable form should be investigated.

Depending on the evolution of a particular tax administration and/or its privacy and confidentiality provisions, it may or may not be able to share information. A list of potential sources of information that can be used to assist the tax administration in locating non-filers, as well as stop-filers and tax debtors, is provided in Appendix 10.B.

[225] OECD (January 2012), p. 2.

Contacting Persons Identified as Possible Non-Filers

Making initial contact with the potential taxpayer by the most efficient and effective means available is preferred. In most cases, this will be the telephone, but it could be a letter that is mailed, faxed, or hand-delivered and in some jurisdictions an e-mail, requesting that the taxpayer come into the office for an appointment.

- If the taxpayer cannot be located, details of the efforts to locate the taxpayer should be recorded and forwarded to the group supervisor so that he can close the case on the automated or manual control log.
- If the taxpayer claims that he/she has registered, as much information as possible is gathered (registration name which may differ from "non-filer" name, date and place of registration, form of registration, etc.) and checked against the registration database. If the registration is located, the case is closed. If not, the collector must register the taxpayer and secure tax documents.
- If the taxpayer admits that he/she has not registered and cooperates with the collector in preparing and filing the appropriate documents, the collector documents the facts in the case file and forwards the closed case to the group manager.
- In some instances, the collector will find that the taxpayer's records are too complex or too extensive to prepare the required documents and must therefore refer the case to the audit division for handling. The collector would also refer cases to audit when the taxpayer refuses to cooperate and file their tax returns. In a very few instances, the collector will find strong indications of criminal behavior and, thus, should recommend that the case be referred to the investigations division for further examination.

10.1.13. Writing off Tax Debts

Most modern tax administrations have the authority to write off tax arrears that are considered to be uncollectible. This authority is essential to proper administration, as it frees resources from attempting to collect debts that have no reasonable possibility of being collected. It is also good accounting, as it removes uncollectible tax debts from the accounts of the tax administration, and it presents the government with a more accurate picture of the amount of arrears that have some potential for collection.

A write-off procedure for uncollectible accounts should be developed and agreed to by all, including the Ministry of Finance. An example of the process could be:

- Accounts are listed by type of tax, date, principle, penalty, interest, and the reason for being considered uncollectible;
- A committee of senior tax officials reviews the list to ensure the account is uncollectible;
- The list is submitted to the head of the tax administration for approval;
- The accounts are transferred in tax administration records as uncollectible, which removes them from the general listing of receivables;
- In the interest of transparency, the list is published in a newspaper; and

- The list is submitted to the Minister of Finance as a draft bill for Parliamentary approval.

It should be stressed that a write-off process does not extinguish the debt. While writing off a debt stops interest and penalties from accruing and removes the debt from the tax administration's accounts receivable, collection actions can resume if taxpayers and/or their estates are discovered to have funds or assets. For example, the tax debt can be returned to the active receivables, subject to any statutory limitations, if:

- The debtor has returned from abroad;
- The whereabouts of the debtor becomes known; or
- Previously unknown assets are discovered.

Tax administrations should develop a write-off policy which:

- Ensures that all reasonable steps have been taken and that no further recovery action is practicable;
- Clears debts from receivables where it is not considered practicable to pursue the tax debtor any further, so that the tax administration can continue to concentrate resources on collectible debts;
- Provides tax officers with clear parameters to identify accounts as candidates for write-off; and
- Creates a consistent and transparent process where tax debts may be written off.

At a minimum, tax administrations should annually review all tax debts which are not recoverable and those that are not considered cost-effective to collect. Where the tax debts are approved as being uncollectible, the tax administration should write off these accounts and place them in a suspense account on the revenue accounting system where interest and penalty cease to accrue and there is not any further collection action.

Uncollectible accounts for the government are the equivalent of "bad debts" for private sector businesses. The decision to write off a debt is a business decision that is justified by the facts of the case, which are properly documented. No amount should be written off where there is a reasonable prospect of recovery. It is the responsibility of the tax administration to conduct "due diligence" to ensure that all efforts have been made to collect the account. A report of these efforts is submitted for review to the appropriate level of authority in the tax administration and/or Ministry of Finance. It is the responsibility of the approving authority to ensure that the process and documentation satisfy scrutiny by a third party, such as the Accountant or Auditor General. As the decision to write off an account is an internal business decision, it is not communicated to the taxpayer.

A write-off should be considered only when the liability is no longer in dispute (e.g., the amount is not the subject of an appeal or objection). In some countries, a partial write-off (or "write-down") is permissible where full recovery of the account is not possible, but there remains a reasonable chance that a portion of the account will be collected.

The following is a non-exhaustive list of indicators of when the tax administration should consider a debt for potential write-off:

- The debtor is deceased;
- The debtor has moved abroad, or all efforts to trace him/her have been unsuccessful;
- The circumstance of a particular case makes recovery unreasonable (due to age, health, extraordinary hardship, or other matters beyond a taxpayer's control[226]);
- The debtor has been declared bankrupt;
- Taking recovery action would cost more than the outstanding debt;[227] or
- The debt is past the statute barred date.

Uncollectible cases should be coded so that the various reasons for write-off can be tracked to determine if there is a trend and what strategies could be developed to prevent or deal more effectively with some of the situations noted above.

Write-off Procedures

The general process for write-off would require that the tax administration:

- Identify an account for write-off;
- Complete all investigations;
- Prepare a write-off report documenting the above and recommending write-off, and
- Have the appropriate authorities review and approve it.

The write-off report should be initially reviewed and signed by the supervisor/manager. The number of additional signatures required for approval of the write-off usually depends on the amount of the debt. In all cases when a write-off is proposed, it should be reviewed and/or approved by the division head responsible for collections. The write-off file that is prepared should consist of the write-off report, along with supporting documentation that presents the efforts made to collect the debt. The write-off report requires documentary evidence to support:

- All appropriate notices to advise and notify the taxpayer and/or representatives have been mailed/delivered to the taxpayer's last known address;
- All actions to locate the taxpayer, assets, and/or income have been carefully documented;
- All analyses of ability to pay have been completed; and
- All possible legal actions have been taken, without success in obtaining payment.

[226] Cases involving extraordinary hardship due to age, sickness, and other factors beyond a taxpayer's control are usually considered for "remission," where the taxpayer has made such a request. In these cases, the requests are usually referred to the most senior level of the tax administration and/or Cabinet. These cases are reviewed on the basis of "justice" and not as an internal business decision. Once a decision has been made to approve remission, the debt is permanently extinguished.

[227] Normally, small value cases are considered uneconomical when they have been on the accounts receivable list for a few years and the cost of the salary of the officers handling the case exceeds the value of the debt.

Related or Multiple Taxes

Often, during the course of reviewing a file, there may be a number of related tax debts. In such cases, the responsibility for all related accounts should be with the collector who was first assigned the tax file with the largest debt. This collector will become responsible for all the files and for ensuring all actions have been taken on all the related accounts, and then writing the write-off report for each of the related files. If the collector does not have knowledge or experience with a particular tax – e.g., VAT or property tax – then the collector will be responsible for coordinating all actions. This will involve communicating with the collectors responsible for the specific tax, and having all investigations, reviews, and completion of the write-off report done at the same time. In addition to the tax debts, taxpayers often owe debts to other government departments (e.g., social taxes). Collectors should ensure that they have confirmed with the other departments what debts, if any, are outstanding and what efforts have been made by the latter to collect the debt. If the other department is writing off its debt, this should also be noted in the report.

In many countries a Write-off Review Committee is formed to ensure that the tax administration has appropriately carried out its "due diligence" in processing write-offs. The existence of the committee is intended to add another level of control to a process which has the potential to defer interminably the collections of an account. This committee will generally be comprised of three senior managers within the tax administration and, where possible, officials from the Ministry of Finance and/or the Accountant General’s Office. There should be a recording secretary, who is responsible for ensuring that all documents and files are properly handled and decisions are documented. The meeting should be convened at least once a year and an agenda distributed in advance that states the date, time, location, and participants attending the meeting. The agenda should also list the order that files will be reviewed and any procedural issues to be discussed.

10.2. Common Trends

Given the complexity of the collection process, the variety of enforcement instruments offered by laws, and the importance of this function in the compliance strategy of the tax administration, tax administrations around the world are attempting various alternatives for improvement. The following is a discussion of common trends.

10.2.1. Data Integrity

Many tax administrations encounter data integrity and reliability issues concerning the arrears balances on taxpayer accounts. Some of the problems can be attributed to data entry where tax returns and/or payments are posted to the wrong accounts, overrides are used to ignore error messages and incorrect information is posted to accounts, there are incorrect return dates, and there are taxpayer identification number transposition errors.[228] Other problems could be that a return was received and the taxpayer received a confirming receipt, but the tax administration cannot locate the return. Or, a hard copy of a

[228] Digits of the unique taxpayer identification number are switched.

return may be in the taxpayer file, but the return has not been posted to the tax account. Conversely, there may be a record on the tax account, but the hard copy cannot be located. In other instances, the entire taxpayer file may be missing. There can be similar problems with payments. Often, the recommendations of the collector will resolve many of these issues.

The above set of problems results in unreliable system balances for taxpayers, causing collections staff to spend considerable time verifying and correcting account balances before contacting taxpayers about their arrears. One relatively common solution is to verify the account balance with a special notice/statement that is sent to each taxpayer to verify or provide documentation to dispute the amount within a specified time. Usually, this process is managed by a collections unit, but would use a special audit program to deal with disputed amounts, with the goal of achieving a quick resolution. The audit would set the new account balance, if there is any change. The collections unit would be responsible for changing the account balance when the taxpayer produces documentary proof, for example, of payments made but not recorded in the computer system. Notices under this program should be sent out in manageable numbers so that the tax administration is not overwhelmed with disputed balances. The largest balances should be dealt with first. More importantly, to eliminate many of the above-cited problems, countries are rapidly implementing e-filing and e-payment.

10.2.2. Transfer of Tax Debt Liability

Some tax administrations have the authority, under defined circumstances, to transfer a tax liability from a tax debtor to a third party. For example, the tax administrations in the United States and Canada can hold directors of a business personally liable for failing to remit taxes that were collected from employees or customers, such as personal income tax (PAYE), social security contributions, and value-added taxes (VAT). Generally this transfer of liability applies to taxes that were collected as trust funds.

Similarly, some tax administrations can transfer a tax debt to a person (the transferee) who has a "non-arm’s length" relationship (e.g., a relative) with a tax debtor, in the event that the transferee receives property from the tax debtor at less than its fair market value or with the intention to defeat the collection of a tax.[229]

10.2.3. Initiatives for Potential Non-Filers

Data matching involves bringing together data from different sources and comparing or matching it and is a highly effective way to process large volumes of information in order to identify specific taxpayers for further action or investigation. Larger tax administrations have this in-house capability, but smaller administrations may be handicapped by budget constraints.

Center of Data Matching Expertise

One possible solution is for smaller countries to contribute to a center of expertise that is loaned on a rotating basis to countries in the group. There are, of course, many hurdles to this approach, such as

[229] This requires a strong rule of law and is not recommended for countries below the last level of maturity described below.

data confidentiality and cost sharing. However, if smaller countries cannot afford sufficient expertise, then variations of this resource sharing between countries may become a viable approach.

Targeted Data Matching

During targeted data matching, the tax administration would compare the tax administration's registration database to smaller datasets with very specific purpose, rather than the usual comprehensive databases of, for example, business registrations. For example, 'luxury motor vehicle registration' would be a pilot project to evaluate the use of luxury vehicle registration information from both Customs data and domestic vehicle registrations, matched against the personal income tax data base to identify non-filers. In its most simplistic form, stationing tax inspectors at busy intersections to note license plate information and run it later against the license database has been used successfully where the database cannot distinguish vehicle models and years or there are other difficulties. In some countries, working with police, the vehicles have been pulled over for immediate identification of the driver, which is then run against the personal income tax database.

Electronic filing of 'interest and dividend payments' is a requirement in many countries for withholding tax on interest and dividend payments made by trusts, partnerships, banks, and other financial institutions. Data matching this information against personal income tax data can quickly detect non-filers.

Countries have been successful in locating 'visible wealth' (high net worth individuals) by observing certain assets. The two easiest are luxury homes and expensive items, such as yachts and airplanes, but the list can also include airline tickets, especially those flying business class. Property registries are sometimes cumbersome for a computerized search for a variety of reasons. Some tax administrations have found it to be more efficient to actually walk the streets and note those homes that are relatively new and large. Then, they use a very rough proxy for estimating what amount of income it would take to own such a home and maintain that lifestyle. They would also search the records to find the legal owner and then determine if a tax return had been filed.

Box 10.2. Targeted data matching and other compliance activities in Italy

In Italy, it is estimated that there are about 2.5 million luxury cars, but, in 2009, less than two percent of Italy’s 41 million taxpayers declared annual income of more than the $260,000 which tax officials estimate is needed to maintain a lifestyle appropriate to owning a luxury car.

Also in Italy, the Tax Police patrols the marinas and search shipping registries to determine the ownership of the yacht or, even more directly, they board the yacht and speak to the crew or others on board to determine ownership. Nearly half of boats larger than 35 feet are registered to people who declare income of less than $26,000 a year, and 604 airplane owners declared annual income between $26,000 and $65,000.

Increased data matching

The U.S. IRS has shown that there is a high correlation between tax compliance and third-party information reporting. It is estimated[230] that individuals whose wages were subject to withholding reported 99 percent of their wages for tax purposes, while self-employed individuals are estimated to report only about 68 percent of their income, and self-employed individuals operating businesses on a cash basis report just 19 percent of their income. Interestingly, income that is not subject to third-party reporting is highest among taxpayers with the highest incomes.

Various countries require a form to be completed by payers who purchase goods and services (including non-employees for whom PAYE withholding does not apply), royalties, and health care in the course of their trade or business. This reporting requirement can apply to businesses, non-profit organizations, and all levels of government, but generally would not require personal payments to be reported, such as homeowners paying a contractor for renovation work.

Box 10.3. Data matching in the United States[231]

For example, the United States requires Form 1099-MISC, to be completed and submitted. For tax year 2006, more than five million payers submitted more than 82 million 1099-MISCs to IRS, reporting over $6 trillion in payments. Payers submitting fewer than 250 completed forms may submit paper versions, but they must meet IRS specification so that they are capable of being converted using IRS scanning equipment. All other payers must submit electronically.

Payees are responsible for reporting payments they received from payers. The IRS then uses an automated process to detect information mismatches between nonemployee compensation and other payments reported on 1099-MISCs and payees' income tax returns. When a return is not filed by a payee, an exception report will identify the non-compliant taxpayer.

For tax year 2004, the IRS used data matching to assess $972 million in additional taxes for payee underreporting that it detected using the above process. However, the IRS admitted that the program only pursued less than half the cases.

10.2.4. Tax Clearance Certificates

Tax clearance/compliance certificates are a feature of many tax administrations. The intent of the certificate is that taxpayers who are seeking public sector contracts or certain licenses, such as casino, Customs bonded warehouse, Customs broker, etc., are required to obtain a certificate from the tax administration. In order to obtain a certificate, the person must be registered as a taxpayer, all the tax affairs of the applicant must be current, or, if they are a tax debtor, there must be a valid payment arrangement to clear the debt. Some countries have extended the requirement for a certificate to importers of goods where, prior to release, the importer must have a valid certificate. Other countries require a certificate before a person is allowed to board an aircraft.

[230] Treasury Inspector General for Tax Administration (2006), p. 11.
[231] GAO (2009), p. 33.

The theory behind certificates as an enforcement tool is valid. However, the administration in many tax jurisdictions leaves a lot to be desired. It can be a slow tedious process taking many days even when a taxpayer is fully compliant. In the short-term, the denial of tax compliance certificates may be the most effective means of obtaining compliance from taxpayers who are non-filers or stop-filers as well as those who are tax debtors, but there are significant problems with the tax compliant certificate system in many countries. The rules can be opaque and open to the discretion of officials, and it can be a point of corruption, because tax certificates are often required urgently, allowing unscrupulous tax officials to take advantage.

The organizational structure of tax administrations has evolved mainly to a functional type organization. While this is a good structure, it does present some difficulties for the concept of single counter service when it comes to compliance certificates. Deciding whether a taxpayer is compliant in a functional organization necessitates involving the audit division, arrears collection division, returns and payments, and sometimes other separate sub-divisions within the tax administration. This can be a time-consuming process that is delayed if the responsible contact person in the division is not available.

Many tax administrations do not have adequate record systems. Physical files may not be up to date, or they may be signed out or been misplaced. In addition, the taxpayer account records on the computer system may be unreliable. In most cases, the computer system is unable to present a consolidated view across all taxes, with the result that the tax administration has to look up the taxpayer separately for each tax type to get a complete overview of compliance. This can be a time-consuming process.

In some situations, a "negative" list of non-compliant taxpayers may be useful. For example, where a taxpayer is known to be non-compliant, Customs should be informed that the taxpayer is not in possession of a compliance certificate, to ensure that the importer account is flagged and shipments are not inadvertently cleared. When Customs is informed that a taxpayer is non-compliant, a letter should be sent to the taxpayer notifying them and informing the taxpayer that Customs will require a compliance certificate to clear their shipments.

If a tax compliance certificate process is used, it should be modernized to reduce delays and minimize possible opportunities for corrupt practices. The operational target should be to process an application in 24 hours. Physical "certificates" should be abolished in favor of an electronic certificate or access to a secure database of valid certificates. In the case of importers, there should be a valid certificate computer file that the Customs clearance system references prior to releasing shipments. The approval system for certificates should be computerized, and an audit trail retained, to foster transparency and as an anti-corruption measure. In some cases, exceptions may be made where a taxpayer doesn’t fully qualify, but there must be a documentary trail retained that includes the rationale for the exception.

10.2.5. Tax Amnesties

Tax amnesties are discussed in many countries as a quick "fix" to a tax compliance problem and/or to provide additional revenue that the government perceives it would not otherwise have. Contrary to this perception, amnesties are neither a fix to the problem nor do they provide sustained revenue increases.

Although an amnesty can cause a brief revenue increase, the history of tax amnesties shows they are not likely to generate sustainable new revenue unless accompanied by implementing measures to strengthen the administration and other measures that address the reasons for the problem in the first place.

If the tax law provides the necessary legal framework, and there are well-structured administrative collection and enforcement policies that are, in fact, administered, then a tax amnesty should not be necessary. In this context, an amnesty would be an admission of failure in the ability to administer the tax system and an indication that some components of the tax administration and/or law are not functioning properly. Often, the reality is that tax administrations suffer from an inability to collect taxes after they have been assessed. Sometimes, the legal system works and the tax authority wins a judgment in court. However, the debt may remain uncollected due to an overburdened and cumbersome legal system, through which all cases, no matter how small, must navigate, usually getting lost at some point along the way.

Generally the motivation for the government is to raise revenue in the short run and simultaneously induce those individuals who did not previously pay taxes (non-filers) to register, or to induce the repatriation of capital that had fled the country. After the amnesty period expires, theory suggests that these newly "discovered" taxpayers would remain in the system and continue to pay taxes. Another possible objective of tax amnesties may be to start a new tax regime, such as introducing a major organizational change and maybe a new IT system that will improve the administration. The desire is to start these changes with new accounts that have zero balances owing.

A strong motivation in favor of an amnesty is the potential for a windfall revenue gain from collecting outstanding and evaded liabilities. Thus, part of the amnesty program may be an inducement offered to taxpayers to come forward by temporarily reducing or removing penalties on outstanding or evaded tax liabilities. This type of amnesty program is usually only effective in increasing compliance and, consequentially, tax revenue when it is accompanied by enhanced audit and collection enforcement that introduces a threat that the non-compliance will be discovered. Administratively, this offer must also be combined with permanent solutions that may include organizational and operational changes, combined with possible legal reforms aimed at addressing the compliance problems that created the debts in the first place. Experience has shown that the fundamental problem(s) that caused the amnesty are rarely addressed.

The windfall gain may to some extent only be an illusion. Depending on the terms of the amnesty, it may only be accelerating payments that would have been otherwise collected. The amnesty may actually be forfeiting interest or penalties that would have been collected on the debt had the amnesty not been in place. This usually occurs when the amnesty applies to taxpayers already under investigation for delinquency or evasion.

If taxpayers perceive that an amnesty is due to a weakness in the tax administration's ability and is likely to be repeated, then they have a strong incentive not to come forward. If they do come forward, it is only to pay some nominal portion of their larger tax bill, as they believe that the tax administration is weak and probably does not have the ability to check. In addition, since the taxpayers expect that the amnesty will be repeated, they can come forward but then disappear in the interim until the next amnesty. As a result, tax administrations also implement publicity campaigns stressing the post-amnesty enforcement program to convince taxpayers that may be wavering to come forward. Additionally, those that do come forward during an amnesty should not perceive that they will be targeted for closer scrutiny in the future. Instead, the message should be that, because they are now compliant, they will have the same audit probability as any other honest taxpayer.

Some amnesties provide a guarantee to taxpayers that they will not be audited, provided their tax payment increases by more than a specified percentage over the previous tax period. This type of measure is not without problems. Taxpayers with tax liabilities greater than the specified increase will likely reduce their tax payment to the minimum amount where they are guaranteed to escape an audit. If they are starting from a very low base of declared tax compared to their real liability, they could probably escape being audited for many years. Further, by repeatedly meeting the minimum required annual increase, they effectively preclude audits and protect these underpaid tax liabilities. In practice, this audit guarantee will also assist the tax administration since there probably are not sufficient trained audit resources (capacity) to conduct a larger enforcement program anyway. A recent example of this practice is the amnesty in Turkey where, if a taxpayer increases their income tax base by 30 percent in 2006, 25 percent in 2007, 20 percent in 2008, and 15 percent in 2009, they will be exempted from a tax inspection. In the case of VAT, the increase would be 3 percent in 2006, 2.5 percent in 2007, 2 percent in 2008, and 1.5 percent in 2009.

Another measure used in amnesty programs is a guarantee that a taxpayer's returns for previous tax periods will not be audited provided that the most recent return is correct (a "don't look back" policy). For the taxpayer to protect past underreporting, all future tax returns would have to be filed correctly, but, once again, the taxpayer must perceive that the risk of being audited will increase.

An amnesty may not only fail to address compliance problems, but may also be counter-productive, as honest taxpayers, who have faithfully paid their taxes on time, may resent the breaks given to tax debtors and evaders to the point where compliance suffers. The consequent loss in future revenue from non-compliance by those who were formerly compliant must be assessed against the potential for immediate revenue gains.

There are also negative implications that are internal to the tax administration. Both auditors and collectors can be demoralized, as the effort they put into investigations and collecting taxes could be viewed as a waste of their effort.

Amnesties can be structured and targeted to specific groups of non-compliant taxpayers. For example, an amnesty may only be applicable to individuals who are non-filers. In 2010, the U.K. announced the "Tax Health Plan" that would give doctors and dentists the opportunity to give full disclosure of any undisclosed tax liabilities and benefit from a fixed penalty of 10 percent. Those failing to take advantage of the scheme faced the risk of investigations, "naming and shaming," and stiff penalties. In Greece, subsequent to an amnesty, the authorities published the names of around 60 doctors who were accused of failing to settle their tax bills in their efforts to target this sector.[232]

From 2008 to 2011, there were at least 27 countries with amnesties, which are briefly described in Appendix 10.C. The amnesties ranged widely from a total exemption from penalty, interest, and prosecution, to only a waiver from prosecution. Despite their apparent growing adoption worldwide, the desirability of tax amnesty programs is often debated due to the difficulty in assessing their effectiveness. The rationale for introducing a tax amnesty usually has two objectives: (a) raising short-term net revenue, and (b) improving tax compliance so as to increase revenue over the medium term. The problem is assessing whether these two objectives have been achieved. Although revenues may have increased, other factors, beyond the forgiveness aspect of the amnesty, may have caused this change, such as the threat of a "name and shame" campaign, sharply increased penalties, and wider changes in the economy. While there may have been a change in compliance, it may have been caused by increased audits, harsher penalties, introducing e-filing and e-payment, etc.

If it is determined that there will be an amnesty, it is important that, if necessary, legal changes to strengthen the tax law be considered for implementation along with any announcement of an amnesty. In fact, most amnesties are accompanied by publicity campaigns emphasizing that tax enforcement is about to be toughened. In many countries, more than an announcement is needed, and the amnesty must be accompanied by specific new legal measures and a modern administrative process.

There are alternatives to an amnesty, such as granting administrative discretion to waive penalties. This approach has an effect that is similar to an amnesty, but, unless the conditions under which such discretion can be exercised are very carefully specified, opens up opportunities for corruption. For this reason, discretionary amnesties are best avoided, as they do not enhance equity.

10.2.6. Privatized Tax Collection

Privatized tax collection is when the government passes on its obligation to collect taxes to private companies, in return for a fixed or ad valorem fee. This contrasts with "tax farming," where a private individual or organization pays an amount to acquire a tax debt, and thus gives the government revenue certainty, and subsequently recoups that payment by collecting money from the people within a certain area or business.

Box 10.4. Privatized tax collection in the United States

> In 2006, the U.S. IRS outsourced the collection of taxpayers' debts to private debt collection agencies, which were being paid between 22 and 24 percent of the amount collected. Opponents to this objected, as the IRS would be handing over personal information to these agencies. Other concerns were that the incentive system to collect was perverse, as collectors would earn more on amounts collected, encouraging them to use pressure tactics to collect the maximum amount.

[232] Brabant (2010), para. 1.

> When the IRS dealt directly with taxpayers, it had governmental discretion to negotiate settlements with them, including the power to suspend or even cancel debts. The IRS recognized that this lack of governmental discretion was a problem with private contractors and the IRS attempted to only give them "easy" cases that it did not believe would require any discretion to resolve.
>
> Unfortunately, many cases were not as straightforward as they initially appeared, and it soon became clear that the resolution of most cases required some form of governmental discretion. Since the private collectors were paid on the basis of success, taxpayers were pressured into paying instead of being referred to the IRS where they could have received a more beneficial settlement. Although the concept of private collectors was a well-intentioned effort, abuses occurred and the program's inefficiency led to its termination in early 2009.

Private tax collection does have some advantages. First, it enables an administratively weak tax administration to offload some administrative costs by shifting them onto the private sector. Second, privatization presumably mitigates corruption opportunities at the collection point, as private collectors do not enjoy the same protection as civil servants and can be easily terminated more easily for poor performance or for taking bribes. As illustrated by the problems in the United States, a disadvantage is the risk of overzealous collection, which could result in a deterioration of taxpayer relations.

10.3. Tax Administration Maturity

Four levels of maturity of the collection function of tax administrations are presented below to help interested officials make determinations and identify strengths and weaknesses of their respective tax administrations.

Collections: Maturity Level 1

Key word: "Reactive"

- The collection function follows up outstanding amounts when advised of such amounts, but does not proactively identify delinquent taxpayers. There are no regularized stop-filer and non-filer programs, but only pursuit of late payers and non-payers in reaction to pressure on meeting revenue targets.
- Taxpayers are treated separately under each tax for purposes of debt collection, and the legal provisions are not coordinated (there is no offsetting of tax liabilities).
- The tax administration does not have a consistent approach for selecting cases for collection action. No debt is classified as non-collectible and proposed for write-off.
- Notices are paper based and sent by mail which may not be reliable. Notices require approval by high-level management and may be delayed or not sent.
- Notices that are mailed but returned as undeliverable are not systematically followed-up.
- There are no consistent procedures for collections (e.g., collection log) and no procedures for referring cases to audit or fraud investigations. Collection information is not used to initiate BoJ audits or for fraud investigation intelligence.

- Enforced collection tools (e.g., liens and seizures) are rarely used and usually would not be successful if the taxpayer challenged them in court, as there is insufficient documentation of past collection actions or there is too much discretion in procedures.
- New employees are subject only to informal on-the-job training on related legal requirements, such as the definition of delinquency, withholding requirements, and related penalties. There is minimal training on collection procedures or on complex collection issues, such as jeopardy cases or departure prevention. Existing employees are not provided refresher courses or other training.
- There is no automation of case selection and distribution of collection cases is discretionary by the supervisor.

Collections: Maturity Level 2

Key word: "Ad hoc"

- The collection function follows up outstanding amounts, but does not systematically identify delinquent taxpayers. Ad hoc stop-filer and non-filer programs are undertaken, but the focus remains on the pursuit of late payers and non-payers as a result of pressure on revenue targets.
- Taxpayers are treated separately under each tax for purposes of debt collection, and legal provisions are not coordinated (there is no offsetting of tax liabilities).
- The tax administration uses an ad hoc approach for selecting cases for collection action. No debt is classified as non-collectible and proposed for write-off.
- Notices are paper-based and generally sent by mail which may be unreliable, although the tax administration begins to research other channels for communication.
- There are some consistent procedures for collections (e.g., collection log), but no procedures for referring cases to audit or to fraud investigations. Collection information is not used to initiate BoJ audits or for fraud investigation intelligence.
- Enforced collection tools (e.g., liens and seizures) are used occasionally, but would have limited success if the taxpayer challenged them in court, as there is an insufficient documentation of past collection actions.
- New tax administration staff receive some formal course training and on-the-job training on collection procedures and related legal requirements, such as the definition of delinquency, withholding requirements, and related penalties. Existing staff are subject to occasional, but irregular, refresher courses. There is still no training on complex collection issues, such as jeopardy cases or departure prevention, bankruptcy, and payment arrangements.
- There is no automation in the selection and distribution of collection cases.

Collections: Maturity Level 3

Key word: "Systematic"

- The collection function follows up outstanding amounts although they may not use a risk-based approach and, on an ad hoc basis, identifies delinquent taxpayers, including stop-filer and non-filers. There is an identification of large taxpayers who are stop-filers, although it may not be systematic.

- Even with combined taxpayer accounts, taxpayers are treated separately under each tax for purposes of debt, as the collection provisions for each tax have not been harmonized (there are offsetting debits and credits with other taxes but no offsetting of tax liabilities with other government payments).
- The tax administration uses a systematic approach to identify existing taxpayer cases that are potentially easier to collect (not necessarily the ones that represent highest risk to revenue). Debt may be classified as non-collectible and submitted for write-off.
- The tax administration employs multiple channels to notify taxpayers of their outstanding tax obligations. Notices are somewhat automated.
- There are consistent procedures for collection (e.g., collection log), including for referring cases to fraud investigations and audit. Collection information is not used to initiate BoJ audits or for fraud investigation intelligence.
- Enforced collection tools (e.g., liens and seizures) are used when appropriate and are typically successful when challenged in court, because they are supported by sufficient documentation of past collection actions and there is limited discretion in procedures.
- New and existing tax administration staff are subject to formal course training and on-the-job training on collection procedures and related legal requirements, such as the definition of delinquency, withholding requirements, and related penalties, as part of their individual development plan and of a rigorous training curriculum. However, the curriculum and course content are not updated regularly. Training on complex collection issues, such as jeopardy cases or departure prevention, bankruptcy, and receiverships, is ad hoc and not a part of the curriculum, if it exists at all.
- There is no automation in the selection and distribution of collection cases.

Collections: Maturity Level 4

Key word: "Strategic"

- The collection function implements two distinct activities: 1) identifying delinquent taxpayers; and 2) following up outstanding amounts. Separate stop-filer and non-filer programs are an integral part of the collection function.
- The taxpayer is treated as a single entity for purposes of debt. Tax collection powers are harmonized if under separate laws for each tax, or there is a tax code that covers all taxes.
- A cost-benefit or "business" approach to collections is employed, and the tax administration considers potential yield before collection action. Non-collectible debt is classified and written-off.
- The tax administration employs multiple channels to notify taxpayers of their outstanding tax obligations. Notices are largely automated.

- A collection log with all collection actions is maintained, and collection cases are referred to audit and fraud investigations, when necessary. Information collected by the collection section is used to initiate BoJ audits and for fraud investigation intelligence.
- Enforced collection tools (e.g., garnishment, liens, and seizures) are used when appropriate and are typically successful when challenged in court, because they are supported by sufficient documentation and the application of consistent, transparent collection policies and procedures.
- New and existing tax administration staff are provided formal course training and on-the-job training on collection procedures, the use of software, basic accounting, and similar topics as part of their individual development plan and of a rigorous training curriculum. The curriculum and course content are updated regularly. The course curriculum addresses complex collection issues, such as departure prevention and jeopardy cases.
- Collection case selection and distribution (to collectors) is automated.

10.4. Latin America and the Caribbean

The general state of tax collection in the LAC region leaves room for considerable improvement, as evidenced by the large stock of tax arrears that are older than five years in most countries.[233] Although there has been considerable technical assistance within the region during the past few decades by various organizations, a well-functioning collections program requires a proper organizational structure, modern legislative provisions, an IT system that provides users with the necessary information, and modern management principles. In addition to these basics, the importance of an appropriate culture within the tax administration is often overlooked. In recent months, a comprehensive survey[234] of tax and customs administrations was conducted in a large sample of LAC countries. This study noted that a disproportionate share of human resources tends to be devoted to overhead activities, at the expense of providing an adequate number of trained collection staff. The other significant observation was that, on average, only 28 percent of tax liabilities assessed through audits are eventually collected. This poor collection performance was attributed to delays and other weaknesses in the judicial system, such as lack of specialized capacities, and inadequacies in the post-judicial enforcement processes. The survey noted that the stock of uncollected tax debts continues to grow, in some countries quite rapidly, and that resources are often wasted on futile efforts to collect old debts, rather than taking risk-based approaches and focusing on recent delinquencies. In addition, tax compliance and collection can be adversely affected by the difficulty taxpayers encounter in trying to pay their taxes. In this regard, concerning the ease of taxpayer compliance, the study reported that LAC countries do not fare well in comparison with countries in other regions.

LAC counties have looked to improve collection efforts with various strategies. Below are some illustrative, non-exhaustive examples:

[233] Shown in the introduction to this chapter.
[234] Ter-Minassain, Teresa (2012), "More than Revenue. Main challenges for taxation in Latin America and the Caribbean", Inter-American Development Bank, Policy Brief No. IDB-PB-175.

- Peru, Ecuador, and Suriname, among other countries, have received donor assistance focused on developing reliable taxpayer identification systems, unifying taxpayer accounts, creating special units for large taxpayers, and using the banking system for collection purposes.[235]
- Brazil and Chile have undertaken initiatives to reward tax collectors based on their collection effort. When targets were exceeded in Brazil, however, it was observed that collectors may be over-zealous in order to attain their bonus payments.[236]
- El Salvador received assistance from USAID to create a Fiscal Compliance Division to follow up on pending cases and assist taxpayers to become compliant and a Fiscal Compliance Call Center to make automated calls to absent and delinquent taxpayers to remind them of their obligations. In 2009, the tax administration saved $215,000 a month in operational calls and brought 2,685 stop-filers into compliance in the first half of 2009, compared to 917 who had responded to mailed reminder notices in the first half of 2008. The call center made 34,721 robo-calls in 2009, as opposed to 3,495 letter notices in 2008, and corresponding tax collections from stop-filers rose from $1.57 million to $3.12 million.[237]

Overall, and most significantly, while many LAC countries have modernized and strengthened their tax administrations, the effectiveness of tax collections remains problematic. The following are highlights:

- Survey statistics for LAC in 2010 revealed that new tax debt being added exceeded collection levels of existing tax debt and, thus, the stock of tax arrears was growing at a worrying rate. It was further observed that part of these increasing arrears was attributable to some taxpayers abusing the system by filing legal appeals to delay the collection of otherwise legitimate cases.[238]
- Countries such as Bolivia, Brazil, Colombia, and Ecuador, for example, have assigned a major role to banks in tax collection. This decision is attributed to insufficient resources in the tax administration, inefficiencies of the tax administration managing the cashier function, security, and personal safety concerns, and because these countries recognize that banks are already specialized in the handling and control of payments.[239]

10.5. Key Benchmarks and Guidelines

An effective collection function in the tax administration is essential, but depends on many factors.

- As discussed in Chapter 3, the tax administration should have all necessary legal powers to properly manage tax debts owed to the government and be allowed to use them in accordance with established procedures. Preferably, the legislation should be a single, comprehensive tax law that defines all collection and enforcement powers and procedures for all taxes. Legal provisions and related procedures should aim to be nondiscretionary and transparent.

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235 Lledo et al. (2004), p. 23.
236 Kahn et al., p. 189.
237 Dod (2011), p. 8 and Murdoch et al., p. 8.
238 Inter-American Center of Tax Administrations (CIAT) et al. (2012), p. 50.
239 Gomez Sabaini et al. (2012), p. 52.

- There should be a consistent approach and written procedures by which tax debt should be pursued as a priority. Debt collection activities should not be reactive (e.g., with revenue targets), but rather a part of deliberate overall collection and enforcement strategies.
- Priorities for collection action, as well as tax arrears that should be written off due to limited possibility of collection, should be identified.
- As in Chapter 6, the tax reporting and payment system should be simple, and unnecessary barriers should be removed to facilitate tax compliance. This includes, but is not limited to, providing clear and timely instructions, understandable tax forms, and paying taxes at banks or implementing e-filing and e-payment. Simplification efforts should aim to reduce costs, and increase the accuracy of tax collection.
- Automation plays an important role in collections. There must be confidence in the taxpayer account balances as reflected by the IT system, and the system should:
    - Produce a consolidated current view of the taxpayer account which provides a single balance of all taxes that a person owes and the monies that may be owed to the taxpayer, including any refunds such as VAT;
    - Automatically apply penalties and interest;
    - Be capable of producing monthly management reports, including aged receivables and collection; and
    - Select cases for assignment by collection management based on risk parameters set in the system.
- Collections should be effectively organized. There should be a separate collections unit within the tax administration that is fully empowered to manage the debt collection function. The role of this unit and its responsibility needs to be clearly understood. The authority to make decisions regarding installment payments, partial payments, and mitigation should be clarified and supported by detailed, documented guidelines. The head of the tax administration, while maintaining general management oversight, should only be involved on an exceptional basis.
- Collection staff must be adequately trained and adequately compensated.
- Management supervision should be required, and managers, supervisors, and collection staff should be held accountable for non-adherence to legal provisions and procedures.

A key benchmark for collections, in the case of large taxpayers, is that virtually all taxes should be paid on time, leaving no tax arrears. Large taxpayers can materially and adversely affect a country's revenue. This is an ideal state that may be difficult to attain, but, at least in the case of taxes that are trust funds (i.e., VAT and PAYE), this should be the objective even for the short term.

With respect to small and medium countries, the relative size of debt inventories varies widely between countries. Generally, however, the approach recommended is to examine variations in overall payment compliance by applying a benchmark ratio of the aggregate year-end tax arrears (excluding disputed debt) to aggregate net revenue collections. The OECD notes that this indicator varies enormously, but that the majority of countries have a ratio of less than 5 percent (16 out of 32) or between 5 and 10 percent (8 out of 32).[240] For a specific country, a broad indicator of payment compliance and collection effectiveness should be developed by looking at changes in this ratio over a period of time (perhaps five years).

Another ratio, similarly examined over a time span of several years, should be computed as tax debts written off to the value of year-end tax outstanding. This ratio would determine the relative magnitude of debt written off as uncollectible. Although comparison with other countries with respect to this ratio is extremely difficult due to the different debt policies applied when writing off uncollectible tax debts, a trend may be indicative.

[240] OECD (January 2009), p. 97.

Chapter 11. Objections and Appeals

David Crawford

This chapter examines the conditions necessary for an effective appeals system that encourages trust in the tax system and, thus, creates a better investment climate. It also examines related problems and, in particular, the concerns of small and medium taxpayers, who often face the most pronounced impediments during appeals, such as prohibitive expense and general lack of access to the appeals process.

In general, there are two scenarios that provide the taxpayer with an option to appeal. First, modern tax systems rely on taxpayers to self-assess their tax liability and file a tax return. Upon receipt of filing, the tax administration may subject the return to a review. The administration may review the information in the tax return and the supporting documentation and often measures the return against various risk factors. Reviews can vary. In larger, automated tax administrations, this may be a fully automated review. In smaller, less sophisticated tax administrations, the review may be a desk audit. Independent of the type of review, the general practice at the completion of the review is to issue an "assessment" based on review findings. This assessment can accept the taxpayer’s self-assessed liability as filed or can vary the declared liability either upward or downward. The taxpayer receives a notice from the tax administration that informs the taxpayer of his or her right to object to the findings of the assessment.

A second scenario that may trigger a taxpayer appeal is in response to the findings of a tax audit. Tax laws provide the tax administration with the legal right to audit a taxpayer. When the audit is finalized, the taxpayer is notified of the audit decision. This notification is an assessment (in some countries termed a re-assessment) and, again, the taxpayer is provided with the opportunity to dispute the findings.

In either of the above circumstances, a taxpayer may opt to appeal if the taxpayer is not satisfied with the explanations of the assessment, if the taxpayer's request for an adjustment has not led to a satisfactory outcome, or if the interpretation of the law is disputable. If the taxpayer opts to appeal, generally, the taxpayer will first file an objection with the tax administration. In many tax jurisdictions, this objection process is mandatory. That is, unless the tax administration provides a waiver, the taxpayer cannot bypass this step and proceed directly to the courts. If the taxpayer's objection is unsuccessful, the taxpayer may proceed to filing an appeal with the courts.

On the surface, it may appear that taxpayer appeals are a relatively straightforward topic. A review of literature, however, reveals relatively little written about tax appeals, other than an acknowledgement that there is a process that usually begins with an internal activity ('objection' or 'administrative appeal') that may subsequently escalate to the courts ('formal appeal' or 'judicial review'). Similarly, it is difficult to find examples of appropriate performance measures for the appeal process, as many countries do not have detailed statistics or performance standards for taxpayer appeals. Thus, it is appropriate to preface this chapter with a general outline of the various themes that are usually encountered when discussing what an appropriate taxpayer appeals system should embody.

Independence

A country's citizens look to the judicial system, including the sometimes quasi-judicial tax appeals system, to provide protection for their rights and to ensure that actions that are taken by the State are lawful. The General Assembly of the United Nations on 29th November 1985, endorsed "Basic Principles of the Independence of the Judiciary," wherein:

> *"The independence of the judiciary shall be guaranteed by the State and enshrined in the Constitution or the law of the country. It is the duty of all governmental and other institutions to respect and observe the independence of the judiciary."*

Both the authority and legitimacy of the courts depend on the perceptions of the users of the courts. The users (public) must respect the work of the court and must be able to trust that the decisions of the court are arrived at through the application of the highest professional standard, which includes the appointment, without confrontation and disputes, of judges, whose integrity and competence are above question.

At the first level[241] of a tax appeals system, the taxpayer's case is usually reviewed either by the tax administration or by a special legislatively sanctioned body within the tax structure (i.e., the body may be internal, but separately reporting to either the head of the tax administration or the Minister of Finance). Under this arrangement, the taxpayer may not consider the process to be very credible.[242]

One of the most common complaints from taxpayers about the first stage of the appeals process is that the tax administration is not capable of a detached and objective review of any objection.[243] Often, persons assigned to review taxpayer objections are regular tax employees who are assigned temporarily to this task. Tax employees reviewing objections may perceive the possibility that finding in favor of the taxpayer could adversely affect their career prospects. Taxpayers may perceive that disclosing their grounds for an appeal at this stage unfairly allows the tax administration to prepare their rebuttal to the taxpayer's case.

At the first level of the appeals process, where the taxpayer's case is reviewed internally by the tax administration, the taxpayer must have confidence that the appeal is being reviewed impartially and

[241] For the purpose of clarity, the first level of a taxpayer appeal, which is at the tax administration level, will be referred to as an "objection" while those appeals that utilize the courts, including a special tax court, will be referred to as an "appeal."

[242] Taxpayer perceptions are important and, even when the facts support the staff handling the objection is genuinely impartial, objective, and negotiating in good faith, the taxpayer may have the perception that the situation is otherwise

[243] Tax administrations with limited resources often attach relatively little priority to developing a robust taxpayer appeals program, especially where past or current practice is to evaluate tax administration performance largely on revenue.

objectively. However, most tax administrations tend to staff this process with former mid- to senior-level tax auditors. In these cases, it is important to be aware of the audit mindset (where there is suspicion of the taxpayer) that these auditors have developed during their career and which may cloud their perceptions and fact finding in the appeals process. Additionally, having worked in the audit section, the reviewer is often familiar with the auditor, who originated the assessment, and may be less willing to challenge a colleague. Furthermore, many tax administrations rotate their staff through the appeals function since there is often no career path strictly within appeals, and some tax organizations may tend to regard this as a "dead-end" job. Thus, a person serving in the appeals function may view making decisions that are favorable to the taxpayer as a career threatening move.

Taxpayer concerns about credibility also apply to the second level of a tax appeals system. In cases where countries have a special 'tax court,' taxpayers may question the court's independence, particularly if the court's members are former tax administration officials. If, on the other hand, appeals are heard in the general system, the taxpayer may question whether the judiciary has the competence to review highly technical tax arguments and issues (e.g., transfer pricing cases, the composition of taxable income, or audit techniques that are appropriate to establish a tax liability, etc.).

Attracting the Best

Training of tax administration staff, who handle appeals, is also an issue. In many instances, staff assigned to the appeals function receives little or no training. Having served as a good auditor who raised many assessments does not necessarily qualify staff to review taxpayer objections, especially if he/she is not provided with training.

The traditional method of finding suitable candidates for the courts has been to attract leading members of the bar for judicial appointments or, sometimes in the case of specialized tax courts, to appoint former tax officials. In many countries, an escalating disparity between judicial remuneration and the earnings of successful lawyers and businessmen makes it difficult to find experts who are willing to be appointed.

Timeliness

In many countries, it can take years for the judicial system to hear an appeal in the court. Even at the first level of the appeals process, objecting to the tax administration can take several years. This is an especially important issue. In cases involving value added tax (VAT), for example, with the passing of each month, the potential liability for tax on each transaction, plus interest and penalties, is a major uncertainty for businesses.

While undue haste would be counterproductive, neither taxpayers nor the tax administration benefit from the uncertainty inherent in an overly long dispute process. The length of time to settle an appeal can also adversely affect the financial health of a taxpayer. Where an adverse decision is finally rendered, the penalty and interest that has compounded on any unpaid tax over the intervening years can be excessive. Conversely, in a country that is experiencing high inflation, the financial effect of the assessment on unpaid tax can be diminished if the appeal process can be dragged-out.

Expense

Appeals can be expensive for both the tax administration and the taxpayer. In addition to staff time, the costs of litigation borne by the administration can be substantial. Often, taxpayers cannot represent themselves and must hire legal counsel. Sometimes, court rules do not allow taxpayers to represent themselves. Even when they do, the courts may hold the taxpayer to the same standard as they would hold legal representation. For small and medium taxpayers, in addition to the prohibitive expense of hiring legal counsel, there is also the cost of the time that these taxpayers spend away from their business.

Access

Taxpayers, and particularly small and medium ones, may have limited access to the appeals process. For example, even at the first level of the process, hearings may be held only in the capital city, which may be far-removed from the taxpayer[244]. Additionally, hearing times may be inconvenient and costly to the taxpayer. Meetings may be scheduled without enough advance notice or they may be scheduled at mid-week or mid-day, which are often inconvenient times for small and medium taxpayers. Meetings may also be re-scheduled at the last moment, imposing further expense on small and medium taxpayers that they cannot afford.

Encouraging Appeals vs. Revenue Flows

Many countries have recognized that it can take an excessive amount of time for a case to make its way through the appeals system. Previously, most tax laws required the tax under dispute to be paid in full before an appeal was considered. Many argued that this was excessive and imposed a financial burden on the taxpayer. As a result, many countries removed the requirement to pay the tax under appeal. This, unfortunately, had an unintended effect. In jurisdictions where filing an appeal automatically suspends collection action by the tax administration against the amount of tax under appeal, taxpayers can use the appeals process to thwart legitimate tax arrears collection actions. In addition, taxpayers can file appeals in order to buy time to remove assets from the reach of the tax authorities. As discussed below, a requirement to post suitable security when filing an appeal is an accepted general practice.

11.1. Leading Practice

The following figure provides general, high level guidance on an appropriate appeal system. These and other pertinent topics are detailed below.

[244] As a leading practice, Chapter 4 cites the need for tax administrations to provide adequate coverage and services by requiring technical staff to travel periodically from central office locations to remote areas to hear taxpayer objections, appeals, provide taxpayer education sessions, etc. The discussion on 'mediation' below also addresses service in remote areas.

Figure 11.1. Leading practice with respect to appeals[245]

Independence of appeals officers and bodies: A precondition of any credible appeals system is the independence of the appeals bodies. This may be difficult to achieve when the appeals are heard within the tax authority.

Adherence to the principles of natural justice: The legal principle of "hear the other party" is the bedrock of the principle of natural justice.

Reasonable preconditions for filing an appeal: In some countries, taxpayers are expected to pay some or all of the disputed tax in advance. Where this it is not required, taxpayers are required to pay the tax amount, along with market rates of interest, if they lose their appeals.

Time-bound appeals process: The appeals process must be time-bound, thus resulting in the speedy resolution of appeals.

Progressive selection: The tax appeals system must result in the effective resolution of the majority of cases at the lowest levels of the dispute resolution structure.

11.1.1. Appeal Grounds and Documentation

Tax jurisdictions typically require that appeals be made in writing, first, to either the head of the tax administration or a special and distinct body within the tax administration, as discussed below. These first level appeals are commonly referred to as "objections" or "administrative appeals". Common practice allows any person to file an objection on behalf of a taxpayer. This could include a spouse, family member, friend, representative, accountant, lawyer, employee, etc., as long as they are authorized by the taxpayer to represent them. The appeal should include the detailed grounds for the objection. For example, it is not sufficient to state that the grounds for the objection are because the tax is unfair.

The following information is generally included in an objection by the taxpayer:

- Taxpayer name and address;
- Telephone number(s), where the taxpayer can be contacted during the day;
- The representative name (if applicable);
- Telephone number(s), where the representative can be contacted;
- The date of the assessment notice;
- The assessment notice reference number (if applicable);
- The tax type assessed (VAT, personal income tax, etc.);
- The tax period of the assessment;
- Taxpayer identification number (TIN);
- The relevant facts and reasons for the objection; and
- Copies of all documents that support the objection.

[245] The World Bank (2011), p. 90.

The taxpayer is required to sign and date the objection. An authorized officer must sign an objection made by a corporation.

11.1.2. Appeal Process

The process for the first level of appeal – the 'objection' or 'administrative appeal' – varies. Generally, however, and as above, an appeal would be addressed to either the head of the tax administration or a special and distinct body within the tax administration. In most small administrations, there is a person or persons dedicated to reviewing taxpayer appeals and advising the head of the tax administration of their findings. Larger organizations will have a separate, often legislated, organization mandated to review appeals. In many countries, the sole person who has the legal power to issue a decision as a result of an appeal is the Minister of Finance, or the person to whom the Minister has delegated this authority.

The first stage of the appeals process should likely be conducted within the tax administration or by a body perceived by taxpayers as closely aligned with the tax administration:

- This is cheaper than setting up an entirely separate body;
- Objections being scrutinized at this level can serve a quality control[246] function, where at least the most blatantly incorrect assessments should be immediately detected and overturned;
- A reasonably well-functioning objections process leads to relatively timely settlements, without resorting to a protracted and expensive dispute in the courts;
- Objections at the first stage are relatively informal and accessible at minimal cost. This is especially important in the case of small and medium taxpayers; and
- Access to objections can be further strengthened for small and medium taxpayers by utilizing the existing network of tax offices, and objections can be resolved at the local tax office level.

The review of the objection must be impartial (and must appear to be impartial), objective, and timely. Importantly, the basis upon which appeals officers grant or deny decisions must clearly be set out in publically available documentation. This documentation should clearly indicate that the primary factor governing the decision is the assessment itself and that the review is based on ascertainable facts supported by proper evidence. The documentation should also note whether the assessment is in accordance with the law and any relevant administrative policy.

As noted previously, there is a lack of available statistical information regarding objections and appeals in most countries. Procedures vary and it is therefore difficult to determine a norm or average. However, if the objection process is functioning well, a general guide would be for the majority of cases

[246] When measuring the performance of a tax administration, frequent measures are: (1) the number of tax assessments and (2) the monetary value of assessed taxes. When measuring performance, there is a tendency for the organization to focus resources on what is being measured. Sometimes, the focus may not be on the quality of the assessment, but rather on raising an assessment in order to meet statistical requirement, even though the validity of the assessment may be questionable. Other times, auditors may simply make assessments without taking the time to resolve questionable "gray area" transactions, as they are under pressure to process a target amount of revenue per audit day expended.

to be resolved at the first level of appeal.[247] It should be noted, however, that even if the number of cases proceeding to court is low, this does not necessarily signify that the first level appeals process is satisfactory. It is possible that taxpayers whose objections are overruled may well have a strong case, but lack the will, finances, or courage to pursue their case at the next level in the process.

If the taxpayer's objection is unsuccessful, the taxpayer can then resort to the courts for judicial review ('formal appeal'). The judicial review process varies by country. In an attempt to remove tax cases from the often slow progress of the general courts, some countries have established special tax courts,[248] where the judges have expertise in tax matters. In addition, to make the system more accessible to small and medium taxpayers, who often cannot afford legal counsel, the tax court may also have an informal procedure that allows taxpayers to represent themselves or to be represented by an agent. This informal procedure should be intended to enhance access to the court for taxpayers, where the amounts at issue are small. In contrast to the general procedure, there may be no mandatory forms, filing fees, and the legal and technical rules of evidence may not apply. Some countries have established tax tribunals to hear unresolved disputes between taxpayers and the tax administration, as less expensive, pre-formal court forums. For example, in 2009, the U.K. established a First–tier Tribunal (Tax) Chamber to hear appeals for direct or indirect taxes not resolved by Her Majesty's Revenue and Customs. Tax tribunals may be viewed more favorably by taxpayers to settle tax disputes because of: 1) their independence from the tax administration; 2) the ability to challenge an assessment without pre-payment of the tax (although posting a bond may be required); 3) the expertise of the judges, who are trained on and hear only tax cases; and (4) efficiency and cost savings, with informal procedures as the norm, as explained above. Cases that can best be resolved in tax tribunal forums are those where different interpretation of facts by the tax administration and the taxpayer is the main focus of the tax dispute. If the taxpayer's case is denied by the tax court or tribunal, recourse can be sought at another more senior court(s). As the case progresses through the legal system, it becomes increasingly formal, expensive,[249] complex, time consuming, and legally burdensome.

Complex tax appeals, such as cases where the tax dispute is centered on different interpretations of tax law by the tax administration and the taxpayer, should be resolved in formal court proceedings. In addition, appeals by large taxpayers should be resolved in accordance with a formal process that is better suited to complex cases that involve sophisticated taxpayers and significant amounts and/or principles.

Box 11.1. Objection and appeals statistics in Canada

In Canada, 95 percent of cases are resolved at the first level of appeal. Of the remaining 5 percent of cases that proceeded to the tax court:

[247] For example, in Canada, about 95 percent of cases are resolved at this level. Jaglowitz (1999), p. 2. Canada, however, may be unique. Authors of other chapters of this product have suggested 80 percent.
[248] The same OECD survey of the 41 countries responding, 21 countries indicated they have a specialized court to deal with tax issues.
[249] Some countries allow costs to be awarded by the courts. For small and medium taxpayers, the specter of costs being awarded to the government in the event of an adverse decision can be a large financial risk that acts as a deterrent to appealing, especially if the potential costs outweigh the tax under appeal.

- 34 percent of the assessments were confirmed without change;
- 19 percent were allowed in part;
- 27 percent were found in favor of the taxpayer; and
- 20 percent were considered invalid or requested compassionate relief from interest and penalties.

Significantly, of all the appeals filed with the tax court:

- 22 percent were settled before going to trial; and
- About 35 percent were abandoned by the taxpayer or were dismissed.

Of the remaining 42 percent of cases where the tax court rendered a judgment, less than 10 percent were subsequently appealed to a higher court. Thus, as a percentage of all appeals first filed with the tax administration in Canada, less than one half of one percent of objections result in a case being appealed beyond the tax court. It is also noteworthy that, during the intervening two decades since these statistics were first compiled, the picture has remained relatively unchanged,[250] as reported in a May 2012 evaluation of tax appeals by the Canada Revenue Agency (CRA).

11.1.3. Tax Litigation

After exhausting the objection or administrative appeal option, the taxpayer may commence an action in court. At this point, the legal department of the tax administration should become involved and should obtain the case file from the appeals division. The legal department's first task is to collect information about the case, including:

- The taxpayer's name, name of business (if a legal entity), and address;
- Taxpayer identification number;
- Extension of filing information, such as the date on which an extension was requested and granted;
- The due date for return, after extension;
- Assessment information, such as the amount of the assessment, the assessed amount in dispute, the date of notice of the assessment, the individual who issued the notice of assessment, and the tax year(s)/period(s) at issue;
- Administrative appeal information, such as the date of the initial appeal, the date of the subsequent appeal, the amount in dispute (which may differ from the amount of the assessment), and the decision, including the amount and date; and
- Information about the court hearing proceedings, such as court hearing dates.

Once this information is obtained, senior counsel will assign the case to a staff member who will review and evaluate the merits of the case and make a decision on how to proceed. The vast majority of cases will involve taxpayers appealing adverse decisions issued at the administrative appeals level. However, while unlikely, it is possible that the tax administration may also appeal an adverse decision issued at the administrative level.

[250] Canada Revenue Agency (n.d.), section 5.1.2, para. 5. "27% of the decisions were in favor of the taxpayer and 26% in favor of the CRA. An additional 17% were partially agreed upon between the CRA and the taxpayer. The remaining 30% were dismissed because the taxpayer did not meet the timeline to file a notice of objection (11%) or the notice of objection was considered invalid for other reasons (19%)."

The review and evaluation should include the following steps:

- Review the appeal to verify that it is complete and accurate;
- Determine whether the date that the taxpayer filed the legal action is within any statute of limitations. This date would also determine the time in which the tax administration must file a response;
- Determine whether the action was filed in the court with jurisdiction to hear the matter;
- If the taxpayer attempts to file a complaint that is not timely or attempts to file the complaint in a court that does not have jurisdiction to hear the case, the court should not accept the taxpayer's complaint. If the court erroneously accepted the complaint, then the legal division's attorney must draft and file a motion to dismiss the case;
- Review the case to identify contested issues; and
- Research the issues, including:
  - Identifying and reviewing provisions in the law, regulations, instructions, guides, manuals, circulars, bulletins and other sources in existence at the time under appeal, plus subsequent legal amendments, to verify that no provisions apply retroactively to the period under dispute;
  - Identifying and reviewing articles in other laws that may affect the issues being contested;
  - Reviewing any administrative pronouncements and prior decisions on the issues; and
  - Reviewing any case law relevant to the issues.

The assigned staff member's decision on how to proceed, along with the basis for the decision, should be submitted to the senior legal counsel for approval. The recommended course of action should consider:

- Whether the case is important enough to go to court to get clarification of a "grey" area of the law and whether the case based on the facts is strong enough to contest as an adverse decision may place the tax administration in a more difficult position. There may be a need to get input from the Ministry of Finance on whether, from a tax policy and political perspective, the case should be contested in court;
- The amount of money at issue;
- The number or potential taxpayers who may be affected by the decision;
- The likelihood that the tax administration will prevail; and
- The benefits that may result from a favorable decision, as a function of the time expended on the case.

At the conclusion of the case, including all appeals, the assigned staff member who prepared the case must complete a case summary report. The purpose of the report is to ensure that the legal division is optimizing its limited resources. Frequently contested issues may signal a need for legislative amendments or additional clarification in instructions to the taxpayer.

11.1.4. Taxpayer Access to Information

Tax administrations, as part of their obligation to provide sufficient information to enable taxpayers to self-assess and comply with the tax law, should also provide clear guidance on taxpayer rights when they disagree with an assessment. This includes providing both a synopsis of the appeal process to gain general understanding, as well as detailed procedures, time limitations, and how to make a request for an extension of time to file an appeal. A common practice is a leaflet is provided to taxpayers either at the beginning of an audit or it is attached to the assessment notice to explain their rights. In addition to a leaflet the assessment notice may also direct the taxpayer to the tax administration's website where there is extensive information.

It is important that the tax administration keep the taxpayer informed of the status of their objection. The tax administration should also be required to disclose the information on which it relied in arriving at the assessment under dispute. To facilitate the open exchange of information, tax administrations, on request, will normally provide the taxpayer with the copies of documents in their possession related to the issues in dispute. These documents can include:

- The taxpayer's tax returns;
- Reports prepared by the tax auditor to support the assessment;
- Working papers prepared by the auditor that are relevant to the issues under dispute;
- Records of discussions between an appeals officer and an auditor regarding the assessment;
- Copies of court decisions and relevant sections of legislation relied on by the auditor to support the assessment;
- Scientific, appraisal, and valuation reports relied on by an auditor to determine the assessment; and
- Information obtained from third parties with whom the taxpayer is doing business, such as sales invoices, purchase orders, and cancelled checks.

What is not available to the taxpayer is confidential or sensitive information regarding other individuals and businesses. Most tax laws have stringent provisions regarding confidentiality, and the taxpayer cannot receive information concerning other parties, such as:

- Personal information relating to another person;
- Information from a third party obtained on the expectation that the information would remain confidential;
- Information subject to solicitor/client privilege, such as legal opinions and referrals for legal opinions, including the submissions made in support of the referral;
- Documentation related to an ongoing investigation;
- Confidential information obtained from other government departments and treaty partners; and
- Audit techniques, limits, tolerances, and specific tests, the disclosure of which could prejudice the results or future use.

11.1.5. Mediation and Compromise Settlements

The design of the dispute resolution process should be client-focused, and the system must give taxpayers the feeling that they are being treated fairly and impartially. Besides the issue of impartiality, poor communication by the appeals officer can leave the taxpayer dissatisfied in the event that the tax administration disallows an objection. For example, the decision to deny an objection may be ambiguous or not explained to the taxpayer in sufficient detail.

Unlike the normal legal system, where case law and precedents are referred to and where taxpayers in similar circumstances are, or should be treated the same, the outcome under mediation may well differ from case to case because of the personalities of the players involved and the existence of any aggravating or mitigating circumstances. This could be mitigated by drafting specific instructions or criteria, along with authorization as to what would be permitted to offer or accept in a situation of any given sort. To ensure the quality of the mediation process, rather than employing a decentralized system involving various small tax offices, one option to consider is mediation placed at the head office level, with specialists ensuring uniformity in the application of the law and any applicable policies pertaining to small and medium taxpayers. With this option, appeals specialists would travel to various small tax offices, which would remove the need for taxpayers to travel.

The skill of the mediator in tax law is crucial, since to the untrained eye almost all cases can seem to be in the tax administration's favor. The tax administration should train mediation specialists, who would be fully authorized to mediate sessions, while also being responsible to apply applicable tax policies. These specialists could also either travel to various smaller tax offices or, where there is sufficient work, be stationed at these offices[251]. This would remove the need for taxpayers and their representatives to travel.

The skill of the mediator in rephrasing and restating the appeals officer's explanations for the disallowance of a taxpayer's objection may change a taxpayer's perception of unfairness or injustice. It is on this premise that, if taxpayers believe that the system treats them with fairness and impartiality, they will be satisfied with the system regardless of whether the objection is resolved their favor or not. Furthermore, this process of restatement may assist appeals officers in seeing the taxpayer's point of view.

A mediation component should follow the initial negotiations between the appeals officers and small and medium taxpayers. Mediation should be available to small and medium taxpayers if they request it. The emphasis in a mediation should be on qualitative rather than quantitative considerations (i.e., the purpose of mediation is to provide taxpayers with the best possible opportunity to get fair, objective, and impartial treatment and to facilitate administrative efficiency). Mediation is a simple and cost-effective method to resolve disputes for small and medium taxpayers, where the principles involved may not necessarily be complex. During this process, taxpayers may be able to deduce on their own that they have, in fact, been treated fairly and that they have little or no chance of success in court. The

[251] Although centralized mediation is preferred, some jurisdictions and tax administrations are just too large.

process should be able to quickly identify and settle cases, in which the tax administration may have been overly zealous in assessing "grey areas," which may be quickly reduced or removed from the assessment. In addition, frivolous taxpayer objections can be identified quickly with the result that additional tax administration resources are not wasted.

As previously stated, mediation should be available only to small and medium taxpayers. Cases where mediation may be unsuitable are large taxpayers, since they have financial resources and access to the necessary expertise. Cases that involve an investigation for criminal tax evasion should also be excluded from mediation.

If current law has provisions that allow compromise settlements,[252] in the case of small taxpayers, the mediation approach would take a more prominent role in settling taxpayer objections. Compromise settlements, as previously noted, have some significant downside risks. In addition to superseding the power of the court, they may also allow abuse and corruption.

11.1.6. Costs

In any tax appeal, the costs of litigation borne by the government can be substantial. It would be reasonable to assume that, if cases can be diverted from litigation, there will be realizable savings. Similarly, if taxpayers were able to resolve their disputes satisfactorily out of court, they would also have savings. Furthermore, if a system can be devised where decisions are timelier, there may be greater taxpayer satisfaction with the tax system, which could conceivably translate into better compliance. Additionally, tax revenues, where the case is settled in favor of the government, will flow more quickly into the treasury. The question is whether a process can be devised that would provide a greater opportunity for agreeable settlements before the matter is taken to court, and secondly, whether in devising such a process either the tax administration or the Minister should be able to negotiate the settlement of an assessment.

In some cases, a settlement should be negotiated. First, there is an emphasis on simplifying the tax system for small and medium taxpayers, because many tax regimes are admittedly too complex to be fully understood, except by professionals who specialize in tax. Small and medium taxpayers generally do not employ such tax experts, as they are costly. As previously discussed, this same problem exists with preparing an objection or an appeal. For small and medium taxpayers, who are usually hands-on and deeply involved in the daily operations of their business, the cost of preparing an appeal includes the time taken out from running their business. In addition, the financial cost of hiring experts can be

[252] A compromise settlement must have a legal basis in the tax law. It allows the tax administration to settle a tax debt for less than the full amount owed. Generally, if a taxpayer cannot pay the full tax liability, or doing so creates a financial hardship the debt may be reduced after the tax administration considers the unique set of facts and circumstances of the taxpayer including: 1) the taxpayer's ability to pay; 2) the taxpayer's income; 3) the taxpayer's expenses; and 4) the ability of the taxpayer to borrow. In these cases the tax administration has the legal ability to make an offer to settle the tax debt for the most that can be expected that could be collected within a reasonable period of time. In an OECD survey, 18 of 41 countries responding indicated that they can negotiate a risk-based settlement. (OECD (2009), p. 147). In this survey, some countries noted that they have the ability to determine their likelihood of success in court and make risk-based settlements with the taxpayer.

prohibitive. The appeal system is complex and can be bewildering to anyone who does not have both a tax and legal background. Although the tax, penalty, and interest assessed may be technically correct, often the penalties and compounding interest can quickly cause the amount to become unaffordable, especially for small businesses. In addition, since word travels quickly in business circles, placing a small business in financial difficulty can be detrimental to the current or future business relationships and success of the business. This is all the more reason for taxpayers to remain or, as a stop-filer, disappear in the underground economy.

A country's financial laws[253] usually allow for a remission of penalty, interest, and even tax under defined circumstances, usually relating to taxpayer hardship, but this can be a long process and there is no certainty that a remission will be granted. Some countries, such as Canada, also have a legislated "fairness" policy, which can be applied where any or all interest or penalty owed by a taxpayer can be cancelled because of a delay or an error by the tax administration, circumstances beyond the control of the taxpayer, or the taxpayer's inability to pay. In many countries, there is ability to write-off tax, penalty, and interest, if these are considered as uncollectible.

Modern tax laws are very specific with regard to the powers of the Minister and generally do not provide for the exercise of any discretion[254] when it comes to assessing tax legally imposed, nor does most tax legislation allow discretion to reduce an amount of tax when it comes to collecting tax that is legally due. Another possible impediment to achieving a negotiated settlement is that many tax laws do not include the possibility of a third party determining the taxpayer's liability. There are only two parties with such power: the tax administration exercising the delegated authority of the Minister and a court of competent jurisdiction. Tax laws generally do not allow another party, such as a neutral arbitrator any authority to negotiate a settlement. To add an arbitration level to the appeals resolution process would require substantial legal changes in many countries and, more importantly, could render the courts redundant, which is not a desirable outcome. Finally, in countries where institutions are weak and corruption can be problematic, adding powers to negotiate the amount of tax payable on an

[253] Tax administrations usually have a mechanism whereby they can take a common sense approach to dealing with taxpayers who, because of personal hardship and/or circumstances beyond their control, cannot comply with the requirement to file and /or pay their taxes on a timely basis.

There are instances where, although an amount may be legally due, the collection of tax, interest, and /or penalty can be uneconomical, against common sense, or promote the perception that the application of the law is unfair. The most common circumstance for requests for relief from penalties are acts of God, such as earthquakes, floods, tornadoes, and hurricanes. Other common requests for relief from penalties are due to family related responsibilities.

It varies from country to country who has the authority to provide relief from a penalty, interest or even tax. Depending on country's legal system, the authority could be vested with the Minister of Finance or the Cabinet and, in some instances, it is delegated to the head of the tax administration.

Usually relief is through a remission which is a defined legal process that results in forgiving an amount of tax, penalty, or interest that a taxpayer would otherwise be liable to pay. A remission can be retroactive and cover an amount the taxpayer has already paid which will result in a refund. Most countries require the taxpayer to request the remission in writing, usually stating the reasons, to initiate the remission process.

[254] Tax reform programs usually have three core elements: i) a shift away from reliance on trade taxes, and the introduction of a broad-based VAT; ii) simplified tax design, including abolition of some taxes, simplification of others, reducing the number of different tax rates, widening the tax net, and reducing high tax rates; and iii) giving less discretion to tax officials and generally improving tax administration.

assessment can be courting disaster. What would be appropriate is to supplement the already existing appeals process within the tax administration with a mediation process specifically designed for small and medium taxpayers.

11.1.7. Payment of an Assessment

Depending on the country and the situation, a taxpayer may or may not be required to pay all or part of the tax amount in dispute before an objection or an appeal can be resolved. To deter frivolous appeals, although this is not the prevalent practice, paying a deposit should be considered leading practice, except, again, in cases of financial hardship for the taxpayer. As the time frame for lodging the objection is longer than the time frame for paying the assessment, the taxpayer should pay[255] the assessment on or before the due date, even if they are going to lodge an objection. Otherwise, or in cases where the deposit is smaller than the total amount of tax, unpaid interest should continue to accrue on the unpaid amount.[256]

Most VAT laws regard VAT as an amount that is held by the taxpayer (tax collector) in trust for the government. Similarly, withholding tax on employees (PAYE) is also regarded as a "trust fund." Since these taxes are government money that the taxpayer is collecting on behalf of the government, most tax laws require that either any outstanding tax liability (VAT and PAYE) be fully paid or the taxpayer provide suitable security before any appeal can be accepted. Generally, tax laws vary as to whether any tax or deposit is required during an appeal related to other taxes, since these taxes are not trust funds. To prevent frivolous appeals, especially where large sums are involved, some countries require a payment of 50 percent of the tax assessed. Other countries, especially for individuals, do not require any payment to be made when the taxpayer files an appeal. It is common practice that once an appeal has been accepted, any collection action against the taxpayer for the amount under appeal is suspended until the appeal has been decided unless there is a risk that the taxpayer will be unable to pay or that the taxpayer will flee the country.

In the case of small and medium taxpayers, provided an appropriate system can be devised to fast-track objections as suggested herein, the advance payment of the full amount of taxes in dispute should be waived as long as the taxpayer continues to file tax returns and all other payments remain on time.

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[255] In the OECD survey, 25 of the 41 countries responding indicated that, where a case is under administrative review, the countries can collect the disputed tax, although in Cyprus this only applies in the case of certain direct taxes. This compares with cases under court review where 33 of 41 countries can, albeit in some cases only in certain circumstances, collect the disputed tax.

[256] Under the legislation, the Canadian tax authorities cannot start legal action to collect income taxes owed until 90 days after it sends a notice of assessment. It will hold off collection action if the taxpayer is contesting the assessment through the Agency's internal appeal process or through the Tax Court of Canada, except for large corporations who are required to pay at least 50 percent of the tax in dispute. Furthermore, this restriction does not apply for amounts that are considered to be trust fund taxes, such as GST (VAT) or employee withholding (PAYE).

11.1.8. Objection Time Frame

Normally, the time to file an objection ranges from 21 days to 90 days after the date of assessment,[257] and the appeal must be filed in the manner described in the tax law. Sometimes, there is legal latitude to accept an objection after the time has elapsed, if there are reasonable grounds for the delay; however, an extension is not granted automatically. Often, the taxpayer must make a request in writing, outlining the full facts and circumstances of why they need an extension. The head of the tax administration and/or head of appeals must be satisfied that the particular circumstances made it unreasonable to expect the taxpayer to file the objection within the allotted time.

11.1.9. Taxpayer Perception

The tax administration should make an effort to gauge taxpayers' perception of the objections and appeals process. The first step should be to ask taxpayers, through a survey or questionnaire instrument, their perceptions on whether they receive impartial, timely, and objective treatment. For example, a questionnaire could ask, among other things, whether the tax officer has impartially considered the taxpayer's objections to an assessment and whether the tax administration's position was clearly explained. The questions could also help identify and assess legal issues so as to ensure that sufficient information is made available to reach a more accurate or reasonable decision. The tax administration should take appropriate actions if taxpayers are found to have widely negative perceptions of the process.

11.1.10. Understanding the Taxpayer Appeals System

The following are some fundamental statistics that will assist in determining the "health" of the appeal system.

The tables below are a recommended starting point for gathering relevant information about appeals at the objection stage within the tax administration, as well as subsequent appeals at each level in the courts. Significantly, the OECD has noted that appeals data received from countries vary widely, and there are a large number of gaps in the data which suggests weaknesses in the operational performance data collected by many tax administrations. The OECD has observed that few countries have performance standards for administrative review of their appeals processes, despite the fact that is an integral part of the tax administration's role.

Figure 11.2. Information for a review of the appeals system

Tax Appeals	Year			Year			Year		
	%	No.	Amount	%	No.	Amount	%	No.	Amount
Opening inventory as of									

[257] According to an OECD survey, the time period in which taxpayers can appeal to administrative review varies widely between countries. The minimum time reported was 8 days, and the maximum 5 years. OECD (January 2009), p. 147.

Tax Appeals	Year			Year			Year		
	%	No.	Amount	%	No.	Amount	%	No.	Amount
(Date)									
Appeals Submitted									
Appeals Decided									
Ending Inventory as of (Date)									
% small & medium taxpayers									
% in favor of taxpayer									
% in favor of small & medium taxpayers									
% partially accepted									
Average time to finalize objection									

In addition to the above statistics, it will often prove beneficial to examine the outcome of taxpayer objections. This classification of objections may assist in identifying other weaknesses that could be addressed, for example, by taxpayer services. A table similar to the following may be helpful.

Figure 11.3. A review of the outcome of appeals

Classification of Taxpayer Objections	
Types	**Definitions**
Agreement - allowed in full	The objector is in agreement with the tax administration's decision to allow everything that was requested in the taxpayer's objection.
Agreement - allowed in part	The objector is in agreement that the tax administration will allow only a portion of what was requested in the taxpayer's objection.
Confirmed with agreement	The full amount of the assessment is confirmed with the taxpayer's explicit agreement.
Upward with agreement	The decision is made by the appeals officer to increase the tax assessment with the taxpayer's agreement.
Confirmed without agreement	The full assessment is confirmed without the taxpayer's agreement. Usually, the taxpayer has expressed disagreement to the Appeals officer.
Allowed in part without agreement	The decision is made by the appeals officer to allow part of the objection. The taxpayer does not agree with the adjusted amounts.
Upward without agreement	The decision is made by the appeals officer to increase the tax assessment without the taxpayer's agreement.

Classification of Taxpayer Objections	
Types	**Definitions**
Late filed objection	The objection case is closed because it was not filed within the specified time frame.
Invalid – other	Used when a case is closed for a reason that does not fall under any other code.

11.2. Common Trends

Many of the challenges faced by tax administrations with respect to appeals are related to offering quality services to small and medium taxpayers. For example:

- These taxpayers are numerous and diverse;
- They typically have general poor knowledge of tax laws and are often not aware of any subtle complexities;
- They may not be aware of their tax obligations;
- They tend to be less sophisticated, with accounting systems that are very basic, records that are handwritten, etc.;
- They often have limited computer access and skills; thus, they require costly face-to-face services and more extensive support through printed brochures and leaflets; and
- They are a "revolving clientele," because of their short business life cycle, which demands ongoing effort to educate newcomers.

Box 11.2. Objection and appeals by small and medium taxpayers in Canada

Canada's taxpayer information programs are equal to, if not better than, those of other countries. All forms are available on the website, as are clear instructions, guides, and other publications that explain the application of the various tax laws. There is a telephone information system, where tax officers can quickly answer most tax questions. Interactive tax software is widely available – some without charge. There are also videos and outreach programs to assist taxpayers. In an attempt to assist small and medium taxpayers who disagreed with decisions by the tax administration at the objection level in the appeals process, the tax court introduced an informal process, relaxing the normal court rules and making it easy, in theory, for taxpayers to represent themselves.

Yet with all this information and assistance available to taxpayers, in a recent case, the Chief Justice felt compelled to write:[258]

The vast majority of informal appellants in this Court act for themselves or are represented by persons without any legal background. This, the Tax Court has in common with all other Canadian courts. Employees of the Tax Court try to assist the appellants and prospective appellants in getting their appeal to trial. The Court has produced a video describing the conduct of an appeal. Judges try to help the taxpayers subject to their limits of judicial impartiality.

Nevertheless, taxpayers and their lay representatives are often intimidated by the process and are unable to fully prosecute [defend] the appeals. This is what happened here.

[258] Canadian Chamber of Commerce (2012), para. 5.

… A need for taxpayers to be better prepared for their appeals before this Court is obvious. Legal Aid programs must consider extending their assistance to taxpayers, notwithstanding current budgeting issues. Dealing with a government bureaucracy, the CRA, for example, and then with a court is very stressful, even on the most experienced persons. Unjust tax assessments may cause strain on the family relationship and ought to be challenged with public support when appropriate.

Many countries have not attempted to introduce an informal appeals process and still require taxpayers to seek the assistance of a lawyer to represent them in court. At the same time, many countries may not have as robust a taxpayer service program, both of which are impediments to small and medium businesses. The Canadian "experiment," although enabling small and medium taxpayers to represent themselves, has been less than satisfactory.

To put the plight of small and medium taxpayers in perspective, in Canada in 2005,[259] some 60 percent of income tax cases, 30 percent of GST (VAT), and 75 percent of cases involving other taxes before the tax court were self-represented.

The Canadian tax court concluded that the same challenges are present when considering the ability of small and medium taxpayers to mount an informed and credible objection/appeal in a system that is unfamiliar and sometimes intimidating.

The following is a discussion of these and similar issues and trends in tax administrations that attempt to resolve these challenges.

11.2.1. Timeliness

A major point of contention for taxpayers is timeliness. In many countries official or informal surveys cite protracted delays[260] at the objection stage as an impediment to businesses and an especially burdensome problem for small and medium businesses.

Box 11.3. Timeliness of appeals in Canada[261]

In the early 1990's, Canada had an average elapsed time to finalize an appeal of approximately 100 days. Averages were, however, deceiving since it took an average of 77 days for the simplest case to almost 400 days for the complex cases. During a review by the Canadian Auditor General, it was also found that the statistics regarding elapsed days were deficient since the statistics failed to account for pending objections, which formed over half the inventory of appeals. Pending objections are those cases that are set aside to await the outcome of a similar dispute. In this situation, taxpayers had the option of either having their case dealt with as part of a group of similar cases and placed in pending inventory or pursuing it in the courts on an individual basis.

Statistics showed that it took on average over 800 days for the completion of pending objections from the date they were received from the taxpayer and that over one quarter of these objections had been in process for more than three years.

[259] Gallant (2005), p. 337.
[260] For example, in a report on the administration of sales taxes in the State of Arizona, the Auditor General found that the average time taken to reach a hearing decision was 14.4 months. (Office of the Auditor General of the State of Arizona (1981), p. 13)
[261] Office of the Auditor General of Canada (1992), para. 21.40.

Problems with the timeliness of appeal resolutions have resulted in some countries imposing stricter time limitations on the tax administration to resolve appeals. Some countries, in addition to imposing time limits to decide an objection, have also imposed penalties on the tax administration. For example, where an objection is not decided within the specified time, the matter under objection is automatically found in favor of the taxpayer. It is then up to the tax administration to weigh the cost of litigation and the likelihood of success against the potential revenue as a business decision. Importantly, in countries where the judicial system refers to precedence, a default cannot be cited as a precedent; therefore, other taxpayers in similar circumstances may not rely on a default decision as being applicable to their circumstance. Some countries have even considered that where there is a default judgment in favor of the taxpayer that the tax in dispute or a portion be withheld from the tax administration's budget to "encourage" them to be more efficient. This solution is not recommended since it can result in insufficient operational funds for the tax administration, which can have unintended consequences.

11.2.2. Tax Ombudsman

The independence, objectivity, and impartiality of the tax administration, as previously discussed, is somewhat questionable, since the first level of appeal is generally staffed by seasoned tax auditors, who are selected from the general ranks of the tax administration and bring their "audit mindset" to the job. In addition, taxpayer perceptions are important and, even if the tax administration staff handling the objection is genuinely impartial, objective, and negotiating in good faith, the taxpayer may feel otherwise. The taxpayer does not have a choice in whether or not to pay tax – it is compulsory and, at the assessing and collection level, it can be confrontational. This can "cloud" a taxpayer's perception of whether the treatment during an appeal will be fair and impartial.

There is a need for a third party to act as a referee, since the tax administration and the taxpayer may not be able to deal with each other in an impartial, objective, and calm manner. This referee would act as a buffer between the taxpayer and the appeals officer to create an atmosphere for meaningful discussions. An appropriate referee must be chosen. Tax legislation is complex and the neutral third party must know the tax law at issue, so as to be able to identify issues and subtly steer the meeting towards areas on which consensus can be reached. This knowledge of the applicable tax law is an absolute requirement, since achieving any settlement that is outside the law is of no value to the taxpayer and would only aggravate the situation. Since this is a mediation as opposed to arbitration, the mediator should also be able provide the taxpayer, if requested, with an opinion as to the merits of the cases presented by both sides. This opinion would be particularly valuable to the small and medium taxpayer, who may have neither counsel nor an informed opinion of his/her chances in court. The taxpayer is essentially the exclusive beneficiary of getting the mediator's opinion on the case, since tax officials have access to legal advice and government legal counsel.

There are two approaches to mediation. There can be an "in-house" mediator, who is part of the taxpayer objection process within the tax administration. Alternately, many countries have already established special bodies, such as an ombudsman office, to investigate public complaints concerning government agencies. In some OECD countries, a dedicated tax ombudsman[262] has been established to investigate complaints concerning the tax administration.

Generally, the ombudsman only has the authority to investigate service-related complaints, which may include:

- Mistakes, which refer to misunderstandings, omissions, or oversights;
- Undue delays;
- Poor or misleading information;
- Unfair treatment; and
- Staff behavior.

As a result of any investigation, the ombudsman can suggest that the tax administration:

- Give further reasons for a decision;
- Correct a misunderstanding, omission, or oversight;
- Offer an apology;
- Change a policy or procedure;
- Make changes to systems or applications;
- Review its service standards; or
- Consider further staff training.

It is suggested that countries that do not already have an ombudsman give serious consideration to establishing one. In addition, the role of the ombudsman should be expanded to include mediation and, where necessary at the conclusion of mediation, an assistance role, such guiding a taxpayer in applying for a remission of tax, penalty, and interest in cases of hardship.

11.3. Tax Administration Maturity

Objections and Appeals: Maturity Level 1

Key word: "Informal"

- The right of the taxpayer to object at the tax administration level is loosely provided for in the law or secondary legislation or by a tradition of appealing to the tax administration to review an assessment.
- Objections are handled in an ad hoc manner without clearly defined procedures. There are no standard forms or accepted time to object or respond. The processes for handling the objection, if published, are vague.

[262] In the United Kingdom, the Adjudicator's Office investigates complaints and helps to resolve complaints from individuals and businesses that remain unhappy about the way their affairs have been handled. In the United States, the Taxpayer Advocate Service is an independent organization within the Internal Revenue Service (IRS) that assists taxpayers who are experiencing economic hardship, whose problem has not been resolved through normal IRS channels, or in cases where an IRS system or procedure may not be working as it was intended.

- The taxpayer is not advised if the objection takes longer than anticipated to review. The tax administration does not inform the taxpayer if a decision is subject to further appeal rights.
- The objection, when received, is not communicated to collection staff, and the objection does not stop collection action.
- Objections are reviewed by a committee of high-level managers and tend to involve the same persons that originally handled the case.
- The process for submitting objections is not automated (i.e., through the web), and neither is the objection process work flow.

Objections and Appeals: Maturity Level 2

Key word: "Legislated"

- The right of the taxpayer to object is defined in the law or secondary legislation, but it is not clear which decisions of the tax administration are subject to reconsideration. The mechanism for submitting an objection is not clear either.
- Objections are handled in an ad hoc manner without clearly defined procedures. There are standard forms and time to object requirements, but no clear time to respond requirements and published processes for handling objections are vague. The process for allowing an extension to the time to object is not clear.
- There are procedures for handling objections, but a lack of detailed guidance, such as detailed internal operating manuals regarding, for example, the calculation of elapsed time to respond to an appeal where the taxpayer has been requested to provide additional documentation and whether the time to respond to an appeal is suspended during this response period.
- The taxpayer is not advised if the objection takes longer than anticipated to review. The tax administration does not inform the taxpayer if a decision is not subject to further appeal.
- The objection when received is not communicated to collection staff, and the objection does not stop collection action.
- Objections are reviewed by a committee of high-level managers and tend to involve the persons that originally handled the case. There is limited automation of the submission of objections (i.e., through the web) and/or the objection process work flow.

Objections and Appeals: Maturity Level 3

Key word: "Institutionalized"

- The right of the taxpayer to object is defined in the law or secondary legislation and, although the mechanism for objection is clear, it is not clear which decisions of the tax administration are subject to reconsideration.
- There are clearly defined and sometimes publicized procedures for handling objections. These include standard forms, an established time to object, an established time to respond, processes for submitting and handling objections, and rules for allowing an extension of time to object.

- Procedures may lack certain provisions, such as requirements for the material that should be reviewed (including original case files, objection submissions, and the law) and precise specifications of when legal services staff or the taxpayer should be involved.
- The taxpayer is not advised if the objection takes longer than anticipated to review. The tax administration informs the taxpayer of their further appeal rights should they disagree with the decision.
- Although an objections stops collection action, the communications between the objecting taxpayer and collections staff of the tax administration are not clearly defined.
- Objections are handled by internal experts. There are no clear internal requirements to use staff that was not involved in the original case. Although clearly defined, procedures for objections differ across types of decisions and/or taxes.
- Although the taxpayer may be able to submit objections electronically, the objection process work flow is not automated.

Objections and Appeals: Maturity Level 4

Key word: "Streamlined"

- The right of the taxpayer to object is clearly defined in the law or secondary legislation. All tax administration decisions of fact or law are subject to reconsideration, perhaps with very few exceptions, such as a binding ruling.
- There are clearly defined and publicized procedures for handling objections. These include standard forms, an established time to object, an established time to respond, defined processes for submitting and handling objections, and rules for allowing an extension of time to object.
- Procedures require that the tax administration inform taxpayers of incomplete or invalid forms (such forms are not simply ignored); allow the tax administration to request additional information from taxpayers; require the review of key data (including original case files, objection submissions, and the law); allow for meetings between the tax administration and the taxpayer; and allow for the withdrawal of objections (including the tax administration's request that the taxpayer withdraw).
- Procedures exist to allow the taxpayer complete access to information in their tax file (except third-party information and other information barred by statute).
- The taxpayer is advised if the objection takes longer than anticipated to review. The tax administration informs the taxpayer if a decision is not subject to further objection.
- Procedures require that objections be handled by independent internal reviewers, who are experts on the topic, but who were not involved in the original case.
- The procedures for objections are the same across all types of tax administration decisions and/or types of taxes. All decisions, which are the result of objections, are subject to an appeal.
- The taxpayer can submit objections electronically. The objection process work flow is automated (e.g., collectors are automatically notified of objections).

11.4. Latin America and the Caribbean

There is little data on appeals, save for information on the general appeals process, around the world and in Latin America and the Caribbean (LAC). According to a CIAT study,[263] the tax laws in LAC countries usually regulate the general appeals process, and all administrative actions that impose obligations or deny taxpayer rights can be appealed, although the appeals path and processes vary. All national laws provide such mechanisms either through the tax administrations, special tax courts, or the courts of justice.

Box 11.4. The appeal process in Latin America and the Caribbean[264]

Barbados: Taxpayers may object to their assessments by written notice or online, and the objection must be submitted within 21 days of the date of the notice of assessment. The objections are reviewed by the Department and "Notices of Re-assessment or Settled Assessment" are issued to the taxpayer. If the taxpayer is still dissatisfied, he or she may submit an appeal to an appeals board or directly to the Supreme Court.

Guatemala: Guatemala does not have specialized tax courts, and appeals may be filed by taxpayers or their representatives only with the tax administration (Superintendencia de Administración Tributaria).

Panama: Law No. 8 from 2010 created the Tax Administrative Court. The court is an independent executive, specialized, and impartial body which will have competence, in general terms, to acknowledge and resolve administrative appeals against decisions issued by the tax administration (Dirección Generales de Ingresos) and provincial revenue administrations nationwide, including claims for refunds of national taxes, with some exceptions (e.g., customs and some other cases).

Peru: Pursuant to the provisions of the tax code from 1999 and amending laws, the taxpayer may file appeals requesting the reversal of decisions before the tax administration, followed by an appeal before the Fiscal Court. The resolution of the Fiscal Court is the final administrative recourse, but it can be contested before the Judicial Branch. The Fiscal Court is a body attached to the Ministry of Economy and Finance, which has deciding powers and self-sufficiency in the performance of its specific functions, while depending on the Ministry for administrative support.

Trinidad: The Inland Revenue Division has a period of six years within which to assess the return of the taxpayer, and can issue an assessment of tax liability or refund to the taxpayer. If the taxpayer disputes the assessment, he/she has 15 days to lodge an objection to the Inland Revenue Department, requesting that the assessment be revised. There is no fee to query a tax assessment and request a re-assessment. The Objection Section of the Department has up to two years to respond to an objection under current legislation for income and corporation tax. If the taxpayer is not satisfied with the results of the re-assessment, he/she may appeal to the Tax Appeal Court. The Tax Appeal Court is an independent separate agency for the resolution of tax disputes between taxpayers and the tax authority. It a self-managed public body with administrative, functional, and technical self-sufficiency, and has jurisdictional competency in the whole national territory. Its financial allocation is determined by an allocation from the central government.

According to the same survey, appeals often result in delays in collections, as many taxpayers abuse appeal rights to delay collections unnecessarily. Recently, there has been a decrease in the number of appeals in LAC countries, except for in Brazil and Nicaragua, although it is not clear whether this is due to changes in tax administration procedures or to lack of control. At the same time, data from the CIAT

[263] Inter-American Center of Tax Administrations (CIAT) et al. (2012), sections 4.3 – 5.7.
[264] Information from CIAT (http://www.ciat.org/index.php/en/products-and-services/ciatdata/).

study show an increase in the percentage of unresolved cases. A few countries are noteworthy for their relatively long resolution processes, specifically Colombia (15 years[265]) and Brazil (12 years).

Box 11.5. The appeals process in Brazil

> Until 2009, Brazil did not have an administrative process to settle tax disputes and relied on formal judicial proceedings. The Brazilian court system had a backlog of tax cases. Approximately 2.5 million tax cases represented BR 600 billion in unpaid taxes, nearly a third of Brazil's 2008 gross domestic product. An additional 1.8 million taxpayer disputes had yet to reach the judicial stage. The average tax dispute took twelve years to work its way through the Brazilian court system.[266]
>
> Currently, the taxpayer can appeal before the Administrative Tax Appeals Board. Administrative revision panels are highly specialized in tax matters, and appeals can take three to five years to conclude. At this level, however, 75 percent of the tax assessed is maintained.[267] Further, decisions are non-binding and may be challenged by the tax administration on the same issue. At the judicial litigation level, there are two levels of estate/federal courts and a superior courts level, where there is a requirement to post a guarantee in order to litigate the tax debt. It could take up to anywhere from three to ten years for the courts to settle the matter.

The author's personal experience is that LAC countries provide for appeals, but many fail to define an administrative appeals system. The laws instead leave the definition of the administrative appeals process to the tax administration, without adequate assurances that objections will be dealt with in a timely manner. This is a noteworthy problem in the LAC region, where the appeals system is used by the taxpayer – usually by large taxpayers – to delay the legitimate collection of taxes. This means that LAC countries should require some form of deposit/payment or explore penalties for unjustified appeals. Appeal procedures are available, even in the most rudimentary tax administrations, but may be vague and, in a lot of countries, internal and not available to the public. These procedures usually cover the content that a taxpayer must include in an appeal, but usually do not require a specific form.[268] As with all other tax administration functions, LAC countries differ in their ability to handle objections and appeals effectively. However, based on the information in this section, LAC countries should be placed in the third level of the maturity model with respect to appeals.

11.5. Key Benchmarks and Guidelines

While there is limited information and data on different countries' approach to appeals, the best source of guidance is statistics collected by the OECD.[269] Even in the OECD, however, countries vary widely on many benchmarks related to appeals.[270] The following, thus, are qualitative key guidelines to the proper functioning of appeals.

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[265] Inter-American Center of Tax Administrations (CIAT) et al. (2012), section 5.7.
[266] Korb et al. (2009), para. 2.
[267] KPMG (n.d.), para. 16.
[268] It should be noted that this is the case even in some developed countries, such as Australia (until recently) and Canada (still the case with the Goods and Services Tax).
[269] OECD (January 2009), p. 147.
[270] The objection and judicial appeal period vary between 1 month and 6 months (with exceptions). A third of OECD countries allow risk based settlements and a third have a specialized tax court. It should be noted, however, that most OECD countries allow collection during the objection and during the judicial appeal.

- There should be a separate and independent body to handle the first level of tax objections at the tax administration level. Appeals officers must be able to act independently of the tax administration, both in appearance and fact;
- The process and procedures must provide the taxpayer with adequate time and opportunity to present their case; however, the appeals process at each level should be time-bound to provide an expedient resolution;
- Any preconditions for filing an objection with the tax administration and a subsequent appeal with the court must be reasonable. In the case of small taxpayers, filing fees, if any, must be reasonable and proportionate and should take into account whether taxpayers are expected to pay in advance some or all the disputed tax. Where taxpayers lose their appeal, the outstanding tax they are required to pay should be subject to reasonable rates of interest;
- There should be a penalty to discourage frivolous appeals that are found to be without merit and were intended to delay the legitimate collection of taxes;
- Special assistance should be available to small and medium taxpayers to assist them in preparing an appeal and, where possible, "relaxed" rules should apply in situations where taxpayers represent themselves;
- The large majority of appeals should be resolved at the first level of a taxpayer objection[271];
- The tax appeals system should be managed through an electronic office where comprehensive information concerning appeals is available, appeals can be submitted electronically, and the taxpayer can, where practical, submit documents and monitor the progress of their appeal; and
- There should be a system of advance tax rulings to provide taxpayers with certainty on how a transaction will be treated for tax purposes in the future. This will often resolve any areas that could be assessed and lead to an appeal.

[271] 80 percent may be appropriate, as suggested above.

Chapter 12. Information Technology

Guillermo Jimenez

Information technology (IT) has experienced rapid advancement in the last few decades. IT has had a direct and profound impact in the way private and public entities conduct business. In particular, IT is a crucial component of modern tax administration, as it enables tax administrations to better gather and analyze information, proactively manage workload and resources, foster a cooperative engagement with taxpayers, and standardize the treatment of taxpayers, facilitating the uniform application of the tax law.

Today, IT is increasingly important to tax administration. In 2008, the OECD estimated that tax administrations spend at least 15 percent of their total budget on IT.[272] However, tax administrations in need of IT interventions face an increasingly complex IT solution landscape, with many areas of potential IT interventions, multiple approaches to implementation, and many vendors. In addition, IT remains costly and is often less successful than desired.

The objective of this chapter is to discuss the core IT components and capabilities as they relate to tax administrations.

12.1. Leading Practice

The purpose of this section is to discuss leading practices in the use of IT in tax administration. Specific focus is given to the role of IT in supporting the core functions of a typical tax administration as well as leading practices in the implementation of an IT support organization.

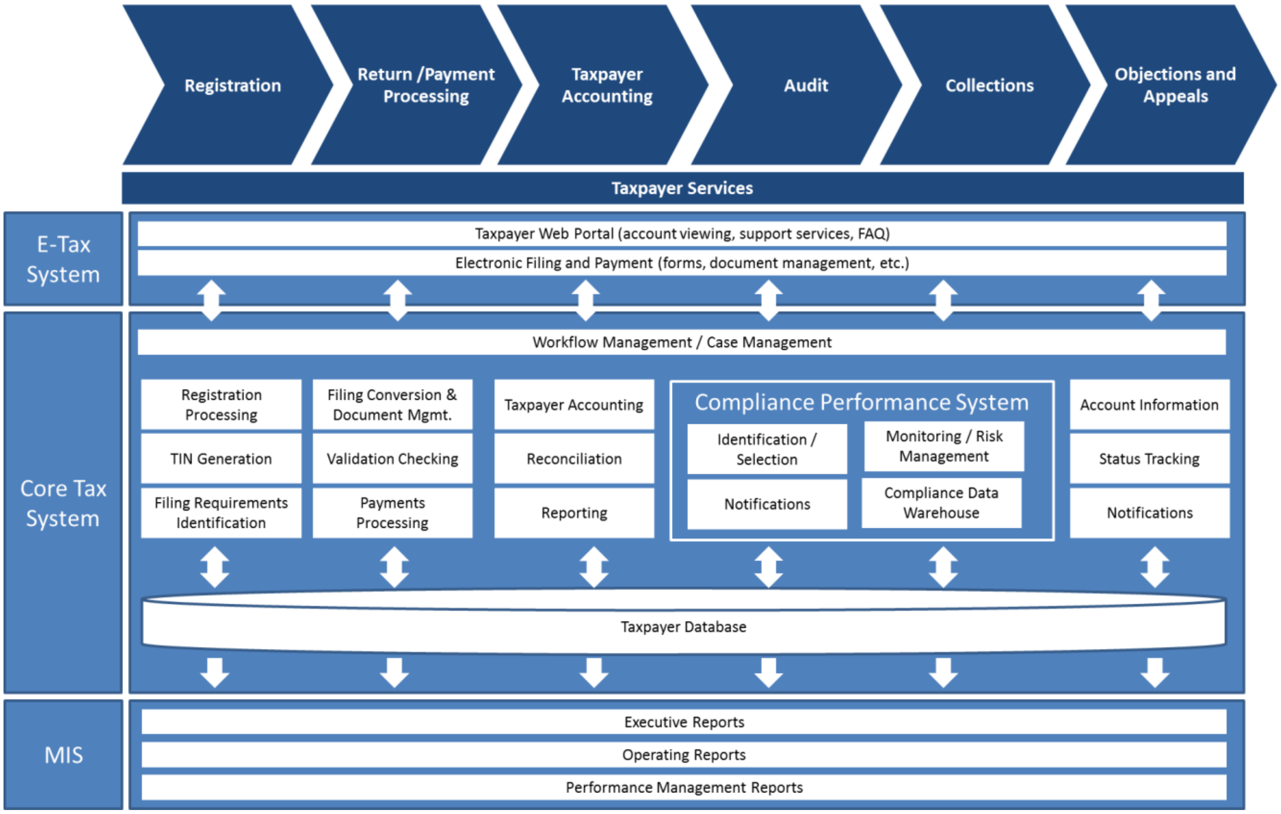
12.1.1. The Role of IT in Tax Administration

Historically, the most prevalent use of IT systems in tax administrations has been to underpin the core tax administration tasks of processing returns and payments and collecting relevant information. The 'core tax' component of contemporary IT systems continues to provide support for these tasks, enabling the tax administration to move away from heavy manual processing and to direct its resources to facilitating, monitoring, and enforcing compliance. Today, IT also facilitates voluntary compliance by opening multiple, interactive and electronic channels with taxpayers. This component of modern IT systems, dubbed the 'e-tax system,' may include support for electronic registration, filing, payment, information dissemination, and other functions. With respect to compliance monitoring and enforcement, the 'compliance performance system' of modern IT systems supports the tax administration's audit and collections functions in collecting and managing information on target areas where non-compliance poses greatest risks to revenues. In addition, as with any organization, the 'management information system' (MIS) component of the modern IT solutions facilitates decision-

[272] OECD (January 2009), p. 78.

making by getting the right information to managers and staff. This IT solution 'landscape' for tax administrations is shown in the following figure and is further detailed below.

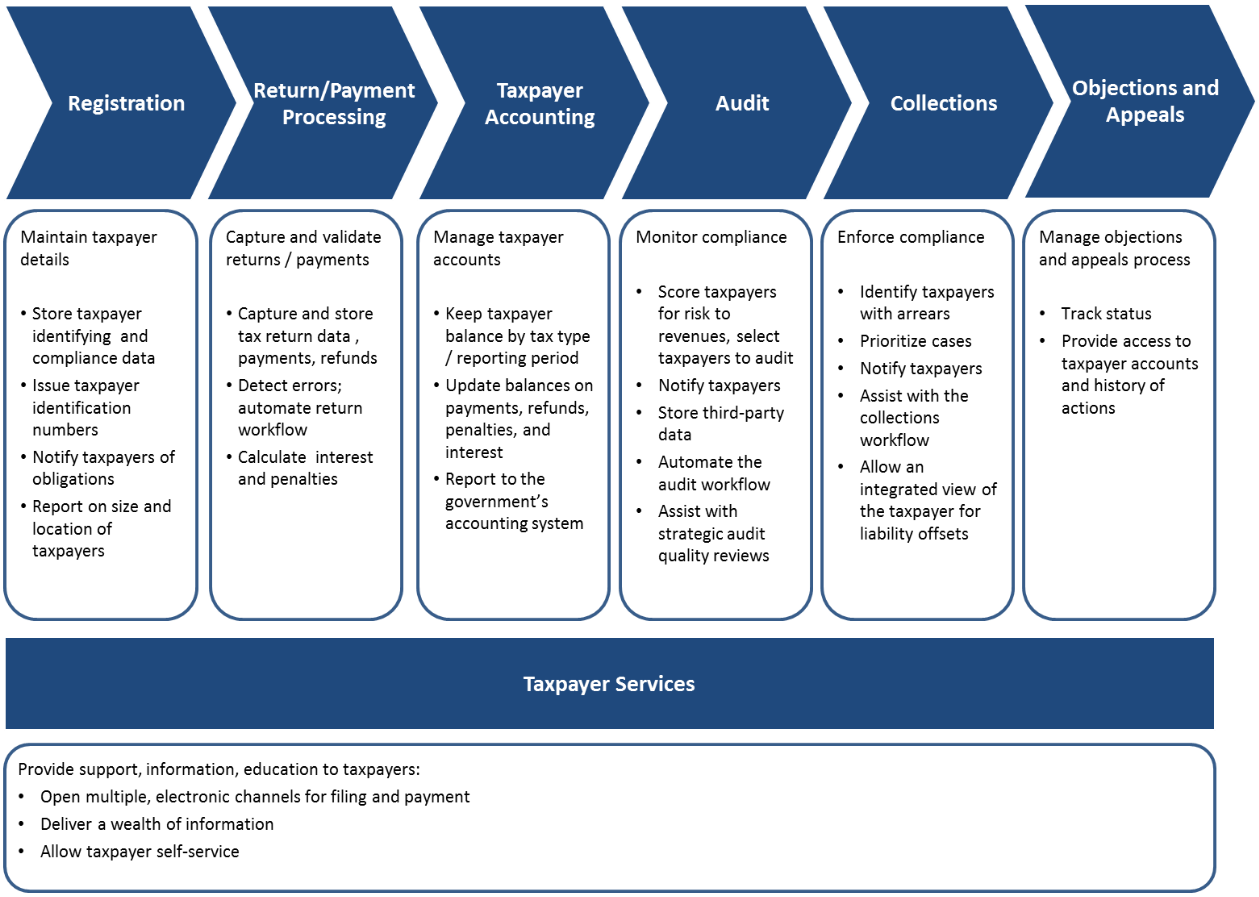
Figure 12.1. An illustrative IT solution landscape



Core Tax System

What is dubbed the 'core tax system' in this solution landscape model is the central system of record in a tax administration and the primary enabler for intensive processing. It provides technology support, at varying levels, to all functions of the tax administration: processing of registration filings and issuing taxpayer identification numbers (TIN); validating and processing returns and payments received through different channels; maintaining taxpayers' accounts; providing tools to identify and pursue delinquent taxpayers; automating appeals tracking; and providing taxpayer service staff with access to taxpayer information to enable a better level of service, among other functions. The following are examples of the type of IT support to each of the tax administration's functions.

Figure 12.2. IT support to tax administration functions with the core tax system



Registration: Registration is the process, by which the tax administration collects basic taxpayer identifying information, including names, addresses, and legal entity types. This information allows the tax administration to know who its taxpayers are, where they are located, and whether they are active or inactive. Modern tax administrations also collect compliance information, such as business activity types or estimated turnover, to plan future compliance activities. During registration, most tax administrations issue a unique TIN and, perhaps, a registration certificate, and provide the new taxpayer with information on his or her filing and payment obligations.

The basic registration functionality of a tax IT system includes the storing and maintenance of taxpayer identifying information, the automatic issuance of TINs and taxpayer certificates, and the automatic determination of taxpayer filing requirements. Effective registration with tax IT systems uses unique TINs to facilitate exchange of information between government agencies to ease the detection of non-compliance; integrates registration across taxes to allow for a single view of the taxpayer during audit or collections; centralizes the registration database to allow for effective non-compliance monitoring; provides a single facility to the taxpayer to register for all taxes to simplify compliance; and interfaces with the e-tax system, allowing new taxpayers to register online.[273] A single, centralized taxpayer registration database also enables proper planning, allowing the tax administration to rationalize staffing and resources based on the size and geographic location of the active taxpayer population. Many of these tasks would be impossible without IT. For example, an IT system can automatically verify that a newly issued TIN is, in fact, unique, while the same verification would be nearly impossible manually if the taxpayer population is large.

Return, payment, and refund processing: Filing and paying are the two primary obligations of the taxpayer. Returns and payments require significant effort on the part of both the taxpayer and the tax administration. Their smooth processing reduces costs to the tax administration, reduces risks to the flow of tax revenues, and increases taxpayer certainty, which improves the perception of fairness amongst taxpayers and facilitates voluntary compliance.

Tax IT systems that handle the processing of returns and payments must quickly and accurately capture and validate taxpayer data from paper and electronic documents to electronic transactions. For example, during paper return processing, tax administration staff will enter major transactions from the tax return into the tax system. During payment processing, payment transactions may similarly be entered into the system, although in most countries it is common to allow payments through financial institutions (banks). These are processed by the tax administration and reflected in the taxpayers' accounts electronically and automatically. Data integrity is a fundamental pre-requisite. The tax IT system usually allows for some form of data entry verification and return computation verification, automatically flagging exceptions. Specialized workgroups that are established to handle errors and exceptions are facilitated by the workflow management functionality in the IT system. All returns are archived electronically and are easily accessible during audit and collections. Return and payment data are used to automatically calculate liability, interest, and penalties. Since the data entry of taxpayer returns and payments remains one of the most labor intensive functions within the tax administration, an effective tax IT system incorporates functionality for electronic filing and payment, including payments through financial institutions.[274]

Taxpayer accounting: The tax administration maintains taxpayer ledgers with balances of taxpayer liabilities – tax, interest, penalties, and others – and refunds owed, and records debits and credits to these balances from payments or refunds. Similarly to registration, proper taxpayer accounting enables other tax administration functions. Modern tax administrations maintain balances by tax type and reporting period, but allow a single look at the taxpayer across taxes for purposes of compliance or, perhaps, the offsetting of tax liabilities.

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[273] Many systems in emerging countries are inhibited by a poorly designed, disparate approach to registration. Too often, registration systems are specific to tax types, regimes, or ad-hoc structures. This creates obstacles for taxpayers and complicates the process for tax administrations.

[274] In most emerging countries, tax return and payment processing is either paper-driven or supported by tools that simply record data electronically as submitted. Supporting information, such as financial statements, are paper-based. Processing is heavily impacted by large volumes of filings during specific times and often results in 'acceptance' delays and data transcription errors.

With IT, the taxpayers' accounts are accurately and automatically updated in a timely manner during the processing of returns, payments, refunds, and with the assessments of tax, interest, and penalties. All tax-related transactions are recorded in a formal accounting system for balancing, reconciliation, and reporting. Historic records for all tax liabilities, payments, penalties, or interests are stored electronically and are instantly accessible.

Audit: The role of the audit function is to monitor compliance by examining returns and supporting information. Modern tax administrations prepare an audit plan based largely on staffing levels and previous audit experience and attempt to select those returns for audit that pose the highest risk to revenues, thus subjecting compliant taxpayers to rare audit interventions, while making potentially non-compliant taxpayers fully aware of costs to non-compliance. Audits can be extensive and may include face-to-face interviews with the taxpayer, inspection of the taxpayer's facilities, financial ratio analysis, third-party data validation, and an inspection of books and records, whereby sample transactions are "walked through" the entire bookkeeping process. The audit workflow is generally complex, following different paths depending on the circumstances. For example, an auditor may take various courses of action, such as: deciding not to pursue the audit due to a lack of risk to revenues; forwarding the audited return for fraud investigations; or completing the audit and requesting supervisor approval of audit results. Audit steps and results are documented in detailed audit reports for use in potential appeals and periodic strategic audit quality reviews.

A basic tax IT system assists the tax administration, first, with the audit plan, by automatically quantifying the risk that each taxpayer poses to revenues and selecting high-risk taxpayers for audit. The system may automate the audit case workflow and, in some cases, will do so fully, such as through the automatic forwarding of cases to auditors based on the auditors' skills and availability. The system also provides relevant return and other available information to the auditor during the actual audit and, in modern systems, may provide a view of taxpayer accounts that is integrated across taxes and tax periods. The rapid initiation of investigations in cases of potential taxpayer fraud is incorporated into the business and system processes. Audit reports are archived for easy access during objections and appeals and for strategic quality reviews. In modern systems, audit information is captured in the compliance database – discussed below – for future audits of the same or other taxpayers, since discovering pertinent information about one taxpayer, when auditing another, is possible. Finally, third-party validation is especially important, and the system may solicit information from a variety of third-party sources in the verification process (e.g., bank account statements, business transactions, insurers, and employer data, including expense reports, among others).

Collections: Tax administrations enforce compliance by pursuing and obtaining or negotiating outstanding payments, initially through engagement with the taxpayer, and, where necessary, through legal enforcement. Modern tax administrations employ an integrated approach to collection enforcement and debt management, where the taxpayer is treated as a single entity for tax debts. This reduces the workload on the tax administration and simplifies interactions with the taxpayer. In addition, a cost-benefit based approach to collections, in which the modern administration prioritizes collection potential before pursuing collection actions, can have a positive impact on the tax revenue stream.[275]

Accurate taxpayer accounting with IT can enable the collections process with the automatic identification of delinquent accounts and the automatic generation of relevant notices. In some countries, collections have been supported by automatic call center facilities that target delinquent taxpayers with calls to remind them of their taxation obligations. The collections case workflow is managed by documenting all collections actions taken and forwarding cases to appropriate officers and management. Information generated during the collections process is integrated into the compliance database for use in future collections or audit activities. Modern IT capabilities in the area of collections also allow for the automated prioritization of collections cases based on the potential of the case to produce revenue.

Objections and appeals: The taxpayer should be allowed to file objections directly with the tax administration regarding its decisions and should also be able to appeal those decisions outside of the tax administration (e.g., through the courts).[276] This provides recourse to the taxpayer and plays a central role in establishing a perception of fairness and engendering voluntary compliance.

Since objections and appeals are the only recourse actions available to taxpayers, and are generated by taxpayers for specific cases, these require careful consideration and the opportunity for automation is limited. Many countries take a "manual" view of these processes. That said, IT can support the objections and appeals function by providing access to the taxpayer account information, tracking the status of objections and appeals cases, and registering the results of appeals. In addition, the e-tax system can allow for the electronic filing of objections and can provide online information updates to the taxpayer with regard to the objections process.

Taxpayer services: Taxpayer services facilitate voluntary compliance by providing information, education, and assistance to taxpayers during filing, payment, collection, and other processes. Modern tax administrations provide support to taxpayers across all tax administration functions, tailor information to different types of taxpayers and taxes, provide both easily accessible and complex information, and use multiple channels, including the web, paper brochures, and telephone inquiries.

IT support to taxpayer services typically begins simply with the provision of online information to taxpayers or with the automated routing of taxpayer inquiries. The maintenance of a well-organized taxpayer web portal, for example, with instructions and frequently asked questions, reduces phone and other inquiries and provides uninterrupted information to taxpayers. Many tax administrations have gone further, introducing e-tax systems. These are described below.

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[275] For example, larger and more recent debts may be given priority over other collections cases, when the analysis indicates that these cases may have higher revenue potential. Risk-driven approaches to collections have received much attention recently. See, for example House of Commons (2009) and Office of the Controller and Auditor-General (2010).

[276] The internal reconsideration process followed during objections and the external appeal process are quite different and are usually handled by separate divisions in the organizational structure of the tax administration. Further detail is provided in Chapter 11.

E-Tax System

The e-tax system offers electronic registration, filing, and payment, as well as education and information to taxpayers. Broadly, the e-tax system is a comprehensive internet portal[277] that forms a suite of secure self-service options to taxpayers, may provide a single point for information and actions, is typically available 24 hours a day and 7 days a week, and does not require intervention from tax administration staff. An e-tax system is not necessarily a standalone IT component. For example, the e-tax system must be integrated with the core tax system to provide the taxpayer with services, such as the ability to view account information and the status of refunds. The e-tax system is thought of as a separate component, as, unlike other components, it is 'taxpayer-facing.'

E-tax systems are often thought of solely as IT support to taxpayer services. It should be clear, however, that e-tax systems do more than provide information, education, and assistance to taxpayers. With components such electronic registration and filing, they also reduce the tax administration's cost of administering taxes. Taxpayers also enjoy reduced costs of compliance when they no longer have to spend time and effort to contact the tax administration by correspondence, telephone, or in person, at the tax administration's offices, where long delays are customary.

Compliance Performance System

The compliance performance system supports the tax administration in identifying potential non-compliance, in selecting for audit those taxpayers that pose high risk to revenues, in prioritizing those collection cases that have high potential for obtaining revenue, in tracking compliance cases from initiation to closure, and, for future planning, in developing intelligence on areas (industries, geographical areas) where the level of non-compliance and fraud is systematically high.

Similarly to the e-tax system, the compliance performance system is not a standalone IT component. In fact, this system must be integrated with the core tax system, as it must draw on taxpayer information. The compliance performance system, however, is usually discussed separately, as it has functionality and information that is very specific to compliance monitoring and enforcement. For example, audit selection requires that each taxpayer is classified according to the risk that this taxpayer poses to the government's revenue stream – a task that cannot be done manually and that is also not used outside of audit and, perhaps, fraud investigations. In addition, audit risk-scoring and other activities used to detect and address non-compliance require the storing and use of extensive information – from taxpayer accounts, to historic information on compliance risks, activities, and results, to third-party data. Along with the relative complexity of compliance process workflows, this integrated 'compliance data warehouse' justifies treating the compliance performance system as a separate component.

[277] Mobile phones have also become an important additional electronic service delivery channel that has grown rapidly over the past 5-10 years. The OECD previously reported that just over half of surveyed revenue bodies revealed the use of taxpayers‘ mobile phones for taxpayer service-related purposes, although, for the most part, the services offered were fairly limited and the volumes quite low. OECD (March 2010), p. 56.

Management Information System

The MIS facilitates the collection and dissemination of performance information throughout the tax administration. It plays a crucial role in the smooth operation of a modern tax administration by ensuring that staff and management get the appropriate reports at the right time.

Frequent and accurate reports can assist with identifying emerging performance and revenue risks and internal problems and provide management with sufficient advance warning to develop an appropriate response. For example, in the area of collections, reports on the inventory of tax arrears, new arrears, and closed arrears help define whether there is too much new debt or whether there is too little production by the collectors. Management of the collections function can use these and other reports to determine how many collection cases can be addressed, which cases can be put aside, whether different methods of contacting taxpayers should be used, whether to seek additional staff, whether to focus on a particular non-compliant sector, or whether staff need additional training.

Although the MIS relies on the taxpayer database as shown earlier in Figure 12.1, it is discussed here as a separate component of the IT system for two reasons. First, the MIS is very important to performance reporting and management. Second, in practice, the MIS normally extracts and analyzes data separately from the core tax system. This prevents transactions that require significant processing power, such as report retrieval, from competing against core tax transactions. For example, in federated system architecture,[278] an operational data store (ODS) – a database that integrates data from several sources with the purpose of further processing – can be used for online analytical processing activities (OLAP), such as data manipulation and reporting, while also integrating and standardizing data taxonomies from multiple, disparate sources.

12.1.2. Sequencing of IT Improvements

Many tax administrations in emerging and transitional economy face limited funding. These countries must decide on a limited set of IT interventions and choose the activities and processes that are most suitable for IT and that have the greatest impact on achieving strategic objectives.

There are no "one-size-fits-all" solutions, and the appropriate IT intervention depends on the existing capability and the specific strategy of the tax administration, among other factors. Where the tax administration has limited or no IT, however, the following sequencing of IT interventions is likely to be successful. First, the tax administration should use IT to support its comprehensive registration function. This is the foundation upon which subsequent IT functions are built. It provides the tax administration with the basic information necessary to manage its taxpayers. Second, the tax administration should automate heavy processing and resource intensive functions, such as taxpayer accounting, filing, and return, payment, and refund processing. Efficiencies in these areas allow the tax

[278] The federated system architecture is a decentralized system architecture, where several teams or business units share data in a semi-autonomous way – controlling certain elements of their corresponding data (e.g., registration information may be controlled independently of return processing information) – but where, despite autonomy, teams are expected to comply with certain common concepts or behavior during data processing (e.g., both registration and return processing describe taxpayers and affect the same taxpayer accounts).

administration to redirect resources to more valuable revenue mobilization activities, such as risk-driven audit and cost-benefit driven collections, and will reduce the costs of compliance for taxpayers to enhance voluntary compliance. Third, IT should be used to enable compliance activities (e.g., a compliance performance system) and to further reduce the cost of compliance for taxpayers (e.g., an e-tax system that provides information, education, and support beyond simply allowing electronic filing and payment).

In the long-run, the tax administration should aim to implement integrated tax systems that support all functions and taxes with common case management and workflow applications. If revenues must be mobilized in the short-term, a comprehensive and integrated registration system and accurate taxpayer accounting, followed by systematic compliance programs are key.[279]

Another important factor is the sequencing in the deployment of taxpayer support services. Typically, taxpayer services are deployed in coordination or as part of an overarching e-Government strategy. In the absence of a specific e-Government coordination agency, tax administrations with the support of the IT organization will embark in delivering electronic services to taxpayers and citizens in general. Delivery of these services generally follows the three phases of e-government[280]. The three phases, namely: publish, interact and transact, align in the evolution of use of ICT as a tool to support taxpayers. During the publish phase, the tax administration makes available relevant information to taxpayers in its website including: legislation, forms, filing calendars, frequently asked questions among others. In the interact phase, functionality for capturing taxpayers requests may be implemented such as making available email addresses, discussion boards or even making available forms or other mechanism to allow taxpayers to submit specific inquires. Finally, during the transact phase, gradually or as part of an integral effort, a full eTax System is made available to taxpayers. The phases do not necessarily have to be implemented in sequence and, in most cases, the interact and transact phases are deployed as part of an overall implementation effort.

Box 12.1. Guatemala's BancaSat eTax services[281]

In August 2001, Guatemala initiated BancaSAT, an online tax filing and payment system supported by the World Bank and managed by the Guatemalan tax agency, Superintendencia de Administración Tributaria (SAT). In December 2002, BancaSAT accounted for 84 per cent of the tax revenues of the country. The online system has significantly reduced SAT's transaction costs and improved service delivery. The system is considered largely successful and highly regarded by users, in particular because of its simplicity.

12.1.3. IT Support Organization

Previous sections discuss the benefits that technology brings to tax administrations. This section addresses the intricacies of the organization in charge of delivering, managing, and maintaining the full range of technology solutions supporting the tax administration.

279 Murdoch et al. (2012), p. 5.
280 InfoDev (2002), p. 3.
281 Wajsman (n.d.), p. 1.

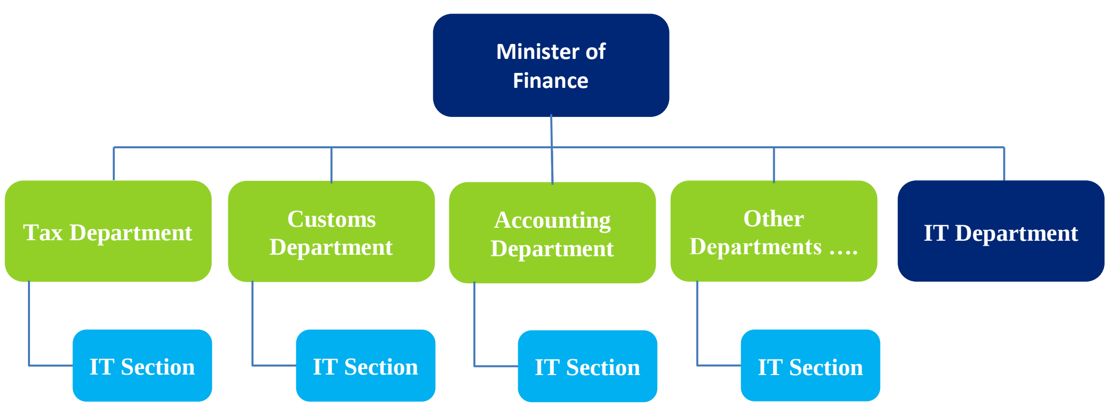
Tax administrations are often a part of larger organization – the Ministry of Finance. In most cases, the Ministry of Finance, has established an organization structure that includes an enterprise IT governance mandate. In other cases, tax administrations may be semi-autonomous or autonomous revenue authorities with dedicated IT support, but may still have to respond to an overarching mandate for the use of technology for the delivery of services. In both, a dedicated IT Department or an IT organization at the ministerial level is key to the delivery of IT services.

> "The introduction and adoption of computerized information systems in rich private firms in developed countries is difficult and poorly understood. Introducing information technology (IT) in public bureaucracies of developing countries with limited resources, weak management, and unskilled staff is even more difficult."
>
> *Source: Information Technology and Innovation in Tax Administration edited by Glenn P. Jenkins*

Historical Evolution

In terms of IT organization, tax administrations and, more broadly, Ministries of Finance, are not much different from regular commercial organizations. Investment in IT support and applications within the organization is assigned based on strategic priorities, with some departments reaching a higher level of computerization than other departments that are deemed less strategic. In the case of Ministries of Finance in emerging and transitional countries, for example, is not uncommon to find that the finance function (accounting and treasury) has reached a more advanced level of maturity than a tax or a budget department in terms of computerization.

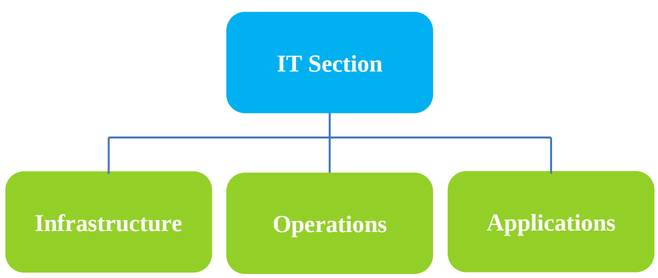
Figure 12.3. A typical Ministry of Finance IT organization



Today, however, donors and governments understand the role of technology in the tax administration, and, at different levels, tax administration modernization projects have considered computerization as a key component. Unfortunately, it is not uncommon to find that IT departments at the Ministry of Finance level lack the competencies and infrastructure to support the implementation of reforms or to quickly react to demands generated by the reform efforts. This lack of central support usually forces reform projects to establish independent IT efforts. This is not unique to tax reform or tax administrations, or to government organizations for that matter. There are cases where broader reforms encompassing not only tax administration and policy, but also financial management, have contributed to the creation of IT support units or workgroups that tend to evolve into full-fledged IT sections. In El Salvador, for example, as a result of the implementation efforts of the Modernization of Tax Administration System (MOST), and later on the Modernization of Financial Systems (SAFI), IT resources were assigned to support the tax, customs, treasury, budget, and accounting departments. Over time, these pockets of IT support have evolved into separate sections that rarely communicate or interact, creating potential integration,[282] standardization, and, in some cases, information security risks. Another historical factor that contributed to the decentralization of IT was the transition from central mainframes to distributed computing that facilitated the creation of geographically or departmentally dispersed resources.

IT silos within organizations are a common issue that reaches national levels in the case of governments. The Treasury Board of Canada, for example, has recognized this issue and enacted the "directive of management of information technology," referencing the fact that "The federal government invests a significant portion of its annual budget on information technology and supporting infrastructure. Rapidly developing technology, incompatible business practices, and the fragmented approach to IT investments undermine effective and efficient delivery of government programs and services. Multiple data centers and networks also pose significant security risks. A more strategic approach to IT investments is needed to ensure interoperability of departmental systems and compatible business practices."[283]

Figure 12.4. A typical departmental IT organization



In addition to the departmental silos, by nature, IT organizations tend to create internal silos around technology domains or platforms, such as servers, databases, or applications. IT departments are commonly divided or separated into infrastructure sections and application sections. In general, this division of responsibilities is designed to clearly define each person's responsibilities and activities,

[282] Integration not only refers to infrastructure integration, but also information integration. A typical information integration issue in Ministries of Finance emerges from the different importance that pieces of key information is given depending of the business process that the IT application supports. For example, a TIN is of prime relevance for the tax administration, but is not equally important for a treasury or accounting department that focuses on effective handling of accounts payable and receivable, but not on properly requesting or validating TIN numbers for government suppliers. In this case, when the tax administration wants to request data from the financial system for, say, VAT reconciliation purposes, the information provided typically lacks proper validations, making it impossible to consolidate and match taxpayer information. Similar cases can be observed in Customs administrations, for example, where the focus of the business is to collect and protect all Customs and Excise revenues, and to control the import and export of contraband goods that can be achieved without even capturing a TIN.

[283] Treasury Board of Canada Secretariat (2009), section 3.2.

which are supported by specific job descriptions. However, this separation in technology domains creates additional issues, including the lack of an integrated view of technology as a service to the business, in our case, the Tax Administration. Resources become so focused on their own domain that they lose perspective and fail to understand the overall picture.

With this type of organization, the applications group tends to be the closest one to the business (or, for the purposes of this document, the tax administration), and tends to garner a larger share of the budget for IT resources than the infrastructure group. This dynamic usually leaves the infrastructure group with scarce resources for maintenance and upgrades, which is one of the main reasons why, over time, infrastructure becomes outdated, unreliable, and unstable.

Infrastructure Consolidation

One step in the right direction that Ministries of Finance are taking towards a reliable provision of IT services is infrastructure consolidation. As discussed previously, application management and supporting infrastructure has sprawled over different departments as part of individual initiatives, creating a different array of infrastructure management issues. 'Infrastructure' here refers to the core physical components that provide common services across the organization, including connectivity, equipment, systems, and software. This infrastructure is used to build the capabilities of specific systems, such as a Tax Administration System or a Financial Management Systems. Often, in Ministries of Finance, infrastructure to support the tax administration and Customs is physically separate and maintained by separate groups. Similarly, infrastructure supporting Financial Management Systems is also managed by departmental resources. This situation, as pointed out before, creates an array of integration, security, and other issues and does not exploit the potential savings in maintenance and acquisition that can be obtained when planning and execution is conducted in a centralized fashion.

With the advent of reliable and more accessible communications technology, it is now possible to centralize infrastructure for consolidated management purposes, providing access to this infrastructure to different departments and allowing them to continue their regular operations and application development efforts without the burden of properly maintaining the underlying infrastructure. The Latin America and the Caribbean (LAC) region has experienced a rapid growth in accessibility to telecommunications infrastructure, and donors are also focusing resources in further developing the sector to support government initiatives. For example, in its strategy for the information and communications technology (ICT) sector, the World Bank states that: "Governments are investing in connectivity infrastructure for government systems; installing high-bandwidth, low-cost networks; extending government networks and services to unconnected institutions, provinces, and universities (National Research and Education Networks); establishing emergency communications; and minimizing the risks of information-security and privacy breaches."[284]

Infrastructure consolidation should be led by the Ministry of Finance’s IT Department and supported at the highest ministerial level to mitigate any potential resistance by affected departments. IT sections at

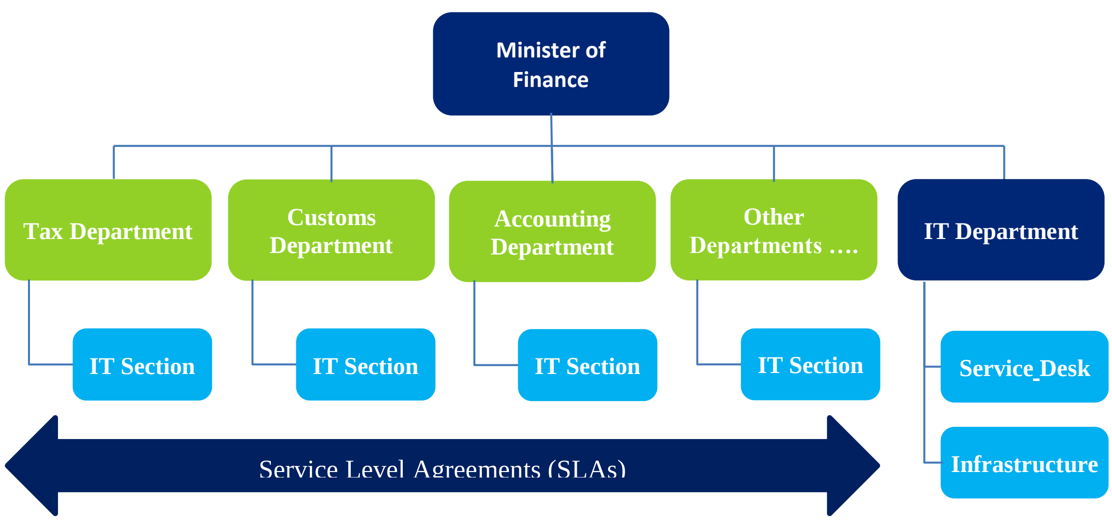
[284] World Bank Group (2012), p. 25.

the departmental level will usually support consolidation efforts, as they are perceived as a relief from the complex task of properly maintaining and avoiding infrastructure obsolescence, among other benefits. In general, infrastructure consolidation efforts, when executed properly, should bring benefits that include: operational efficiency, enhancing operational staff efficiency, reducing power and cooling costs, streamlining disaster recovery functions, and minimizing the cost of data center administration.

It is important to understand that, depending on the complexity of the organization, infrastructure consolidation efforts can take several months to a couple of years to complete.

One important aspect and consideration during infrastructure consolidation that is usually neglected is the close cooperation with the implementation partner or vendor in order to define and implement monitoring techniques with a service-oriented approach. Vendors at network, server, storage, application, and desktop levels need to work in coordination and integration in order to provide the IT Department with relevant and opportune information on the performance of the different components. In an ideal scenario, all the elements are combined to support a business process that reflects established policies and automatically delivers pre-determined levels of services. For example, network and storage utilization may become critical for a VAT tax return processing service at the end of every month. In this case, and as defined by policies, resources are prioritized to this particular service over other services, such as internet access for employees.

Figure 12.5. Infrastructure consolidation



Service Level Agreements

The concept and practice of establishing, monitoring, and adhering to service level agreements (SLAs) should be introduced as part of the infrastructure consolidation efforts. The SLA exposes the organization to an IT service-oriented culture that should serve as the base for more mature service-oriented support and organization.

The Information Technology Infrastructure Library (ITIL),[285] a best practices IT service management framework, defines a Service Level Agreement as "an Agreement between an IT Service Provider and a Customer. The SLA describes the IT service, documents service level targets, and specifies the responsibilities of the IT Service Provider and the Customer. A single SLA may cover multiple IT Services or multiple Customers."[286]

In the case of Ministries of Finance, SLAs are established between the IT Department, maintaining the centralized infrastructure, and the different internal departments, including the IT section for the tax administration, whenever it is present.

The IT Department is in charge of monitoring the different SLAs for internal clients, and resources should also be dedicated to monitor SLAs between the IT Department and external vendors. External vendors include Internet Service Providers (ISPs), hardware and software providers, and vendors and third-party providers for the full array of services that the IT Department consumes.

Service Desk

With the consolidation of infrastructure and streamlining of support functions, leading practice calls for the implementation of a single point of contact between the IT organization and its customers. This is a dramatic change in the culture of support, as users in traditional organizations often learn which technicians in the IT Department can resolve their issues and become accustomed to contacting those technicians directly. However, this traditional arrangement is poorly structured and controlled, leading to unpredictable levels and quality of support for users.

ITIL introduces the concept of the "service desk" and differentiates it from the traditional "help desk." ITIL defines the "service desk" as "the single point of contact between the service provider and the users. A typical service desk manages incidents and service requests, and also handles communication with the users."[287]

In addition, the IT service desk should be differentiated from the help desks that departments establish for their customers. In the case of the tax administration, a help desk to support taxpayers may be established as part of the taxpayer services function.[288] In this case, the help desk is rightfully managed by the tax administration, but the technology used to deliver this service (e.g., the telephone system and associated hardware and software) should be managed by the centralized IT Department under the consolidated infrastructure scope of work.

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[285] The Information Technology Infrastructure Library (ITIL) is a set of practices for IT service management (ITSM) that focuses on aligning IT services with the needs of business. ITIL describes processes, procedures, tasks, and checklists that are not organization-specific, used by an organization for establishing integration with the organization's strategy, delivering value, and maintaining a minimum level of competency. It allows the organization to establish a baseline from which it can plan, implement, and measure. It is used to demonstrate compliance and to measure improvement.

[286] ITIL® V3 Glossary (2007), p. 44.

[287] ITIL® V3 Glossary (2007), p. 44.

[288] Taxpayer services are discussed in Chapter 6.

IT Policy

Another evident need is the definition of a central organization that issues policy for IT purposes. In order to minimize security and information integrity risks, and to leverage economies of scale for procurement of technology, IT organizations must follow a single and coherent policy, aligned to the overall organizational strategy and business policies.

As discussed previously, IT sections will continue to act as service providers to their own departments. When it comes to procurement and resources (both human and material), these IT sections usually operate under the governance of the department that they serve. Each IT section procures technology based on what it determines to be best for its department, which sometimes creates issues related to integration, security, and other areas. IT policies need to be established to cover the use of resources, including the Internet and other shared resources. Policies must also account for existing assets and inventory, as well as the procurement of new technology, licensing, and data retention, recovery, and security.

> "The rapidly increasing pace of technological change will have a significant impact, positive and negative, direct and indirect, on Tax administration organizations. Information technology, which includes telecommunications and computerized systems, looks set to increase productivity substantially, with savings in time as well as money, while at the same time affording customers a better service. On the other hand, the human element is affected by technological changes in different ways, by making jobs more important for some, while posing a threat to others."
>
> *Source: CIAT Handbook for Tax Administration Organizations - July 2000*

Policies should be prepared and enforced by the IT Department and issued with the full backing of upper management at the level of the Minister or Deputy Minister of Finance. One typical mechanism of control for procurement is a process whereby an IT procurement committee, led by the IT Department, is established to analyze and approve new technology procurements. Under this type of process, the procurement of goods and services cannot proceed without the approval of the IT procurement committee.

12. 2. Common Trends

This section presents IT trends that are not universally practiced, but are emerging practices in IT initiatives that tax administrations should consider.

12.2.1. Commercial Off-The-Shelf and Custom-Built IT Systems

Custom-built and COTS solutions are at the two extremes of the implementation channel spectrum. The purpose of this section is to highlight the differences between the two and the key decision factors that impact the tax administration's choice of one or the other. The focus of the following discussion is on complete IT solutions for tax administration, with all elements of the IT solution landscape discussed above, as this is when the choice of custom-built vs. COTS solutions usually arises. In practice, the term 'COTS' may apply to a narrower solution, ranging from shared infrastructure and middleware to integrated core processing systems (registration, returns and payment processing), to shared analytics and integrated case management for compliance, and tax administrations can use a mixture of custom-built and COTS solutions for components of the comprehensive IT system.

Characteristics of COTS and Custom-Built Development

In reality, the distinction between custom-built and COTS can be difficult to discern. It is possible for a tax administration to purchase a COTS solution and to subsequently make significant alterations. The COTS solution would be tailored to such an extent that a custom development would have been a more appropriate solution. This, in itself, is not necessarily a barrier to implementation, provided that the tax administration understands the extent of modifications, plans for the associated time and cost, and ensures that support arrangements are not impacted by extensive modification. Either option, or a combination of the two, can provide value to a tax administration.

Custom-built Development

As above, in-house custom-built developments were widely employed as an implementation approach up until the late 1980s. From the 1990s to the present day, this approach has been widely reduced due to the complexity of implementation and the growing availability of external providers and products, amongst other factors, although this phasing out has been slower in emerging and transitional economies than in developed countries, perhaps due to the lack of funds, the need for flexibility, and even the biases of the IT staff. As tax administrations moved away from internal system development, the emphasis shifted to vendor provided alternatives. The shortcomings associated with in-house development, such as the lack of internal capacity, could be bridged by external providers with implementation experience and technology expertise.

Vendor provided custom-built systems have been implemented in a number of countries with varying success. A common approach to custom-built solutions is to implement them by component or module, which may be suitable for tax administrations with already existing technology, time constraints, limited resources, and a need for flexibility, or for tax administrations that aim at quick revenue gains or cost reductions. The most significant benefit associated with custom-built systems is control. By planning and implementing changes using internal or contracted IT resources, tax administrations are able to wholly own the development process, giving them significant influence over system design and implementation.

There are also disadvantages of the custom-built approach. There may be difficulties in defining business and technology requirements or in ensuring the sustainable transfer of technology from the vendor to the tax administration.[289] Sometimes, this is the result of time and cost pressures. Other times, the tax administration lacks internal expertise, as software development for a modern tax administration IT system with all key IT competencies requires knowledge in many areas, including databases, user interfaces, security, and web services, among others. In addition, vendors may have

[289] See Bozeman (2000) and Haug (1992).

limited local knowledge, which can inhibit progress, particularly in tax administrations unused to change. Finally, designing, custom-building, and implementing a full-scale – across all functions – tax administration IT system 'from scratch' takes many years.

Figure 12.6. Advantages and disadvantages of custom-built IT solutions for tax administration

Advantages	Disadvantages
▪ A solution tailored to the tax administration's structure and needs ▪ Lower initial development cost and potential for more rapid initial implementation ▪ Greater buy-in from counterparts as they have more control over the system and have ownership over design and implementation ▪ Leverages internal expertise ▪ Capitalizes on existing investments (e.g., leverages existing technology investments) ▪ Internal control of enhancements and maintenance ▪ Flexibility to make changes as needed to be responsive to needs, especially where procedures and requirements may not be well defined	▪ Dependency on availability of internal expertise (potential key person reliance, capacity issues, etc.) ▪ Significant internal change / project management capability required for large information technology projects ▪ Difficulty retaining key IT staff ▪ Difficulty keeping pace with advanced technological change (including new technologies, security standards, etc.) ▪ Difficulty enforcing best practice (e.g., integration across tax types) ▪ Difficulty maintaining high documentation standards ▪ Longer development time for full-scale implementation

Commercial Off-the-Shelf Deployment

COTS solutions – a response to the demand for the quick implementation of robust and sustainable tax administration systems – provide cutting edge technology and implementation expertise. COTS solutions are ready-made, transferrable, and generally designed to accommodate leading practice in business processes. A good COTS solution: provides for localization (natural language, currency); uses current technology; is improved by periodic releases; allows for multiple communication channels (e.g., web-enabled); allows input from multiple sources (keying, scanning, e-filing); is able to interface with external authorities (e.g., business registry and Customs); allows for the centralized or decentralized implementation of individual functions; is modular, scalable, and maintainable; is well documented; and is hardware independent.

Most software companies issue new releases to comply with IT technological trends and so COTS solutions provide cutting-edge technology with potentially shorter implementation timelines, are rigorously tested, share deployment costs amongst users, often provide superior functionality and capabilities, and, over time, can have a lower total cost of ownership than customized solutions. There is also the potential to adopt new technologies, such as Software as a Service – a model of 'renting software' – and Platforms as a Service – a model of renting hardware, operating systems, and storage and network capacity.[290]

In general, COTS solutions provide some level of flexibility and are typically designed in a manner that facilitates some configuration for certain functions without incurring significant development costs (e.g., form design tools and workflow design tools simplify development; tax computations and audit selection criteria are housed in "rule engines," easily accessible and configurable to local needs and legislation). Although COTS solutions are configurable to meet most of the requirements of a tax administration, some may require customization.[291] In practice, where there is high level of process variability or differences between current and leading practice, generic COTS offerings may not be fit for the purpose, and the costs to customize the COTS package can rival the costs associated with the development of a custom-built system. Key elements of process variability include a high degree of human intervention, complex business rules, and complicated organizational relationships. Where the base level of tax administration technology is very low, COTS solutions can be attractive, as sometimes it makes more sense to start from scratch with a ready-made product.

Figure 12.7. Advantages and disadvantages of COTS IT solutions for tax administration

Advantages	Disadvantages
▪ Higher quality, fully-integrated solutions ▪ Built-in industry best practices for all IT competencies (core tax, management information, compliance performance system, and e-tax systems) ▪ Reinforces best practices as the new system provides additional discipline over processes and procedures	▪ Customization required to meet local requirements, given variability of laws and procedures ▪ Lack of buy-in with respect to changes in existing business processes, organization, and IT infrastructure by users and disputes with the vendor may lead to a failed implementation ▪ Requires significant change

[290] Both would reduce upfront investment costs at the expense of ongoing fees. While this is an unproven approach today, this model may work with sufficient scale. These types of offerings become more attractive in austere environments where a large capital expenditure is not possible, but where an annual subscription agreement can be completed between donors and host countries. Since information would be stored in a "cloud," security and the confidentiality of taxpayer data is a concern.

[291] For the purposes of this chapter, configuration is changing the workings of the system to conform to specific settings by using the functionality already provided to the user, without actually "programming." For example, a COTS solution may allow the design of tax forms for data entry of taxpayer returns with simple point-and-click operations. Customization means modifying the functionality of the system, perhaps through programming or data conversion.

Advantages	Disadvantages
▪ Future development costs shared with other customers ▪ Implementation track record ▪ Cutting-edge technology ▪ Potentially shorter implementation timescales ▪ Rigorous testing and deployment methodologies	management capability in the absence of leading practice ▪ Relatively high initial license and implementation costs ▪ Vendor reliance for support and maintenance (i.e., external risk and potential cost issues) ▪ Not component-wise (full package offered)

Key Decision Factors

With respect to the strategic and selection guidelines discussed above, three decision factors are most significant to the choice between custom-built and COTS solutions. These are discussed below.

Strategic Objectives

Fundamentally, the decision between custom-built or COTS solutions boils down to a choice between being in the business of software development and maintenance or relying on established, albeit standard, solutions. In essence, this is a choice between cost and control.

In total cost of ownership terms, custom-built solutions may be cheaper for smaller tax administrations, particularly in consideration of licensing costs, whereas COTS solutions may be more cost effective for larger implementations with a wider breadth of system requirements. COTS solutions may be appropriate where there is major tax administration reform across all tax administration functions that requires sufficient funding and commitment to reform and leading practice, as in the cases of Egypt and Costa Rica below.

Box 12.2. COTS Implementation in in Egypt

USAID's Technical Assistance for Policy Reform project in Egypt assisted the government during 2002-2005 with the establishment of a Model Customs and Tax Center (MCTC). The MCTC was open to taxpayers of minimum size, located in Cairo, and classified as importers. Although participation in the MCTC was voluntary, the number of participating taxpayers grew quickly from 300 in 2003 to 2,000 in 2005. Improvements in taxpayer services, such as shortening the time for customs clearance from seven days to one day, were quoted as the main reason for the interest. After the MCTC was converted into a Large Taxpayer Center (LTC) in 2005, at the recommendation of the IMF, the center handled roughly 70 percent of total Egyptian tax revenue. The LTC was cited as one of the reasons for the reduction of Egypt's overall negative fiscal balance from 9.6 percent in 2004-2005 to 6.8 percent in 2007-2008. USAID's Technical Assistance for Policy Reform II (2005-2010) assisted the government of Egypt with the merger of its tax departments into a single Egyptian Tax Authority (2006). As a result of the merger and other project activities, more than 1 million active self-assessing taxpayers in 2006 and more than 600,000 in 2007 were added to the tax rolls, income tax collections grew albeit lower income tax rates, and overall tax collections increased by reported record-breaking 20 percent year-over-year in 2006.[292]

Box 12.3. COTS Implementation in in Costa Rica[293]

During the 1980s and 1990s Costa Rica achieved substantial growth, but did so at the cost of significant increases in its net outstanding internal debt. The central government's domestic debt represented 15 percent of GDP in 1990 and reached 26 percent of GDP in 1997. In 1998, Costa Rica embarked on significant tax policy reforms aiming at revenue mobilization, as well as simplification, reducing the existing multiplicative legal framework, repealing a number of provisions that significantly eroded the tax base, and counteracting the revenue impacts of trade liberalization reforms from early 1990s and a number of recurrent and contradictory VAT and excise tax reforms introduced during 1990s.

In 1999, after unsuccessfully attempting to adopt the Honduran IT system, the tax administration began to develop a custom-built IT system, launched the Sistema Integral de Información para la Administración Tributaria program, and, in its 2000 strategy, identified the need for web-based modules for return filing and the re-deployment of hardware platforms. Later user satisfaction surveys, however, revealed a number of problems with the implementation. In 2006 MOF launched its New Integrated Model of Digital Tax initiative, citing not only the need to increase tax collections and minimize fiscal deficits, but also the need to combat tax evasion and corruption in the system. A number of COTS systems were identified and evaluated before the SAP Tax and Revenue Management system was chosen.

More often than not, COTS solutions in developing and transitional countries fail, because tax administration processes do not conform to leading practice and there is insufficient funding or inadequate management of change. A number of countries, such as El Salvador, Georgia, and Bosnia and Herzegovina – the latter recently moved to a "hybrid" custom/COTS solution – have opted for piece-wise reform over time with proper prioritization of targeted custom-built IT interventions. In the long-run and on occasion, custom-built solutions may prove costly with short lifespans and multiple implementation efforts, as in El Salvador.

292 Murdoch et al. (2012), p. 5.
293 Jimenez et al. (2012), p. 47.

Box 12.4. Custom-built Implementation in in El Salvador[294]

El Salvador's tax administration pursued a custom-built solution through a series of reform projects. The USAID funded Modernization of Salvadoran Taxation (MOST) project, running between 1991 and 1995, resulted in an overhaul of the tax administration landscape, including the replacement of the legacy tax mainframe system and the decentralization of computing. This project addressed the core aspects of tax administration IT and, by 1994, the MOST team had developed a custom-built FoxPro based system that included VAT and income tax registration, return processing, payment processing through banks, and some basic audit selection tools. Over the course of this project, USAID also worked with the Ministry of Finance to change its approach to taxation, with a focus on measures to improve compliance. In parallel, IADB provided support for the establishment of a Large Taxpayer Unit with an information technology department responsible for the design, development, and deployment of a separate custom-built tax administration system dedicated to large taxpayers.

In 1998 the tax administration initiated an IT integration program as part of an effort to combat a decline in tax revenues. By 2002 both systems had been integrated onto a single Linux based platform that used Informix as the database environment and PowerBuilder as the application language, replacing the MOST FoxPro system. The system facilitated increased processing requirements and eliminated the duplication of functionality. The new system, dubbed Sistema Integrado de Información Tributaria (SIIT), provided a single platform for taxpayer registration and returns processing with basic taxpayer accounting, archiving, and audit functionality.

By 2002 the new SIIT was suffering from hardware performance issues due to high data traffic and increased user demands. The Ministry of Finance requested further assistance, emphasizing the need for system modernization support and enhanced audit functionality. In 2002 USAID launched the Tax Administration Project (TAP), which deployed new hardware platforms and introduced an off-site system for field audits.

By the end of 2004 a raft of new tax measures increased pressure on tax administration operations and systems with additional compliance requirements, tighter controls on VAT, and new filling requirements. In 2005, USAID launched the Tax Policy and Administration Reform (TPAR) project aimed at further system modernization. Between 2005 and 2010 the TAPR project team replaced the SIIT system with a new version dubbed J-SIIT, which replaced Informix and PowerBuilder with Oracle and Java and provided increased data processing capacity and functionality to support web-based taxpayer services. An updated desktop client for tax officers and a Fiscal Compliance Call Center were included. The Fiscal Compliance Call Center comprised an automated system to call delinquent taxpayers, including stop filers, and remind them of their tax liability. A major focus of the TAPR project also was the complete redesign of the audit process, including the deployment of a Case Selection Management System (CSMS) that automated the risk-scoring audit selection process and the assignment of audit personnel to each case, rather than leaving such decisions to the discretion of tax officials, and monitored the progress of audit cases. A Taxpayer Assistance Call Center was also created to provide assistance, orientation, and legal guidance to taxpayers on their tax obligations.

With respect to control and intellectual property rights, the tax administration usually owns the source code of custom-built development, whereas the vendor retains ownership for COTS products. Thus, if future customization is required, the tax administration may be locked in with the COTS vendor.

Requirement Identification – Implementation Complexity

All modern tax administrations have the same core functions, such as registration, return and payment processing, audit, and so on. Even so, not all tax administration face the same level of IT implementation complexity. In the simplest case, the administration may be handling a single tax with a

[294] Ibid., p. 37.

limited filing population and a single central tax office and processing center.[295] Given the low number of taxes (one) and the centralized staff and infrastructure, this is a tax administration relatively free from complexity. A COTS solution may not be suitable in this case, as many COTS solutions do not permit the scaling back of core revenue management functionality and are relatively inflexible in cost terms.

Complexity increases in conjunction with the number of taxes and the size of the geographic footprint. COTS solutions become more appropriate as complexity and scale increases, assuming conformity with leading practice. In addition, larger projects require a wider breadth of expertise – systems security, internet skills, document management, etc. – that is uncommon in internal IT departments. Custom-built solutions are more appropriate with smaller or targeted system implementations, where local knowledge and speed are important.

Existing Capability Assessment

Attention should be given to the assessment of organizational structures and processes against leading practice. COTS solutions are developed according to leading practice and organizations that conform typically face reduced need for customization, incur lower implementation costs for COTS solutions, and have a better chance of success. Conversely, organizations that deviate significantly from leading practice are likely to encounter higher customization costs and longer implementation times. Excessive customization can, in some instances, blur the line between COTS and custom-built solutions. In cases where adhering to leading practice requires change, strong leadership support is fundamental and the administration's ability to manage and implement change must be considered.

It is often the case in developing and transitional countries that processes and existing IT solutions are ad hoc, not well documented, or simply non-existent, in which case many IT implementations will falter. Processes and capabilities should be at least formalized and, perhaps, streamlined before the IT approach is validated and custom-built or COTS solutions are pursued. It could be argued that COTS solutions can and should be used to "enforce" leading practice. If so, IT must be a part of larger reform that depends very much on political will and change management, among other factors.

12.2.2. IT as a Service Organization

IT organizations facing the challenges associated with the decentralization of technology resources and that recognize IT as a key enabler of overall business objectives are increasingly adopting and implementing actions towards becoming a service management oriented organization. To understand IT service management (ITSM), one must first understand the meaning of services. A service is a means of delivering value to customers by facilitating outcomes that customers want to achieve without having to bear specific costs and risks.[296] Furthermore, services that customers can directly utilize or consume

[295] Qatar is a country with a single tax, limited filing population, and a single tax office. Bosnia and Herzegovina, on the other hand, collects all major taxes and does so at different levels – national, entity, or region / municipality – and many offices. Fortunately, Bosnia and Herzegovina has a single tax administration law based on leading practice. El Salvador is another complex case of implementation (VAT), as the country attempted to connect all store registers directly to the TAS.

[296] Cartlidge (2007), p. 6.

are known as "business" services. IT organizations supporting tax administrations should move beyond a focus on cost optimization of technology domains or silos and strive to become service-oriented organizations that are also concerned with how technology components are assembled into services and how these services are delivered to the tax administration.

12.2.3. IT Organization Consolidation

IT organization consolidation, whereby multiple IT sections consolidate under a single IT Department, is an ambitious endeavor. Efforts to consolidate often face considerable internal resistance from departments that are accustomed to having direct access to their IT application resources.

A recent study by the Ministry of Finance in El Salvador concluded that a major IT consolidation of its Financial Management Units (Treasury, Accounting, Budget, and Public Investment) addressed issues and provided the benefits presented in the following table:[297]

Figure 12.8. Issues and benefits of IT consolidation in the Ministry of Finance

Issues	Potential benefits
▪ Duplication of efforts. Application maintenance is provided by different actors and units originating different solutions to what are usually common problems; ▪ Lack of IT support to departments that are less developed in IT; ▪ Lack of adherence to IT policies; ▪ IT services are provided as a reaction to issues and do not proactively identify and tackle potential risks; ▪ IT strategy is defined at a department level and lacks a more integrated financial management vision; ▪ No single point of contact for Financial Management Units at the Government level to support their operations. ▪ Difficulty developing new projects due to minimal flexibility in terms of resources; ▪ Lack of standardization; and ▪ Solutions lack a long-term vision.	▪ Increase the level of availability of the Financial Management System; ▪ Design and development of integrated solutions; ▪ Maximize the utilization of shared resources; ▪ One single solution for similar issues; ▪ Policy standardization and application; and ▪ Empower staff by sharing a common technology framework.

The analysis above, applies to an IT organization that supports the finance function but the result of the study also apply to Tax Administrations where fragmentation of IT support has occurred and even for Tax Administrations that are part of a larger organizations with dispersed IT support.

[297] Dirección Nacional de Administración Financiera (2012), p. 8.

12.2.4. The IT Solution Decision

The first examples of IT systems in tax administration can be traced back to the 1960s. Developed in-house, these were standalone applications, designed to support specific tax administration functions, and were generally not integrated across tax types or functional areas.[298] Over the following two decades, tax IT systems began to occupy an increasingly central role in the operation of tax administrations and, by the early 1980s, the first integrated systems appeared.[299] These were custom-built and, thus, one-off solutions developed in accordance with the specific requirements of the tax administration. Built either in-house or by external providers, these systems had long and complex development cycles, high-risk implementations, and significant investment expense.

During the 1990s, the demand for integrated tax IT systems continued to grow, and, as the 1990s drew to a close, commercial off-the-shelf (COTS) solutions became widespread. These were ready-made, rather than designed for specific needs, and typically based on leading practice. While they still required customization and investment expense, they were marketed as integrated and configurable to meet the varying requirements of modern tax administrations with reduced implementation timelines and investment costs.

In the early 2000s, COTS solutions expanded to incorporate enterprise resource planning (ERP) and customer relationship management (CRM) applications. Provided by ERP/CRM vendors such as Oracle, SAP, and Microsoft, these were marketed to tax administrations as all-encompassing solutions, providing the means not only to implement and automate common processes across taxes, but also to more effectively manage workload and resource distribution through workflow management applications and monitoring progress through enhanced management information systems.[300]

Today, the pace of change in IT provides continuous innovation in systems development, including in tax administration systems. It is no surprise that modern tax administrations around the world use a variety of IT solutions to meet their technological needs. In 2010, the OECD reported that developed countries used, nearly universally, custom-built solutions for traditional revenue management functions, such as registration, collections, and audit, and a mixture of custom-built and COTS solutions for modern functions, such as online applications and reporting.[301] Emerging economies, on the other hand, used a mixture across all functions. While large, integrated tax IT systems are almost ubiquitous in OECD countries, however, they are less common in emerging economies,[302] where IT capability tends to reflect the maturity of the tax administration.

[298] The U.K. Inland Revenue's first computer system, planned in the 1960s to run nine computer centers across the country, implemented 'Centre I' in 1968. Margetts (1999), p. 109.
[299] The EC VAT information exchange system (1993) and the Indonesia property tax system (1985) are discussed in Jenkins, (1996).
[300] Puerto Rico, for example, implemented PeopleSoft for taxpayer registration and management in 2004-2006.
[301] OECD (March 2010), p. 4.
[302] In 2000, Arturo A. Jacobs stated that developing countries' "organization's information systems are still largely manual. At best, tax administrations in many developing countries count only on a smattering of computer

The IT Solution Landscape

IT systems enable modern tax administrations, providing the means to achieve strategic objectives through data management, process automation, and taxpayer engagement. If appropriately designed, tax IT systems can help tax administrations to effectively collect and store taxpayer information, conduct analysis for targeted compliance activities, and provide taxpayers with simple channels for complying with tax obligations.

There are a number of ways in which IT can benefit the tax administration, but the decision to implement IT is not always simple. While available solutions for comprehensive and integrated modern tax administration IT system have similarities, with the typical components of the IT landscape, there are also differences. There are, for example, distinct implementation channels, such as custom-built and COTS solutions, that may influence the cost, time-to-market, and usability of the solution. There are various 'roadmaps' to the system, including piece-wise implementations – component by component – or full-scale implementations – of all IT components across all tax administration functions. There is perhaps a simple, historical rationale for the fact that tax administrations in OECD countries use custom-built solutions for traditional functions and COTS solution for 'modern' ones. These administrations may have opted against full-scale implementations and chosen modern solutions to accommodate new activities and complement already present IT components for traditional functions. There are also, of course, many vendors[303] and various potential areas for IT intervention. The purpose of the remainder of this section is to provide an approach to making the appropriate IT decision.

IT Procurement as a Strategic Business Decision

Although IT can clearly contribute to the tax administration's objectives, the decision to procure IT should not be taken lightly. IT solutions may require changes to the organization, processes, staffing roles, and staff skills. In addition, IT solutions are costly and will divert the administration's limited resources from other important activities, but may falter if not appropriate. Even if the implementation itself succeeds, an unfitting IT solution may have a short shelf-life and limited usefulness. The IT decision is thus a strategic business decision,[304] one that must conform with the tax administration's overall strategic objectives to ensure usability and the needed level of institutional capacity, and one that is preceded by a rigorous cost-benefit analysis to ensure that the administration's limited resources are spent wisely.

Strategic Objectives

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equipment at a few office locations, much of it old equipment supported by outdated technology." Jacobs (2000), p. 1.

[303] An illustrative list of vendors is provided in Appendix 12.A.

[304] Oliver (2002), para. 2.

The tax administration is not an IT provider, and IT is simply an input that allows the tax administration to perform its tasks and achieve its objectives. Although the primary task of tax administrations is the same – to collect the right amount of tax from the right taxpayer at the right time – their interim strategic objectives can vary greatly: to achieve uniformity in applying tax laws; to provide quality service and taxpayer education; to improve targeted audit programs; or to develop effective managers. Each of these objectives calls for a different IT intervention. For example, uniformity in applying the law can be achieved through automated workflows that reduce discretion. Quality service and taxpayer education may call for an e-tax system or components thereof. The better targeting of audits requires automated risk-scoring mechanisms or, perhaps, a compliance performance system. Effective management relies on an MIS.

Of course, long-term strategic plans would likely take a holistic approach to tax administration, addressing organization, taxpayer segmentation, staffing, facilities, functions, human and institutional capacity, integrity, and communications, as well as technology. In the medium term, however, IT interventions should conform to other programs and projects of the tax administration. It would be inappropriate, for example, to pursue the automation of audit workflows if a subsequent organizational restructuring is expected to change the levels of audit reviews and approvals.

Cost-Benefit Analysis

The cost of IT implementation is relatively simple to define and quantify. Still, there are direct costs to IT, such as hardware, software, procurement, implementing, integrating, operating, training, and replacement expenses, indirect costs, including staff time spent on requirement definition and other procurement activities, training, testing, and general downtime, while the solution is being deployed.[305] An illustrative list is provided below. This total cost is sometimes dubbed the 'total cost of ownership' of the IT solution.

The benefits of IT implementation can and should be translated directly into contributions towards the tax administration's tasks. First, with IT, the direct costs of administering the tax system may diminish. For example, data entry staff time will be reduced due to the introduction of e-filing, making the administration more efficient. In practice, it is more likely that resources – budgetary, staffing, or other – that become available to the tax administration after IT implementation would be placed into new uses. For example, with the introduction of e-filing, staff may be re-trained to provide education, support, and information to taxpayers. Second, the tax administration may become more effective. For example, e-filing reduces the number of keypunch errors made by tax administration staff during data entry. Third, benefits to taxpayers should be included, as the tax administration is not a profit-making business, but an integral part of the government machinery. With e-filing, taxpayers may spend less time and money preparing, printing, and mailing paper returns, as well as less resources following up on the status of their filings, payments, and refunds. This means that the tax administration becomes less

[305] To simplify matters, the term 'opportunity cost' is not used. The government's staff labor and IT solution suppliers to government hardly operate in competitive markets and, hence, the opportunity cost of IT implementation does not necessarily reflect supply costs. Using opportunity costs, however, would necessitate that the social benefits of foregone tax administration actions be investigated, which, as discussed below, is difficult.

intrusive in the business environment. Fourth, the tax administration may become more even-handed in applying the law. Furthermore, e-tax systems lessen the opportunity for corruption by reducing direct interactions between tax administration staff and taxpayers. A specific e-filing initiative may be complemented with automatic return checking and notifications, reducing staff checking and the corresponding discretion.

The following are illustrative quantifiable costs and benefits of IT implementation.

Figure 12.9. Illustrative costs and benefits of IT implementation

Illustrative costs	Illustrative benefits
Procurement costs: ▪ Hardware and software / licenses; ▪ Staff time spent on procurement, implementation, integration, operation, testing, training; ▪ Staff downtime. **Operating costs:** ▪ Maintenance (e.g., backups, license tracking, security prevention / recovery, IT personnel time); ▪ Infrastructure (floor space, electricity); ▪ Internal and external audits; ▪ Future training. **Replacement:** ▪ Replacement, upgrade, or decommissioning expenses.	**Effectiveness:** ▪ Higher revenues with more formal taxpayers, less fraud and evasion, or larger assessments. **Efficiency:** ▪ Less staff time on core tasks. **Better business and taxpayer environment:** ▪ Less taxpayer time spent on compliance; ▪ Less staff time spent on non-compliance (involuntary errors). **More uniform application of the law:** ▪ Higher revenues.

It should become immediately obvious that the table above displays two types of benefits of an inherently different nature. Efficiency and business environment improvements reduce economic efficiency losses. In economic terms, with such improvements, both the tax administration and the taxpayer can be made better off without making either, or anyone else, worse off. Higher revenues, on the other hand, are simply additional transfers from the taxpayer to the government. In an economic sense, a cost-benefit analysis of changes in government operations should include only the first type of benefits. It is possible to argue that, when the government provides goods and services that would not be provided by the private sector due to externalities or transaction costs, higher revenues would similarly bring about efficiency improvements. However, this is not always the case. A cost-benefit analysis of IT improvements should be appropriately constrained to comparing procurement, operating, and replacement costs with improvements in administration and taxpayer efficiencies.

The following figure shows a simple estimate of the monetized benefits of unified business and tax registration in Georgia.

Figure 12.10. Monetized benefits of unified business and tax registration in Georgia[306]

92 GEL = average daily net profit of business in Georgia

*43,000 businesses registered annually

<u>* 5 days saved by new procedures</u>

=19.78 million GEL

1 day of accountant/lawyer work saved

<u>*45 GEL average daily salary</u>

=1.935 million GEL

99,000 GEL in annual Tax Department personnel time saved

Total annual savings = 21,814,000 GEL or $12.4 million

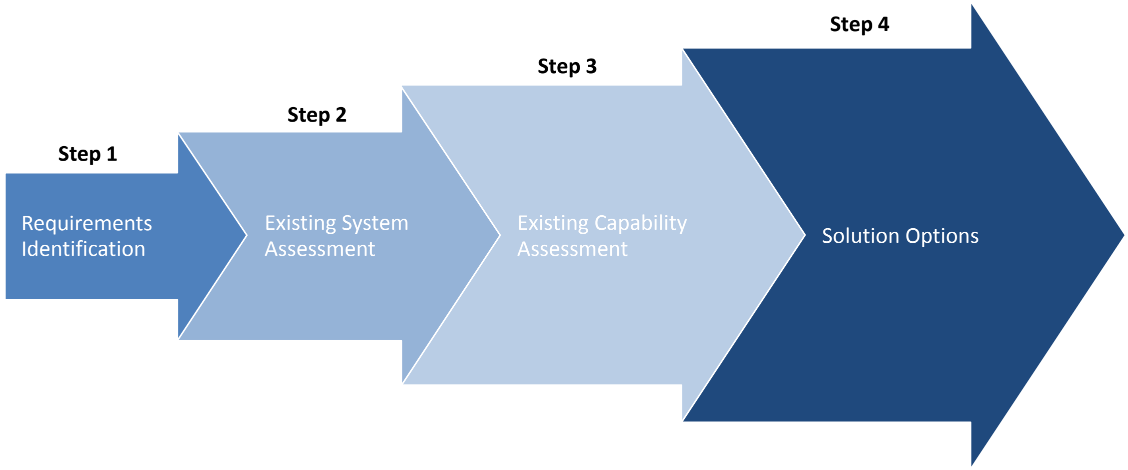
Not all inputs can be easily translated into quantifiable costs. For example, IT implementation may result in staff frustration. Similarly, not all improvements can be easily translated into quantifiable strategic outcomes. For example, third-party data matching can improve compliance monitoring and enforcement and will help institute a perception of fairness amongst taxpayers, improving voluntary compliance and resulting in higher collections, as well as in general taxpayer satisfaction. Difficulties in monetizing costs and benefits, such as staff frustration or taxpayer satisfaction, should not detract from the need for a cost-benefit analysis. In some cases, tax administration officials can rely on the experience of other countries to develop general benchmarks. For example, a 2007-2008 Danish study found that taxpayers subject to third-party reporting and matching had evasion rates below 1 percent compared to 40 percent for taxpayers not subject to third-party reporting and matching.[307]

Selection Guidelines

A simplified IT acquisition process of four steps is shown in the figure below. The tax administration can follow this or a similar process after validating the strategic business need for IT investment. The first step in this acquisition process is to identify the requirements for the solution. The second and third steps are to assess existing systems and capabilities. The last step is to review system solution options and identify the most appropriate one. These are detailed below.

[306] Adapted from Gallagher (n.d.).
[307] Dogan (2011), p. 71.

Figure 12.11. Four-step IT acquisition assessment process



Requirements identification: A typical full-scale – across all elements of the IT solution landscape – tax IT system procurement comprises over three hundred requirements, including general technical requirements, specific technical requirements for each of the core tax administration functions, and a number of non-technical requirements related to security, user interface, and other. These are derived from the strategy and must comply with existing business rules (e.g., legislation), documentation and training needs, and the need to cooperate with other agencies, amongst other factors.[308] Attention to these is important, as future development, customization, testing, and piloting are the most time consuming and costly part of the implementation and would be streamlined with properly specified and detailed requirements.

Existing system assessment: Existing (legacy) systems should be assessed to understand if such systems can accommodate IT requirements and to identify the gaps between existing systems and future system needs.

Existing capability assessment: An assessment of existing capabilities, including previous development experience, should include the IT capacity of future users, the capacity of IT staff to develop and support the system, the need for modifications to existing structures and processes, and the ability of the tax administration to manage change. The latter is specifically important in larger implementations that may require wider institutional change.

System options: Solutions that satisfy the requirements should be researched and analysis completed, including total cost of ownership and timing of implementation. The figure below presents an illustrative example of the decision criteria and the key questions that need to be answered when assessing system options.

[308] World Bank (n.d.), p. 1.

Figure 12.12. Illustrative system selection decision criteria framework

Decision driver	Definition	Illustrative weight
Cost of ownership	How does each option compare against other options in terms of total cost?	15%
Core to business	How well does each option relate to the business direction, activities, and capabilities?	15%
Time to market	How quickly will the option deliver the solution, and is this in line with strategic objectives and corresponding action plans?	15%
Degree of customization	How well does each option provide the needed functionality, and how much additional development is needed?	15%
Skilled resource availability	What level of skilled resources is needed to develop or support each option, and are sufficient skills available?	15%
Technology compatibility	How well does each option complement existing technology (e.g., architecture, infrastructure, security)?	15%
Intellectual asset strategy	How well does each option meet the intellectual property ownership needs or requirements of the administration?	5%
Exit strategy cost	How costly is it to exit each option?	5%

12.3 Tax Administration Maturity

The maturity levels of tax administrations, with regards to IT structure and management, are discussed below.

Information Technology: Maturity Level 1

Key word: "Paper-based"

- Taxpayer registration information is placed in paper-based systems or supported by basic computerized tools, such as Excel or Access. Many taxpayers are not registered or entered in the system, and the registration system does not provide support for registration compliance. There is no automated support for duplication validation. Management reports summarizing the taxpaying population do not exist.
- An IT system does not exist.
- IT is limited to the use of Microsoft Office or similar applications, typically for the issuance of notices (manually typed) or for keeping an ad hoc database of taxpayers.

- The use of common applications as IT solutions is ad hoc and varies across individual staff. Common applications have limited ad hoc documentation.
- IT development / procurement decisions are taken by individual staff and address the needs of their specific position.
- Limited IT training is provided to selected junior staff and includes only basic computer skills (i.e., Microsoft Office).
- No IT staff exists to provide support with simple tasks, such as computer and network setup.

Information Technology: Maturity Level 2

Key word: "Disjointed"

- The IT system provides only processing support to core functions (e.g., registration, filing and payment processing). The system was built incrementally, storing tax information separately for each type of tax or for each administration function.
- IT is used in some core functions (usually registration and taxpayer accounting), but not in other core functions (e.g., fraud investigations, audit). IT is generally not used by support function staff (e.g., legal services). IT use is limited to the automation of simple processing and does not provide management information, facilitate workflow, or provide taxpayer support.
- The use of specific IT applications is ad hoc and varies across divisions. Specific IT applications have limited ad hoc documentation.
- IT development / procurement decisions are taken by heads of specific decisions and address the needs of their specific decision.
- Limited IT training is provided to selected junior staff and includes mostly basic computer skills and on-the-job training in the use of the IT solutions.
- Limited IT staff provides support with simple tasks, such as computer and network setup, as well as with occasional requests by division managers for development.

Information Technology: Maturity Level 3

Key word: "Supporting"

- Registration information is maintained through occasional ad hoc programs, but not in a timely manner. Maintenance includes both adding new registrants and removing taxpayers who are no longer active. It does not include updating information upon taxpayer reorganization.
- A formal registration system, integrated across tax types, exists and new taxpayers are registered accurately and in a timely manner. Unique TINs are assigned and verification prevents duplicate entries. The system provides sufficient management reports, but these are not used.
- Sufficient information to determine liability is captured electronically as soon as practical (i.e., before computational verifications, audits, etc.). The IT system provides efficient data capture facilities that increase data accuracy (e.g., optical recognition technology, where practical).

Returns are captured offline by the taxpayer or financial institutions, and transmitted to the tax administration for further validation and processing.

- Payment information is captured electronically, and all required information for a proper matching with a tax liability is present. Proper matching of payments with liabilities allows the administration to maintain an accurate and reliable taxpayer account and balance.
- Information, support, and education are provided through somewhat detailed instructions, but usually just for common processes (e.g., filing, but not audit or collections). These instructions are rarely updated and do not take taxpayer feedback into account. Taxpayer services are tailored by taxpayer segment (individual / business, large / small, etc.) and by type of tax. Taxpayer services use multiple channels (telephone, web, paper) and vehicles (FAQs, instructional brochures). There is, however, a need for expert technicians for complex queries. Information provided by taxpayer services is not binding on the tax administration. IT is used to deliver information by means of websites that disseminate information, instructions and forms. The tax administration website is occasionally updated and is not easy to use or does not provide sufficient information to taxpayers.
- The IT system includes primarily two competencies: 1) processing support for core functions; and 2) a limited web-enabled system for taxpayer services / self-services, with functions such as online registration, filing, and payment. The system is integrated across tax types and functions, merging all information.
- IT is used in most core functions (except, perhaps, fraud investigations) and is available to staff of support functions (e.g., legal services). IT provides automation, facilitates workflow, produces management reporting and information, and provides taxpayer services, although management reporting and information are usually ad hoc, and taxpayer services and workflow facilitation are limited.
- IT system applications are integrated across taxes for some functions (e.g., payment and taxpayer accounting), but not others (e.g., filing, refunds). The IT system was documented when initially built or acquired, but the documentation has not been updated.
- IT procurement / development decisions are taken by senior management, who review IT requirements and evaluate solutions. The IT solutions, however, are not a part of the overall strategy of the tax administration.
- Training on the use of the IT solutions is provided to all junior staff, but rarely to management staff. Management staff does not use the system, but rely on IT staff for reporting.
- An IT division participates in designing, defining requirements, documenting, and procuring the IT system. The tax administration, however, faces difficulties retaining knowledgeable staff.

Information Technology: Maturity Level 4

Key word: "Integrated"

- Registration information is maintained regularly and in a timely manner, not only by adding new registrants, but also by removing taxpayers who are no longer active, and by updating information upon taxpayer reorganization.

- A formal registration database and system exist and new taxpayers are registered accurately and in a timely manner. Unique TINs are assigned and verification prevents duplicate entries. The system provides sufficient management reports that are effectively used by officials. Web-enabled registration allows taxpayers to register and maintain their records.
- Sufficient information to determine liability is captured electronically as soon as practical. Electronic filing is implemented and supported by the IT system. The IT system provides a consistent taxpayer account facility, keeping track of liabilities and payments by tax types and tax filing periods. Every financial event that is recorded is directly reflected, in nearly real time, in both the tax administration's own revenue accounting ledgers and the taxpayer account.
- The IT system allows the processing of all payments received from the taxpayer through different channels. Payment information is delivered to the tax system in electronic format, and multiple options of payments are offered to taxpayers on the e-tax/web system.
- Information, support, and education are provided across all tax administration functions (e.g., registration, filing, payment, etc.). These are detailed and are updated regularly based on taxpayer feedback. Taxpayer services are tailored by taxpayer segment (individual / business, large / small, etc.) and by type of tax. Taxpayer services use multiple channels (telephone, web, paper) and vehicles (FAQs, instructional brochures, expert technicians responding to complex questions and generalists for other questions). Information provided with taxpayer services is binding on the tax administration. The tax administration website is properly updated, and tools to interact with taxpayers have been implemented.
- The IT system(s) includes four competencies: 1) processing support for core functions; 2) an MIS for data management and analysis that facilitates the collection and dissemination of information throughout the organization; 3) a web-enabled system for taxpayer services / self-services; and 4) a compliance system.
- IT is used in all core and support functions and provides automation, produces management reporting and information, and facilitates workflow and taxpayer services.
- IT system applications are integrated across taxes and tax administration divisions. The IT system is fully documented and the documentation is regularly updated with changes, if any.
- IT solutions are validated within the tax administration's overall strategy. Specifically: 1) the business need is validated; 2) all costs are accounted for (total cost of ownership includes implementation, maintenance, training, etc.); 3) general technical, specific technical, and non-technical requirements are taken into account; and 4) various solutions are evaluated.
- Basic computer skill training and training on the IT system is a part of the tax administration's training curriculum. All staff, junior and senior, are provided training, including refreshers, and management regularly uses the system for management reporting.
- An IT division participates in designing, defining requirements, documenting, and procuring the IT system. The tax administration has access to competent and experienced IT staff.

12.4. Latin America and the Caribbean

LAC countries have made significant progress in the application of IT to support the tax administration functions. Particular focus has been given to the taxpayer service functions and the return processing function with different degrees of progress in other core functions. A recent study by the Inter-American Development Bank (IADB) collected information from 17 tax administrations in LAC.[309] Among the more relevant observations, the report notes that in the survey countries:[310]

- With the exception of Brazil, Ecuador, and Mexico, all the observed tax administrations define the specifications for IT investments and the vast majority of computer software to support tax administration functions is developed internally.
- Most of the observed tax administrations have evolved from the "publish" phase of e-Government to some level of the "interact" and "transact" phases[311] described in Section 12.1.2. The services offered include forms, frequently asked questions, and the filing of applications or appeals.
- Internet return filings have steadily increased in the countries surveyed and, in some cases, represent the most important filing method, such as in Argentina, Chile, Dominican Republic, Ecuador, Mexico, and Peru, along with Brazil where electronic filing is practically the only method of filing.

The points above illustrate the progress LAC countries have made in applying IT to improve operations. It is important to note that the level of computerization achieved by most tax administrations has been the result of progressive, focused efforts oriented to improve some specific component of the overall IT support spectrum. For example, in the Dominican Republic, after the implementation of the "Virtual Office" project in 2006, the percentage of returns filed electronically grew from none in 2006 to 80 percent of VAT and 75 percent of Income Tax returns processed by the administration.[312]

The discussion above would place some LAC countries in the third level of the maturity model, with some of the most advanced countries conforming to attributes of the fourth level of the maturity model.

There is still a lot of room for LAC countries to realize efficiencies through the use of IT. As noted by the IDB in their analysis of the state of tax administrations, "there is still great scope for increasing the use of [the] Internet, which still has an insufficient use…[S]olutions such as electronic invoicing and fiscal printers to promote better implementation of the tax system should also be considered."

12.5. Key Benchmarks and Guidelines

The following are key guidelines and selected benchmarks for this chapter, discussed throughout the chapter and summarized here:

- **Use of IT in Tax Administration.** The use of IT is not a choice, but a necessity of modern tax administration. The use of appropriate IT, when implemented correctly, helps tax

[309] The 17 countries survey by the IDB in the preparation of the report are: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay. The IDB has initiated a similar exercise for the British Caribbean.
[310] Inter-American Center for Tax Administrations (CIAT) et al. (2012), section 6.3.
[311] See section 12.1.2.
[312] Batista (2009), p. 23.

administrations become more effective by increasing revenue, delivering better services to taxpayers, and maximizing the utilization of scarce resources. Similar to the way that businesses use IT to support their operations, modern tax administrations must implement IT solutions to achieve their strategic and operational goals.

- **Process simplification and business reengineering as a prerequisite.** A basic IT solution must cover the core processes of a tax administration. It is also important to remember that IT must support sound and streamlined processes, which implies that process reengineering and best practices must be aligned with the IT solution. There is no benefit in implementing an IT solution to support outdated and ineffective processes. The implementation of an IT solution must follow process simplification.
- **Sequencing of IT Improvements.** The use of IT evolves alongside tax administration practices. In an initial stage, tax administrations focus on registering and capturing taxpayer information and filings. At a later stage, audit and case management functions become important. At this point, information is collected from different sources to support the audit function, tax administrations evolve towards a risk management focus, and information is used to implement sophisticated risk profiles and case selection for audit. Finally, IT becomes important in supporting the policy management function and enabling the creation of models with historical data.
- **Implementing IT requires a strategy**. Developing and implementing a coherent IT strategy is crucial for successful IT procurement and implementation. When required, changes in legislation must be implemented, organizational structures may have to be redefined, and enhanced operational procedures should be developed.
- **IT is a service**. IT supporting organizations must evolve into service-oriented organizations, but this is a long path that should be carefully planned and executed. A natural path of implementation starts with IT infrastructure consolidation, before moving towards the implementation of specific processes, such as incident management[313] and change management[314]. Implementation of these processes should be in accordance with established best practices and frameworks, such as ITIL.
- A recent benchmarking study that included 13 different countries from Europe, North America, and Latin America found that "the strongest correlations between IT and increased efficiency occur where IT substantially reduces or eliminates manual work (e.g., data capture technology in submission processing, sophisticated website features in taxpayer service)."[315]
- Gartner, a technology research firm in the United States, routinely surveys organizations in different sectors to determine their IT investment at the enterprise-level. Three relevant metrics were produced in their most recent publication for government organizations with an

[313] ITIL (2007), p. 39 defines the incident management process as "the process responsible for managing the lifecycle of all incidents. Incident management ensures that normal service operation is restored as quickly as possible and the business impact is minimized."
[314] ITIL (2007), p. 16 defines change management process as, "The process responsible for controlling the lifecycle of all changes, enabling beneficial changes to be made with minimum disruption to IT services."
[315] Dohrmann et al. (2009), p. 9.

operating budget of less than 250 million USD, against which LAC tax administration IT can be benchmarked[316]:

- IT spending as a percent of operational expense is 11.1 percent;
- IT spending per employee is $16,172; and
- IT Full Time Equivalents (FTEs) as a percent of employees is 7.0 percent.

[316] Guevara et al. (2012), p. 13-15.

Chapter 13. Human Resource Management and Organizational Development

Diana Osinski, Colin Lethbridge, and Suzanne Bond Hinsz

Given the heavy reliance on personnel to carry out core functions and the fact that the wage bill for staff often exceeds 80 percent of total operating costs, human resource management is a key issue for tax administrations.[317] Managers worldwide realize that the effective management and development of organizational personnel is vital to the accomplishment of organizational goals. In other words, tax administrations have a large investment in their employees, and it is essential that they have a Human Resources (HR) function that assists management in achieving business goals. This chapter discusses the key HR management and organizational development functions of a tax administration.

13.1. Leading Practice

The HR function should consistently and efficiently support the tax administration's fundamental need to utilize high performing employees effectively. As part of the business planning process, the HR function should work with managers to identify the resources needed to execute strategic and operational business plans, as opposed to focusing just on day-to-day administrative issues, such as processing the required paperwork for employees to join or leave the tax administration. While line managers are responsible for managing personnel on a day-to-day basis, good support systems from the HR function can make their job easier. Increasingly, tax administrations are finding that improving the HR function is a key strategy in reducing overhead costs while increasing quality. Even today, however, the HR function in many tax administrations continues to play primarily an administrative role, as opposed to a strategic one.

In general, the role of the HR function should be to support line managers to effectively manage employees to accomplish their departmental business goals. HR activities can be categorized as follows: attracting, selecting, retaining, developing, motivating, and effectively utilizing employees. Listed below is an overview of the fundamental HR functions, their key activities, and their affiliated business purpose:

Figure 13.1. Fundamental HR functions

Human Resources Functions	Activities	Business Purpose
Selection and Placement	• Conduct job analysis • Establish selection criteria • Recruit	• Attract employees • Select employees • Develop employees

[317] OECD (March 2011), p. 101. In tax administrations in Latin America, personnel costs averaged 68.1 percent of total costs in 2010, with Argentina, Uruguay, Honduras, Mexico, and Chile exceeding 80 percent (CIAT et al (2012), p. 19).

Human Resources Functions	Activities	Business Purpose
	• Interview and select • Manage personnel changes • Undertake staff planning • Promote career development • Conduct management succession planning	• Effectively utilize employees
Training and Development	• Conduct training needs assessment • Create training plan • Develop, select, and deliver training	• Develop employees • Retain employees • Motivate employees • Effectively utilize employees
Performance Management	• Implement a performance improvement process: ○ Set business goals ○ Create job descriptions ○ Establish performance expectations ○ Motivate / provide feedback ○ Engage in coaching ○ Conduct performance appraisals • Facilitate employee communication and involvement programs	• Retain employees • Motivate employees • Develop employees • Effectively utilize employees
Compensation	• Establish compensation philosophies and practices • Create pay structures	• Attract employees • Retain employees • Motivate employees • Effectively utilize employees
HR Management and Effectiveness of HR Function	• Establish policies and procedures • Create delivery systems • Employ methods to evaluate and measure employee performance	• Effectively utilize employees

Through the effective management of employees, managers can improve employee performance and increase efficiency, thereby increasing tax revenues and reducing employee-related expenses. Effectively managing employees, however, is not the responsibility only of HR. HR and functional line managers each have a role in strategically managing the human assets of the tax administration. Listed below is an overview of the key roles for HR and line managers for each HR function:

Figure 13.2. The roles of HR and functional line managers

Human Resources Function	Human Resources Role	Line Manager Role
Selection and Placement	• Provide tools for job descriptions • Manage employment applications	• Complete job descriptions • Define required job skills

Human Resources Function	Human Resources Role	Line Manager Role
	• Facilitate interview process • Screen applicants • Coordinate staff plans • Provide direction and resources for career paths and management succession planning	• Make hiring decisions • Develop staff plans • Provide information about career paths and management potential • Provide counsel to employees
Training and Development	• Coordinate training plan • Provide resources, policies, and guidance to develop and deliver training • Develop and deliver train-the-trainer courses • Evaluate training effectiveness	• Determine department training needs • Assign staff to help develop and deliver technical training courses • Develop employees (on-the-job) • Evaluate training effectiveness
Performance Management	• Coach managers to give employee feedback • Ensure fair employee treatment • Develop performance appraisal process and forms	• Define performance requirements and priorities • Communicate performance expectations • Give employee feedback • Evaluate performance
Compensation	• Establish pay structures	• Make compensation decisions
HR Management Plan and Effectiveness of HR Function	• Develop methods to evaluate the HR function	• Ensure accountability

The HR function should be a business partner providing specialized services that help tax administration managers work with their personnel to accomplish organizational goals. As a business partner, the role of HR is to ensure that the tax administration manages its employees as a valuable asset, with improved methods for managing individual and team performance, resulting in higher effectiveness and efficiency, and leading to increased tax revenue and reduced operating expenses.

Listed below are some ways that HR and line managers may enhance the role of the HR function as a value-added business partner. HR managers:

- Adopt goals that add value and bring results to the tax administration;
- Learn how the tax administration runs from the perspective of a line manager;
- Become a partner in the strategic business planning process;
- Connect the goals and programs of the HR function to the strategic business plan;
- Become proactive, rather than reactive, and take the initiative to become a business partner and an asset to the management of the tax administration;
- Broaden the role of the HR function from "administration" to a "service provider"; and

- Measure and report results of the activities of the HR function in relation to tax administration results.

Line managers:

- Expect HR managers to be a value-added business partner;
- Involve HR managers in the strategic business planning process;
- Expect HR managers to contribute to the overall improved effectiveness of personnel in the tax administration; and
- Hold HR managers accountable for measuring and reporting results of the activities of the HR function in relation to tax administration results.

13.1.1. Selection and Placement

Generally, the recruitment protocol for a tax administration is established by the government. The government establishes how and when openings are posted and for how long, how many candidates, at a minimum, must apply for an open position, and what the interviewing protocol should be. A challenge for tax administrations is the external pressure to hire specific individuals. Therefore, the established protocol should ensure that the hiring decision is based on whether the candidate is appropriate for the job.

One way to confirm that a candidate has the appropriate traits for the job is to follow the protocol of 'behavior-based' selection. Behavior-based selection is based on the knowledge, skills, and behaviors that directly relate to those needed on the job. The steps in behavior-based selection include:

- Establishing selection criteria;
- Identifying effective recruiting sources;
- Interviewing qualified candidates; and
- Selecting the most qualified candidate.

In addition, a behavior-based interview is an effective way to determine if the candidate has the experience, skills, and knowledge required for the job. The behavior-based interview should be based on objective criteria rather than subjective opinions and impressions. Behavior-based interviewing relies on the premise that the best indicator of future performance is past behavior. The interviewer can directly observe behavior – what a person says or does – and/or ask the candidate to describe an example when he/she has had to use a specific behavior in past jobs and what the results of this behavior were.

Box 13.1. Innovative recruitment practices in Italy[318]

In Italy, the revenue agency in 2009 blended competition and learning as a means of screening applicants. Job seekers completed a series of training events and on-the-job learning and were evaluated at each stage. Those having good results at each stage were hired. This approach reduced agency training costs and led to faster onboarding for staff whose behavior was in alignment with agency values.

The behavior-based interview is structured. Questions are written for each of the important selection criteria for the position, and all candidates are asked the same questions. A behavior-based interview guide is developed for the position, containing the questions and space for the interviewer's notes. During the interview, the interviewer writes notes in the interview guide about the candidate's responses to the questions. These notes aid the interviewer in recalling specific examples and situations that the candidate provided as responses to the interview questions.

Behavior-based interview questions are written in a way that prompts candidates to give concrete examples about how their experience demonstrates capability for each of the selection criteria categories. They eliminate hypothetical responses, such as what the candidate would or should do in a situation. Following a behavior-based interview is an appropriate way to select suitable candidates for open positions.

13.1.2. Staffing Levels

Although there are variations in the staffing of functions amongst tax administrations[319], the following figure provides an indication of staffing allocations to high-level functions. Differences are largely shaped by the level of use of self-assessment for income tax, automation of routine tax administration tasks, consolidation of tasks such as data processing and customer service centers, outsourcing for functions such as IT support, number of staff included in overhead costs, and the size and organizational structure of field offices.

Figure 13.3. Average staff usage (percent of total) in major tax administration functions[320]

Countries	Client Account Management	Audit and Other Verification	Enforced Debt Collection	Corporate Management	Other
OECD	30.76	32.43	10.41	14.79	11.68
Non-OECD	28.91	32.43	10.14	15.60	12.92
All	30.22	32.43	10.33	15.02	12.04

The overall number of staff employed in any tax administration depends on the tax administration's budget allocation and usually a bidding process by the government agencies and individual departments. There are no strict benchmarks. After allocations are made, the departments must plan the most effective

[318] OECD (March 2011), p. 108.
[319] See, for example, figure 10.9 of Chapter 10 for the variation in staffing numbers in enforced debt collection functions.
[320] OECD (March 2011), p. 139.

way to deploy the resources allowed. Some inferences can be drawn from USAID's collecting taxes database[321] (2010), which shows a higher number of taxpayers per tax official (conversely, fewer tax officials per taxpayer) in high income countries (908) than in low-middle income countries (270). These numbers should be used cautiously, however, as the number of taxpayers per tax official depends on many factors, including on the comprehensiveness of the tax system and advances in technology, amongst other things.

13.1.3. Education and Skills

Striving for more highly qualified staff members is a strategic issue for a number of tax administrations. Some tax administrations reflect this in their strategic plans or annual plans as a key initiative on its own or as part of achieving a related performance goal. A number of tax administrations report on staff skills, development, and/or educational attainment as part of their annual reports or business plans.

Actual attainment of university level education varies widely across those countries on which the OECD collects statistics. While the average rate of staff holding degrees is 46 percent overall, in six countries more than 75 percent of employees are degree holders, while in nine countries less than 25 percent hold degrees. In terms of driving change and increasing organizational performance in key areas, the education and skills of staff members are important for leaders to consider carefully.

Figure 13.4. University degrees in tax administrations[322]

Degree level educational attainment of staff	Number of tax administrations in category
Less than 25 percent	9
25-49 percent	14
50-75 percent	12
Over 75 percent	6

University education is a good start, but there are other qualities that need to be tested in the recruitment procedure to ensure candidates most suited to the tax administration are selected.

Given the nature of the tax administration’s work, staff at all levels could well come into direct contact with the general public. At a minimum, all staff need good interpersonal skills and an ability to deal with confrontational situations. Depending on the level of work, other skills and qualifications may be necessary. Clerical staff will be expected to have secondary education, be able to use computers, and understand and carry out the basic procedures and processes of the administration. Staff of principal functions will need to exercise basic professionalism, including the following:

- Good judgment;
- Sound analytical skills;
- Excellent decision making abilities;

[321] http://egateg.usaid.gov/collecting-taxes
[322] OECD (March 2011), p. 113.

- Drive and determination;
- Ability to work alone and in unfamiliar premises; and
- Ability to work as a member of a team.

Regardless of the position, an accurate, complete, and up-to-date job description should be on file for each tax administration staff member. Each job description should contain the following items:

- Job purpose;
- Responsibilities;
- Working relationships and lines of reporting (internal and external); and
- Job specifications:
    - Education and experience
    - Skills and knowledge
    - Competencies.

It should be noted that it is not uncommon to have qualifications written in the law. This is not a recommended practice, because these qualifications tend to be incomplete and make the tax administration and employed staff reluctant to prepare more detailed and accurate job descriptions. This can greatly limit the ability of the tax administration to attract, select, retain, develop, motivate, and effectively utilize employees.

13.1.4. Training and Development

Training

Training that is applicable across the civil service, such as induction training, ethics, and courses like project management and leadership skills training, is often offered through civil service training institutions. Increasingly, tax administrations are outsourcing training for management and leadership-related skills to private companies. Due to the technical nature of the work of tax authorities and the unavailability of candidates in the hiring pool who already have all the necessary technical skills, tax administrations often need to train staff. This training is essential in order to develop the workforce necessary to carry out the organization's mandate. The OECD reports that 90 percent of tax administrations conduct assessments of their current and future skills and capability needs, and develop a plan to fill any gaps.[323]

Although there may be a training function in the government responsible for delivering training courses applicable across government agencies, tax administrations must develop specialized technical training. Tax administrations that do so typically rely on a systematic approach to developing training programs and materials to achieve specific learning goals and to provide performance-based training, such as Instructional System Design (ISD).

[323] OECD (March 2011), p. 100.

At the highest level, the ISD process consists of identifying what learners currently know, defining what they need to know, and creating an intervention to bridge the gap. Instructional design is informed by research-based theories about how people learn and has its roots in behavioral and cognitive psychology. For more than three decades, the prevailing model of instructional design has been the systems model, which includes analysis, design, development, implementation, and evaluation, and which is better known as the ADDIE Model[324]. ADDIE is a step process, which means that each step has an outcome that leads to the subsequent step:

- Analyze the gap between what learners currently know, and what they need to know;
- Design a learning intervention to bridge the gap;
- Develop learning materials according to the design;
- Implement the training program; and
- Evaluate the implementation.

Although there are many ISD models, ADDIE is the most widely used and is able to provide performance-based training that meets learners' needs.

It should be noted that tax administrations commonly provide training without establishing standards for design, development, or delivery and without evaluating whether learning occurred or whether participants use what they learned once they are back on the job. Instead, most tax administrations rely on informal, on-the-job training that may or may not produce the desired impact. Serious consideration should be given to designing and implementing a formal on-the-job training program. In best practice terms, the bulk of learning undertaken by anyone in a new role is predominantly acquired on the job itself rather than in the classroom. The 70/20/10 Learning Concept created by the Center for Creative Leadership suggests that on average:

- 70 percent of learning and development takes place from real life and on-the-job experiences, tasks, and problem solving. This is the most important aspect of any learning and development plan. For example, the real learning from a skill acquired in a training program or from feedback takes place on the job when the skill or feedback is applied to a real situation;
- 20 percent of learning and development comes from feedback and from observing and working with role models; and
- 10 percent of learning and development comes from formal training.[325]

[324] Summerville et al. (2008), p. 45. The ADDIE model appears in literature as early as 1970s (see, for example, Briggs (1977), p. 390). It should be noted that there are variations of the ADDIE model, but, at a high level, the model contains the phases described above (Allen (2012), Chapter 2).

[325] The 70/20/10 learning concept was developed by Morgan McCall, Robert W. Eichinger and Michael M. Lombardo at the Center for Creative Leadership and is discussed in Lombardo et al. (2000).

Box 13.2. Redeveloped training approach in Kosovo[326]

The Tax Administration of Kosovo (TAK), with assistance from USAID, significantly redesigned its staff training function. An important part of this was the introduction of the Instructional Systems Design (ISD) methodology for all training activity based on a five-step ADDIE (analysis, design, development, implementation, evaluation) process.

Prior to 2010, the TAK Training Department operated as a 'travel agent' making administrative arrangements for staff travelling outside Kosovo, and each functional area of TAK Headquarters organized its own training activities. The previously established Training Policy and Training Commission had both been abandoned and previous attempts at establishing a Training-of-Trainers program had failed.

In mid-2010, TAK senior management committed to re-adopting its past Training Policy, re-establishing its Training Commission, and fully staffing its Training Department. A comprehensive Training Needs Assessment, comprising four competency surveys covering various functional roles in TAK, was conducted, along with an institutional capacity survey across TAK's 700 employees. The assessment identified the need for:

- The re-establishment of the "Training-of-Trainers" program. The new program included three courses covering curriculum development, test writing, and presentation and facilitation skills;
- A range of technical training courses covering audit, taxpayer education, and enforced collections;
- Management training with six courses covering managing results, managing performance, managing teams, managing change, managing operations, and managing communication; and
- Soft skills training, such as computer skills and English language training.

A comprehensive 12-month induction program was also prepared for 36 new tax inspector hires and involved alternating sessions of off- and on-the-job training.

Today, TAK has a fully functioning Training Department supported by a Training Commission that monitors training activity progress and a team of over 50 internal trainers. TAK has taken on full responsibility for design and delivery of all training courses. TAK has a comprehensive range of training materials, including instructor guides and pre- and post-training tests. Participants' ratings of the training received are consistently high, and post-training evaluations show that over 90 percent of training has been retained three months after the training.

Induction

In addition to a formal training program, tax administrations should have an induction program. The term 'induction' is generally used in a workplace context to describe the entire process during which employees adjust or acclimatize to their jobs and working environment. As part of this process, 'orientation' can be used to refer to a specific course or training event that new starters attend in their first few days or weeks, and 'socialization' can be used to describe the way in which new employees build up working relationships and find roles for themselves within their new teams. The induction program has to provide all the information that new employees need without overwhelming or diverting them from the essential process of integration into a team.

The purpose of induction is to ensure the effective integration of staff into or across the organization, which benefits both the individual and the organization as a whole. A good induction program normally contains the following elements:

[326] Source: author Diana Osinski.

- Orientation (physical) – describing the office facilities;
- Orientation (organizational) – showing how the employee fits into the team and how his/her role fits with the organization's strategy and goals;
- An awareness of other functions within the organization, and how the employee fits within that structure;
- Meeting with key senior employees;
- Health and safety information;
- Code of conduct/ethics training;
- Explanation of terms and conditions of employment;
- Details of the tax administration's history, its products and services, and its culture and values; and
- A clear outline of the job/role requirements.

Bearing in mind the foregoing, an approach that adheres to the following principles should be adopted:

- As much as possible, attempts should be made to replicate the same quality and content of the learning journey across the first year for all new hires;
- Progress should be tracked continuously throughout the period by designated peers, managers, and other stakeholders;
- Problems and issues that arise should be escalated and dealt with in a timely fashion;
- The new hires should be treated as individuals. However, the adoption of a strong peer group ethos and evolution of a 'community' spirit should also support their development;
- There should be strong continuous emphasis on the principle of personal accountability for individual learning and performance;
- Robust feedback should be secured throughout the learning period; and
- The majority of learning should be on-the-job, consistent with leading practice in learning.

Career Development

A formal career development program is another key program that facilitates the effective utilization of employees in the tax administration. Career development programs allow employees to match their job skills and interests with opportunities for development and advancement within the tax administration. Formal career development programs have several important purposes for the tax administration. They:

- Provide employees with the opportunity to learn and advance;
- Foster career satisfaction and, therefore, retain employees and reduce the cost of turnover;
- Fill open positions with internal candidates;
- Support the movement of employees to new jobs;
- Stimulate creativity and high levels of interest in work throughout the tax administration; and
- Develop depth and back-up for staff.

A career development program is a formal program that requires the HR function to coordinate the collection of information from across the organization and develop a program that meets the needs of the tax administration and its employees. Listed below are the components of a formal career development program:

- **Analyze staffing plans to determine high priority career development needs.** Determine high priority career development needs by analyzing staffing plans and identifying jobs that may be affected by changes, such as changes in business priorities, skill and experience requirements, and volume of workload. Some high priority career development needs may be described by the following types of situations:
    - Jobs requiring skills not currently possessed by existing employees (e.g., the adoption of modern methods of taxpayer control, such as fraud investigations);
    - Jobs targeted to accomplish high priority business goals (e.g., instituting modern risk-based audit selection and planning);
    - Jobs that have a history of high turnover (e.g., technical personnel in the IT support function);
    - Jobs where the workload is expected to change significantly (e.g., return processing with VAT threshold changes); and
    - Jobs requiring special skills and specialization (e.g., transfer pricing auditors).
- **Identify priority job families targeted for the career development program.** Job families are jobs grouped by similar skills, knowledge, and experience requirements. The tax administration functions listed in Chapter 2 of this product are, in essence, job families. A higher level aggregation is also possible, however, as evidenced by the organizational structures that many tax administrations employ. A number of tax administrations combine client (taxpayer) facing functions under a single division, such as taxpayer services and education with registration, or audit or collections with special enforcement programs, such as stop-filer identification.
- **Complete job descriptions and skills requirements for jobs in targeted job families.** The identification of skill requirements for jobs within targeted job families is an important feature of a career development program.
- **Develop career paths.** A career path is a logical career progression from one job to another job within a job family and between job families. The career path is based on the common skill requirements of jobs.
- **Create career path information resources for employees and managers.** The career path information needs to be written and available to managers and employees for use in staff planning and development.
- **Provide tools and training for employee career development.** Managers and employees each have a responsibility in a successful career development program. Written materials and training programs define and communicate roles, responsibilities, resources, and opportunities in the career development program.
- **Managers are usually responsible for conducting career development planning sessions with their employees.** In career development planning sessions, managers help employees determine

their skills, interest, experience, and possible career goals. Career development plans include developmental activities, such as training for additional skills, special job assignments, and other tasks that give employees the opportunity to develop new skills. Managers need training, support, and consulting for their career development coaching role.

- **Employees are responsible for becoming informed about career path possibilities and making decisions about career goals.** Career development training programs for employees are usually focused on assisting employees to evaluate their skills, interests, and experience and to set career goals.
- **Develop a system to track individual employee career development plans and progress.** The HR function has an important role to play in coordinating the development of career path information and establishing an organization-wide system that keeps track of individual career development plans and progress. Employees who are actively engaged in career development activities constitute a pool of internal candidates available for placement into open positions.

Management Succession

Another important program tax administrations should have is a Management Succession Plan. Management succession planning is the formal process that identifies developmental activities to prepare an employee for management positions with greater responsibility. Management succession planning is important for the tax administration because it establishes a method for identifying successors to each key management position. Management succession provides continuity of management leadership, which is important, especially in environments in which there is significant turnover of managerial staff. Where there is significant turnover, it is necessary to groom a larger pool of middle managers than might otherwise be necessary. With an effective management succession plan in place, a tax administration has greater flexibility to strategically move managers within the organization. The components of a management succession planning program are described below:

- **Evaluate performance of individual managers.** Some of the information that tax administrations use to evaluate the performance of managers include:
  - Performance rating;
  - Ranking within the peer group;
  - Listing of areas for improvement; and
  - Creating a development plan.
- **Identify potential future positions for each manager.** Since one of the main goals of management succession planning is to identify potential replacements for open management positions, managers are carefully evaluated to identify their potential for future positions. The potential for which each manager is assessed includes promotion, movement into lateral positions, and suitability in his/her current position. This assessment includes an estimate of the length of time before the manager is expected to be ready for potential future positions.
- **Identify possible successors for each current manager.** Possible successors are identified for each manager.

- **Summarize manager evaluation information.** The information from individual manager evaluations is compiled and summarized. Based on the summary, priorities and plans for management development programs are identified, such as:
    - Training;
    - Work assignments; and
    - Recruiting and hiring needed management talent.

13.1.5. Performance Management

Performance management is the process of managing tax administration employees and teams based on established performance expectations and measured performance results. The OECD notes that 91 percent of the tax administrations reporting indicate that they have performance management systems. A significant number (36 percent) do not set objectives for individual staff members at the outset of the performance period, but all report that their staff members are subject to performance assessments.[327] Mexico's tax administration is one of a few that engage in 360 degree assessments in which performance is assessed by the supervisor, co-workers, subordinates, and clients.[328]

Box 13.3. 360-degree assessment

Traditionally, performance appraisal has been limited to a feedback process between employees and supervisors. With increased focus on teamwork, employee development and customer service, however, organizations have devised systems to obtain performance feedback from a variety of additional sources. According to the U.S. Office of Personnel Management (OPM)[329] a "360-degree assessment" represents a full circle of performance-feedback sources with whom an employee interacts on the job, such as the employee's supervisor, peers, subordinates, and clients. OPM cautions that it is not necessary, or always appropriate, to include all feedback sources in a particular appraisal program, because the organization's culture and mission must be considered, and the purpose of feedback will differ from each source.

In a 360-degree assessment, generally, feedback providers fill out an anonymous online feedback form with questions covering a broad range of workplace competencies about an employee. The feedback forms include questions that are measured on a rating scale and also ask raters to provide written comments. The person receiving feedback also fills out a self-rating survey that includes the same survey questions that others receive in their forms.

An international company which specializes in 360-degree feedback, employee surveys and other tools[330] explains that the 360-degree assessments <u>do</u> provide pertinent feedback that can help evaluate behaviors and competencies, how others perceive an employee, skills, such as listening and courtesy, and subjective areas such teamwork, leadership, and character. However, such assessments <u>do not</u> provide feedback to measure how well employees are meeting performance objectives, whether an employee meets basic job requirements, the adequacy of basic technical or job-specific skills, or objective criteria, such as attendance and quantitative objectives.

The process of performance management involves line managers consistently:

[327] OECD (March 2011), p. 101.
[328] Ibid., p. 110.
[329] U.S. Office of Personnel Management (1997), p. 1.
[330] CustomInsight.com (2013), p. 2.

- Defining performance requirements and expectations;
- Communicating performance expectations to individuals and teams;
- Measuring the actual performance in relation to the desired performance; and
- Giving regular feedback and rewarding desired performance.

The HR function should support line managers by providing activities and programs that facilitate the performance management process. The process begins with the tax administration's goals. To support the tax administration's plans, each department, work unit, or team sets its goals and plans. To support the work team's goals, each person on the team has individual standards or objectives. To keep the work team moving quickly and in the right direction, managers should provide motivation and feedback. When someone has an ongoing performance deficiency, managers should provide continuous coaching. If the performance problem does not improve, managers should conduct discipline discussions.

After a period decided by the tax administration leadership, managers should write and discuss the performance appraisal, measured against the individual's or team's standards and objectives. A performance appraisal is a summary of the employee's or team's performance over a designated period of time, usually six or 12 months. An effective performance appraisal is based on the standards and objectives set at the beginning of the performance period. However, it should be noted that performance appraisals do not replace regular, continuous feedback and coaching. More importantly, they usually do not motivate or improve performance. The purpose of performance appraisals is to:

- Serve as a regular checkpoint for providing formal feedback to an employee; and
- Document performance for making future management decisions, as described below.

Individual employees or work teams may both be appraised. The appraisals may be done by the manager of the employee or work team, by peers, or by the team itself.

Appraisal forms vary from tax administration to tax administration. More important than the format of the form is the ability to accurately evaluate performance and document the justification for the rating. It is common to see high performance ratings and no written justification for them. In such cases, the performance rating becomes a less valuable metric to use in making personnel-related decisions.

A performance appraisal system has many components to ensure that it works for the benefit of employees and the tax administration. The system usually provides guidance as to the following points:

- How frequently appraisals for each team or employee should be done (usually every six or 12 months, although for some standards managers may need to provide daily or weekly feedback. Employees are more likely to work to improve their performance if they receive frequent information about how they are doing);
- How the appraisal date for each employee or team should be decided (e.g., the anniversary of employment, the same date for all employees or teams, or some other method);
- The categories to include in the appraisal (an appraisal form may also be provided);

- The rating scale to use for evaluating performance;
- The method for filing the appraisals, and who has access to the appraisal files; and
- Whether appraisal ratings will affect salary increases.

After completing a performance appraisal, managers should be able to make decisions related to the following five areas:

- Salary recommendations;
- Recommendations for promotion;
- Career planning;
- Developmental planning; and
- Possible disciplinary actions.

These decisions may also be made by a small group of senior management personnel instead of directly by the manager. The manager will then continue the performance management process by reviewing and setting new performance standards and objectives with the employee and/or team.

Providing frequent and appropriate feedback is one of the most important things a manager at a tax administration can do to let employees know how well they are performing. Feedback is the communication of information about the quality and quantity of performance by an individual or team. The most effective form of feedback is when the manager provides it verbally and in person. Providing feedback is a simple process and usually does not take much time.

It is also important for managers to motivate their employees. What managers say and do affects the ability for a person to motivate himself or herself. Therefore, the manager creates an *environment for motivation*. Motivating employees, or creating a motivational environment, is part of everything a manager does. The major advantages of managers making a conscious effort to motivate are:

- Increased productivity;
- Higher quality of work; and
- Improved morale.

Listed below are four strategies for motivating employees:

- Giving feedback to employees
  - Reinforces current and desired performance;
  - Corrects undesired performance; and
  - Provides information about how to complete a task.
- Providing a positive work environment
  - Sets the direction for the work team;
  - Sets a good example;
  - Provides satisfying work activities;

 - Provides a satisfying work setting; and
 - Removes obstacles to job satisfaction.
- Giving appropriate recognition and rewards
  - Includes positive recognition for good work; and
  - Includes small gifts, certificates, and prizes.
- Soliciting ideas and feedback from employees
  - Listens to and welcomes new ideas;
  - Holds staff meetings to keep everyone informed; and
  - Asks for suggestions from employees about how to improve the work environment or overcome obstacles.

If the feedback and motivation strategies do not encourage optimal tax administration performance, managers may need to coach some employees. Coaching is a more formal problem-solving process than feedback. The outcome of a coaching session should be a plan for improving or correcting performance. Coaching keeps an employee focused on the performance goals and corrects or improves poor performance.

13.1.6. Staff Satisfaction and Engagement

Staff engagement is critical to high performing organizations and many tax authorities monitor and evaluate employee satisfaction. According to the OECD, 81 percent of tax administrations routinely measure engagement, satisfaction, and motivation.[331] Organizations that are highly effective actively engage their staff and help their staff to make meaningful connections to each other and to the purpose of their work.

Organizations that are able to communicate a meaningful connection between employees and the organization’s core purpose perform better than those that do not. Better performance includes stronger financial performance and increased client and employee satisfaction. Successfully communicating organizational purpose is also beneficial in terms of recruiting and retaining staff.[332] In environments in which it is difficult to attract and retain the best staff, this is a potent and actionable measure for managers. Also, when conducting staff surveys to gauge employee satisfaction, it is good practice to disseminate and share the results.

13.1.7. Compensation

Obviously, tax administrations need employees to execute tax-related work, and one of the fundamental reasons employees work is to receive a salary. Beyond the basic business reasons for paying salaries, some tax administrations control compensation to achieve other goals. The following compensation philosophies are designed to achieve various designated goals and can be used alone or in combination.

[331] OECD (March 2011), p. 100.
[332] Deloitte Core Beliefs & Culture Survey 2012 was conducted among 1,310 U.S. adults age 18+, who are employed full time in non-government, for-profit businesses with 100 employees or more. Of those professionals who qualified, 298 were classified as executives and 1,012 were classified as non-executives, based on job title and job role.

Figure 13.5. Compensation philosophies

Philosophy	Definition	Reason
Pay for the job	Every worker who does the same job is paid the same salary.	The work of a certain job is worth a specified value. No one who is doing that work is paid more or less than that value. The tax administration may give cost of living salary increases to all employees based on the percentage of inflation. This approach may diffuse tension arising from pay differentials for staff performing the same job, but also may discourage motivation for innovation and achievement.
Pay based on market pricing	Every worker who does the same job is paid within a salary range based on market pricing (average salaries for the same competencies).	The tax administration may decide to use a philosophy of paying salaries at the high end of the range in order to attract good workers. The tax administration may decide to use a philosophy of paying salaries in the middle of the range in order to retain employees at the competitive rate. The tax administration may decide to use a philosophy of paying salaries low in the range in order to reduce salary expenses. In this case, the tax administration takes the risk of not being able to attract or retain good workers.
Pay for seniority	Every worker receives the same amount or percentage of salary increase each year. Over several years the workers with longer tenure are paid more than workers who have not worked at the tax administration as long.	Workers are compensated for staying on the job. The purpose of this philosophy is to retain workers at the tax administration who have job knowledge and experience.
Pay for performance	The annual (merit) salary increases are based on an individual worker's performance during the year. A pay-for-performance system usually uses salary ranges based on market prices.	Workers are compensated for good performance. Top performers receive the highest percentage salary increases. Average performers receive salary increased near, or slightly higher, than the percentage of inflation. Poor performers receive no increase. The purpose of this philosophy is to retain the good performers. Theoretically, workers are more in control of their salaries. Good workers can progress to the top of

Philosophy	Definition	Reason
		their salary range in several years, and be highly compensated for the quality of the work they do.
Incentives and bonuses	Compensation above the worker's salary. Incentives are paid for doing work beyond normal expectations, based on the quantity above normal. Bonuses are paid based on achieving certain criteria or level of achievement. Bonuses are most often available to executives, but may be awarded for any worker for a special achievement.	Incentives increase productivity without hiring additional workers and adding salary expense. Bonuses motivate workers to strive for excellence. The criteria for executive bonuses are usually established, like a contract, at the beginning of the fiscal year. The criteria usually include high goals for performance (individuals, department, and the tax administration).

13.2. Common Trends

13.2.1. Separate Employment or Budget Conditions

Modern government-wide HR functions use complex job assessment systems that set out to measure the roles and responsibilities of all jobs across the civil service. To equalize pay scales across government agencies, positions are categorized into an overarching matrix, in which each position with similar weights of responsibility receives the same remuneration, independent of the agency or department in which it is located.

For many years, tax administration staff have argued that their jobs are unique within the general civil service and that they face much more difficult tasks than the normal deskbound tasks in most other departments. Discussions around whether tax administration staff merit higher rewards for their work have resulted in myriad outcomes.

As noted in Chapter 3, the semi-autonomous revenue authority (SARA) is one approach to implementing separate conditions for revenue authority staff. Countries in Latin America and the Caribbean (LAC) are, in fact, at the forefront of re-organizing tax administrations previously under the Ministry of Finance into SARAs. As discussed in Chapter 3, civil service staff remuneration in most developing countries is generally very low and far from competitive with the private sector. This situation may contribute to significant observed levels of corruption. Studies on the success of SARAs remain inconclusive. A recent presentation by the IMF, focused primarily on SARAs in Africa, highlights that while SARAs have helped increase remuneration for tax officials and improved HR, they have not necessarily translated into better reduced corruption, increased flexibility for reform, or better incentives for good performance among staff.[333]

[333] Kloeden et al. (2012), p. 9.

As an alternative to separating the tax administration salary scale from the civil service, some tax administrations have considered rewarding tax officials based on the amount of annual revenue collection. Allowing the tax administration to retain a portion of collected revenues, whether to pay tax officials' salaries or for general budgeting, has had many disadvantages. These are discussed in detail in Chapters 10 and 14, with one example in Box 3 below.

Box 13.4. Remuneration based on annual collection in Egypt[334]

> The Sales Tax Commissioner in Egypt negotiated 20 percent of the annual sales tax collections in excess of the collection target set by the Ministry of Finance as departmental bonus to spend at the Commissioner's discretion. The bonus was especially resented by the Income Tax Department. The sales tax collection target was exceeded each year, and there were continuous rumors that advanced collections and other nefarious methods were employed. When the Sales Tax Department and the Income Tax Department were combined into the Egyptian Tax Authority, the system was abandoned.

13.2.2. Staffing Levels

Since 2004, the OECD has been collecting data on overall staffing in tax administrations, and the data show a trend toward fewer staff.[335] As tax administrations gain more operational efficiencies through increased reliance on electronic transactions and information flow, improved workplace technology, increased automation, and reorganizing workflows along functional lines, the need for staff is reduced. The chart below makes the trend toward overall reduced staffing levels clear. Moreover, even tax authorities with relatively low levels of staff overall report that they expect to hire fewer staff up to 2015.

13.3. Tax Administration Maturity

This section presents a four-level model to allow interested officials to self-assess the general level of maturity of their tax administration's HR framework.

HR Management and Organizational Development: Maturity Level 1

Key word: "Basic"

- The HR function is not seen as a strategic part of managing the performance of the organization.
- The HR function may be carried out within the tax administration or as part of the larger civil service, but, regardless of where the function fits, it is not yet capable of carrying out a range of modern services for the organization.
- The HR function primarily focuses on basic HR administrative activities.
- The organization has not yet developed a code of conduct.
- The remuneration structure does not yet effectively incentivize ethical action and strong performance.
- Job descriptions are yet to be developed, out of date, or insufficiently detailed.

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[334] Source: author Colin Lethbridge.
[335] OECD (March 2011), p. 137.

- The HR function's cadre of senior leaders lacks HR skills, training, or education.
- Training is ad hoc or limited to senior staff teaching junior staff about changes to the tax code.
- The organization lacks a training curriculum, access to trainers, and/or access to relevant training.

HR Management and Organizational Development: Maturity Level 2

Key word: "Developing"

- The HR function recognizes that it can play a strategic role in executing the organization's mission and is beginning to review its roles and responsibilities with a view to increasing the effectiveness of core functions, such as hiring, retention, development, training, remuneration, and motivation.
- The HR function is tracking the satisfaction of its key stakeholders with its services and is trying to build on strengths and address weaknesses.
- The HR function is reviewing its own structure, roles and responsibilities, and staffing needs in light of feedback from key stakeholders.
- The HR function is reviewing laws and policies that limit its effectiveness and is recommending relevant changes.
- The HR function recognizes its key role in promoting and enforcing codes of ethics and conduct and is beginning to fulfill this role.
- A training needs analysis of the tax administration has been undertaken and shaped into a training and development plan.

HR Management and Organizational Development: Maturity Level 3

Key word: "Consolidating"

- The HR function is seen by the rest of the tax administration as providing an important and vital service.
- The HR function is achieving increased levels of satisfaction among its key stakeholders in its core functions, including hiring, retention, development, training, remuneration, and motivation.
- The HR function is able to influence laws and policies that limit its effectiveness.
- The HR function tracks compliance with ethics and codes of conduct and is seeing increased compliance.
- An effective training and staff development system is in place and is producing impact on the job, as validated by course evaluations.

HR Management and Organizational Development: Maturity Level 4

Key word: "Leading"

- The HR function is seen by the rest of the tax administration as a key strategic partner and is brought into all major decisions taking place at the highest levels of the organization.

- The HR function tracks its performance in executing its core functions and continuously improves its systems.
- Laws and policies are conducive to building a strong, capable, and motivated tax administration, and the HR function is seen as an important advisor when new laws and policies are under consideration.
- Much of the code of conduct and related compliance systems are tracked automatically through electronic means, so HR staff can efficiently identify anomalies and investigate further as needed.
- The training and staff development system promotes continuous improvement of training approaches and curriculum in order to stay current and effective, such that operations clearly improve due to the training and development staff members receive.
- Some of the most satisfied government employees are found in the tax administration, and it is easy for the organization to attract and retain high performing staff members.

13.4. Latin America and the Caribbean

CIAT's recent study of tax administrations in Latin America provides a good synopsis of HR in tax administrations in the region, and the following discussion draws largely from the study.[336]

In 2010, the number of taxpayers to tax administration staff in the LAC region averaged 760.[337] These staffing levels are comparable to the staffing level average of upper-to-middle income economies, but lower than the average of high-income economies (908 taxpayers to tax staff). Quite interestingly, staffing levels of tax administrations in the region increased by an average of 9.1 percent over 2006-2010, contrary to the downward trend noted in OECD countries above, and contrary to what one would expect from the aforementioned comparison. This number is dominated to some extent by several countries with sharp increases in staffing (Brazil, Ecuador, Guatemala, Nicaragua, and Uruguay), although a few countries have also shown sharp reductions (Bolivia, Colombia, the Dominican Republic, and Paraguay).

The distribution of staff in 2010, on average, was 11.9 percent to taxpayer services, 30.1 percent to audit and examination, 25.2 percent to revenue and collection, and 32.8 to other functions, of which 22.4 percent were dedicated to administrative services, HR, and information technology. The proportion of staff dedicated to audit and examination seems consistent with OECD averages, while the proportion of staff dedicated to tax control is quite high. Although the definition of functions in this distribution is unclear, interestingly, CIAT notes that the number of staff in tax control functions is generally insufficient.

As noted in Chapter 3, LAC countries have led the way with regard to the establishment of SARAs. This is one of the factors that have resulted in improvements in remuneration to tax officials. Salaries of tax officials are generally higher than the rest of the public sector, although still lower than the private sector (except in Argentina). Most tax administrations have established variable compensation (i.e., bonuses) based on performance, which in some administrations can range up to 20 percent of basic salary. There

[336] Inter-American Center of Tax Administrations (CIAT) et al. (2012), chapter 3. Less information is available on Caribbean tax administrations.
[337] USAID's Collecting Taxes database, http://egateg.usaid.gov/collecting-taxes.

are large variations in remuneration, but these are to be expected given different socioeconomic situations.

Box 13.5. Reforming staffing levels and compensation in Peru

Peru is a dramatic, albeit early example of reforms of staffing levels and compensation in the tax administration. Peru's SARA was established in 1988, but real reform took place in 1991. Between March and September of 1991, the tax administration's workforce was reduced from over 3,000 to 800 through voluntary resignation with monetary incentives and competency tests, and salaries were increased to be competitive with the private sector.[338]

Today, however, Peru's tax administration stands out as the one tax administration in Latin America with salaries that are significantly lower than those of the private sector.[339]

Recruitment processes are well established and, according to the CIAT study, "impeccable." Recruitment uses technical tests and, in some cases, requires that candidates pass selected courses at tax administration training centers. Over 50 percent of employees possess university degrees, which is higher than the OECD average. Continued training is a priority, and most LAC tax administrations have training departments that utilize both classroom and distance training to teach management and technical topics.

Box 13.6. Training of tax officers in Chile

The Internal Revenue Service of Chile organizes different educational courses with durations ranging from five weeks to five months dedicated to team work, decision-making and stress, time management, assertiveness, communication, personal development, and other topics. As long ago as the mid-1990s, 2,500 persons annually spent more than 100,000 hours in training.[340]

Today, Chile's tax administration has one of the lowest employee attrition rates amongst tax administrations in OECD countries – 2.8 percent in 2009. It continues to identify staff training needs, develop training plans aimed at achieving higher efficiency levels in work teams, and evaluate training for effectiveness. The latter is important, as Chile's Law 20.431 of April 2010 establishes an economic incentive linked to taxpayer satisfaction with the level of service provided, as measured by surveyed taxpayers.

13.5. Key Benchmarks and Guidelines

Measuring the performance of the tax administration’s HR function requires an understanding of how employees perceive the tax administration’s performance in the key areas described below and whether employee satisfaction improves over time.

- Are employees satisfied with the standard of communication within the tax administration?
- Do they feel well trained to carry out their duties and responsibilities, and do they have satisfactory prospects for career development with the tax administration?

338 Bejakovic (n.d.), p. 12.
339 Inter-American Center of Tax Administrations (CIAT) et al. (2012), section 3.4.
340 Bejakovic (n.d.), p. 13.

- Do they have sufficient training to effectively, efficiently, and productively use the tax administration's technology, and is this training up to date? Do they find the available equipment and technology to be sufficient for them to do their jobs?
- Are they satisfied with how tax administration leadership manages change and measures employee performance?
- Do they have a comprehensive, up-to-date job description that accurately reflects their position in the tax administration, along with formal written policies and procedures on how to conduct their daily work?

An example questionnaire that addresses the five areas above is presented in Appendix 13.A. In addition, a number of benchmarks can be derived from the discussion above:

- Where tax filings are nearly universal (i.e., most individuals and businesses are required to file), 850 taxpayers per tax administration staff seems to be an appropriate staffing level.
- The distribution of staff in OECD countries varies across countries. However, a significant number of surveyed countries report over 30 percent of employees dedicated to taxpayer account management (registration, filing and payment, taxpayer services), over 30 percent of staff dedicated to audit and verification, and over 10 percent of staff in enforced collections. Management staff in two-thirds of the countries was 10-20 percent.[341]
- Time spent learning should be in the neighborhood of 40 hours per year.
- Employee attrition rates should be low (5.5 percent on average in the OECD[342]).

[341] OECD (March 2011), p. 139.
[342] Ibid., p. 112.

Chapter 14. Budget Planning and Resource Management

Yassie Hodges

Government budgeting is simply a process of allocating limited financial resources to deliver services (roads, hospitals, education, law enforcement, etc.) that will effectively meet the needs of citizens. The tax administration plays a critical role in this process because its overall mission is to collect the revenue needed to fund these services.

In order to carry out its tasks effectively and efficiently, the tax administration requires adequate staffing, equipment, and working facilities. A lack of these resources often handicaps tax administrations. Shortfalls can often be traced to an inadequate budget planning process or a failure to present a strong business case for the resources needed. Tax administration management often settles for taking the prior year budget and increasing it by some percentage, without a full evaluation of what is needed to adequately deliver programs. However, a carefully prepared budget is critical to pursuing the necessary resources to execute program goals and objectives in an effective and efficient manner. A good budget hinges on sound projections that are based on realistic assumptions and a clear means of attaining deliverables.

This chapter will outline the overall budget planning process, budgeting methodologies, elements to be considered by a tax administration in developing a budget, and steps to take in effectively managing available resources in order to meet program objectives.

14.1. Leading Practice

The budget preparation process for the government generally starts nine to ten months before the budget is presented to the legislature. The responsibility for preparing the government's overall budget normally lies with the Ministry of Finance (MOF), with input from the line agencies. A typical budget preparation process may consist of variations of the following activities:

1. The government's financial team, which may consist of representatives from various agencies, including the Budget Office, the MOF, Planning and Economic Development, Legal Counsel, etc., commences a series of meetings to analyze past economic trends and monitor revenue flows in order to begin developing revenue projections for the upcoming fiscal year. Through this process, the financial team develops budget ceilings for each agency based on projected revenues.
2. The MOF issues a budget circular to each agency outlining the guidelines and timelines for the submission of budget requests. During this time, MOF staff conduct budget orientation sessions with line agencies to review the contents of the budget circular. As a general rule, the following elements are included in the budget circular:

- A statement of the country's macroeconomic and financial situation;
- The overall deficit target and expected resources;
- Budget priorities;
- Allocations for continuing policies and programs;
- An indication of the expenditure savings expected in ongoing programs; and
- The format for presentation of the line agencies' budget requests.

3. The agencies develop their proposed budgets in agreement with the established guidelines and submit them to the MOF.
4. MOF staff analyzes individual budget submissions and prepares recommendations and develops budget schedules and revenue statements. Agency heads are presented with the MOF recommendations / modifications for review and discussion. If changes are made as a result of the discussions undertaken, the agency's budget is revised accordingly.
5. The agencies' proposed budgets are then presented to the government's financial team for review, recommendation, and approval. After consultation with the President, the recommended budget is finalized and forwarded to the Legislature.
6. The Legislature reviews the budget, supporting bills, schedules, and summaries submitted by the President. The committee responsible for appropriations and budget conducts individual budget hearings for each agency. During the hearings, agency heads, their key financial personnel, and citizens are given the opportunity to testify. Throughout the process, the Legislature may add, change, or delete any item in the proposed budget.
7. Once passed by the Legislature, the President may approve the budget or veto it (partially or in its entirety) and return it to the Legislature with objections.
8. Once the budget is enacted, the President exercises fiscal control of expenditures through the MOF. If the fiscal resources available to the Government in any fiscal year are insufficient to satisfy the appropriations approved for such year, the President may take administrative measures through the MOF (such as reducing budget allotments) to align expenditures with available resources.

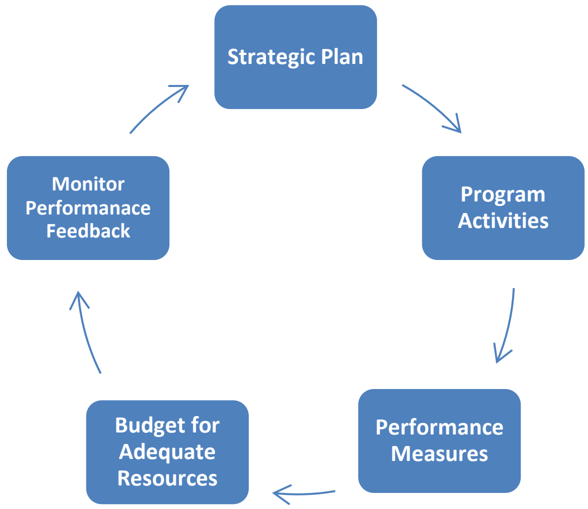
14.1.1. Strategic and Budget Planning Linked

The budget planning process can be a valuable tool for continuous improvement of agency programs. As a result, it is often linked with the agency's strategic plan, taking into consideration the following elements:[343]

- The agency's mandate, consistent with statutory requirements;
- A set of outcomes;
- The approaches to achieving these outcomes;
- A description of how activities and processes will be used to achieve these outcomes; and
- A budget outlining resources needed to deliver projected outcomes.

[343] The tax administration's strategic planning process is discussed in further detail in Chapter 15.

Figure 14.1. Budgeting and the strategic plan



The result of this exercise is a document outlining the agency's plans and, most importantly, how these plans are to be achieved. If done effectively, the agency properly budgets for each item in the strategic plan, which serves as the roadmap for everything the organization does on a daily basis.

14.1.2. Budgeting Methodologies

The approach taken by the agency in developing its proposed budget in support of the strategic plan can directly influence the level of funding that it is allotted. Outlined below are a number of approaches often referred to when discussing the budgeting process.

- The **top-down approach** to budget planning generally refers to the assignment of spending ceilings to agencies before annual budget requests are prepared. Often, officials establishing the ceiling limits are somewhat removed from the day-to-day budgetary challenges experienced at the front line in implementing policies and procedures. This can lead to a budget that does not adequately reflect the resources needed at the front line. As a result, agencies may feel they are required to meet impossible standards without adequate resources.
- A **bottom-up budget** is generally created by middle managers and submitted to upper management for approval. Although prepared by individuals implementing the budget, bottom-up budgeting has its drawbacks, because managers may tend to overestimate the resources needed in anticipation of potential cuts as it goes through the review process. Since line managers may view things from the perspective of their individual programs, little appreciation may be given to the big picture, e.g., the challenges of allocating resources for the entire country.
- A **line item budget** is simply a listing of each of the agencies' revenue sources and each item that will be purchased during the fiscal year. The line-item budget has historically been the most widely used budgeting methodology, because it is relatively easy to prepare and requires limited financial skills. The simplicity of the methodology also allows for management officials to easily monitor revenue and expenditures. The major deficiency of line-item budgeting is the difficulty in

determining the actual results generated as a result of resources expended. It is also difficult to establish priorities and determine the quantity or quality of services which could be generated at various expenditure levels.

- A **program budget** provides the agency with the opportunity to identify the total cost of each program and set spending limits and priorities. A downside, however, is that programs tend to overlap, which can make allocating resources and collecting data difficult.
- **Performance budgeting** similarly reflects the budget of each program, but also incorporates performance information. Specific goals and objectives are tied to expenditures for each program. The focus is on what will be accomplished with the resources provided.
- **Zero-based budgeting** starts with "**zero**" and requires all departments to justify funding for their programs. Budgets are established based upon what is needed for the upcoming period, regardless of whether the budget is higher or lower than prior allotments. The department must also reflect the various levels of service which could be provided with different levels of funding options available. A justification document is also required to reflect the effects of various funding levels (e.g., maintaining the current level, reducing funding by a certain percentage, or increasing funding by a certain percentage).

Although the line-item budget methodology has historically been the most widely used, international trends have been moving towards performance-based budgets. This change has occurred because line item budgets reflect what resources will be spent on (e.g., salaries, benefits, office supplies, travel, utilities, equipment, etc.), whereas performance-based budgets reflect on what will be accomplished as a result of the resources expended in terms of measurable results achieved (e.g., increased revenue collection, increased customer satisfaction, etc.). The attention to program results in a performance-based budget provides an advantage over traditional budgeting approaches.

A comparison of the pros and cons of the various budget methodologies is presented in the figure below.

Figure 14.2. Comparison of budgeting models

TYPE BUDGET	PURPOSE	CHARACTERISTIC	RESPONSIBLE PARTIES	SUCCESS FACTORS	PROS	CONS
1. Line Item	a. Aims to spend resources according to plan b. Prevents misappropriation of funds c. Promotes financial accountability	Focus on prior year allocation as starting point	Central budget managers	Minimum amount of staff time and expertise needed to create and track the budget	Works well when time is short and there is considerable complexity, with multiple stakeholders and a high potential for conflict	Not good for dealing with questions of efficiency, effectiveness, and future and/or previously neglected concerns
2. Program	a. Aims to ensure that programs are achieving goals and objectives b. Promotes program accountability and effectiveness	Focus on program plans, goals, and objectives	Program analysts and managers	Requires the resources necessary to develop program plans, goals, and objectives	Provides a clear linkage between program activities and budget allocation	Requires considerable investment of resources and has a high potential for conflict
3. Performance	a. Aims to ensure that programs are effective b. Aims to ensure that program are efficient (cost effective) c. Promotes efficiency / effectiveness	Performance measurements utilized to determine efficiency and effectiveness	Mid–level managers	Requires considerable resources to develop reliable measures and time to develop the skill sets of those responsible for developing measurements	Provides an objective way of documenting accomplishments	Time-consuming and expensive, with a high potential for resistance because of fear of measures being used to reduce funding
4. Zero-Based	a. Assesses continuation of programs annually b. Focuses on priorities	Annual evaluation of current program activities	All levels of management	Requires considerable time and resources to assess all programs annually	Provides an opportunity for activities to be evaluated annually and an opportunity to reallocate resources	Places a high burden on organizational resources, and it is difficult to achieve comparability across organizational units

14.1.3. Budget Preparation

In the tax administration, budget formulation starts at the headquarters office, well in advance of the start of the calendar or fiscal year, and with consideration and joint deliberations by top-level officials of the impact of applicable Ministry and/or government-wide directives and resource ceilings, long-term strategic objectives of the tax administration, and historical performance data to develop annual work plans for the operations functions, from which costs for budget formulation can be computed. From these deliberations, after approval by the Deputy Director General (Operations),[344] each of the operations chiefs issues, to each district/field office director and division heads, higher-level directives, an outline of expectations, and planning assumptions for the development of annual work plans. These "assumptions" include the changes or improvements in laws, procedures, methods, systems, or resources that are expected for the next year and should be considered by each of the operations functions in planning for results.

Each of the division heads, with input from subordinate managers and coordination and approval of the district-field office director, develops and submits to headquarters an annual work plan to meet the expectations outlined by their respective headquarters offices. The annual work plans are corrected, adjusted, and consolidated at headquarters. Costs are then computed for salaries, training, capital improvements, etc., and the tax administration's proposed budget is presented to the MOF. The tax administration's representative at the MOF for budget purposes should be the Deputy Director General (Administrative Services) and/or his or her Chief Budget Officer.

To ensure an all-inclusive process, consideration should be given to utilizing the following approach in developing the agency's work plans and budget.

- Ensure that an Information Technology (IT) representative is included at all functional meetings for work plan development. There is often a disconnect between IT and the operational units, and efforts to bring them together early in the budget planning process can enhance overall program delivery;
- Participants at all levels should come to an agreement on the overall approach to be utilized throughout the work plan and budget planning process, including but not limited to the following:
    - Considering lessons learned from prior work plan and budget planning exercises to capitalize on successes and address problems experienced in the past;
    - Developing reporting templates (as needed) and automating as much of the process as possible to save time and ensure that everyone follows the same overall approach; and/or
    - Blocking off dedicated meeting time and brainstorming on the overall objectives of the organization and the resources needed to accomplish those objectives. If each function

[344] An organizational structure for the tax administration is suggested in Chapter 4.

is working in isolation and not taking into consideration the overall objective of the administration, resources will not be utilized in the most effective manner;

- Participants at all levels should be expected to work together to reconcile budget allocations that will allow the tax administration to achieve its objectives. This may include discussions on programs and activities that should receive additional funding, others that should remain at the previous year's level of funding, or even some that should undergo cuts. These discussions, including decisions to cut programs, should keep the need to achieve tax administration objectives as their focal point.
- Documentation and communication are critical to ensure that there are no misunderstandings as the process unfolds. Documenting and communicating the budget and work plan process timelines, the established guidelines, and the budget assumptions utilized will help keep everyone on the same page; and
- The final proposed budget document for the tax administration should reflect a consolidated and complete view of the resources needed to effectively deliver the administration's programs.

14.1.4. Developing Cost Estimates

Regardless of which budget methodologies they utilize, agencies will need to prepare their best estimate of the actual costs for delivering program results. In preparing an appropriate cost estimate to formulate the budget, it is critical to think through what is required in a logical manner. Consideration should be given to resources required to effectively deliver current programs, new programs, and capital investments, such as integrated tax management systems. Particular care should be taken with regard to cost estimates for IT and training needs, including determining true needs and computing and communicating cost-benefit analyses for both, as discussed below. Tax administrations must now have a variety of modern IT systems to be effective and efficient in the modern business environment and, as discussed below and in Chapter 12, the acquisition of technology is one of the major expenditures undertaken by most tax administrations. Training of staff – not just basic training, but continuing professional education and "refresher" courses – are vital for top performance and delivery of expectations by tax administration staff. Training is, unfortunately, often relegated to a low level of priority in many tax administrations because of budget shortfalls.

Clearly, for all costing, budgets should require a justification which explains the rationale for each budget category and how the agency arrived at its cost estimates. Tax administrations must be able to show how the allotted resources will ultimately enhance revenue collections (directly or indirectly). Some preliminary questions to consider during the costing exercise include:

- What resources are needed to implement ongoing programs, including staffing, facilities, equipment, office supplies, transportation, fuel, telephone, etc.?
- What resource constraints hindered the agency from meeting last year's goals and objective?
- Are there new laws, policies, and procedures that must be implemented?
- Are the current resources sufficient to implement new laws, policies, and procedures and, if not, what additional resources are required? and

- What capital investment initiatives are being considered, and what resources are needed to bring these initiatives to fruition?

Every planned activity should have a cost attached. The typical costs incurred to deliver tax administration programs are outlined below.

1. **Personnel Costs:** Personnel costs generally comprise the largest amount of requested funds.
   a) **Salaries:** Salaries are monetary compensation paid to the administration's employees, including executives, managers, technical staff, administrative staff, etc. Based upon the information included, consideration should be given to:
      - Whether cost of living increases or merit awards will be given. The tax administration must budget accordingly for the cost of these items; and
      - Whether there is a need to recruit new hires. Before deciding to recruit new hires, the tax administration should evaluate whether staffing in other departments can be utilized to accommodate vacancies. If additional staffing is needed, the cost of new personnel should be included. If the recruitment process has not been finalized, the normal salary rate for the position being recruited should be included.

   b) **Fringe benefits:** Fringe benefits are additional benefits provided to supplement an employee's regular pay. Some examples of fringe benefits include:
      - Life and health Insurance;
      - Social security;
      - Retirement plans;
      - Transportation; and/or
      - Accommodation.

   c) **Consultants:** Consultants are individuals who provide expert advisory or other services for brief or limited periods of time. The budget justification for consultants should include:
      - The consultant's name and organizational affiliation (if applicable);
      - The services and/or advice they are going to provide;
      - Their daily rate of pay, and the number of days they will work on the project or program; and
      - Costs to cover any travel and per diem for bringing outside consultants to the agency.

2. **Non-personnel cost:** Consideration should be given to the tools personnel need on a daily basis to carry out their activities.
   a) **Furniture and equipment:** Work stations, chairs, file cabinets, computers, etc.
   b) **Materials and supplies:** Materials and supplies include items such as paper, pencils, computer software, photocopy paper, ink, toner, etc.
   c) **Communication:** Communication costs include the cost of various mediums utilized in communicating with taxpayers, such as telephone installation, monthly telephone charges

(landlines, mobile phones, voice over Internet protocol), Internet service providers, printing, photocopying, and related duplicating expenses, such as binding, postage, etc.

d) **Travel:** Travel costs include transportation (air, boat, auto, ground, etc.), housing (hotel, motel, guest house, etc.), meals, tips, phone calls, and similar expenses. Consideration should be given to local, domestic, and international travel needs. A budget justification for travel should address:
   - The purpose of the travel;
   - The specific destination, if known, of each trip;
   - The number of individuals going on each trip;
   - The mode and cost of transportation to be used; and
   - The number of days of per diem and the per diem rate.

e) **Other expenses:** Other expenses should be as carefully defined as other categories outlined in the budget. One example of this type of expense is:
   - Training and staff development: Since a large portion of an agency budget is spent on training and staff development, it is important to budget carefully.[345]

3. **Indirect costs:** Indirect costs, sometimes referred to as overhead or facilities and administrative costs, are those costs that are not specifically attributable to a particular program, but are valid expenses associated with the general operation of agency. These may include:
   - Office rental;
   - Operations and maintenance of facilities; and/or
   - Security;
4. **Capital investments**: Capital investments include the acquisition of capital assets, which, in government accounting, are simply assets that are expected to be productive over several years. These include:
   - Vehicles;
   - Building construction or renovation; and/or
   - Information technology.

One of the major capital investments undertaken by most tax administrations worldwide is the acquisition of integrated tax systems and data warehouses. Depending on the size and the needed functionality of the system, the cost of this investment could range from US$10 million to over US$100 million.

Capital investment initiatives are often faced with implementation delays, cost overruns, and funding constraints. Therefore, in establishing a budget for these types of investments, the tax administration should utilize the "Twelve Steps of a High-Quality Cost Estimating Process" shown in Appendix 14.A. Outside assistance from subject matter experts should also be

[345] According to the American Society of Training and Development, in the United States, major organizations spend over 3 percent of their total payroll on training (American Society for Training and Development (2012), p. 7.). In addition, in 2010, 15 out of 34 OECD tax administrations reported major planned changes in staff training (OECD (March 2011), p. 103).

considered to help identify the size and range of costs generally associated with the effort under consideration.

14.1.5. Managing Budget Execution / Implementation

Once the budget has been approved, the next step is budget execution – also referred to as budget implementation. The budget execution process involves ensuring that the financial resources made available to an agency are directed towards achieving the program deliverables outlined in the strategic plan for which the funds were appropriated.

Once the budget authorization is received, the tax administration may obligate funds to carry out program activities. However, the final budget may often be less than what was originally reflected in the strategic plan. A review of the plan in light of the actual budgetary allocations should be conducted, modifications made as appropriate, and responsible parties designated for the delivery and periodic reporting of results.

Each tax administration unit is responsible for evaluating programs and examining projects to ascertain whether they are meeting their targets and objectives on an ongoing basis. Generally, most tax administrations have established monthly reporting of key performance indicators for program deliverables. The tax administration should assess not only the effectiveness of the program, but also the effective use of the allotted budget in executing the program.

Some common problems associated with budget execution include:

- Large deviations between the approved budget and the proposed budget, thereby undermining policy and planning efforts;
- Spending above approved levels;
- Weak internal controls that allow waste, fraud, and abuse;
- Insufficient record-keeping, hindering effective audits; and
- Untimely reporting, hindering the agency's ability to manage spending;

Operational reviews should therefore be conducted periodically to monitor, measure, and evaluate performance. Reviews should take into account the points listed below.

- The tax administration should evaluate its financial performance relative to the final budget. Regular monitoring of budgetary performance provides an early warning of potential problems and gives decision makers time to consider modifications if major deviations in budget-to-actual results occur;
- The tax administration should monitor and evaluate external factors that may affect budget performance and achievement of goals. Factors outside the administration's control, such as the national or regional economy, statutory changes, and legislative mandates, may affect achievement of goals. Monitoring these factors helps the administration to evaluate and respond to the effect of these external influences on programs in a timely manner;

- The tax administration should monitor, measure, and evaluate capital program implementation. Monitoring the status of capital projects helps to ensure that projects are progressing as planned, problems (such as delays in key milestones and cost overruns) are identified early enough to take corrective action, funds are available when needed, and legal requirements are met;
- The budget should be adjusted in light of unforeseen events. The budget is a plan based on a set of assumptions that may not always match actual experiences during the implementation phase. The tax administration should watch for significant deviations from expectations and modify the plan to reflect revised expectations; and
- The tax administration should monitor and evaluate taxpayer satisfaction with programs and services. Often, the main contact for many taxpayers with the tax administration is through the programs and services that it provides. Therefore, it is important for the administration to be aware of and respond to taxpayers' perceptions of these programs and services. The taxpayers' perception of the quality of services is an important factor in their overall perception of the administration and has a potential impact on the allocation of resources.

Establishing an effective budget execution process increases the tax administration's ability to more efficiently and effectively deploy resources and to introduce modifications to the plan, if required, in a timely manner.

14.2. Common Trends

With the current worldwide economic situation and revenue pressures experienced by government, many tax administrations have started evaluating options to secure the resources needed to deliver programs. One area receiving increased attention is self-budgeting based on a percentage of revenue collected. Opponents have expressed concern that tax administrations that are paid based on revenue collected may use pressure tactics to collect the maximum amount.

The first country in LAC to implement self-budgeting based on a percentage of revenue collected was Peru in 1991, using 2 percent of tax revenues collected, followed by Argentina, Bolivia, and Guatemala.[346] The concept of basing the tax administration's budget on collected revenue has been embraced in theory by a number of countries, especially those which have created revenue authorities.[347] To increase the base revenue collections upon which the percentage would be taken, other tax administrations have assumed collection of non-tax related services, such as stamp duty, motor vehicle registration, and transfer of motor vehicle ownership.

In some countries, such as Kenya, the annual budget disbursements made to the tax administration have historically been less than the specified percentage. To correct this problem, some have argued that agencies should be allowed to deduct their allowable percentage first, and then transmit the balance to the general account, rather than depositing the full amount of revenue in the general

[346] Inter-American Center of Tax Administrations (CIAT) et al. (2012), section 2.1.
[347] Revenue authorities are discussed in Chapter 4.

account and waiting for the disbursement later. This practice should be discouraged. If the tax administration is allowed to retain a fixed percentage of revenue collected, it will have no incentive to become more cost efficient in the programs they execute. In addition, and equally important, the tax administration will have a very strong incentive to ignore the rights of taxpayers and generate unjustified additional assessments or undertake unwarranted enforcement actions in order to increase their budget.

Another issue gaining increased attention is the policy adopted by many governments whereby unspent funds lapse at the end of the year. This practice encourages managers to use funds near the end of the fiscal year for fear of budget reductions in subsequent years. This year-end spending spree, however, may not lead to the most effective use of resources. Effective management and monitoring of budget expenditures in line with program deliverables throughout the year may leave some funds unspent at the end of the year. Thus, some have argued that agencies should be allowed to automatically carry up to two percent of the budget forward to the next year.

14.3. Tax Administration Maturity

The use of a maturity model allows the tax administration to self-assess its operations and design strategies for adopting leading practices. Since the budget planning process is critical to the overall success of the administration, opportunities for continuous improvement should always be explored.

Evaluating existing operations against the following maturity model is the first in a series of steps that should be taken. Consideration should be given to: 1) targeting a specific maturity level for each key area; 2) determining the maturity level of current practices and identifying the gap between the current practices and the desired maturity level; 3) assessing the risks to the agency and the biggest opportunities for improvement; 4) establishing priorities and assigning accountability for developing and implementing improvement strategies; and 5) implementing a process to ensure continuous improvement through routine monitoring and periodic assessments.

Budget Planning and Resource Management: Maturity Level 1

Key word: "Scattered"

- The tax administration has some financial management practices (e.g., for budgeting, managing cash flow) in place, but they are inadequate, with many gaps that affect day-to-day operations.
- Managers know many of the costs of their activities, but there is no consideration of the impact of operational, programmatic, or strategic changes on costs.
- No benchmarking of costs of other agencies is performed, which limits the administration’s ability to understand its cost drivers.
- There is limited project planning or project management for capital investments. Occasional projects may have project plans with risk management arrangements and timetable for delivery, but the use of plans is inconsistent and there is no aggregation of project plans at program level.

No projects are subjected to rigorous expenditure appraisal (a detailed analysis for the project rationale, relevance, effectiveness, efficiency, and impact).

- Budgets are finalized after the start of the fiscal year.
- There is a lack of monitoring of expenditures. There is a distinct lack of automated processes, and most monitoring is paper-based.
- The tax administration has no awareness of the data and corresponding IT needs of different users, both internal and external and users find that the reports they receive do not give them the information they need.
- Financial and operational performance is not openly discussed with external stakeholders.
- Financial and operational performance information is reported separately, and their formats are incompatible. They are often reported at different times and use different metrics, making it impossible to assess a single activity or output from both a financial and operational perspective.
- Staff who monitor the budget tend to use their own spreadsheets rather than the existing financial systems, leading to significant manual work and duplication of monitoring.

Budget Planning and Resource Management: Maturity Level 2

Key word: "Basic"

- The tax administration has basic financial management practices in place that allow it to function on a day-to-day basis, but that are not adequately linked to the administration's operational performance data.
- Managers know many of the costs of their activities, but there is little understanding of the impact of operational, programmatic, or strategic changes on costs.
- No benchmarking of costs of other agencies is performed, which limits the administration's ability to understand its cost drivers.
- There is still limited project planning or project management for capital investments. Significant projects may have project plans with risk management arrangements and timetables for delivery, but the use of project plans is inconsistent and there is no aggregation of project plans at program level. A few major projects are subjected to rigorous expenditure appraisal (a detailed analysis for the project rationale, relevance, effectiveness, efficiency, and impact).
- Budgets are finalized after the start of the fiscal year.
- Monitoring information is not provided to senior management until the second half of the fiscal year and contains little forecast information.
- The tax administration's different systems produce contradictory internal monitoring information reports, and the year-end statutory accounts are difficult to reconcile with management information. Little investment is made in IT.
- Financial and operational performance information is openly discussed with external stakeholders, but the presentation is likely to be unclear and lacking sufficient explanation for

non-finance professionals, giving rise to the risk that users will fail to understand the impact of the information.

- Financial and operational performance information is still reported separately, and their formats are incompatible. They are often reported at different times and use different metrics, making it impossible to assess a single activity or output from both a financial and operational perspective.
- Staff who monitor the budget are unable to access monitoring information online and in a format that allows them to monitor or forecast information easily.

Budget Planning and Resource Management: Maturity Level 3

Key word: "Rigorous"

- The tax administration has in place professional financial management practices which enable it to cope effectively in challenging times and will identify opportunities to improve its performance.
- Managers and staff can demonstrate their understanding of costs, different ways in which costs can be measured, and the ways in which costs can change when discussing current operational and future plans. They are, however, not always aware of the costs of outcomes and programs and the impact of changes on those costs.
- Cost analyses are regularly updated and there is an effort to benchmark costs across operational units, but there is little effort to look for benchmarks outside of the administration.
- The administration has a rigorous approach for capital expenditure appraisal and project management. All plans are produced to an acceptable level of quality. The business case, along with program and project management processes, is meaningful and adds value to the agency. All significant programs and projects consider the expenditure appraisal (a detailed analysis for the project rationale, relevance, effectiveness, efficiency, and impact), risk management plan, and project plan.
- Budgets are agreed at least a month before the start of the fiscal year and managers are fully aware of what budget levels to expect.
- Managers are able to use the financial systems to produce accurate, timely monitoring information, but not always forecasts. A comprehensive set of tailored reports is available for internal use. The systems enable the creation of reports that drill down as necessary and meet specific needs. The administration occasionally reviews the ongoing relevance of the suite of reports.
- There are reliable IT systems that are linked across all primary financial statements and that can be accessed remotely by managers. The system is integrated to minimize duplication of information and maximize interface possibilities.
- Financial and operational performance is openly discussed with external stakeholders and appropriate information is presented in a relevant and useful manner for external stakeholders.

- A set of operational performance metrics is reported jointly with financial information and aligned to the strategic objectives of the tax administration.
- Staff who monitor the budget and operational managers can access the reports and monitoring information easily. There is a clear and visible trail from the regular management accounts to the year-end financial statements.

Budget Planning and Resource Management: Maturity Level 4

Key word: "Strategic"

- The tax administration has in place financial management practices that allow it to anticipate both challenges and opportunities for improvement.
- Managers and staff can demonstrate their understanding of costs, different ways in which costs can be measured, and the ways in which costs can change when discussing current operational and future plans. They are aware of the costs of outcomes and programs and the impact of changes on those costs.
- Cost analyses are regularly updated and there is an effort to benchmark costs across operational units and outside of the administration.
- The administration has a rigorous approach for capital expenditure appraisal and project management. All plans are produced to an acceptable level of quality. The business case, along with program and project management processes, is meaningful and adds value to the agency. All significant programs and projects consider the expenditure appraisal (a detailed analysis for the project rationale, relevance, effectiveness, efficiency, and impact), risk management plan, and project plan. There is a readily applicable methodology for small to medium project appraisals.
- Budgets are approved one to two months before the start of the fiscal year as a result of a well-organized planning process and are updated to reflect any significant events close to the end of the year.
- Managers are able to use the financial systems to produce accurate, timely monitoring information and forecasts. A comprehensive set of tailored reports is available for internal use. The systems enable the creation of reports that drill down as necessary and meet specific needs. The administration routinely reviews the ongoing relevance of the suite of reports.
- There are reliable IT systems that link across all primary financial statements and that can be accessed remotely by managers. The system is integrated to minimize duplication of information and maximize interface possibilities.
- Financial and operational performance is openly discussed with external stakeholders and external reports contain information tailored to users' needs and are developed in collaboration with key external groups and partners.
- A set of operational performance metrics is reported jointly with financial information and aligned to the strategic objectives of the tax administration.

- Staff who monitor the budget and operational managers can access the reports and monitor information easily. There is a clear and visible trail from the regular management accounts to the year-end financial statements.

14.4. Latin America and the Caribbean

In 2006, the OECD surveyed the budget agencies in the following seventeen countries from Latin American and the Caribbean (LAC) to solicit comparative data on budgetary procedures and institutions: Argentina, Barbados, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Jamaica, Mexico, Panama, Paraguay, Peru, Trinidad and Tobago, Uruguay, and Venezuela. Survey results from 13 countries responding indicate that many LAC countries have introduced performance information into the budgeting process.[348] The constitutions of countries like Brazil, Colombia, and Mexico actually mandate the linkage of performance budgeting to objectives reflected in their National Development Plans.

Individual countries, however, are at different stages of implementation. Argentina, Chile, and Mexico have been developing performance measures for almost fifteen years, while Ecuador, for example, had just started a pilot program at the time of the survey, and Venezuela had not developed any performance measures.

The following table reflects the approach used to evaluate performance in different LAC countries.

Figure 14.3. Performance evaluation measures in LAC[349]

	Performance Measures	Evaluation	Benchmarking	Other
Argentina	X			
Bolivia		X		
Brazil	X	X		
Chile	X	X	X	X
Colombia	X	X		
Costa Rica	X	X		
Ecuador			X	
Guatemala	X			
Mexico	X	X		
Paraguay	X			
Peru		X	X	
Uruguay	X	X		

However, the survey also noted that, in many LAC countries, information on performance is not used in negotiations between the Ministry of Finance and agencies. In addition, the survey noted that most

348 Curristine et al. (2007), p. 4.
349 Ibid., p. 23.

countries in the region, with the exception of Bolivia and Uruguay, rely on an organic budget law – one that establishes budgeting fundamentals, but that countries vary in many aspects of the budgeting process.[350] For example, the time frame for budget negotiations between the central budget department and agencies varies between half a month (Brazil) to five months (Colombia) and that the number of mid-year budget amendments can be as little as none (Chile, Guatemala, Mexico) or as high as 20 (Venezuela).[351]

According to a high-level study of budgeting in tax administrations by CIAT, the budget process for tax administrations in the region has been affected significantly by the trend to establish semi-autonomous revenue agencies.[352] The following are highlights:

- Only the Guatemalan tax administration has the autonomy to determine its own budget. All tax administrations are subject to the supervision of the Comptroller or Court of Auditors.
- In 1991, Peru was the first LAC country to introduce a model for financing whereby 2 percent of revenue collections were allocated to the tax administration budget. This model was followed by other countries, such as Argentina, Bolivia, and Guatemala.[353]
- Not all semi-autonomous revenue agencies, however, use salary scales that are separate from the civil service scales. Argentina, Bolivia, Colombia, the Dominican Republic, Guatemala, Honduras, Nicaragua, and Uruguay can do so.
- The tax administrations' budgets grew significantly during 2006-2010, by approximately 25 percent on average, but individual countries vary. While spending on tax administration in Argentina and Honduras increased by over 100 percent during the period, Bolivia, El Salvador, Guatemala, and Nicaragua show decreases.
- In 2010, 68 percent of the tax administrations' budgets were directed to staff costs, which is in line with averages across OECD (72 percent[354]). Approximately 4 percent were directed to investment, although there were large variations.[355]
- The average cost of tax collection – the ratio of the tax administration budget to collected revenue – was 1.37 percent, which was over the OECD average of 0.96 percent.[356]

14.5. Key Benchmarks and Guidelines

The evaluation of the overall budget is the responsibility of an independent government auditing office. This office generally has the role to evaluate the execution of the budget regulations and, if necessary, conduct investigations regarding any violations of the legal framework by public officials, as well as

[350] Ibid., p. 5.
[351] Ibid., p. 19. The number of supplementary budgets is for the two years prior to the report.
[352] Inter-American Center of Tax Administrations (CIAT) et al. (2012), section 2.1.
[353] In addition, as discussed in Chapter 10, Brazil and Chile have undertaken initiatives to reward tax collectors based on their collection effort.
[354] OECD (March 2011), p. 118.
[355] There is no comparable OECD information, but the study does indicate that the amount may be insufficient (Inter-American Center of Tax Administrations (CIAT) et al. (2012), section 2.4).
[356] Ibid., section 2.5.

suggest sanctions when appropriate. All agencies, however, should conduct their own internal reviews to:

- Ensure resource allocations are within statutory limits and used for their intended purpose;
- Examine the extent to which desired results are being achieved and whether they can be achieved at a lower cost alternative to reach the desired results;
- Evaluate the efficiency of the operation, including the utilization and control of resources (e.g., duplication of efforts, mismanagement of equipment, supplies, etc.);
- Evaluate whether financial records are complete and reliable;
- Determine whether program implementation targets are being met;
- Determine the degree to which the goals and objectives outlined in the strategic plan are being achieved;
- Determine whether data are being collected and reporting guidelines are being followed;
- Determine whether there is supporting documentation for all funding documents issued;
- Determine whether the operating units verify availability of funds prior to obligating funds; and
- Determine whether performance against obligation plans is evaluated monthly, and whether the tax administration researches the cause of deviations that exceed plus or minus 5 percent.

With respect to tax administrations, various quantitative benchmarks can be devised but should be used with caution, as circumstances – legal and economic – can impact benchmarks significantly. An important benchmark is the cost of collection ratio discussed above (i.e., expenditures of the tax administration over revenues collected). The cost of collection in OECD countries on average is approximately one percent. Other benchmarks are discussed above and in various chapters of this product, such as expenditures on IT over total expenditures (11 percent), the cost of the collection function over total expenditures (30 percent), and expenditures on salaries over total expenditures (70 percent).

Chapter 15. Strategic Planning

David Crawford

Strategic planning is an important management tool that is used to guide the deployment of resources and provide focus on key activities and measurements of achievement in attaining the vision or future state of the organization.

There are a number of methodologies that can be used in developing a strategic plan, as evidenced by a prolific number of essays, research papers, and management books. With respect to tax administrations, there is not a standard approach to strategic planning, nor is there a standard template that can be applied. Tax administrations operate in varied environments, face different challenges and obstacles, have different visions of their future state, and operate with widely varying organizations. Additionally, tax administrations do not tend to publish full text versions of their strategic plans for others to use as examples when developing their own plans.

This chapter introduces the concept of a strategic plan, some of the principles, issues, and topics that are almost universally addressed in the few publically available strategic plans, and a possible hybrid approach to strategic plan development.

15.1. Leading Practice

According to internationally accepted principles, the tax administration should: (a) promote voluntary compliance; (b) be efficient, by raising the maximum amount of revenue under the law with the least cost and effort; (c) be effective and administratively capable of delivering the desired policy objectives; and (d) equitable, offering fair treatment of taxpayers. Making the tax system efficient, effective, and equitable is difficult when confronted with an external environment that is complex and can be politically disposed, along with a variety of internal challenges, such as staff shortages, operating budget constraints, poor facilities, etc. Even the most carefully crafted and appropriate tax policies, and the best intentions of adhering to the principles of a good tax system, are of little importance if the tax administration cannot effectively implement them.

Some of the more common problems confronting tax administrations, at the domestic level, include: the mandate to tax a vast informal economy with little financial infrastructure; the struggle to collect revenue in the face of poor attitudes toward paying tax, resulting in poor tax compliance; relative tax complexity and poor taxpayer education; major gaps in administrative capacity; shifting tax structures; trade liberalization; corruption; and a deficient rule of law. At an international level, tax challenges for countries include capital flight, a lack of relative power in negotiations around foreign direct investment, tax competition, and transfer pricing abuse by multinational firms.

Unfortunately, one of the basic tools of modern tax administration management is often overlooked – namely, the process of diagnosing existing problems and developing an appropriate strategy to address them. This process requires articulating where the administration wants to be by developing a future vision, identifying the key problems/challenges, and defining key goals, as well as the options for achieving these goals, in a strategic plan. A strategic plan is a tool that helps management do a better job, as it assists in establishing the key linkage between core values, the principles of tax policy, and the tax administration, by anticipating challenges, developing appropriate responses, and effectively utilizing strengths to achieve improvements. The strategic plan helps to focus the entire tax administration's resources and efforts and guides all parts of the tax administration towards the same goals.

The strategic plan sets out objectives for the duration of the plan in the key areas against which successful performance will be measured. Normally, it also includes a brief description of the major planned projects for the period of the plan and a justification on how each project will contribute to the objectives. The strategic plan is supplemented with detailed action plans describing how each major organizational unit is to accomplish the objectives of the strategic plan. These action plans usually describe who has responsibility for various actions, the milestones, timing, required resources, and a rough budget. These action plans also contain a brief justification for how they will contribute to achieving the objectives. Finally, to be an effective management tool, the strategic plan requires performance indicators, which reflect performance against each objective. The plan sets performance targets against which actual performance is shown. Most modern tax administrations have clearly defined strategies that are linked to the major functional areas of the organization – audit, collections, taxpayer service, etc. – and most tax organizations aim to increase the quality of audits, improve their revenue collection, deliver quality service to taxpayers, and process information more rapidly and with greater accuracy. Improving the effectiveness of these key functions should be the basis for defining performance standards in most tax administrations.

The end product of the strategic planning process is a collaborative set of decisions on the objectives or goals about what to do, a justification for why do it, and, through a series of actions and projects, an approach on how to do it.

15.1.1. Introduction to Strategic Planning

Strategic planning can be defined as a process of articulating the desired future state of the tax administration and translating this vision into broadly defined goals or objectives and a sequence of steps to achieve them. The strategic plan covers all aspects of the tax administration's activities and must be revisited regularly, since the operating environment is not static, and, as projects and action plans progress, the tax administration needs to measure progress and achievements against the plan. In other words, the strategic plan is a living document and not just a report that is filed away after a box is checked that it has been done.

Strategic planning should not be confused with business planning. The strategic plan establishes broad objectives whereas business plans provide the detailed steps to accomplish individual projects, implement ongoing work, manage risk, or monitor progress[357]. The strategic plan provides direction for how the main responsibilities will be carried out, while the business plan that flows from the strategic plan details the various actions and projects that are required to achieve the vision that is broadly articulated in the strategic plan. This whole process is called 'strategic management'.

Management experts have described strategic management as:[358]

> *"Strategic management is the process of managing the pursuit of organizational mission while managing the relationship of the organization to its environment."*
>
> *James M. Higgins, Rollins College*
>
> *"Strategic management is defined as the set of decisions and actions resulting in the formulation and implementation of strategies designed to achieve the objectives of the organization."*
>
> *John A. Pearce II, Villanova University, and Richard B. Robinson, Jr., University of South Carolina.*
>
> *"Strategic management is the process of examining both present and future environments, formulating the organization's objectives, and making, implementing, and controlling decisions focused on achieving these objectives in the present and future environments."*
>
> *Garry D. Smith, Danny R. Arnold, Bobby G. Bizzell, Houghton Mifflin College*
>
> *"Strategic management is a continuous process that involves attempts to match or fit the organization with its changing environment in the most advantageous way possible."*
>
> *Lester A. Digman, University of Nebraska*

In the case of a tax administration, the purpose of strategic management and the strategic plan is to:

- Document and communicate the vision, mission, and values;
- Align the goals, objectives, and action plans with the mission;
- Allow the tax organization to set priorities given the limited financial and human resources available; and

[357] The terms 'action plan', 'work plan', and 'performance monitoring plan' are used in this chapter to describe plans for projects, ongoing work, or monitoring progress respectively.
[358] Barnat (n.d.), para. 3.

- Allow IT systems to be aligned so that reporting provides meaningful information to evaluate and measure performance.

15.1.2. Political Commitment and Stakeholder Engagement

Prior to embarking on any significant changes in how the tax administration does business, the most important step is to ensure that the government is politically committed to the changes. In the case of sweeping tax reform, there needs to be explicit support for the reform effort through visible political commitment. Without visible political commitment and special programs to inform and obtain support from the taxpaying public, any package of reform measures may not be politically sustainable, and the usual expectation for improvements in tax compliance will be unlikely.

Successful implementation of changes in the tax structure, administration, and systems and procedures also requires committed and capable management teams that are backed by the government's strong political will to introduce change.

In addition, whether the plan is for significant changes or a wholesale reform, it must be politically sustainable. This means that the management and staff of the tax administrations must be involved in the design, planning, and implementation from the beginning. Their taking ownership is essential to success.

15.1.3. Implementing Change

In designing and implementing a strategy, it is important to keep in mind that tax administrations are usually large and often can be more complex than they first appear. Significant changes or wholesale reforms are also complex, often spanning many years and requiring significant human and financial resources to effect change. These resources are often in short supply. Strategic plans can require changes in legislation, regulations, processes, procedures, and staff qualifications and capabilities. The result is that tax administrations with limited resources cannot be expected to implement significant shifts in direction over a short period of time.

Experience has shown that significant changes, such as implementing a self-assessment system or a complete reform, should be implemented gradually through a series of practical and manageable steps. Sudden, swift changes seldom work, and taking significant risks when a country’s revenue is at stake is not advisable.

Any strategic plan must keep the tax revenues flowing during change. If, during planning, there is a possible revenue risk, then a plan to supplement revenues with measures that can be implemented with existing resources should be considered. Contingencies for "worst case" scenarios must also be planned. Ad hoc measures implemented in a state of crisis can discredit the strategic plan and place the entire plan in jeopardy.

In summary, any strategic plan must be realistic, must have employee ownership through a consultative process, and must be a comprehensive plan that considers a coordinated approach and includes the entire organization.

15.1.4. Responsibility, Purpose, and Process

As previously mentioned, the strategic plan is the responsibility of senior management, but it involves a broad base of employees from across the organization to ensure employee commitment. Since strategic plans are often far reaching, they cannot be accomplished in a short time span and, thus, they have a multi-year focus. Most are at least three years in duration, but they can be longer. Where a major tax reform is being undertaken, it is not uncommon for the plan to be for five years or even longer. Shorter activities and projects that contribute to the success of the overall strategic plan will be within this multi-year plan. To be comprehensive, the plan also identifies measurable outputs for performance management. Finally, it is written as a means of communicating to employees, taxpayers, and all stakeholders.

15.1.5. Preparing to Plan

In its most basic form, the process begins with key management of the tax administration meeting to discuss, in a structured manner, what they view as the most important aspects of the organization and their views on attainable goals for the organization. This group of key executives, further discussed below, may also be supplemented with, for example, a senior person representing the Ministry of Finance or, if a revenue authority, a member of the governing board. This group constitutes the 'steering committee'.

The structure of the discussion normally consists of developing a rough framework for the strategic planning effort that is about to be undertaken. Generally, this framework includes the steps in the process, defines who will participate, identifies an individual who will ultimately be responsible for the overall coordination of the exercise and the proper implementation of the results (the 'strategic plan coordinator'), and provides a rough approximation of the time frames.

The strategic planning process requires a lot of work, thought, and discussion. This initial meeting is best described as planning to have a plan. The first question at such a meeting is whether the tax administration is ready to prepare a strategic plan. When preparing to start a strategic plan, many tax administrations conduct a review or an assessment of the current state of the administration. Often, the tax administration seeks external assistance to get a detached, critical view of the organization, processes, and procedures, as well as a sense for how stakeholders perceive the administration.

A good strategic plan for the tax administration should address a number of interlinked components. The failure to address any of the components below may result in failure of the overall strategy:[359]

[359] Murdoch et al., p. 3.

- The adequacy of the tax laws and policies;
- Organization/taxpayer segmentation;
- Staffing;
- Facilities;
- Tax operations/functions (e.g., audit, taxpayer services and education);
- Human and institutional capacity;
- Integrity;
- Technology; and
- Communications.

In addition, some administrations will have either a previous report on taxpayer attitudes and perceptions about the tax system and the tax administration, or may commission a small survey as a resource to be used during the strategic planning sessions. This type of document can be important when conducting the environmental review (discussed later) and in the identification of strategic objectives.

Other current reports should also be gathered in advance of initiating the strategic planning process, such as:

- Any prior reports on the tax administration prepared by the Fiscal Affairs Department of the IMF;
- Documentation on any requests made to external providers of technical assistance;
- Any reports stemming from externally provided technical assistance that the tax administration has received;
- Reports stemming from any study tours to other tax administrations;
- Any prior strategic plans;
- The most recent budget;
- Prior and current work plans from each division of the tax administration; and
- Any other reports that may be relevant to the process.

These reports form the preliminary basis for discussions during the strategy planning sessions. It is the responsibility of the steering committee to ensure that the various background reports and other materials are assembled prior to commencing the process.

During this stage, it is decided who the participants[360] in the strategic planning process will be, the broad parameters and timing of the strategic planning effort, and possibly the suggested number of working groups and their broad mandates.

[360] The bulk of the participants should be selected from the most qualified tax administration employees who possess the required attributes and qualifications, including the ability to work effectively as a team and under pressure, and who are open to new ideas.

A core working group of participants should be selected from all participants and given full access to all resource documents. Other participants should have access to the documents on a need-to-know basis, depending on their particular assignments. When the participants are all assembled, they should be briefed on the need to maintain confidentiality during the process, as the discussions and materials, until approval of the strategic plan, are only in draft form and may change, sometimes significantly.

The development of the strategic plan should be a "bottom-up" process that is within the framework established during the initial senior management meeting. The participants in the development of the strategic plan should be drawn from across the entire organization. Participants should be inclusive of all levels of management, except for the most senior management. The rationale for excluding the head of the tax administration, and possibly the immediate level below, is to encourage an open and honest discussion in the working groups. This open discussion would usually not occur if the most senior persons in the organization were present. In addition, including a broad cross section of the organization instills ownership in the resulting strategy and action plans, as well as understanding among employees of the rationale behind certain goals and actions.

Using the previously identified resource materials, plus the work done during the workshop and by the sub-groups, the working group would create a first draft strategic plan for review by the steering committee. The plan should be accompanied by other draft supporting documents. For example, if a realignment of part of the organization is proposed in the draft plan, then a draft transitional organizational chart to assist in the allocation of human resources to achieve the objectives described in the strategic plan should be attached. This chart would assist in visualizing the reallocation of the positions to better reflect their actual utilization. If the strategic plan includes a reorganization and renovation of the office area, then it should also contain such details as a draft floor plan to better align them with the human resource allocations included in the strategic plan. When approved, these draft floor plan drawings would be important in determining the capital costs (furniture, dividers, etc.) to complete this segment of the strategic plan. The draft should also append a suggested a template for reporting results against objectives outlined in the draft strategic plan, as well as a brief instruction on how to complete each measurement and the potential data sources that would be used to complete the report on a monthly basis. The draft strategic plan should also contain the first draft of action plans. This would be a rough draft and would serve as a template, but may require significant further work by the senior management team to review the proposed tasks, timelines, and deliverables.

The steering committee should provide input and organize a discussion with the head of the tax administration to review the draft document. The head may provide further input and may, at this point, ask the working group to present the draft strategic plan to the entire senior management team. It is during this briefing that the importance of using the strategic plan in guiding the investments and operations of the tax administration over the period of the plan should be emphasized. The plan should be used as an input into the budget and reporting cycle, but, at this point, the plan only contains an educated guess as to resource requirements. During this briefing, it must be emphasized that those members of the management team that are in the best position to more accurately determine resources (i.e., the responsible managers) must fill in the details. In addition, it should be impressed upon the management team that they have responsibility for the achievement of results and for the development of reporting mechanisms for the sub-programs under their areas of responsibility.

Subsequent to this briefing to the head of the tax administration, there may be other briefing sessions before proceeding to the next step. These briefings could include, where the tax administration reports to the Minister of Finance, a briefing to senior Ministry officials or, in the case of a revenue authority, a briefing to the full board. In addition, as part of labor relations, the union may be asked to attend a briefing to secure their input and support if the strategic plan contains elements that would affect labor relations.

15.1.6. Setting the Planning in Motion

The next step is to convene a meeting of all the participants in the strategic planning process. This is probably the most critical meeting in the process, as it demonstrates senior management's commitment to the planning process and provides the opportunity for the head of the tax administration to outline some of the recent internal and external developments that affect the tax administration, as well as what other tax administrations may be doing. The meeting also provides a platform for the head of the tax administration to outline ideas and possible directions for the future of the tax administration. In essence, the broadest general direction is provided, giving participants a general framework for the ensuing strategy sessions.

In opening the session, senior management should set the tone by providing some general, but not detailed, comments and guidance to the participants. It should also be stressed, however, that the participants are challenged to critically examine this information. Management should comment on, but not be dictatorial about, five basic questions:

- Where are we now? This is an abbreviated overview of the organization, policies, and programs;
- How did we get here? This is a short history of previous plans and their outcomes;
- Where are we going? This is an overview of what management sees as some of the challenges and threats. Some of the broad recommendations of the external review can be mentioned, as well as relevant statistics, such as "accounts receivable are trending up."
- Where should we be going? This is a general recap of what has been recommended, with possible general comments on what other tax administrations are doing. Presumably, the head of the tax administration has recently attended meetings with other colleagues and exchanged ideas. It is at this stage that senior management should outline its vision of the future. This serves to set the parameters for the vision. In the case of a donor offering significant assistance to conduct a major reform, the general parameters of the offer should also be outlined.[361]

[361] Although a donor may be specific about the reform assistance on offer, one of the key lessons learned is that there must be buy-in by employees and managers. Thus, although there may be limitations imposed (funding, scope, etc.), gaining buy-in and acceptance is necessary to success. For this reason, within the general parameters set by the head of the tax administration, the participants (with possible guidance) should be given the opportunity to determine the content of the draft strategic plan that goes to the steering committee for comment and review. It may be necessary to supplement the strategic planning workshop with prior sessions on: a) change management; b) high-

- How will we get there? This is the challenge to the participants in the strategic planning process to develop the vision and how to achieve it.

Following these introductory remarks, there should be a workshop session for all participants to introduce them to strategic thinking and planning. Experience has shown that investing in a workshop that devotes sufficient detail to the questions above produces a superior strategic plan. The amount of time spent on the workshop varies, but would generally be at least a week, exclusive of planning. Some general observations to making the workshop a success are:

- The entire senior management team should be present to open the session and demonstrate to all participants the importance of the strategic plan;
- The workshop should be conducted by an expert in preparing strategic plans, and this expert should mentor the tax administration during the development of the plan. This expert should also serve as a discussion moderator and be responsible for distilling the various points that are made during discussions into a draft discussion paper. This discussion paper should later evolve into the framework for the strategic plan;[362]
- The strategic planning process should be the priority for all participants, and they should not be interrupted by their regular duties;
- The workshop should be conducted offsite to minimize interruptions and participants being drawn away for other work;
- It should be ensured that all participants understand that the strategic plan is their opportunity to make a contribution both individually and together to what they want their organization to do and look like; and
- As ideas are presented, the moderator should use the language of the group when noting points – any changes should be only to add clarity.

The workshop should focus on preparing the participants to contribute to the following basic areas of the strategic plan:

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level discussions on best practices in other countries; (c) project management; and (d) other specific topics, depending on the nature of the reform. During the process, a "champion" of the reforms should be identified.

[362] General experience indicates that the introduction to strategic planning, compiling a working paper from various discussion groups, and preparing a first draft of thoughts for further development and inclusion in a rough outline for the strategic plan takes, at a minimum, an intensive three-week effort. This assumes that some of the participants have had previous exposure to strategic planning. During this process all participating staff should be relieved from their regular duties to attend workshops and to participate, as necessary, in the various committees that are formed to develop sub-group documentation and plans. It is estimated that an additional one to three weeks is then required for the strategic plan coordinator to pull all documents together and formulate a first draft of the plan, which can then be presented to the steering committee. After the steering committee comments are received, further work is necessary to construct detailed work plans, review budgets, etc. to produce a final draft. Depending on the extent of the feedback from the steering committee, three to eight weeks could be required to complete the strategy to a final draft stage. In a large tax administration, considerably more time for each stage may be required. All documents during this process should be clearly marked as "DRAFT" until the plan is approved.

- What is strategic thinking?
- What is strategic planning?
- Components of a strategic plan:
    - Environmental analysis;
    - Vision Statement;
    - Mission Statement; and
    - Values/Guiding Principles;
- Determining Strengths, Weaknesses, Opportunities and Threats (SWOT);
- Defining and setting strategic goals;
- Defining and setting strategic objectives; and
- Determining measurable outputs.

Concurrent with preparing and gaining an understanding of the subject matter, workshop participants should also be developing their input to form the draft framework of the strategic plan.

15.1.7. Mission

The next step in the process is to develop or clarify the tax administration's mission, values, and ideal vision. The core business function of collecting taxes is embodied in the mission statement, which usually also indicates the general direction of the organization and what has to be accomplished in the future. The strategic plan takes over from the mission statement to provide guidance on priorities and measurable indicators of quantity, targets, and detailed action plans on achieving specific goals in support of the mission.

The mission is a concise statement of what the organization wants to achieve. A mission statement is, in effect, a very condensed executive summary of what the revenue administration does, what it stands for, and why it exists. Tax administration mission statements tend to focus on collection, quality service, and enforcement. It is also common to make reference to tax collections contributing to the economy and government goods and services.

15.1.8. Environmental Analysis

As part of the development of the mission statement, it is also necessary to define the stakeholders. This step can also be referred to as an environmental analysis. A stakeholder is a person, group, or organization that has an interest in the tax administration, can have an effect on it, or is affected by what the tax administration does. This may include employees of the tax administration, employers, retailers, manufacturers, non-profit organizations, international investors, pensioners, unions, other government agencies, and importers, among others.

When identifying who the stakeholders are, it is also necessary to identify how each stakeholder would judge the performance of the tax administration and the criteria that each would use to identify success. For example, in the case of small businesses, success may be the ease of becoming a registered taxpayer, which could be measured by the number of trips to the tax office, the number of elapsed days to obtain a tax registration number, and/or other relevant indicators.

The identification of stakeholders and their perceptions of the tax administration is only part of the environmental analysis. The analysis also involves using all available internal and external information sources to understand the environment in which the tax administration operates, and to identify the risks and opportunities expected to impact on the organization over the duration of the strategic plan. During this activity, a wide range of available information should be reviewed, including, for example:

- Statements by the government of its priorities for revenue administration, and government activities that can impact on the tax administration. For example, it may be a stated priority to establish duty-free zones or tax holidays for new investors;
- An analysis of the organization's performance data so that areas requiring improvement can be identified objectively;
- Views of department specialists of emerging issues and developments relative to their area;
- Views expressed by stakeholders, obtained through consultation and, if available, survey data, including taxpayer attitudes to the organization's performance;
- Staff attitudes and ideas;
- International developments, particularly in advanced tax administrations, but also in neighboring countries;
- Formal reviews of the organization or other similar entities; and
- External experts' views, including reports on reviews by organizations such as the IMF, OECD, and the EU.

Concurrent with this process, the tax administration should also be documenting its own strengths and weaknesses, as this will assist in developing the specific strategies needed to address the emerging trends being identified.

Once all the stakeholders have been identified, their interests considered, and other information above has been analyzed, the mission statement can be developed to broadly cover all issues and factors.

Box 15.1. Mission statements[363]

In **Argentina**, the Federal Administration of Public Revenue (AFIP), which is an autonomous entity in the Ministry of Economy and Public Finance, is responsible for the collection of taxes for the Federal Government. Its mission statement is to "Manage the implementation, collection, control and examination of national taxes, social security resources and related foreign trade activities; promoting voluntary compliance, economic development and social inclusion."

In **Brazil**, the Secretariat of Federal Revenues of Brazil, which is a body reporting to the Ministry of Finance, is responsible for collecting the Federal Government's taxes. Its mission statement is "To exercise fiscal and customs control with fiscal equity and respect for the citizens, for the benefit of society."

[363] Mission statements for LAC countries are shown in Inter-American Center of Tax Administrations (CIAT) (2011), p. 6-32.

The **Canada** Revenue Agency's (CRA) mission statement is "to administer tax, benefits, and related programs, and to ensure compliance on behalf of governments across Canada, thereby contributing to the ongoing economic and social well-being of Canadians." [364]

In **Chile**, the Internal Tax Service is responsible for auditing the Central Government's taxes, while the General Treasury of the Republic is in charge of the enforced collection of tax debts. The mission of the Internal Tax Service is "To administer the system of internal taxes for fiscal purposes with equity and justice, enabling voluntary performance through the provision of quality services adapted to each type of taxpayers; safeguarding the proper tax compliance, in strict compliance with the effective legislation and focusing its auditing efforts on taxpayers showing a risky tax behavior."

In **Colombia**, the Directorate of National Taxes and Customs is responsible for collecting the National Government's taxes, where the mission is to be "responsible for managing the compliance with tax, customs and foreign exchange duties with quality, through service, auditing and control; facilitating foreign trade operations and providing reliable and timely information with a view to assuring the Colombian State's fiscal sustainability."

In **Costa Rica**, the Directorate General of Taxation is responsible for the collection of taxes for the Central Government, and the mission is to "enforce tax laws, through effective management that promotes voluntary compliance, guarantees information and assistance services to taxpayers and to exercise effective control of tax compliance through actions that conform to principles and values, all within a framework of respect for citizens' rights and guarantees."

In **United States**, the mission of the Internal Revenue Service is to "provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all."[365]

Within these mission statements are also various goals for which measurements of progress and achievement can be developed as part of the strategic plan. Some examples are:

- Ensuring compliance;
- Providing quality products and service;
- Operating with motivated, competent, and well-trained staff;
- Operating with integrity and fairness;
- Ensuring fairness, equity, and equality in the collection of taxes;
- Improving productivity; and
- Efficient and effective use of resources.

15.1.9. Vision

It is during the strategy development process that various "visions" may be developed. The vision must be technically viable, legal, politically acceptable, acceptable to stakeholders, and within the mission of the tax administration. The vision statement is a means of motivating staff and clearly indicating direction to external stakeholders. Most vision statements emphasize the excellence of the

[364] Canada Revenue Agency (n.d.), para. 3.
[365] Internal Revenue Service (n.d.), para. 2.

organization, the achievement of targets, and the establishment of an effective and efficient administration.

After compiling a list of potential visions, it is necessary to critically examine each of the alternatives. It is helpful at this point to develop a chart that lists each vision, the barriers to achievement, the major steps required to overcome the barriers, and the steps to achieving the vision. As an example, a tax administration may propose the vision of a modern, autonomous functional organization. Such an organization could hire persons that possess the qualifications necessary for the positions, as opposed to drawing only from a pool of candidates that completed the general civil service entrance exam and were selected to serve in the tax administration, regardless of their qualifications. In examining the barriers to achievement, it may become evident that the prevailing civil service law, which applies to the tax administration, prevents both a reorganization to more effectively and efficiently deploy staff and any changes in human resource policies for hiring. In this case, fulfilling the vision would require either civil service reform or reorganizing the tax administration into an autonomous revenue authority. It may be decided that neither option is realistic within the time frame of the strategic plan and the vision may be discarded as unrealistic. However, it may also be recommended that options for modernization in this manner be examined for the next strategic plan, and that the tax administration begin preliminary planning along these lines.

The vision statement is a foundation, with which everyone in the tax administration and, presumably, all stakeholders can agree. By gaining agreement on the vision, deciding what must be accomplished in order for the strategic plan to be a success becomes an easier task. If the vision does not have unanimous agreement, then the foundation of the strategic plan is flawed. What will emerge as the development of the strategic plan progresses will be internal territorial disputes and personal interests. The objective of a vision that all participants can agree with is to create an atmosphere where all participants think of the common good of the organization and stakeholders, as opposed to the interests of their own smaller division or department within the tax administration (the latter is often referred to as "silo" thinking).

The final step, after selecting the most appropriate vision, is to articulate this selection in a brief statement that describes what the tax administration will look like once it has successfully implemented its strategy.

In summary, the purpose of the vision is:

- To create a clear picture of what the organization aspires to be in the future;
- To help the organization take a long-term view (as opposed to a series of ad hoc measures that respond to current hot issues);
- To serve as a benchmark for evaluating actions;
- To create a common purpose; and
- To help people understand how they should contribute to the organization.

Box 15.2. Vision statements[366]

Australia[367]: Australians value their tax and superannuation system as community assets, where willing participation is recognized as good citizenship.

Canada[368]**:** The Canada Revenue Agency is the model for trusted tax and benefit administration, providing unparalleled service and value to its clients, and offering its employees outstanding career opportunities.

El Salvador: Be a model public institution that promotes tax culture, ensures quality tax services to taxpayers, and is conducive to effective tax collection, which will contribute to the sustainable development of El Salvador.

Guatemala: Collect the necessary resources for the State to provide the essential services and provide greater opportunities for the development of Guatemalans, by obtaining the maximum performance from taxes; the full and impartial implementation of tax and customs legislation; and the facilitation the voluntary compliance of citizens with tax and customs obligations.

Honduras: In 2014, the DEI will be recognized as a sound, transparent, and responsible tax and customs administration, protected from political intrigues, sustainable and actively contributing to the country's social and economic development.

Nicaragua: Be a professional, flexible, and simple tax administration at the service of the people of Nicaragua.

United Kingdom[369]: We will close the tax gap, our customers will feel that the tax system is simple for them and even-handed, and we will be seen as a highly professional and efficient organization.

Uruguay: Be an organization respected for its effective, efficient, and transparent performance, which based on continuous improvement and applicable technological advances, operates with high standards of quality and ethics that are above reproach and with a professional staff committed to the institutional mission. In its actions, it seeks to optimize voluntary compliance with obligations, meeting both the needs of the taxpayers and their claims, and exercise permanent control on the intelligent use of information, equity, and highly qualified personnel, with the purpose of securing tax resources that contribute to the development of the country's social justice and the welfare of its inhabitants.

15.1.10. Values

The tax administration's values statement sets out the principles or beliefs that guide the tax administration's members as they pursue the organization's purpose. The statement is also used to specify the behaviors and attitudes that the tax staff are expected to display on the job and how the tax administration wishes to be seen externally. There are close similarities between the value statements of most tax administrations, with the most common values being integrity, fairness, honesty, professionalism, respect, efficiency, responsiveness, and cooperation.

Box 15.3. Example value statements

Australia[370]

[366] Vision statements for LAC countries are shown in Inter-American Center of Tax Administrations (CIAT) (2011), p. 48-65.
[367] Australian Tax Office (n.d.), para. 1.
[368] Canada Revenue Agency (n.d.), p. 2.
[369] HM Revenue and Customs (n.d.), p. 4.
[370] Australian Tax Office (n.d.), para. 3.

- Being fair and professional
- Applying the rule of law
- Supporting people who want to do the right thing
- and being fair but firm with those who don't
- Being consultative, collaborative and willing to co-design
- Being open and accountable
- Being responsive to challenges and opportunities

Belize[371]

Effective tax administration rests on the fundamental notion that taxes are collectedly fairly and indiscriminately for the overall economic and social benefit of the citizens of the country. The citizens of Belize have the right to expect a high degree of integrity in the administration of the General Sales Tax (GST) and expect a tax system that is fair and responsive to their needs and that encourages all to pay their due share. The public must trust that administration of the GST will be fair and firm and handled with the utmost professionalism and integrity. The following values and principles underpin the actions not only of the department, but of each and every official in its employ.

Responsiveness: providing accurate, timely, and quality service—with an emphasis on a proactive versus reactive approach.

Transparency: sharing of all information in an open manner to external and internal stakeholders.

Integrity: continually demonstrating high moral and ethical behavior while upholding the rule of law (truthful, mutual respect, fair, honest, open, trust, professional performance).

Efficiency: using resources in a timely, cost effective manner to maximize results in the delivery of service and information.

Professionalism: acting with dedication and skill and in a manner that fully abides by professional standards and rules.

Accountability: taking responsibility for its actions.

Quality Service: identifying service standards and striving to provide quality service.

Mutual respect: treating all taxpayers with courtesy and respect in all dealings, while expecting that this will be reciprocal.

Canada[372]

Integrity is the foundation of the CRA's administration. It means treating people fairly and applying the law fairly.

Professionalism is the key to success in achieving the CRA's mission. It means being committed to the highest standards of achievement.

Respect is the basis for its dealings with employees, colleagues, and clients. It means being sensitive and responsive to the rights of individuals.

Co-operation is the foundation for meeting the challenges of the future. It means building partnerships and working together toward common goals.

South Africa[373]

[371] Belize General Sales Tax Department (n.d.), p. 7.
[372] OECD (March 2011), p. 76.
[373] Ibid., p. 78

Mutual trust and respect; equity and fairness; integrity and honesty; transparency and openness; and courtesy and commitment.

15.1.11. Developing Strategic Objectives – a Checklist

The following checklist will help the tax administration in defining appropriate strategic objectives.

- An objective must be clearly written for a specific result, a single topic, or an area of performance;
- An objective must contain a measurable component (e.g., how much, how many, etc.);
- An objective must represent a significant change;
- An objective must define the results to be achieved;
- An objective should have a target time for completion;
- The objectives are encompassing of the stated mission and values, aligned, and supportive of each other; and
- Objectives should be monitored for progress and continued relevance, and results should be evaluated.

Examples of Strategic Objectives

Some examples of strategic objectives drawn from various countries[374] include:

- Achieve uniformity in applying tax laws;
- Develop simple and efficient tax administration processes;
- Provide taxpayers with timely and accurate information;
- Introduce and expand self-assessment of liabilities and payment of taxes;
- Provide quality service and taxpayer education;
- Encourage the establishment of non-governmental tax agents to assist taxpayers in fulfilling their tax obligations;
- Develop targeted audit programs;
- Provide significant computer support for tax administration operations;
- Adopt a step-by-step approach to significant changes in doing business by using pilot projects to test these measures;
- Achieve fair and transparent administration;
- Develop professional, knowledgeable and skilled employees; and
- Develop effective managers.

[374] These examples are derived from the countries listed in Box 3 and from the author's experience.

15.1.12. Service and Performance Standards

As part of planning, organizations must develop standards to be achieved and the means to measure progress. As a general observation, experience has shown that organizations tend to direct effort and resources to accomplish that which gets measured. Conversely, effort and resources are diverted away from that which is not being measured. As a result, care needs to be taken when setting performance standards[375] and in deciding on how to measure progress.

It is important to monitor the performance of all key organizational tasks. In order to accomplish this, performance standards should be set for each major task and achievement against these standards should be regularly monitored and evaluated, with corrective actions taken, as needed. This is important, as it:

- Ensures that the persons who are responsible for implementing the strategic or operational task are held accountable;
- Provides a management tool to assess the performance of units and individuals;
- Enables management to objectively assess the need for corrective action where targets are not being met;
- Provides a mechanism for shifting the performance focus away from simple revenue measures (money collected) to all of the major operational issues that impact on compliance; and
- Supplies objective information, which can be used to review and, if necessary, modify the strategic plan.

Some general guidelines are:[376]

- Measures should not be too simplistic;
- Ideally, measures should cover both qualitative and quantitative aspects of the task; and
- Measures should include:
    - Quantities or volume of output (how many);
    - Quality of the output (how well, accuracy levels);
    - Timeliness (how long);
    - Monetary values.

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[375] **Performance indicators** define the measurement of important and useful information about the performance of a program or activity, expressed as a percentage, index, rate, or other comparison which is monitored at regular intervals and is compared to one or more criteria. Performance indicators help illustrate how well an organization is doing in meeting its objectives or achieving the desired outcomes. They are a means of assessing and evaluating the characteristics of products, services, processes, and operations of the organization. They need to be relevant to the program's desired outcomes and objectives, quantifiable, verifiable, and free from bias. **Key performance indicators** are quantifiable measurements, agreed to beforehand, that reflect the critical success factors of an organization. Whatever key performance indicators are selected, they must reflect the organization's goals, be key to its success, and be quantifiable (measurable). Key performance indicators are usually long-term considerations. **Standards (or targets)** are norms or time frames, or sometimes just directions (such as "increase" or "improve" some measured situation), that enable an organization to use performance indicators to "judge" performance.

[376] For further information and guidance on formulating appropriate indicators, see Crandall (2010).

15.1.13. Action Plans

Strategy development is about producing a blueprint. The strategy alone, however, achieves nothing. It requires implementation, which means that various programs and projects must be thought through and action plans must be developed. This stage of the process involves translating the high-level strategic objectives into action plans or actual deliverables. At this point, the strategic management process shifts from broad strategic planning to narrower planning that is concerned with shorter-term deliverables. The action plans should clearly identify:

- The tasks to be performed;
- The strategic objective to which they relate;
- The person or unit responsible for their delivery;
- Measurable standards by which performance can be assessed;
- Measures of the quantity, quality, and timeliness of delivery; and
- The costs of implementing the action plan.[377]

The first drafts that go to the steering committee should generally be high-level plans with minimal narrative. These high-level plans seek approval in principle before embarking on the time-consuming process of producing a detailed work plan, detailed budgets, etc. Participants in the strategic planning process are generally divided into various sub-groups, with each being responsible for the development of action plans and other documentation for a particular strategic goal. In some cases, various smaller projects contribute to the strategic objective. Each of these projects would normally have a separate action plan. Often, much of this preliminary planning is done in project management software, as such software makes it easier to visualize the sequencing, notes can be easily appended, and it is flexible.

15.1.14. Ensuring Success

The greatest gains are achieved by adopting an integrated approach to strategic planning. Any strategic plan should address all key areas of the tax administration, but in the case of a major tax reform effort, a holistic approach is mandatory. A holistic approach considers all of the following:[378]

- Tax law and policy;
- The organization, including functional aspects and taxpayer segmentation;
- Tax operations/functions – audit, collection, taxpayer service, etc.;
- Human and institutional capacity;
- Integrity;
- Technology;
- Communications;
- Change management;

[377] An example of the process for estimating the cost of a program in the strategic plan is presented in Appendix 15.A.
[378] Murdoch et al., p. 3.

- Facilities; and
- Budget.

There is no "quick" solution to administrative change, increasing tax compliance, or boosting tax revenue. These require commitment to a long-range, coordinated, and comprehensive plan. The tax administration must expend time and resources to develop a shared "vision" for the future. Past experience dictates that this vision must have the buy-in of not just the current management, but also of those expected to be managers during the lifetime of the strategic plan, as these future managers must provide the continuity, ownership, and determination to see the plan through. Significant resources must be expended not only in creating the plan, but also in managing its implementation. Any new proposals for initiatives must be justified within the context of the strategic plan.

Implementation of a program or project requires the resources of the tax administration. Staff must be informed, fears and resistance dealt with, and staff motivated to work toward the objectives of the strategic plan. Where the plan includes significant changes in processes, procedures, staffing, or organization, there must be a detailed sub-component of the plan that explicitly deals with change management and communication with stakeholders.

Although many changes may be identified as necessary, the pace of change is often dictated by staff motivation, management capacity, and depth of management. In small organizations, there are often not enough managers to handle the reform program and ensure that existing operations continue. The pace of reforms has to be measured in terms of institutional ability to effectively handle change. The sequencing of reforms must be carefully determined and the timetable for implementation must be realistic given capacity constraints, the ability of staff and public to adjust to the reforms, and the need to ensure the effective management of current operations.

If the planning process itself is weak, the resulting strategic plan may be weak and not satisfactory to the organization. In addition, the plan may not turn out as well as expected because of changes in the environment in which the plan is supposed to operate. The plan is a living document and must be regularly revisited, and progress must be monitored, evaluated, and adjusted where necessary. The existence of a strategic plan does not, and cannot, get an organization out of a major crisis. A major crisis is a current event, whereas a strategic plan is a series of objectives that are implemented over time and are designed to accomplish a vision.

Based on worldwide experience in preparing to embark on a reform program, the box below presents conditions that are generally recognized as required for successful tax administration reform.

Figure 15.1. General conditions required for reform

- Sustained political commitment and support.
- Competent, committed, and dynamic leadership.
- A clear vision for the organization's future state, with well-articulated strategies.
- Change initiatives set out in manageable "chunks," rather than a "big bang" approach.
- Legislation that supports the reform proposals or is modified to do so.

- Initiatives to develop executives, middle management, and other institutional capacity.
- Adequate resources, funding, and cash flow arrangements.
- A high level of accountability, founded on sound corporate governance and management structures and processes.
- Good project management and budgeting processes, with appropriate external oversight and supervision.
- Staff and external stakeholder involvement, and strong communications with them.
- Cohesion within the administration, between those developing and implementing reform and those performing current operations.
- Appropriate use of technical assistance.
- Steps to ensure ownership of the reform process throughout the organization.

15.2. Common Trends

Tax administrations are introducing better management tools through planning, improvements in compiling statistics and their analysis, and setting informed targets and operational delivery standards. One of the most important trends for administrations is to increasingly involve their staff in planning and analyzing challenges and opportunities to produce plans that are both better understood across the organization and gain the necessary acceptance.

15.2.1. Increasing Emphasis on Management

As management practices in the private sector have evolved, the management of tax administrations is now beginning to catch up. Empirical evidence of this change is the growing number of tax administrations that now produce strategic plans and annual work plans, actively measuring and monitoring performance, surveying taxpayers to gauge their views and perceptions of service delivery and overall administration.

The practice of setting some form of service delivery standards is seen in 28 of the 34 OECD countries which set some form of service delivery standards, and 25 of the 28 countries which published this information. In the non-OECD countries covered by the report, 12 out of 15 countries produce and publish service delivery standards.[379]

Governments and taxpayers are increasingly becoming concerned with the costs, efficiency, effectiveness, and transparency of their tax administrations. Tax administrations are pressed to justify their costs, requests for additional budgets, and the deployment of resources. Management in many tax administrations is taking a more holistic approach than the former practice of focusing solely on revenue. Strategic plans have an important management role in this holistic approach to managing the organization.

[379] OECD (March 2011), p. 69.

15.2.2. Strengths, Weaknesses, Opportunities, and Threats (SWOT) Analysis

The SWOT analysis is a tool that can be used during strategic planning and at different points of the planning process. It can help the tax administration define actions when the strategic objectives are known, during the preparation of the action plan. It can also help the administration identify action plan activities and outputs and synthesize those into strategic objectives and a vision. In principle, the SWOT analysis is usually not used to prepare the vision, unless the administration knows little of its current state and strategic objectives, while trying to develop a vision. The SWOT can be important, as the identification of strengths and opportunities can be used in the plan to overcome the identified weaknesses and threats and will assist in building a realistic strategy.

During the SWOT, a review of the external environment is conducted to identify both opportunities and threats. This review of the operating environment should consider the economic, political, social, and technological trends and recent events and how these may affect the various stakeholders and their interaction with the tax administration. For example, an election that will be held next year may adversely impact enforcement initiatives, as it might not be politically expedient to crack down on a large number of small businesses in the months preceding the election. This could be a threat to tax compliance, but it could rapidly turn into an enforcement opportunity after the election. Alternately, the current government may want to be seen taking action against tax cheats, which, as part of the strategy development process, would be an opportunity.

The next step in the SWOT is to look inward at the tax administration and identify its strengths and weaknesses. This is usually an examination of the organization’s resources, the present strategies, and how the organization is performing. Once again, the stakeholder analysis has an important role, as measuring performance should be done from a stakeholder perspective. For example, small and medium size taxpayers generally do not have tax experts on staff and often rely on information obtained from the taxpayer services function of the tax administration. This category of taxpayer could judge performance on the basis of readily available information on the tax administration’s website (ease of use), the length of time on hold when telephoning for information and the number of times the call is transferred, and/or the amount of waiting time to see a tax officer at a tax office.

If the SWOT analysis is used to identify strategic issues that affect the tax administration, the administration should focus on the issues that it has the ability to deal with. For example, a general economic decline is not a strategic issue that can be dealt with by the tax administration and is not an issue for this strategic planning forum, but rather, may be more appropriate as a strategic issue for the government as a whole. An expected increase in non-compliant taxpayers that can be dealt with through changes to risk management, collection policy and procedures, or enhancements to the taxpayer service program could, however, be a strategic issue for the tax administration. Strategic issues are those that affect, or, more likely, conflict, with the tax administration’s mission, level of service, compliance programs (audit and collections), administrative costs, organizational design, and management.

Strategic issues should be described in a couple of sentences. Whether an issue is strategic or not should be described in terms of the mission or SWOT.

Figure 15.2. The SWOT analysis[380]

The SWOT analysis	
Strengths: What are the strengths of the organization? • Analyze those strengths that will allow future strategies and tactics to be implemented successfully. • Celebrate the successes and use them as best practices. • Consider how to build on the identified strengths. Examples: • Knowledgeable older staff • Good public image • Well-defined organizational structure • Modern computer system (network & hardware) • Modern Tax Returns Processing Center • Consistently applied and modernized business procedures • A unique TIN is used for all taxes and all transactions with government.	**Weaknesses:** What are the weaknesses of the organization? • Analyze those internal processes, resources, and cultural elements that will be barriers or obstacles to achieving objectives. • Learn from pilot projects. • Consider the implications of the weaknesses. • Brainstorm how to address the identified weaknesses. Examples: • Limited legal authorities for collection and audit powers • Limited legal representation in litigation cases • Lack of resources • The website contains minimal assistance, and publications are dated. • The IT system (software) is old and doesn't provide enough information. • Lack of a structured method to disseminate information internally • Data integrity issues with the computerized revenue system • Laws are complicated and change frequently. • Lack of training for new staff • Insufficient fully trained Information Technology staff • Staff resistance to change
Opportunities: What opportunities does the organization have now and in the future? • Analyze those external demands and influences in the environment that could be used in the future to develop better methods and means. • Consider creating in-house solutions vs. purchasing solutions. • Review the opportunities and how they link to the mission and vision. • Consider what resources are needed.	**Threats:** What are the current threats to the organization or possible future threats? • Analyze those external demands and influences in the environment that could be barriers or obstacles to future results. • Understand the organization's limitations in developing creative solutions. • Assess the threats with a view to reducing their impact or turning them into an opportunity.

[380] Adapted from Belize Department of General Sales Tax (n.d.), p. 6.

The SWOT analysis	
Examples: • New staff are all university graduates • Ensuring updated tax information will encourage compliance • Outreach programs to educate taxpayers and obtain feedback that will help improve tax administration • Potential synergies with the pension system • Other countries' successes can be used to assist in moving forward • Networking with other tax administrations • Access to international training programs	Examples: • A substantial underground economy • Political interference/intervention • Human resource capacity is archaic and cannot respond to staffing requests and other HR issues • Natural disasters • Advanced technology and globalization of business/clients' operations • Use of advanced technology to avoid taxation (e.g., fraudulent documents) • Budgetary constraints • Poor relationship with Customs • Increased demands for tax exemption and concessions

In the figure above, each of the examples of strengths, weaknesses, opportunities, or threats could be rated to assess its impact and establish priorities. For example, threats could be rated on a scale of 1 to 3, with the highest rating applied to a significant threat that demands strong action, a medium level rating applied to a serious threat that cannot be dismissed but requires more information before an action is taken, and the lowest level rating applied to a remote threat, for which caution is necessary, but which is not a major concern

15.3. Tax Administration Maturity

Strategic Planning: Maturity Level 1

Key word: "Focused on day-to-day work"

- The tax administration's vision, mission statement, and goals are unclear and not documented. Only a few individuals, primarily at the senior leadership level, understand what the administration aspires to achieve. Activities are not aligned to the strategic objections and the mission and the organization rarely achieves benchmarks toward its mission and vision.
- The tax administration has no formal strategic plan and does not have in-house capacity (staff skills, tools) to develop a plan. Leaders view the strategic plan as something required by external stakeholders. Staff have limited understanding of the role of strategic planning and do not contribute to discussion about strategy. The administration's programs and services lack clear alignment with its mission and objectives. New programs are often ad hoc reactions to current events unrelated to each other and rarely integrated.
- The tax administration does not have performance targets or indicators to adequately measure performance at an organizational level, and is reluctant to set targets because of a lack of tools, capacity, or time to collect performance data. Leaders and staff focus only on measuring and achieving externally imposed targets (e.g., project targets) or individual targets. The

administration has no benchmark for measuring its success and there are often disagreements about whether the organization is successful and how it can improve.

- The tax administration does not have systems, processes, or tools in place for performance data use. There are no mechanisms to check if data is reliable or correct. Data, when it exists, are often set aside, rarely used, and not analyzed, and there is no compliance or accountability around collecting, using, or ensuring the quality of data. Data is collected because it is required by external stakeholders and there is no internal demand for data. Leaders prefer to make decisions based on "gut feeling" or past experience. Staff lacks capacity to analyze or apply data to their jobs. Even if data are available, the administration is unable to use it effectively. The administration often misallocates resources as a reaction to current events.
- Managers and staff feel that implementation is more important than planning. Attempts to develop work plans or action plans often fail because there are no planning processes or tools, and few staff has experience or interest in this area. Projects are implemented with minimal short- or long-term planning, and may exceed budget, if a project budget was set, and are not implemented on schedule.

Strategic Planning: Maturity Level 2

Key word: "Qualitative"

- The tax administration has a specific vision and mission statement that is formally posted or documented. Few staff know the mission and see a connection between it and their day-to-day tasks. Leaders sometimes use the organizational mission and vision to direct goals and activities and aim to develop a process that will help them more consistently align goals and activities. The administration is sometimes able to achieve benchmarks toward desired goals and objectives when activities are aligned.
- The tax administration has a strategic plan or, at a minimum, has had some discussions around a strategy, but does not have a formal process to develop, update, or monitor activities against the plan. The strategic plan is driven primarily by senior management, with little input from staff, and few staff are aware of the plan. Leaders develop a strategic plan to guide the organization toward the mission, but the plan is rarely referred to and changes are not implemented as a result of the plan, but rather as a reaction to events. Programs are not closely linked to mission or strategic objectives.
- Leaders have set some performance targets, but the targets are not measureable. There are no key performance indicators or plans to collect and monitor data. Only a few staff are aware of performance targets and understand how their individual targets contribute to the administration's targets. They are rarely asked to provide input or feedback on targets. The performance targets that exist are primarily related to revenue collection with minimal attention to other priorities in the plan such as service delivery. The administration is still unable to measure progress towards those targets.
- The tax administration is starting to develop systems and/or tools to assist in using data. However, it is still unclear if the data being collected is applicable or reliable. Data are being

collected and standard operating procedures for compliance, quality control, and accountability on collecting and using data are in the process of being developed. Leaders understand that there is value in using data to guide decision-making, and do refer to it from time-to-time. Some staff are being trained to analyze and use data in their job functions, but the data being used may be incorrect or not applicable to providing an accurate analysis of the project or task being measured. Although the data are being used sporadically, when it is used correctly, the organization is able to identify and avoid negative outcomes or mistakes.

- Some staff have planning skills and have introduced planning tools to the organization. These are occasionally used to develop a work plan or action plans, but the plans are rarely integrated, linked to the strategic plan, or implemented. Staff that use work plans are better able to manage costs, where there is budget responsibility, and schedule, and can identify problems early on.

Strategic Planning: Maturity Level 3

Key word: "Strategic"

- The tax administration's vision and mission statements are posted in multiple locations and integrated into orientation materials and other guidelines. The vision and mission statements have been communicated to all staff in seminars and using other methods. All staff understand how they contribute to it, and can communicate it to external stakeholders. The administration consistently uses a formal process to align strategies and activities to the mission, and it achieves benchmarks toward its mission/vision.
- The tax administration has developed a strategic plan using formal processes and tools to translate it to action plans and work plans. Leaders and staff are involved in implementing the strategic plan and monitoring progress towards strategic objectives and mission. The plan is widely known within the organization and it is consistently used to guide operational and program decisions. The strategic plan contributes to better alignment between programs and operations, and the organization is achieving some strategic objectives.
- The tax administration has established performance targets, key performance indicators, and a formal performance monitoring plan. Staff are aware of these targets, understand how their performance contributes, and are collecting performance data to measure progress towards these targets, though data are not always reliable. Leaders and management consistently review performance data, using dashboards and other tools, and check progress toward strategic objectives. The organization is able to objectively demonstrate its success, and sometimes uses performance data to improve areas where performance is weak.
- The organization has formalized the development of systems, processes, and tools to collect data and has formalized mechanisms to ensure that the data, when it is collected, is both applicable and reliable. There is an internal demand for data, but it is primarily driven from the top. Leaders are using data to inform and guide decision-making. There are documented standard operating procedures for data collection that outline guidelines for data collection, quality control, and accountability, but these are only occasionally followed by staff. The

administration has been successful in using data to avoid making mistakes and, as a result, there has been an increase in positive outcomes.

- The tax administration has formal planning processes and tools, and has built staff capacity to use these tools. Staff have been specifically assigned to compiling and providing senior management with an analysis of the indicators. Leaders and staff work together to develop an annual work plan based on the strategic plan. Action plans are developed for most projects and are integrated. New project proposals that are not provided for in the strategic plan and subsequent work plans are approved when they are in conformity with the plan. Managers are required to implement these, and are consistently able to manage costs and schedules effectively.

Strategic Planning: Maturity Level 4

Key word: "Inspiring"

- The organization's vision and mission statement inspire staff and frame the work of the tax administration as contributing to something important beyond organizational self-interest. The mission statement is frequently referenced by staff and stakeholders. The tax administration sets industry benchmarks. Leaders use internal data, intelligence from outside the organization, data showing trends that will impact the future of the organization, and meaningful staff engagement in order to review and refresh the mission and vision as well as to set benchmarks.
- The tax administration has a multi-year strategic plan that is reviewed annually and translated into annual action plans and work plans. At regular intervals during the year progress against plans is evaluated and plans adjusted, if necessary. Leaders and management consistently use the strategic and action plans as tools to guide decisions and ensure alignment with mission and vision. Staff has skills to contribute meaningfully to the strategic planning process and use strategic objectives to guide their work. Synergies across programs result in greater program efficiencies and effectiveness. There are measurable performance improvements based on direction provided by the strategic plan.
- The tax administration has tested the reliability and feasibility of its performance monitoring plan, including key performance indicators and data collection tools. Leaders consistently have the information they need when they need it. Managers and leaders are measuring the right key performance indicators in order to track progress and detect signs of problems. Staff are consistently involved in setting targets and receive regular updates from leadership on organizational performance. Leaders review and update performance targets to ensure alignment to mission/mandate as well as external threats and opportunities. Through the performance management system, managers make adjustments to programs, resource allocations, and staff performance targets.
- The tax administration systems collect and track data and the data is generally reliable. Leaders and staff consistently use data to guide organizational decisions, capitalize on opportunities, and learn from the past. Staff are held accountable for compliance with regulations regarding data usage, and quality, and there is a culture of compliance with these regulations.

- Leaders invest considerable effort and resources in strategic planning and gather significant information (staff views, stakeholder views, trend analysis, etc.) for the process. Once these plans are defined, they are translated into division, unit, team, and individual work plans, and all are measured on the extent to which they achieve their part of the overall plan. Variance from the plan is managed and adjustments made, such that projects and units deliver services and products on time and on budget. The planning process is intuitive and efficient.

15.4. Latin America and the Caribbean

Abbreviated strategic plans that are usually limited to outlining the tax administration's mission, vision, and values are generally available through the administration's website. The full text of the balance of the plan is generally not in the public domain for the Latin America and the Caribbean (LAC) region with the exception of Belize (see Appendix 15.B) and, more recently, El Salvador. An overview of strategic planning in Latin America, however, is available in a recent CIAT study.[381]

In Latin America, all tax administrations except for Panama and El Salvador have mission and vision statements and, according to CIAT, these contain appropriate values and goals, in line with those produced by OECD countries and may be short (Mexico, Nicaragua) or detailed (Uruguay, Costa Rica). All tax administrations have a strategic plan adopted and in effect, except Panama, which has annual operating plans. It is, however, not clear how often strategic plans are followed by action plans and implementation. One of the few cases of a well institutionalized planning process is presented below. There are also issues with performance monitoring. Revenue targets seem to be primary goals of performance measures, and other indicators are nonspecific, too detailed, difficult to quantify, or not relevant. This places LAC countries between the second and third level of the maturity model presented above.

Box 15.4. Planning in Argentina[382]

Planning by the Federal Administration of Public Revenues in Argentina (AFIP) begins with its long-term strategic plan. AFIP's 2011-2015 Strategic Plan is the second in its series and follows AFIP's 2007-2010 Strategic Plan. It defines AFIP's mission, vision, values, policies, strategic objectives, and strategies. In general, proposals for projects under the strategic plan can be prepared by senior management or bottom up. These proposals are discussed during meetings of operational and technical areas, which discuss the needed information support, prioritize proposals according to timeline and subject, coordinate between similar proposals, and discuss technical issues. Approval is taken by a plenary meeting of top level authorities,

AFIP's planning process is well established in regulations and instructions and has the following phases.

Formulation of the Preliminary AFIP Management Plan: This document accompanies AFIP's draft budget, which is sent annually to the National Budget Office. It includes the most relevant activities – management indicators and improvement initiatives – that will be included in the AFIP's Management Plan. It is prepared in July of each year.

Formulation of the AFIP Management Plan: This document is submitted to the consideration of the Cabinet of Ministers Head Office. It is prepared between October and December of each year with the following phases:

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381 Inter-American Center of Tax Administrations (CIAT) et al. (2012), section 6.4.
382 Adapted from Federal Administration of Public Revenues of Argentina (2012).

- Identification of indicators and phases by the central and operational areas;
- Analysis and prioritization of indicators and initiatives;
- Validation meetings with the top level management;
- Preparation of the Management Plan; and
- Approval of the Management Plan by the Federal Administrator and delivery to the Cabinet of Ministers Head Office.

After the final AFIP Management Plan with observations by the Cabinet of Ministers Head Office is received, it is disseminated to all areas of the Federal Administration. The plan's implementation includes various follow up and evaluation activities during the calendar year, with different cuts in information, according to the periodicity determined for routine activities at pre-defined initiative stages. Periodic (monthly and quarterly) reports are prepared and progress and results are submitted on a quarterly basis to AFIP's Advisory Council. In addition, AFIP uses a Management Plan Follow-up System (a scoreboard) that includes an alert system for promptly visualizing the course of the scheduled activities, where indicators and initiatives are rated according to level of compliance (green, yellow, and red).

At year end, a closing report is prepared with the final evaluation of the institutional management results. The results are submitted to AFIP's Advisory Council, which gives its opinion on compliance with the Management Plan.

15.5. Key Benchmarks and Guidelines

The two most basic prerequisites for proper strategic planning in tax administrations are autonomy and organization:

- Modern tax administrations have political autonomy to manage their day-to-day decision and operational activities. They are independent of political changes. They enhance taxpayer confidence in the administration through the display of fairness, impartiality, honesty, integrity, and professionalism, and through the development of transparent systems and procedures.
- A modern tax administration is organized to meet the most significant commercial risks and priorities. Units requiring specific skills and offering economies of scale are part of a modern tax administration (e.g., return processing centers, revenue intelligence, tax collection, audit units specialized by industry, etc.). The administration largely determines the structure, functional organization, and allocation of resources throughout the organization by operational demand.

Assuming the aforementioned fundamentals are in place, the following are key questions that would assist tax administration officials in identifying whether the strategic planning process at their organization is appropriate.

- Strategic plan development is through the broad-based participation of managers, supervisors and staff;
- All staff are aware of the organization's vision and mission and their role in contributing to its success;
- Stakeholders are aware of the strategic plan;

- The strategic plan is periodically reviewed, progress against the plan is assessed against benchmarks, and, if necessary, the plan is adjusted;
- Management assesses any proposed new projects and initiatives against the plan to ensure their alignment with the mission, vision, action plans and work plans contained in the plan;
- Systems to collect and track performance data have been refined to ensure the data is generally reliable and consistent.
- Management refers to performance data to guide decision making.
- Staff are accountable for their performance against the strategic plan.
- Leaders invest considerable effort and resources in strategic planning and gather significant information (staff views, stakeholder views, trend analysis, etc.) for the process. Once these plans are defined, they are translated into division, unit, team, and individual work plans, and all are measured on the extent to which they achieve their part of the overall plan. Variance from the plan is managed and adjustments made, such that projects and units deliver services and products on time and on budget. The planning process is intuitive and efficient.

In addition, a number of performance targets that are typically included in the strategic plan are discussed in Appendix 15.B.

Chapter 16. Internal Audit

Arturo Jacobs

The purpose of this chapter is to define "internal audit" and to discuss the very important role that the staff of this organizational component play in tax administration. The term "internal audit" refers to the process of conducting periodic reviews to ensure that selected regulations, operations, administrative procedures and programs, and internal controls of the tax administration conform to specified standards and are being implemented efficiently and effectively. Internal audits include the review and appraisal of policies, practices, systems, and procedures as well as the analysis and verification of accounts, financial transactions, internal controls, and reports.

The following aspects of internal audit are addressed in this chapter:

- The primary mission of internal audit and the very important role its staff play in the tax administration;
- The scope of authority that needs to be formally given to the internal audit function for its staff to accomplish their mission and to operate effectively and efficiently;
- Staff qualifications and training;
- The importance of information technology (IT) in internal audit activities;
- A typical organizational chart and the responsibilities of the various organizational units;
- Necessary inter-relationships between internal audit and the internal control function, that investigates alleged corruption and integrity issues among tax administration staff; and
- Operating policies and procedures of the internal audit function.

An outline of a procedures manual for internal audit is also presented to give readers an idea about the full scope of operations of the internal audit function in a modern tax administration.

16.1. Leading Practice

The mission of internal audit is to promote public confidence in the tax administration by providing the public and management with independent, timely, and professional periodic reviews that:

- Promote economic, efficient, and effective administration of the country’s tax laws;
- Detect and deter waste, fraud, corruption, and abuse in tax administration programs and operations; and
- Inform the head of the tax administration of significant risks or deviations from defined laws, regulations, policies, and objectives throughout the organization.

All modern tax administrations have internal audit staff, who conduct independent and professional internal audits on behalf of the Director General to ensure that responsibility at all organizational levels is effectively and efficiently discharged and in accordance with laws and regulations. In carrying out their official duties, internal audit staff must have the full cooperation of tax administration officials at all levels as well as full, free, and unrestricted access to review the tax administration's activities, reports, records, and property. To eliminate any doubt about the authority of the internal audit function, language to the latter effect – preferably statutory, through regulations, or by formal delegation - must be made a part of the official record.

The internal audit function can be, and often is, part of a division in the tax administration's functional structure that also includes the integrity investigations function[383], although these two functions are somewhat different. Whereas internal audit focuses on the quality and efficiency of tax administration systems, procedures, and processes, integrity investigations focus on allegations of corruption and misconduct by tax officials. Integrity investigation staff conduct professional and timely investigations of such misconduct and then recommend sanctions against those officials in confirmed cases. In collaboration and cooperation with the Director of Integrity Investigations, the Director of Internal Audit is also responsible for advising the Director General about the status of the integrity of tax administration personnel. Both functions are also jointly charged with designing programs to identify and apprehend employees or non-employees that are corrupt or are attempting to corrupt employees of the tax administration.

Despite differences between the two functions, their staff must work together closely. In some cases, internal auditors engaged in their routine activities uncover suspected integrity irregularities, which they refer to the Director of Integrity Investigations for further action. In such cases, integrity investigators and internal auditors usually work together to further develop cases by applying their respective knowledge and skills. On suspected integrity cases initially developed by internal investigators, assistance from internal auditors is sometimes required and requested to further develop aspects of cases that are in the realm of internal auditors' knowledge and skills.

The integration of internal audit with integrity investigations in a functional organization structure at headquarters and at regional organizations has been successful in many countries. In the United States for example, the Internal Revenue Service's (IRS) Integrity Investigations and Internal Audit divisions, each with a Division Head, operated very effectively for many years under the Head of a central organization called the "Office of Chief Inspector," whose top official reported directly to the Commissioner of the IRS. At each of the seven regional office locations in the United States, Assistant Regional Commissioners for Inspection supported the respective Regional Commissioners with internal audit reviews and integrity investigations at district/field offices under the jurisdiction of each Regional Commissioner. However, the Assistant Regional Commissioners for Inspection reported directly to the Chief Inspector in the national headquarters, but not to the Regional Commissioners, as an added precaution to maintain their independence.

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[383] Tax administration integrity is discussed in Chapter 17.

Internal audit activities should conform to the standards and guidelines established by a recognized organization in the field of internal audit. The Institute of Internal Auditors (IIA) is the recognized international standard setting body for internal audit. The IIA is an associated member of the International Organization of Supreme Audit Institutions (INTOSAI), which itself is a worldwide affiliation of governmental entities, primarily an umbrella organization for external government audit. As of 2011, its members included the Chief Financial Controller/Comptroller General/Auditor General Offices of nations, with a total of 191 national-institution members. Many countries have also issued standards for the conduct of governmental audits, such as the United States Comptroller General and the Auditor General of Canada.

16.1.1. Differences between Management and Internal Audit Oversight

According to leading international practice, the establishment of financial standards and internal controls is normally the responsibility of management and not of internal auditors. This is so, to ensure that the assets of the organization are properly protected and reflected in the records, that the debts (or liabilities) of the organization are properly reflected, that the organization is operating in an efficient and effective manner, and that the results of operations are properly presented. Managers at each level of the tax administration are required to perform compliance oversight and reviews of progress on objectives in all functions within their own management responsibilities, which are supplemented with periodic reviews by functional analysts (audit, collections, etc.) in the regional and/or headquarters office.

Internal audit, on the other hand, provides higher management with an independent review and assessment of operations, programs, systems development, and financial activities. All internal audit reviews are conducted through planned testing of available data, including statistical sampling techniques, rather than a complete review of transactions. Operations and program reviews assess:

- Whether program objectives are appropriate;
- The extent to which the objectives of the programs are still relevant to the tax administration's mission;
- The effectiveness of management's reviews of internal controls;
- The adequacy of management's system for measuring effectiveness;
- The extent to which a program achieves a desired level of accomplishment;
- The effectiveness of the program or individual program components;
- Factors that inhibit satisfactory performance;
- Whether management has considered alternatives that may yield desired results more effectively or at lower costs; and
- Whether the program compliments, duplicates, overlaps, or conflicts with related programs.

During system reviews, internal audit staff determine whether the design, development, and installation of new automated information systems or applications provide a reasonable assurance that systems and applications:

- Carry out the policies prescribed by management;
- Provide the controls and audit trails needed for management operational reviews;
- Include controls necessary to protect against loss or serious error;
- Are efficient and economical in operations by detecting and deterring inefficiency and waste;
- Conform to legal requirements; and
- Are documented in a manner that will provide the understanding of the system required for maintenance and auditing.

Financial reviews are conducted to allow internal auditors to verify the accuracy and adequacy of financial statements and other reports of financial operations. These reviews provide internal and external users with an independent opinion on whether the reports fairly present the results of financial operations.

In effect, internal audit is a fact-finding function and, as such, has no direct responsibility for, or authority over, employees engaged in tax administration operations. The Director of Internal Audit transmits reports that present the facts developed in the internal audit activities to management officials who are charged with taking appropriate corrective action. Findings are also always reported to the Director General, who is charged with reviewing and appraising all of the tax administration's activities and actions, or the lack of appropriate action.

16.1.2. Qualifications and Training for Internal Auditors

All internal auditors recruited by tax administrations should have a university degree in accounting. After recruitment, internal auditors should have classroom and on-the-job training to prepare them to perform the following tasks:

- Reporting identified problems, and the related causes, to various levels of management and recommending possible solutions or corrective actions; and
- Gathering, organizing, and analyzing facts on financial transactions to determine compliance with relevant regulations, including any financial administration and audit acts of their country, the applicable auditing standards, and the tax administration's rules governing all financial transactions.

Among the topics that should be covered in classroom training courses for internal auditors are:

- Revenue administration;
- Revenue laws and regulations;
- Accounting and accounting systems;
- Internal audit standards and audit techniques;
- Computer fraud;
- Computers as an investigative tool;
- Computer assisted audit techniques;

- Organizational structure and functions of each of the tax administration's departments;
- National finance, administrative, and audit acts;
- Investigative and interviewing techniques; and
- Investigative report writing.

The important classroom and on-the-job training program goals are to enable the internal auditor to:

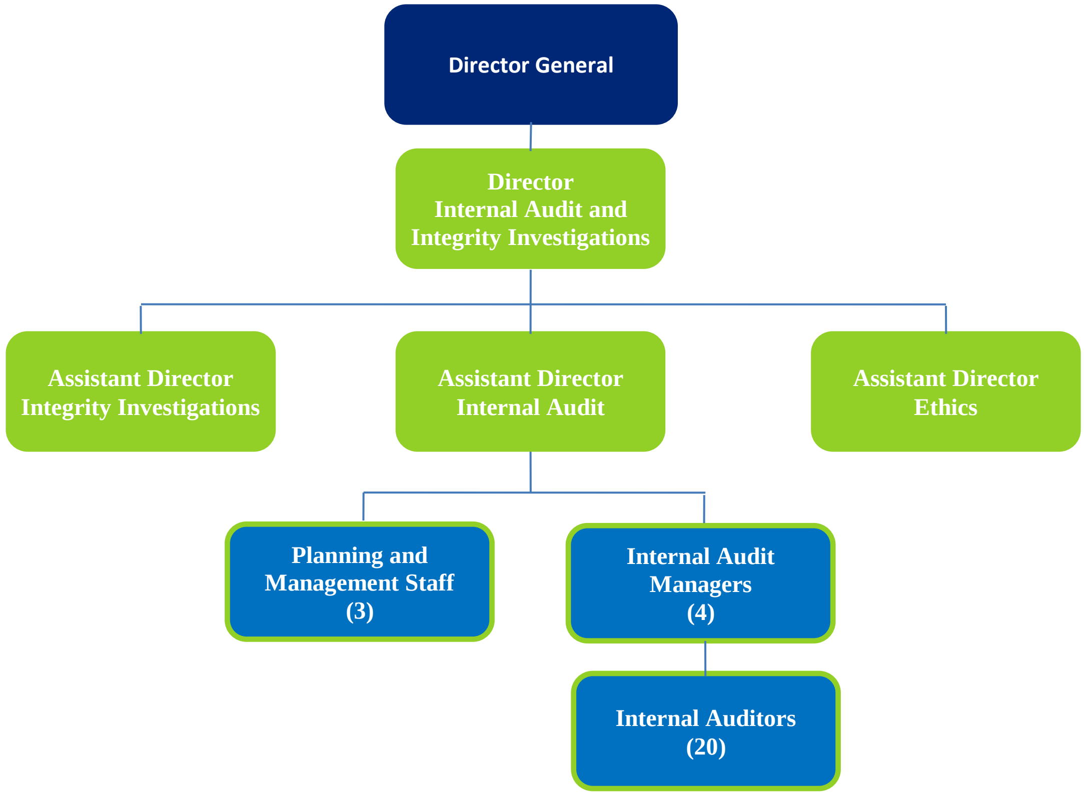
- Conduct complex managerial and financial auditing and special assignments to assess program efficiency, desired objectives, and compliance with program laws, regulations, and other provisions;
- Review and report on matters, such as breakdowns in internal controls and, particularly, the coordination, direction, execution, and accomplishment of the tax administration's programs;
- Prepare internal audit memoranda and draft audit reports on complex functions, systems, or on one or more broad functional areas, in conformance with accepted writing and reporting standards;
- Communicate with appropriate officials at various levels of management on uncovered problems, causes, recommended changes, and the evaluation of subsequent corrective actions; and
- Develop and conduct special in-depth examinations of activities within general guidelines or in high risk programs where employees of the tax administration could commit fraud.

16.1.3. Typical Organizational Structure and Components[384]

The internal audit department's typical organizational structure is shown below and includes the integrity investigations and ethics components, which are addressed in Chapter 17.

[384] Appendices A and B of Chapter 4 show the typical functional organizational structure of the headquarters of large and medium or small tax administrations respectively. Note that the Director of Internal Audit and Integrity Investigations reports directly to the Director General.

Figure 16.1. Organizational structure of an internal audit department



The numbers below the titles of each component of the internal audit division are suggested numbers of accountants and internal auditors, including managers, for small tax administrations with fewer than 5,000 total employees. Medium and large tax administrations should increase staff proportionately. The suggested, small span of control of five internal auditors per manager applies to a tax administration with a fairly new internal audit function. Ten internal auditors per manager is an effective and efficient span of control in an experienced internal audit department. The long-term staffing of internal audit should be established based on studies made to determine the universe of organizations, programs, activities, and functions subject to internal audit. This list should then be consolidated and refined into a list of auditable (or assessable) areas. Once these auditable areas are determined, and decisions on the frequency of audits for these areas are made, it is possible to determine the number of staff required to produce a balanced internal audit program.

The responsibilities of the staff in each of the main components of internal audit are listed below. The details provided can serve as an input for drafting new or amending current job descriptions.

16.1.4. Responsibilities of the Assistant Director of Internal Audit

The main responsibilities of the Assistant Director of Internal Audit are to:

- Serve as the principal advisor on internal audit matters to the Director of Internal Audit and Integrity Investigations and to the Director General;
- Carry out line and functional responsibility for conducting a program of an independent review and appraisal of the operations of all tax administration departments;
- Conduct reviews that provide information on the condition of all functional activities and are sufficient in scope to provide a basis for constructive management action by officials responsible for the activities involved;
- Be responsible for a systematic verification and analysis of financial transactions;
- Review and appraise the protective measures and controls established at all operating levels;
- Supervise the organizational structure for internal audit program operations, including management staff and audit groups;
- Be responsible for the development and execution of the internal audit annual program; and
- Coordinate with the central government's Auditor General, other internal audit governmental institutions, and professional internal audit organizations at national and international levels.

16.1.5. Responsibilities of the Planning and Management Staff

The main responsibilities of the Planning and Management Staff are to:

- Recommend improvements, new procedures, and audit techniques for improving the overall quality of internal audit programs;
- Control, coordinate, and develop the internal audit annual work plan;
- Control, coordinate, and develop the internal audit inputs to the tax administration's strategic plans;
- Identify significant developments, problems, trends, and management initiatives that should receive the attention of the internal audit department and keep abreast of current IT developments so that proper consideration can be given in the development of IT applications to support the internal audit program;
- Conduct research and special studies to ensure that the most efficient and effective computer audit techniques are utilized in carrying out all facets of the internal audit program;
- Develop systems and programs to utilize computerized techniques in carrying out principal segments of the internal audit program;
- Ensure that audit retrieval systems are designed and provided on new or upgraded IT systems, so that internal audit staff can perform audits of these systems;
- Formulate and maintain internal audit policies, procedures, and program guidelines, including manuals and internal audit handbook instructions, and develop and coordinate the training and staff development program for all internal audit staff;
- Control and maintain the internal audit management information system;
- Prepare recurring and periodic reports on the department's programs and accomplishments; and
- Be responsible for the quality control and review of all internal audit reports.

16.1.6. Responsibilities of Internal Audit Managers

The main responsibilities of internal audit managers are to:

- Conduct internal audits of activities and programs in all of the tax administration departments;
- Plan and conduct comprehensive reviews of high impact areas of special interest to the Director General and other top-level officials of the tax administration;
- Conduct special assignments in cooperation with the staff of integrity investigations on cases requiring the specialized knowledge and training of internal audit personnel;
- Plan, control, manage, execute, and report on activities for which internal audit has control responsibility;
- Conduct special surveys, examinations, and projects and coordinate, evaluate, review, and follow through on audit findings;
- Bring significant audit disclosures to the attention of top management of the various departments of the tax administration;
- Conduct reviews of major IT system development projects;
- Help operating managers develop new or improved IT systems by reviewing management proposals and designing specifications to ensure that the IT systems and applications carry out the policies prescribed by management;
- Provide internal controls and audit trails needed for the management and audit of the IT systems;
- Provide effective and cost-efficient controls to protect against theft and serious error;
- Ensure that reviews provide confirmation that IT systems and applications conform to legal requirements and are clearly documented; and
- Participate in the development of long-term and annual internal audit plans and help prepare special purpose audit programs and guidelines.

16.1.7. Main Responsibilities of Internal Auditors

The main responsibilities of all internal auditors are to:

- Develop and implement audit programs designed to evaluate the efficiency and economy with which financial and functional operations are conducted;
- Undertake a constant review of the tax administration’s financial accounting operations and systems with a view to detecting and, where possible, preventing errors and fraud;
- Ensure that the tax administration’s accounting records are accurate, complete, and up to date through the design and implementation of proper systems of internal checks;
- Ensure the effectiveness and adequacy of control systems, procedures, and records by undertaking regular checks of these areas of the tax administration’s operations to detect waste and idle capacity in the use of resources;

- Evaluate the effectiveness of certain policies and procedures in safeguarding the tax administration's assets against defalcation, loss, or waste and, where necessary, recommend appropriate changes to current policies and procedures;
- Report to the Director General any significant deficiencies observed, and provide an opinion as to the adequacy of current policies and procedures; and
- Continuously undertake spot checks of the accounting system procedures and records of the tax administration to ensure that they are:
  - Accurate, complete, and up to date; and
  - In accordance with the provisions of national financial laws and regulations.

16.1.8. Operating Procedures

An annual internal audit work plan is developed and completed two to three months before the start of each calendar or fiscal year. The plan contains the allocation of resources to all activities, such as specific audits and training, and set objectives and responsibilities among the internal audit staff. The planning methodology for internal audit involves three interrelated managerial processes of: 1) deciding how to use organizational resources; 2) interpreting and reporting on what is actually happening in the tax administration; and 3) taking actions in response to this information. Internal audit should develop a universe of organizations, programs, activities, and functions subject to audit and produce an inventory of assessable units that will be utilized to plan organizational resource utilization and to develop budget requests that are specific to the units to be audited.

The planning and execution of the internal audit annual work plan each year should be in conformance with the following:

- Priorities are established to ensure that assessable areas are subject to audit based on risk factors, with each area reviewed on a scheduled basis;
- Audit procedures and guidelines are established to ensure that audit planning and execution are properly accomplished;
- Benchmarks are established to assess the efficiency and effectiveness of audits;
- Audit standards are established, based on IIA/INTOSAI or similar standards; and
- Reporting procedures are established and monitored to ensure that management properly addresses findings and recommendations.

Internal audit findings are usually presented in written reports that contain factual presentations of the auditors' findings. Non-integrity issues found during routine internal audit activities should first be reported in draft to the top functional management official directly charged with appropriate corrective action, such as the head of the audit or collections division. After discussions with the affected official and his staff lead to an agreement on the facts in the internal audit report, the findings are provided to the district/field office director with a request that the Assistant Director of Internal Audit be advised by the district/field office director in writing, by a given deadline, of the corrective actions to be taken (note that the internal audit report may include suggested corrective actions). A copy of the findings is provided to the Director General. Internal audit can and should make sample, follow-up audits to ensure that the corrective actions are, in fact, being implemented. Major issues or areas of disagreement between the internal audit officials and district/field office officials that cannot be resolved at the proper level of authority are referred to the Director General for resolution.

After the completion of an audit (except on internal audits where integrity is an issue), it is extremely important that policies and procedures always require the internal auditors involved to present draft reports and preliminary findings to affected officials, so that they have an opportunity to agree with the facts presented or provide information to correct any errors. In tax administrations that disregard such policies and practices, staff at all levels of the organization’s line and support components tend to view the internal audit reviews of any and all aspects of their operations as "intrusive," and it is common for internal auditors to be viewed by operations staffs as "the enemy." In fact, in this type of organizational climate, those being reviewed can find ways to "thwart" the effectiveness of internal audit reviews to some extent. Therefore, top management of the tax administration, particularly the Director General, the Director of Internal Audit and Integrity Investigations, the Assistant Director of Internal Audit, and top-level functional managers must establish a culture of mutual respect, collaboration, and cooperation between auditors and those who are audited.

The Assistant Director of Internal Audit should prepare an annual report, in addition to any statutory required periodic reports, for the Director of Internal Audit and Integrity Investigations and for the Director General summarizing the audits conducted, the corrective actions taken, and other significant accomplishments. This report should also contain an assessment of the strengths and weaknesses in the systems and controls of the tax administration and recommendations that have been made to overcome weaknesses.

16.2. Common Trends

Internal audit in tax administration has evolved from the task of financial auditing. In addition, advances in technology, changes in risk management, and systems and organizational issues have been changing the roles of internal audit, as discussed below.

16.2.1. Use of Information Technology

In recent years, like other functions of the tax administration, internal audit has embraced the trend for more and better computerization and IT, including many corresponding modern tools, such as:

- A centralized repository of all audit plans, work papers, audit work programs, findings, reports, and follow-up;
- Comprehensive audit plan management throughout the life cycle of each audit, including resource assignments and work plan creation;
- Automatic generation of audit work papers directly from work plans;
- Audit task management with fully automated and customizable workflow;

- Graphical reporting of audit activities, status updates, and results;
- Documentation of recommendations, management responses, and oversight of remediation projects;
- Sophisticated capabilities for creating, managing, and analyzing customizable surveys for any size organization; and
- Enhancement of risk management programs, including:
  - Annual risk assessments;
  - Configurable scoring and prioritization;
  - Streamlined set-up and execution of assessment questionnaires with reusable questions, response sets, and question templates; and
  - Documentation of control tests.

Information technology has transformed the operations of tax administrations all over the world. As internal audit expands its role from financial and regulatory compliance reviews to audits, assessments, and inspections of operations, systems, and quality of ever more computerized components of the tax administration, it too must advance technologically. There is a trend to upgrade the technology infrastructure used to carry out audits – from risk assessments and creating the audit universe, to planning, to audit data collection and reporting. Internal audit components in some modern tax administrations are migrating from their legacy systems and paper-based procedures to web-based, integrated audit management systems.

16.2.2. From Oversight to Strategy

The role and value of the internal audit function in tax administration have evolved over the years from that of oversight to that of strategy, based on the following recent trends.

Evolving Role and Expanding Scope of Internal Audits

Traditionally, financial auditing, controls, and regulatory compliance were the primary focus areas that governed internal audit activities. In recent years, the role of internal audit has expanded to include the assessment of operations, programs, system development, and integrity investigations, in addition to financial auditing and regulatory compliance. More recently, internal audit staff have been involved in reviews and recommendations that focus on business process optimization, streamlining of operations, managing risk, prioritizing goals and activities, eliminating complexity and redundancy, and driving down costs.

Tax Administration Performance and Quality Assessments

Internal audit has been helping to strengthen the organization and management of tax administrations' departments by reviewing and analyzing the efficiency and effectiveness of operations, in addition to conducting quality assurance activities. There is now recognition that internal audit, by reviewing operations and recommending improvements, can guide the redeployment of resources to more revenue productive programs and even contribute to increased revenue collection. Similarly, the implementation of internal audit recommendations has resulted in improved cost-effectiveness of tax administration operations. Furthermore, there is growing recognition that the public's impressions of tax administration operations improve with the knowledge that internal audit staff are conducting reviews of operations and practices, independently from operations staff.

Greater Collaboration with Operations Officials

In the past, in many countries, too many operating officials at all levels viewed internal audit as "the enemy" that was "not to be trusted." Consequently, there was reluctance to share information with internal audit staff. Operations officials in many countries even made it a standard practice to withhold pertinent information from internal auditors. Today's business environment and the expanding role of internal audit call for greater collaboration and stronger relationships between internal audit and operations officials at all levels of the tax administration. The trend, therefore, is moving towards an organizational culture that encourages a free flow of information regarding any issues or concerns between the two parties in a way that fosters mutual respect and facilitates accountability. It should be noted, however, that internal audit must continue to maintain its independence by having a direct reporting line to the Director General.

Shift towards Risk-Based Auditing

Similarly to using computerized mathematical formulae to automatically select those taxpayers for audit that pose the highest risk to revenues, internal audit has begun to identify and prioritize assessable areas based on the greatest risk factors to the tax administration in the internal audit annual work plans. For example, the highest risk for revenue loss to the tax administration is from the country's large taxpayers. Therefore, internal audit reviews in the large taxpayer program must rank very high in the internal audit's work plans. Similarly, Internal audit must also give very high priority to ongoing reviews of major system developments and their implementation because of the very high risk of rapid, negative impact on the entire tax administration, should major errors or deviations not be timely detected and corrected. Data security is also an ongoing challenge for tax administrations all over the world. Therefore, there is a trend for internal audit, along with the entire tax administration, to address all risk, compliance, and governance issues related to data security.

Computer Assisted Audit Techniques

Computer assisted audit techniques (CAAT) are becoming much more necessary to automate and streamline internal audit processes and to alleviate the burden on internal audit staff, who are often tasked with a wide variety and number of reviews on a less than fully automated basis. CAATs enable real-time, automated testing of critical data of the tax administration and greatly increase the efficiency of internal audit staff. In short, technology enables the audit process and allows for risk assessments to be performed automatically, continually, and without any substantial recurring efforts. However, such technology improvements require significant initial investment, as well as training.

Recruitment and Retention of Internal Auditors

Changes in the audit landscape require internal auditors to have a broad range of skills and so the profession is very challenging. Coupled with persistent cuts in governmental budgets worldwide and opportunities for higher compensation in the private sector for internal auditors, it is more and more difficult to find new and retain experienced staff and to maintain continuity in internal audit operations of tax administrations. Therefore, it is incumbent on Directors General and Directors of Internal Audit and Integrity Investigations to be aggressive in policies and practices to recruit and retain good staff. Such policies and practices would include: only recruiting and selecting fully qualified, professional personnel; providing successively challenging training courses for internal auditors and rotating their assignments; developing and administering a meaningful performance evaluation system; and providing prompt recognition and rewards for above average performance.

16.3. Tax Administration Maturity

Four maturity levels of tax administrations with respect to internal audit are described below. Of course, a specific tax administration may find that it fits the characteristics of several of the levels below. In this case, the tax administration may be in transition from one maturity level to another.

Internal Audit: Maturity Level 1

Key word: "Not present"

- There is no internal audit function in the tax administration.
- Internal audits, mostly of financial controls, in all government institutions, including the tax administration, are the responsibility of the central government's Office of Auditor General.
- Internal audits by the Office of Auditor General of any aspect or activity of the tax administration are minimal and occur only once or twice every four to five years for many reasons, including severe understaffing of the Office of Auditor General.
- When performed, internal audits are perfunctory, lack depth, and have little significance, in part because internal auditors of the Office of Auditor General have very little knowledge and understanding of the workings of the tax administration.
- The Director General has little or no knowledge of whether the tax administration conforms to any independent standards of financial and accounting controls.

Internal Audit: Maturity Level 2

Key word: "Aware"

- After recognition by officials of the Ministry of Finance and the tax administration of the need to manage their own internal controls, a small internal audit unit was established, perhaps less than five years ago, under the Director General. However, there is no statutory language, regulation, or delegation of authority to formalize the internal audit role and the authority of its staff.

- Internal auditors have not had classroom training specifically designed for internal audit. Some are not well qualified and do not have university degrees in accounting, and many have little knowledge and understanding of the tax administration's various business processes, revenue laws, and regulations.
- Policy and procedures manuals and handbooks for internal auditors have not been developed.
- There is no planning and management staff (or similar planning unit) in the internal audit organizational structure. The internal audit top official and some of his or her staff develop an ad hoc work plan each year with no input from any other part of the tax administration. Activities in the work plan focus mainly on financial and accounting controls, with little work on assessment of operations, programs, quality assurance, systems, systems development, and risk management.
- There is no knowledge or adherence in the work plans to the standards of the IIA/INTOSAI or other internal audit organizations' standards.
- There is no clear policy or understanding of the differences between operational reviews by management officials and internal audit reviews. Internal audit staff sometimes attempt to order functional staff to take remedial actions on internal audit "findings" not yet corroborated by management. Disagreements about internal audit "findings" are common and usually have to be resolved at the Director General level.
- Relationships between internal audit staff and the staff of most other components of the tax administration are antagonistic.
- The annual contributions of internal audit to the overall efficiency and effectiveness of the tax administration are minimal.

Internal Audit: Maturity Level 3

Key word: "Taking shape"

- An internal audit unit was established, perhaps between five and nine years ago and its role and authority in the tax administration are defined by statutory language, regulation, or delegation.
- Most internal auditors in the unit have university accounting degrees and most have had classroom training specifically designed for internal auditors, but the course has not been updated in recent years to include computer-assisted internal auditing tools and techniques. There are few opportunities for continuing professional education (CPE) for long-time internal auditors. Staff attrition is relatively high, mainly because the private sector offers much higher compensation.
- Policy and procedures manuals and handbooks have been developed and are available in hard copy, but are usually not kept up to date.
- Internal audit recently established a universe of organizations, programs, activities, and functions subject to audit and produced an inventory of assessable units that has been utilized

to plan organizational resource utilization and to develop budget requests that are specific as to assessable units to be audited.

- The internal audit planning and management staff (or similar staff) prepares an annual work plan each year that takes into account the "universe of auditable areas" and input from other top-level functional officials. Activities in the work plan include some audits on internal accounting controls and financial and functional operations, as well as assessments of operations, programs, systems, and systems development. The internal audit unit is beginning to design audits to manage high-level risks to the tax administration.
- IT infrastructure, equipment, and budgets for CAATs are very helpful, but somewhat limited.
- Internal audit activities are completely conducted based on planned testing of available data, including statistical sampling techniques, rather than a complete review of transactions, under the standards set by a regional institution of internal audit which adheres to the standards of the IIA/INTOSAI.
- The fact-finding role of internal audit is mutually understood by internal audit and management officials. Findings of internal audit reviews are usually handled accordingly, with disagreements resolved and management concurrence obtained before findings are finalized and submitted to the Director General.
- The relationships between internal audit staff and the staff of most other components of the tax administration are good, and the internal audit unit is generally viewed as "effective and fair".
- Internal Audit generally meets the performance benchmarks listed below in Section 16.5.

Internal Audit: Maturity Level 4

Key word: "Strategic player"

- An internal audit unit, with its role and authority in the tax administration defined by statutory language, regulation, or delegation, has been part of the tax administration for ten or more years.
- All internal auditors in the unit have university accounting degrees and have had classroom training specifically designed for internal auditors, which is updated every two to three years and includes the latest CAATs. All experienced internal auditors are given opportunities and compensation to attend CPE courses in local universities. Internal audit staff are highly motivated and attrition is low.
- Policy and procedure manuals and handbooks are promptly updated and are available electronically to all internal auditors.
- The universe of organizations, programs, activities, and functions subject to audit for the last few years is subject to focused reviews and recommendations on business-process optimization, the streamlining of operations, managing risk, prioritizing goals and activities, eliminating complexity and redundancy, and driving down costs.
- The internal audit planning and management staff (or similar staff) prepares annual work plans, with input from other top-level functional officials. In addition to activities related to business

process optimization, the work plan also focuses on more and higher priority involvement with audits designed to manage high-level risks to the tax administration.

- IT infrastructure, equipment, and budgets for CAATs are adequate and very helpful.
- Internal audit activities are conducted based on samples, under the standards set by a regional institution of internal audit which adheres to the standards of the IIA/INTOSAI.
- The fact-finding role of internal audit is mutually understood by internal audit and management officials. Findings of internal audit reviews are usually handled accordingly, with disagreements resolved and management concurrence obtained before findings are finalized and submitted to the Director General.
- The relationships between internal audit staff and the staff of most other components of the tax administration are excellent, and the internal audit unit is generally considered a strategic partner.
- Internal Audit invariably meets or exceeds the performance benchmarks listed below in Section 16.5.

16.4. Latin America and the Caribbean

With very heavy reliance on external audits for many years, formal internal audit units as organizational entities within tax administrations are relatively new in most Latin American and Caribbean (LAC) countries. Most LAC tax administrations have internal control organization entities,[385] but there is also a very low number of sanctions and disciplinary actions for infractions, indicating that internal controls are "more a formality than truly effective."[386] A few LAC countries are squarely in the 3rd level of maturity (Chile, Colombia, Argentina, Brazil, Mexico and a few others), but a majority lies between the 2nd and 3rd levels of maturity. The following mix of features of the 2nd and 3rd maturity levels is representative of the situation in most LAC countries.

- After relying mainly on external audits by the central government for many years, internal audit units have been established within the tax administration, and statutory language, regulation, or delegation of authority to formalize internal audit’s role and the authority of its staff exist, but generally lack clarity;
- Some internal auditors have not had classroom training specifically designed for internal auditors, and some newer auditors have little knowledge and understanding of the tax administration’s various business processes, revenue laws, and regulations. Attrition is relatively high, with experienced internal auditors often seeking better opportunities and higher compensation in the private sector;
- Policy and procedures manuals and handbooks for internal auditors have only recently been developed, but hard copies are not usually kept up to date;
- The internal audit planning and management staff (or similar planning unit) prepares a work plan each year, but there is limited or no input from any other part of the tax administration.

[385] Inter-American Center of Tax Administrations (CIAT) et al. (2012), p. 12.
[386] Ibid., p. 71.

Activities in the annual work plan focus on financial and accounting controls, and the internal audit unit is only just beginning to assess operations, programs, quality assurance, systems, systems development, and risk management;

- IT infrastructure, equipment, and budgets for CAATs are extremely limited;
- Internal audit's work adheres to the standards of the Organization of Latin American and Caribbean Supreme Audit Institutions (OLACEF);
- The differences between operational reviews by management officials and internal audit reviews are understood; however, inexperienced members of internal audit's staff occasionally attempt to direct functional staff to take remedial actions on internal audit findings that have not yet been corroborated by management. Disagreements about internal audit findings occasionally have to be resolved at the Director General level;
- Relationships between internal audit staff and the staff of most other components of the tax administration are fair at best, with frequent internal audit staff/operations staff disagreements about Internal Audit findings, which have to be resolved by the Director General;
- Internal audit each year meets some, but not all, of the performance benchmarks listed below in Section 16.5; and
- Waste, fraud, and abuse in the tax administration are decreasing each year, but are still not under manageable control.

It should be noted that external control audit institutions of governments and their audits of financial controls and other activities of tax administrations (and of other government agencies) have a long history in LAC countries. The existence of OLACEF, its periodic regional conferences, working groups, and library of documents is a strong source of support and opportunity for LAC countries as they endeavor to improve their internal audit organizations and activities. In fact, OLACEF, established in 1965 and associated with INTOSAI, abides by the international standards of external government audits.

Membership in CIAT is also source of strength of LAC countries. As members, LAC countries can seek opportunities to get assistance from and collaboration with the Inter-American Center of Tax Administrations (CIAT), which also has and makes available to all its members, a wide array of studies, documents, and publications about internal audit and internal controls. In fact, CIAT published an Internal Audit Manual in 2006[387], which is available to all members.

Perhaps the biggest threat to the internal audit function in LAC countries is the general and persistent inadequacy of financial resources in tax administrations' budgets to upgrade IT infrastructure and facilitate the use of CAATs by internal auditors. Without such modernization and scarce human resources, it is very difficult for internal audit units to expand their assessments of operations, programs, systems, systems development, business process optimization, and audits designed to manage high-level risks to the tax administration.

[387] Inter-American Center of Tax Administrations (CIAT) (2006), *CIAT Internal Audit Manual*. (http://www.ciat.org/biblioteca/opac_css/index.php?lvl=notice_display&id=821)

16.5. Key Benchmarks and Guidelines

The most important benchmark for internal audit is that its work adheres to internationally accepted or leading practice standards, such as those of IIA/INTOSAI. In addition, once the number of staff is determined, the key indicators of performance for the internal audit function each year are:

- 90 percent of routine audits are initiated within 15 days of assignment, and the other 10 percent are initiated within 30 days.
- 60 percent of total available time of internal auditors is spent on direct operations, while 40 percent is spent on training, administrative matters, and personal time.
- In 90 percent of cases, the average number of calendar days to complete is within ±5 percent of the scheduled time.
- In 95 percent of cases, draft reports of findings are issued for management response within 15 days of completion of the audit, and within 25 days for the other 5 percent.
- In 90 percent of cases, reports are completed and submitted to the Director General within 30 days of receipt of managements’ responses, and within 45 days for the other 10 percent.
- In 95 percent of cases, the results of quality reviews of audit work papers and reports by internal audit management are positive.

Chapter 17. Integrity

Terry Murdoch

Integrity is defined in the broad sense of honesty, moral correctness, respectability, fairness, equal treatment, and ethical behavior across a range of operational and management issues. Integrity is not about preventing corruption in a narrow sense, but rather about securing and maintaining public confidence. Integrity is a core value and must be part of the tax administration's organizational culture to prevent wrongdoing and reputational damage. For civil servants, in particular, integrity is about putting the public good above their own personal interests.

Tax administrations are often regarded as lightning rods for corruption in public sectors around the world. Notwithstanding this reputation, the vast majority of tax administration staff is generally honest, industrious, and dedicated. However, the reality is that a few corrupt officials can seriously harm the reputation of the organization as a whole. All failings, whether minor or serious, need to be addressed so that public confidence can be reestablished and the good reputation of the service restored. Unfortunately, given that widespread publicity on this issue drives public opinion, it is incumbent upon the tax administration to take proactive steps to ensure that it maintains a reputation of integrity.

Confidence in the tax administration and faith in its dependability and integrity are factors that have a critical impact on the administration's ability to carry out its role. The administration can maintain public confidence only to the extent that its contact with taxpayers and the general public consistently reflects the highest ethical and moral standards.

Public and political confidence, along with operational effectiveness, can be affected by the inappropriate behavior of a small minority of staff. The sensational and disproportionate publicity arising from their actions overshadows the huge amount of good work carried out every day, often in difficult (and sometimes dangerous) circumstances by the vast majority of staff. It is therefore binding on all tax administrations to have measures to assist in establishing integrity and maintaining it.

17.1. Leading Practice

In general, integrity strategies comprise a variety of direct action measures against corrupt behavior, while simultaneously pursuing reforms of policies and institutions. Such strategies, on the whole, combine three overarching approaches:

- *Fundamental approach:* The objective of this approach is to remove the conditions that give rise to corruption in the first place. Such reforms seek to address weaknesses in policies and institutions by simplifying the tax system and reforming the tax administration.
- *Administrative and legal approach:* This approach introduces rules and regulations designed to specifically limit the discretion of public officials. These are intended to increase the probability

of detection of corrupt practice through strengthened monitoring and enforcement and the timely and stiff punishment of offenders. This approach also includes the implementation of internal monitoring units within organizations and the protection of whistleblowers. Here, senior managers of the tax administration are directly responsible and must be held accountable for failures to detect and/or address breaches.

- *Transparency and standards approach:* This approach relies on good governance promoted through transparency and standards in the conduct of the administration's business. Among the benefits of this approach is the strengthened accountability of public officials and, hence, reduced corruption. Before engaging the public as part of an anti-corruption campaign, however, adequate follow-up and enforcement mechanisms must be in place.

Clearly, none of the three approaches is likely to be sufficient by itself. An effective integrity strategy needs to employ all three approaches. The following sections provide a more detailed description of each of the three approaches.

17.1.1. Fundamental Approach

As discussed above, the objective of this approach is to remove the conditions that give rise to corruption. The following areas should be addressed.

Establish an Effective Tax Regime

Tax policy is both practical and conceptually well founded when it is based on the following principles: simplicity, adequacy, equity and fairness, economic efficiency or neutrality, ease of administration, stability, and certainty. A tax system (and the primary legislation that establishes it) is:

- *Simple, clear, or transparent* if it collects revenues in a way that is easily understood by the taxpayer and is not costly to the taxpayer. The cost of compliance must be kept low, specifically to encourage small and medium taxpayers to comply voluntarily and not make themselves vulnerable to coercion from corrupt tax officials;
- *Adequate, sufficient, or sustainable* if it collects sufficient revenues to allow the government to deliver the requisite level of services;
- *Equitable* or *fair* if taxpayers with similar ability to pay contribute similar amounts ("horizontal equity") and if taxpayers with greater ability to pay contribute larger amounts ("vertical equity");
- *Efficient* or *neutral* if it does not interfere with the economy;
- *Easy to administer* if it allows the government to collect the right revenues cheaply; and
- *Stable* if it generates predictable amounts of revenue year after year.

Tax policy is beyond the scope of this chapter. Suffice it to say that adhering to the above principles goes a long way towards instituting a perception of fairness in the tax system as a whole, and in the government and the tax administration in particular. Of the aforementioned objectives, simple tax laws constitute an important step towards making the public comfortable with the tax regime. Simple tax laws and procedures enable taxpayers to interpret tax law on their own by understanding the true legislative intent of the provisions applicable in their respective cases. Tax laws that reduce discretion with tax officials to a minimum help remove opportunities for rent seeking and increase public confidence in the tax regime.

Organizational Structure

Modern tax administrations have adopted an organizational structure which is functional in nature and is regarded as a positive deterrent against corrupt practice. Separation of the functional work areas (and therefore staff), such as audit, collection, and legal services, is accompanied by a vertical organization with strong headquarters, who oversee managers of specific geographical areas. Such a structure protects some functions from infectious corruption and prevents chain corruption being developed throughout a particular territory.

Similarly, the allocation of a group of taxpayers to a specific employee for control purposes, whether it be office audit, field audit, or collection activities, is not regarded as best practice. Certainly, with regard to audit of the largest taxpayers, it can take time for an officer to familiarize himself/herself with the taxpayer's accounting and business practices, so it makes sense in these specific areas to permit some ongoing relationship for a limited period of time. In general, however, similarities in many operational procedures allow the tax administration to rotate staff among taxpayers frequently in order to prevent relationships and connections that may create opportunities for corruption. In some tax administrations, staff is also transferred across geographical areas to deter inappropriate taxpayer/staff relationships. However, such policies should allow for exemptions in cases of financial and/or family hardships for employees and should therefore be applied judiciously.

Procedures and Practices

Administrative transparency can assist not only in achieving high voluntary tax compliance, but also in reducing opportunities for corruption by tax officials. Standardized procedures and electronic and physical tax forms, which are made widely available to taxpayers, limit one-on-one contact between tax officials and taxpayers. Further, standardized administrative processes ensure that all taxpayers are treated in a consistent manner.

The tax administration must include policies and procedures to detect and deter corruption. All plans and operations should be designed to make corrupt practice difficult and to provide for accurate records of all transactions, their underlying motivation, and the offices and individuals responsible for all actions.

Automation

As more processes are automated, discretion is significantly reduced and processes become impersonal. Obviously, there must be safeguards and security procedures to protect the information within the information technology (IT) system from unauthorized use, abuse, or tampering. The tax administration can protect this information though the allocation of user passwords, limiting access by individual users only to those parts of the system necessary to do their work efficiently, retaining amended documents within the system, as well as indicating who completed the amendment, and only allowing selected development staff to make changes to the software. Providing the IT system is sufficiently secure, automation can significantly reduce the scope for corrupt practice.

Reduced in-person contact with the tax administration is also achieved, to a great extent, by providing taxpayers with options, such as e-filing of returns, e-payment of taxes, filing of relevant applications online, e-tracking of such applications, downloading of tax bills, viewing of tax payments made in banks, etc.[388]

Training

It is vitally important that staff receive appropriate training for the duties they are expected to perform within the tax administration.[389] As tax laws become more complex over time and taxpayers learn new techniques, training should become an ongoing activity, not just a one-off action for new recruits.

It is also important that managers are able to differentiate between honest mistakes made by inadequately trained staff and deliberate errors designed and made for rent-seeking purposes. Ethics training, therefore, should be included as a part of continuing professional education. Training should not focus exclusively on moral or philosophical issues, but rather on instilling an attitude whereby staff, when confronted with ethically ambiguous situations or clear opportunities for corruption, put the reputation of the tax administration ahead of personal welfare or opportunities for financial gain. Moreover, if the risk of unethical behavior is great, the frequency of training should be increased. In any event, ethics seminars and courses should become an integral part of the training curriculum, forming a part of initial orientation of new staff and becoming a staple of ongoing professional education.

17.1.2. Administrative and Legal Approach

The objective of this approach is to limit potential for corruption and to increase the probability of detection of corrupt practices. The following areas should be addressed.

Code of Conduct

The cornerstone of any anti-corruption strategy for a tax administration must be the adoption of a Code of Conduct or Code of Ethics. The Code should preferably contain three important provisions:

1. First, the Code should explicitly identify those acts that would require the automatic imposition of the most severe sanctions, i.e., termination of employment[390].
2. Second, the Code should stipulate that the immediate supervisor of an officer found to have committed the most severe violations of the Code should also be subject to an appropriately severe penalty in cases where the supervisor knew about the violation but failed to report it, or

388 IT for tax administrations is discussed in Chapter 12.
389 Training is discussed in Chapter 14.
390 Harsher sanctions, such as incarceration may be specified in the tax code or the civil service code, but will not be part of the code of conduct.

where the supervisor should have known about the violation if he/she had been exercising proper supervision.

3. Third, all officers should be required to sign some sort of form acknowledging that they have reviewed the Code and have understood its requirements.

It is insufficient, however, merely to adopt a Code of Conduct. There must be appropriate sanctions developed for violations of the Code, which may range from a warning letter to temporary suspension of an employee, dismissal, and referral for criminal action. There must be certainty within the administration that violations of the Code will be sanctioned appropriately. Corrupt employees must be detected, removed, and prosecuted.

The Code of Conduct is the high level regulation, to which all employees must adhere. Supplementary conduct policies that provide significantly more detail on how employees are expected to behave should also be adopted.[391]

The supplementary policies should cover four main areas:

- Behavioral norms around issues, such as: handling taxpayer complaints, disclosure of official identity, confidentiality of information, falsification of official records, conflict of interest, interaction with taxpayers, and off-duty conduct. In addition, there should be guidelines concerning the work environment, including areas like cleanliness, proper attire, behavior and attitude, punctuality, loss or damage to official property, and others;
- Personal conduct relative to: accepting gifts, personal fund raising, lending and borrowing, private employment and outside interests, use of government accommodations, political activities, expressing political views, membership in associations, non-discrimination, and responsibility for personal finances, among others;
- Definitions should be given for, as examples, (a) misconduct and conflict of interest, the latter of which should include circumstances under which an employee must disqualify him/herself from specific assignments, (b) recommending attorneys and accountants, (c) transactions with taxpayers or representatives, (d) purchase of seized goods, and (e) association with persons connected with illegal activities, etc.; and
- Enforcement for breaches of the Code, as well as grievance procedures.

Action must be taken to disseminate these supplementary procedures to all employees, in conjunction with a vigorous program of education on ethics and integrity.

Disclosure of Assets/Income

Given the public perception that corruption is likely to be more prevalent within the tax administration and Customs than other parts of government, some countries have adopted an approach whereby

[391] A model Code of Conduct that includes these primary clauses and supplementary procedures was developed by the Inter-American Center of Tax Administrations (CIAT) (2005), *Model Code of Conduct.* http://www.ciat.org/index.php/en/products-and-services/publications/models.html)

either senior management only, or senior management and all technical staff are required to submit an annual declaration on their income and assets. This declaration would normally include assets and income of close family members.

These disclosures may either be held open for public scrutiny, retained confidentially for internal use, or sealed and only opened when a charge of corrupt practice is leveled against the individual.

Employment Conditions

Although personnel matters are usually given less attention than technical matters, ignoring the former may handicap the tax administration. Staff from the top to the bottom need to have a degree of job security and know that the organization has fair personnel policies. Unfair practices will only further alienate discontented staff, who may then use a perceived lack of fairness as a justification for unethical behavior.

New appointments to the tax administration should be based on competence and an assessment of candidates' skills and integrity, taking into account their personal history and work record, including background checks, as appropriate. The quality of managers, tutors, and mentors is a vital element in setting new hires off along the right road. In the absence of adequate selection processes and training, there is a risk that a lack of integrity will develop in new recruits.

A further guiding principle is the need for an appraisal system that provides a basis for rewarding staff according to performance, and not just according to revenue-driven targets. At the root of this system, the tax administration needs to establish an organization-wide set of balanced performance measures, not restricted to monetary collection targets. These measures should flow down to individual officers through an annual performance review, predicated on agreed objectives and targets established at the beginning of the review period.

Professional advancement within the administration must be based exclusively on merit and qualifications, free from political influence and private connections. In any tax administration, there must be a clear career path for officers to permit staff to have a realistic view of potential advancement.

It is equally important that staff have a sense of organizational belonging, with an emphasis on professionalism. If there are staff within the organization that do not have a clear career goal of their own, and are also not interested in the goals of the organization, then integrity is likely to break down. Integrity depends on the objectives and goals of the organization. If these are not met, there will likely be an integrity problem.

Finally, but importantly, and also one of the most difficult administrative barriers to change, is the necessity to compensate tax officials fairly. Paying competitive salaries in the tax administration should be part of any government's anti-corruption strategy in order to remove incentives for corruption. Low base salary levels are frequently cited as a major cause of the spread of corruption in a tax administration. One way this risk can be alleviated is by pegging the salaries of its tax officials to those for similar jobs in the private sector.[392] This, however, does have consequences across the wider civil service and will prove to be a challenging hurdle to countries in tough economic times.

Internal Audit

The internal audit function should play a dual role on behalf of the head of the tax administration:[393]

- It conducts system audits of all administration offices and operations and advises management on loss prevention and ways to improve efficiency through risk analysis and other means; and
- It is charged with the detection, investigation, and prevention of corrupt practices by employees and taxpayers seeking to corrupt employees.

It is very important, however, that the presence of an internal audit function within the organization is not seen by managers as them being absolved of their responsibility. Indeed, this could become a concern, because the development, maintenance, and enhancement of integrity in the widest sense are essentially a management and operational responsibility. Internal audit supports the management in this responsibility.

Part of the internal audit function is an investigative service that ensures the maintenance of the highest standards of honesty, integrity, loyalty, security and conduct among tax administration employees and that protects its integrity of from attack by outsiders who seek to compromise it through attempted bribery or other illegal or improper acts. This Integrity function has responsibility for planning, developing, conducting, and controlling activities designed to protect the integrity of the tax administration and discharges this responsibility through character and security investigations of employees of the tax administration and through investigations of charges of improper conduct and irregularities on the part of the administration's officials and employees, including:

- Criminal misconduct and serious administrative misconduct by tax administration employees (such as bribery, embezzlement, disclosure or unauthorized use of tax information and conflict of interest);
- Attempts by those outside the organization to corrupt or unlawfully interfere with tax administration operations through bribery, threats or assaults;
- Actions by persons that may affect the safety of Tax Administration personnel;
- Unauthorized disclosure or misuse of tax information;
- Charges against tax practitioners; and
- Extremely confidential investigations of complaints and allegations of misconduct or irregularities concerning high-level officials of the tax administration.

The integrity function also has responsibility for conducting background investigations on tax administration job applicants and appointees and formal investigations of accidents involving tax

[392] Chapter 3 discusses the fact that some tax administrations have been able to pay competitive salaries after becoming semi-autonomous revenue authorities.
[393] Internal audit is discussed in Chapter 16.

administration personnel or property. This investigative service would also conduct probes and tests of high-risk integrity areas to detect corruption involving personnel and activities and use the information developed in these probes and tests to alert managers and employees to potential hazards.

17.1.3. Transparency and Standards Approach

Ultimately, the success of any tax system depends on the population's perception that the system is being administered in a fair and equitable manner. In broad terms, fairness in tax administration requires a balance between the rights of taxpayers and the powers of the administration, as well as consistency in the application of the tax laws. The specific rights of taxpayers must be made a part of the tax code or tax laws, as noted in Chapter 3 and in section 17.2.2 below, and such rights must be publicized often by the tax administration in public information documents and activities.

Transparency and Certainty

All decisions of the administration must be based on objective rules, regulations, and procedures that must be published, disseminated broadly, and readily available to the public and tax practitioners.

Transparency and certainty in the administration can be achieved by providing the taxpaying public with an understanding of the tax laws and the obligations they entail. The administration is, therefore, expected to provide the services and education taxpayers need to comply with their obligations – user-friendly guides, information brochures, inquiry services, seminars, and interpretation of the tax laws, etc.[394]

The administration must adopt a goal of customer service. To do so means to cultivate its clientele as would a private entity trading in goods or services and dependent on its customers for survival. For customer service to be successful, it must be conducted in an atmosphere devoid of subjective or covert motivation and, therefore, requiring the organization to adhere to the highest degree of integrity in its operations.

Objections and Appeals

In any system, there must be checks and balances. Otherwise, the system can be manipulated to the advantage of one person or organization. The work of the tax administration is no exception and must be subject to oversight. The role of the appellate function cannot be underestimated, as this function plays a major part in influencing the public image of the tax administration. The appellate function should allow a taxpayer to take their appeal on a point of law as far as the highest court in the land. This is a guarantee that a fair hearing will be given to all appeals by the taxpayer.[395] Appeal cases put the work of the tax administration under a microscope. The public, in reading these cases, is able to see if the work carried out by the administration was in accordance with the set policies of the organization. The tax administration must be aware that its work is subject to review and that its fairness, transparency, and professionalism will be judged by the public.

[394] Taxpayer services are discussed in Chapter 6.
[395] Objections and appeals are discussed in Chapter 11.

All decisions and/or actions of the administration must be subject to complaint, as appropriate. The process whereby complaints from taxpayers are dealt with must be characterized by impartiality and strict adherence to law and regulation.

These external functions are important because they:

- Provide for public transparency, operational feedback, some measure of integrity, and opportunities to correct mistakes;
- Identify potential wrongdoing and lessons to be learned;
- Salvage public reputation;
- Improve client service and integrity; and
- Test operational accountability.

Box 17.1. Tax administration integrity in Georgia

USAID's anti-corruption efforts in Georgia in the late 1990s began with the establishment of Georgia's Public Defender – an independent institution charged with protecting human rights. The institution received significant USAID funding to bolster the professionalism of its staff. During 2001-2005 USAID's Rule of Law project encouraged access to public information, assisted in drafting procedures for various governmental institutions, and helped non-governmental organizations obtain access to laws. The 2005-2009 USAID Business Climate Reform project provided for significant simplification, standardization, and automation of processes in the tax, commercial law, and business regulation arenas. In the first World Bank/EBRD Enterprise Survey of Georgian companies in 2002, 82.5 percent of the companies reported that they were expected to give "gifts" to tax officials. In 2008 this number was reduced to 8.4 percent.

Public Outreach Activities

Once the tax administration has sufficient systems and safeguards in place internally, it makes sense to communicate this fact to the public and get their buy-in for any anti-corruption strategy. This can be done by communicating the steps taken by the administration to reduce the scope for corruption and by encouraging the public to report any instances of inappropriate behavior by tax officials. Conversely, taxpayers should be warned of the consequences for offering a bribe or seeking to corrupt a tax official.

Consideration should also be given to the idea of establishing a telephone number where taxpayers and tax officials can report violations of the Code of Conduct. To be effective, the number should be publicized widely and any complaints properly processed. Complaints should be anonymous. If complaints are not anonymous, feedback should be given to the person who lodged the complaint.

In addition to an employee’s daily assigned task, each employee has an important public relations role to play. Not only must each employee act with complete propriety, he/she must also be sure that none of his/her actions can be interpreted otherwise. Courtesy, fairness, and competence must mark all of the tax administration's relationships with the public. The administration's employees must be reasonable and as ready to recognize the rights of citizens as they are to protect the rights of the government. Employees that demonstrate this type of attitude will build public esteem and make a major contribution to realizing maximum voluntary compliance among taxpayers. The effectiveness of the tax administration in serving the public interest depends upon the extent to which it and its employees hold the confidence and esteem of citizens. This means that each employee must do his/her part to maintain this confidence and esteem by:

- Performing his/her duties conscientiously, courteously, and in the most effective manner possible;
- Conducting himself/herself during and outside working hours in a manner which will bring credit to the tax administration; and
- Observing the spirit, as well as the letter, of the laws and regulations and internal requirements governing employee conduct.

17.2. Common Trends

Fighting corruption and ensuring the integrity of a tax collecting organization has been a challenge since Roman times! Time has taught both parties to the transaction – the taxpayer and the tax administration – that continuous improvement in all steps of the process is the only way that gets them closer to the ideal where the right tax is paid at the right time by the right person. Technology has certainly brought significant change and improvement and most tax administrations have embraced these trends. Other successful trends are included above. The few noted below are those additional areas that will continue to strengthen the fight against corruption for a fair and professional tax administration.

17.2.1. The Power of Information

In a knowledge society, information is power. Enshrining in law the right of the citizen to information provides an incentive to the tax administration to maintain high standards of integrity. This effectively empowers citizens on the one hand and, on the other, instills fear in the minds of wayward tax administrations regarding any wrongdoing on their part. Many countries have now enacted or adopted something along the lines of a Freedom of Information Act. Such a law empowers citizens to demand information from the government about the details of any action taken or not taken. This type of legislation has forced many tax administrations to promote greater transparency and accountability in their operations.

17.2.2. Citizen / Taxpayer Charters

Even more specific to the tax administration is the adoption of a Citizens or Taxpayers Charter, which is meant to clearly articulate not only the powers and responsibilities of the tax administration, but also the rights and obligations of the taxpayer. It is, in other words, a universal contract between the tax administration and the taxpaying public. The Charter spells out well-defined and objective criteria for various tax actions, which impact the public on a regular basis, so as to encourage fairness, accountability, and efficiency in the tax administration's operations. The Charter may also mandate that the tax administration adhere to time limits for certain actions – e.g., responses to written communications must be sent within 15 days, complaints and grievances must be redressed within 30 days, tax refunds must be issued within 30 days of determination, etc.

17.2.3. Ombudsman

Establishing an (Tax) Ombudsman office facilitates additional oversight of tax officials' behavior. An Ombudsman is a trusted intermediary between the state and its citizens. An Ombudsman office can be set up to handle complaints about or to the state, but must be established in a way that the taxpayer feels comfortable that individuals assigned to this position are independent of the state and the tax administration. A wholly independent office of the Ombudsman affords the opportunity to the general public to file complaints of harassment or corruption, with the reassurance that any genuine complaint will be promptly redressed.

17.3. Tax Administration Maturity

As in other chapters, this section presents a four-level model to allow interested officials to self-assess the general level of maturity of the tax administration with regards to issues of integrity, using "rules of thumb" to assess strengths and weaknesses. Of course, a specific tax administration may find that it fits the characteristics of several of the levels below. In this case, the tax administration may be in transition from one maturity level to another.

Integrity: Maturity Level 1

Key word: "Opaque"

- Relationships with public and private sector institutions are lukewarm, at best, and even border on hostility in many cases.
- There is a substantial lack of legal/regulatory institutions, modern tax policy, civil service rules and regulations for attracting and retaining qualified staff, international accounting and professional standards, and modern financial and banking standards and institutions.
- Significant evidence (albeit much hearsay) points to endemic corruption across all levels and aspects of tax administration, and particularly in the audit function.
- There are no formal complaints made by taxpayers against the administration, and there are no investigations of corrupt practice.
- The process of appointing staff to the tax administration is opaque.
- The tax dispute resolution system is not formalized and, therefore, not effective or objective.

Integrity: Maturity Level 2

Key word: "Hot-and-cold"

- "Hot-and-cold" efforts by top-level officials to establish good relationships with some public and private sector groups – particularly with Customs and public accountants – are initiated but lack coherence and stability.
- There is still a substantial lack of legal/regulatory institutions, modern tax policy, civil service rules and regulations for attracting and retaining qualified staff, international accounting and professional standards, and modern financial and banking standards and institutions.

- Taxpayers and the public remain wary of complaining against the tax administration and its employees despite a more open approach by the latter.
- A rare scapegoat for government corruption is investigated, convicted, and punished.
- The tax dispute resolution system is still not formalized and, therefore, not effective or objective.

Integrity: Maturity Level 3

Key word: "Comfortable"

- Relationships with public and private sector groups are usually positive – e.g., memoranda of understanding with Customs for exchange of data are generally successful, as are forums for public accounting and Chamber of Commerce groups, etc. However, there are exceptions, such as less than cordial relationships with the judiciary or other groups.
- There is a fair degree of development of legal/regulatory institutions, modern tax policy, civil service rules and regulations for attracting and retaining qualified staff, international accounting and professional standards, and modern financial and banking standards and institutions;
- The tax administration has started to embrace many technological advances used in the private sector, such as electronic commerce, interactive telephone systems, and the capture of data by the scanning or imaging of paper documents.
- A formal Code of Conduct/Ethics has been embraced by the tax administration, and staff have undergone one-off ethics training.
- Taxpayers feel comfortable making a complaint directly to the tax administration against the organization or an official without fear of reprisal.
- An effective internal audit function is responsible for investigating allegations of corrupt practice.
- An effective, fair, and objective tax dispute resolution system is in operation.

Integrity: Maturity Level 4

Key word: "Ethical"

- Relationships with public and private sector groups are very positive – e.g., memoranda of understanding with Customs for exchange of data are very successful, as are forums for public accounting and Chamber of Commerce groups, etc.
- There is a high degree of development of legal/regulatory institutions, modern tax policy, civil service rules and regulations for attracting and retaining qualified staff, international accounting and professional standards, and modern financial and banking standards and institutions.
- The tax administration regularly uses technological advances, such as electronic commerce, interactive telephone systems, and the capture of data by the scanning or imaging of paper documents.
- Tax administration staff receive ongoing ethics training, and senior officials are required to file annual income and assets statements.

- An Office of the Ombudsman has responsibility to investigate complaints against the tax administration.
- An effective, fair, and objective tax dispute resolution system is in operation.

17.4. Latin America and the Caribbean

Although there has been much focus on tax administration reform in Latin America and the Caribbean (LAC) over the past decade, it has primarily emphasized the need to raise revenues. With budgetary constraints, as in many other countries around the world, and with much focus on audit by external governmental bodies as discussed in Chapter 16 (Internal Audit), it is not surprising that "integrity" is a relatively new concern for most tax administrations in LAC. Thus, with respect to the integrity enabling principles described above, LAC countries vary greatly. The following are examples:

- *Administrative burden of paying taxes:* According to the 2013 World Bank's Doing Business survey[396], LAC countries are quite evenly distributed with respect to "paying taxes", with Chile ranking 36th, Venezuela ranking 185th, and other countries ranking throughout the interval. Caribbean states average in the middle with a rank of 100. Although countries have focused much on simplification, including through presumptive regimes, much of it has resulted in tax base erosion.
- *Organizational structure and employee conditions:* It is clear that many LAC countries (over 80 percent[397]) have appreciated the benefits of and already moved to a functional organizational structure, which is noted above as one of the fundamental approaches to reduce the scope for corrupt practice. Interestingly, as was noted in Chapter 3, in recent years, LAC countries have been on the forefront of establishing semi-autonomous revenue authorities (SARAs).[398] At a recent conference, the IMF listed a number of reasons that are typically provided to justify SARAs, including increased efficiency, increased pay, and reduced corruption.[399] Again, these latter two justifications are moves to improve the overall integrity of the organization. However, the IMF also noted that, although SARAs tend to increase public confidence in the tax administration and may contribute to better pay of tax administration staff, there has not been conclusive evidence of other improvements.
- *Automation:* LAC countries have also introduced new technology that can help reduce the scope for corruption. Computerization is another fundamental approach to ensuring integrity, and there has been a lot of focus recently on automation through IT in LAC countries as discussed in Chapter 12, with many successes and a number of failures. However, in addition to being costly, simply automating tax administration processes is insufficient. Without improving in the other key areas noted above, LAC countries are unlikely to advance on the integrity front due to the use of IT alone. As evidenced by CIAT analysis,[400] taxpayers in many LAC countries still have

[396] World Bank (2013), p. 52.
[397] USAID's Collecting Taxes Database, egateg.usaid.gov/collecting-taxes.
[398] Mann (2004), p. 1.
[399] Kloeden et al. (2012), p. 6.
[400] Inter-American Center of Tax Administrations (CIAT) et al. (2012), para. 246.

limited access to technology. Furthermore, as discussed in the World Bank's Doing Business survey, rather than advancing simplification, a number of LAC countries have recently introduced reforms that add complexity to the tax system, which is a major impediment to reaping the benefits of automation.

- *Code of Conduct:* While some countries (e.g., Argentina, Brazil, and Mexico) have adopted some service delivery standards, many others have not. In addition, in some cases (Argentina), such standards are not made public.
- *Promoting integrity:* Brazil’s federal tax authority, the Secretariat of Federal Revenue, has been a leader in enhancing public sector integrity, not only in Brazil, but across North and South America. For example, it participated within CIAT in the development of a manual on internal audit in tax administration (together with Argentina, Bolivia, Chile, Costa Rica, Spain and the United States) and a model code of conduct for tax officials (together with Argentina, Canada, Peru, Spain, and Trinidad and Tobago). These activities are considered by senior Brazilian federal tax officials to have positively shaped practices within their own organizational management systems.

Finally, it should be noted that, while the donor community has financed a wide variety of programs in LAC aimed at improving public sector management and promoting greater accountability and transparency in government, there is limited empirical evidence about the degree of integrity in developing countries.

Box 17.2. Tax administration integrity in Brazil[401]

Brazil’s federal tax authority, the Secretariat of Federal Revenue (*Secretariat)*, has been a leader in enhancing public sector integrity in Brazil. This reflects a growing awareness in Brazil for the need to enhance integrity, and not just the efficiency of revenue collection, as part of efforts to modernize the federal tax administration and promote fiscal legitimacy. Enhancing integrity in Brazil’s federal tax administration can support formal business activities, investment, and economic growth. Accordingly, the Secretariat is focusing its future integrity enhancements across three main strands: (1) the promotion of transparency and taxpayer rights, (2) implementing a risk-based approach to internal control activities, and (3) embedding high standards of conduct within the organization.

With a view to promoting transparency and taxpayer rights, the Secretariat plans to extend the information, data, and reach of its Federal Revenue Transparency Page and its Transparency Portal. It is also undertaking a wider consultation exercise with a view to enhancing its current Citizens Charter, as well as taking steps to publish the results of the qualitative and quantitative service standards set out in the Charter.

The Secretariat is also examining how it approaches risks to the organization by, initially, centralizing responsibility for conducting operational risk identification within the Internal Audit Unit (IAU). By mapping the current business processes, the Secretariat will be able to better identify the causes and effects of the operational risks identified. These actions will allow the Secretariat’s IAU to significantly improve its operational risk management.

The Secretariat has identified that ethics and integrity training is not a ‘one-off’ solution and that its staff requires periodic reinforcement of the standards of conduct expected for federal tax employees. It also plans to establish a mechanism to better evaluate and monitor these standards.

[401] OECD (2011).

17.5. Key Benchmarks and Guidelines

In general, the integrity of the tax administration will mirror the legislative, administrative, and social change of the country. As a country's governance structure matures and improves, the integrity of the tax administration will likely follow the same path. In fact, in some developing countries, tax administrations lead all government agencies in status and are viewed by the general public as the most professional, ethical, and corruption-free.

The sub-sections of this chapter have provided some detail on the conditions and infrastructure that should be in place to reduce the opportunity for corrupt practice as much as possible. However, systems will fail in the absence of proper leadership across the organization.

The most important factor in bringing about the necessary improvements in all aspects of integrity is the quality of leadership provided by all managers. Senior management should demonstrate commitment and firm leadership in the drive to create and maintain integrity within their organization, and they should give out a consistent message to their staff – in other words 'practice what they preach.' There is always a risk that senior management will become too distant, devoting too much time to administration or strategy when their greatest value is in working closely with operational staff to ensure that they maintain high standards of integrity in their work. For leadership to be effective, greater efforts are required to close the communication gap between all levels of management, and senior management should take every opportunity to ensure they are visible and accessible, such as by making regular visits to the workplace.

The following points summarize the key features and control and performance management functions that impact directly on integrity and affect public confidence, most of which have been mentioned above in greater detail. These present some key areas which should be visible and where further inquiry may be warranted to test performance of the administration and to pinpoint areas for improvement:

- Effective leadership and senior management commitment (including risk management);
- Good communications between staff at all levels;
- Clear contract/terms and conditions of employment;
- An accessible and clear Code of Conduct and set of organizational values, with sufficient detailed supporting guidance (including confidentiality and the integrity of information; dealing with gifts, gratuities, and hospitality; handling conflicts of interest; political activities; and management of the risk of internal fraud);
- Ensuring the integrity of new recruits and appointees through background checks and/or other methods, where appropriate;
- Ensuring new recruits to the organization are given a thorough induction on integrity requirements;
- Technical and soft skills training and professional development;
- Performance management, including the regular assessment of performance and behavior;
- Monitoring and maintaining integrity;

- Procedures for reporting or raising concerns, including internal grievances and "whistleblowing";
- Discipline and criminal referral policies and procedures; and
- Governance and effective internal investigation arrangements.

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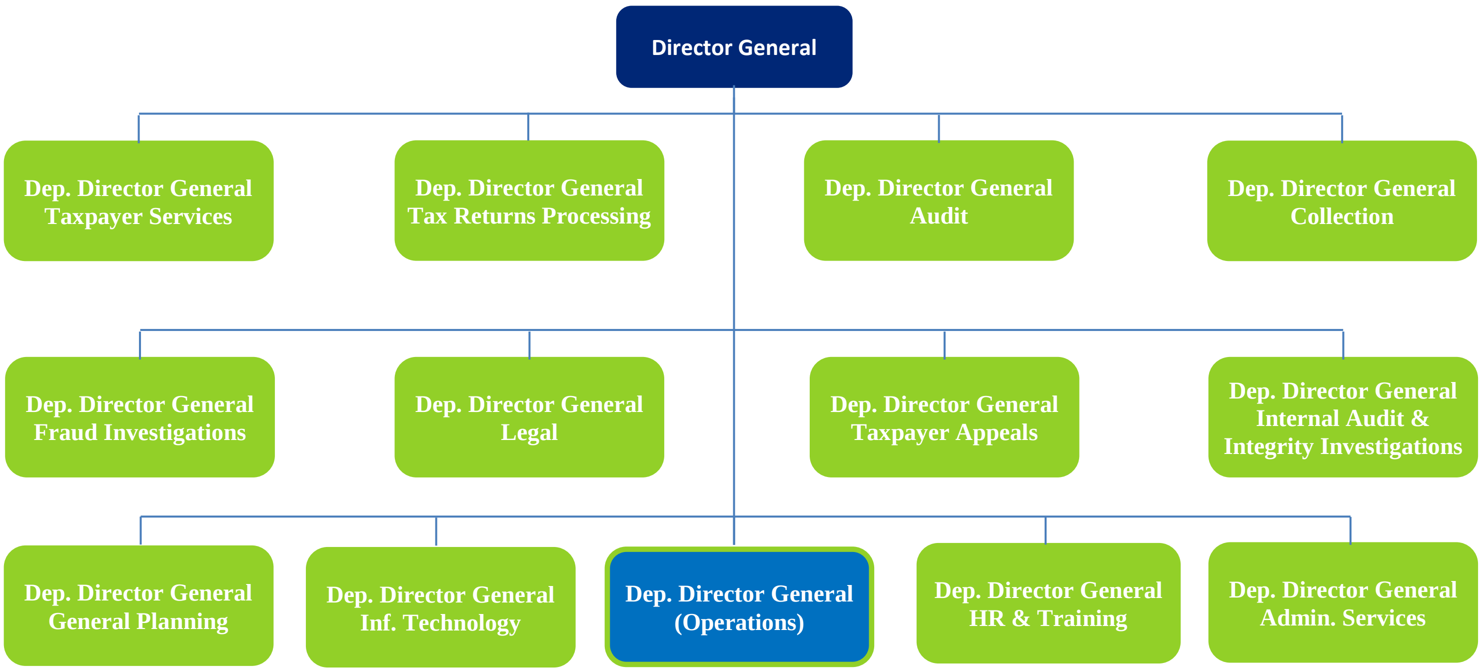
Appendix 4.A. Medium or Small Tax Administrations[402]

Figure 4-A.1. Headquarters office of a medium or small tax administration



[402] Source: author.

Figure 4-A.2. Operations structure of a medium or small tax administration

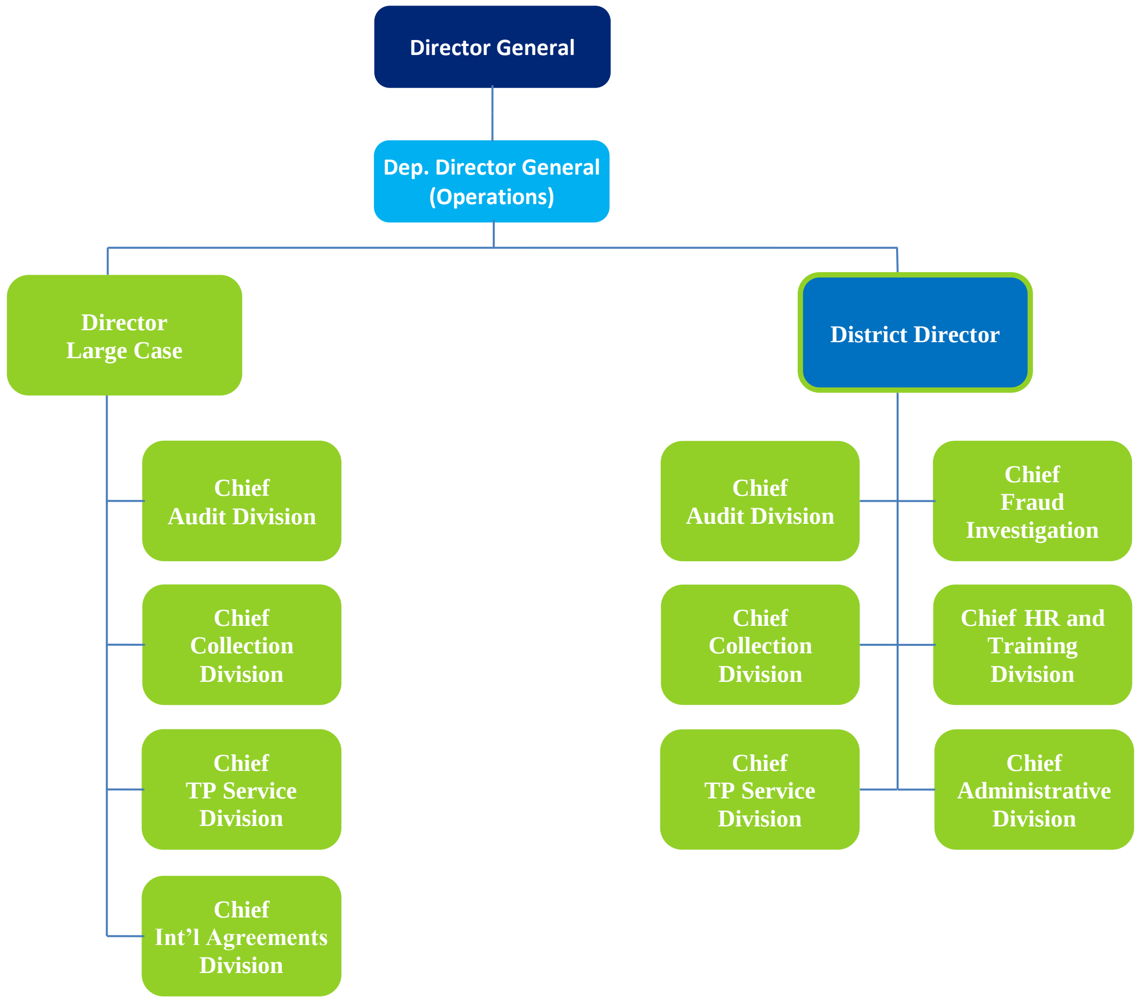
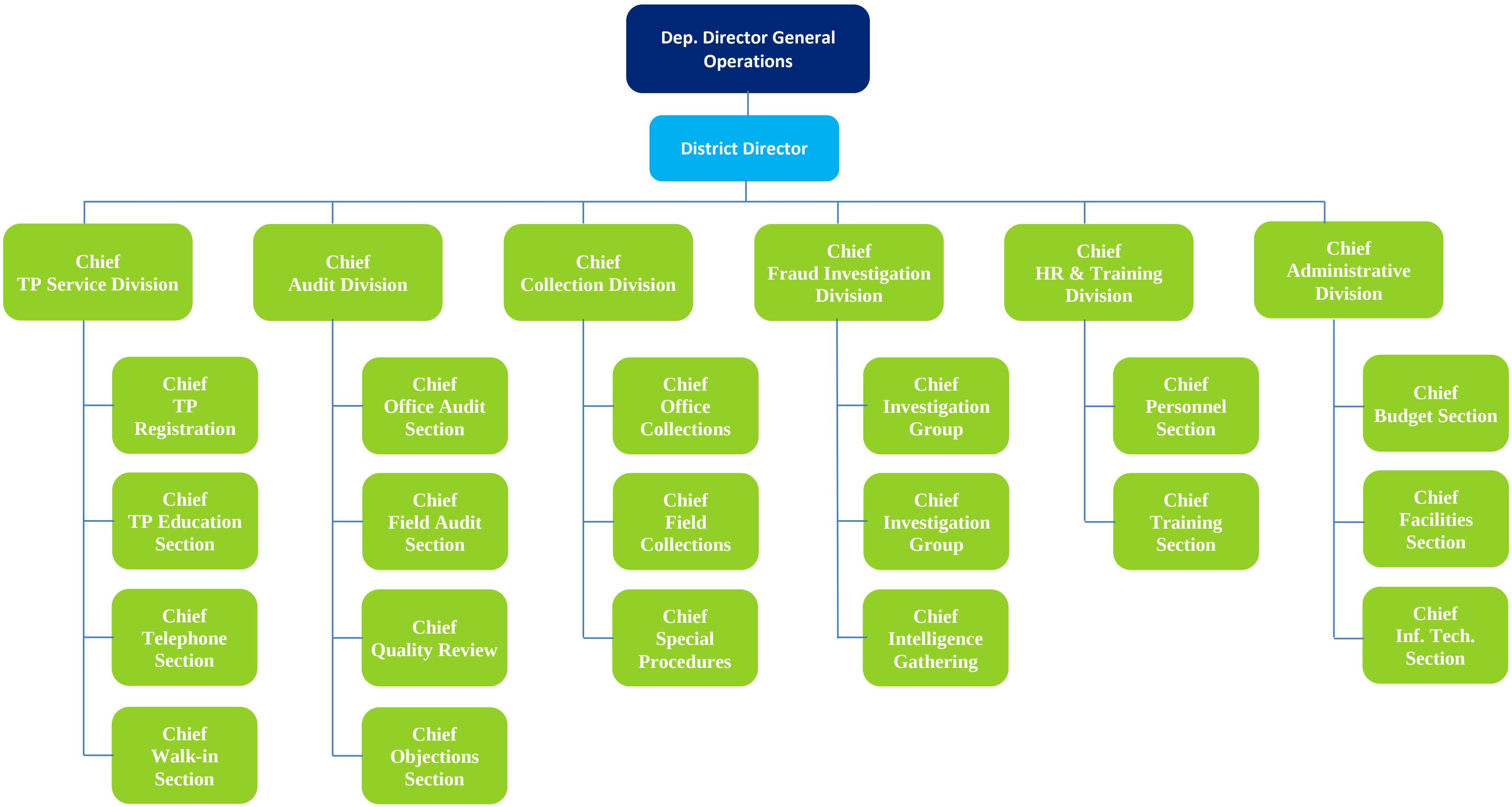
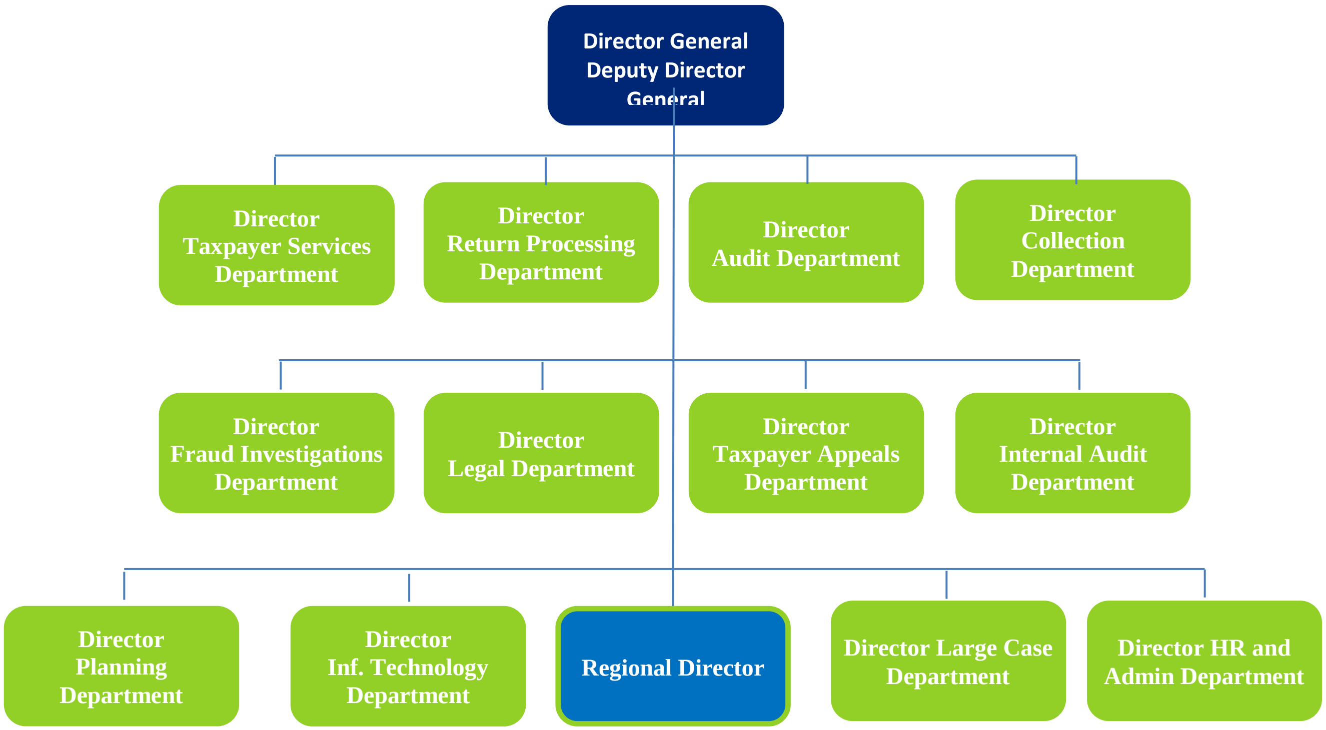


Figure 4-A.3. District/field office of a medium or small tax administration



Appendix 4.B. Large Tax Administrations[403]

Figure 4-B.4. Headquarters office of a large tax administration



Note: Tax policy units are not included in the organizational charts, despite the fact that tax administrations of many countries have them. Tax policy unit staff is comprised of public finance economists, tax attorneys, statisticians, modelers, and computer specialists, who undertake a wide range of studies on policy issues directed toward changing the structure of tax laws to achieve fairness, efficiency, and simplicity and propose new tax legislation or amendments to existing tax legislation through the Ministry of Finance. As such, tax policy units should not be a part of the tax administration, but should instead be placed at the Minister of Finance level, under a Permanent Secretary or Deputy Permanent Secretary. Nevertheless, tax administration officials, who apply the theories in nuts-and-bolts operations, are the ones who experience the effects of tax policy at the implementation level.

[403] Source: author.

Figure 4-B.5. Regional office of a large tax administration

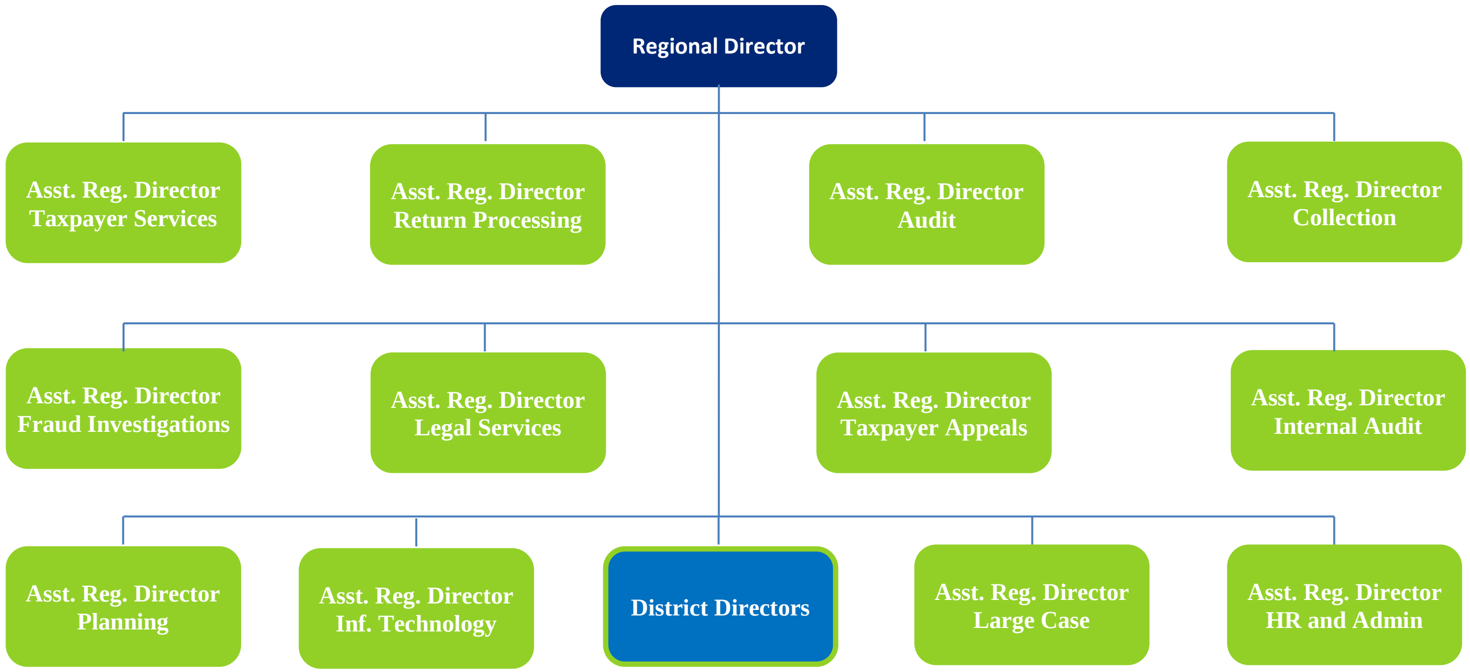
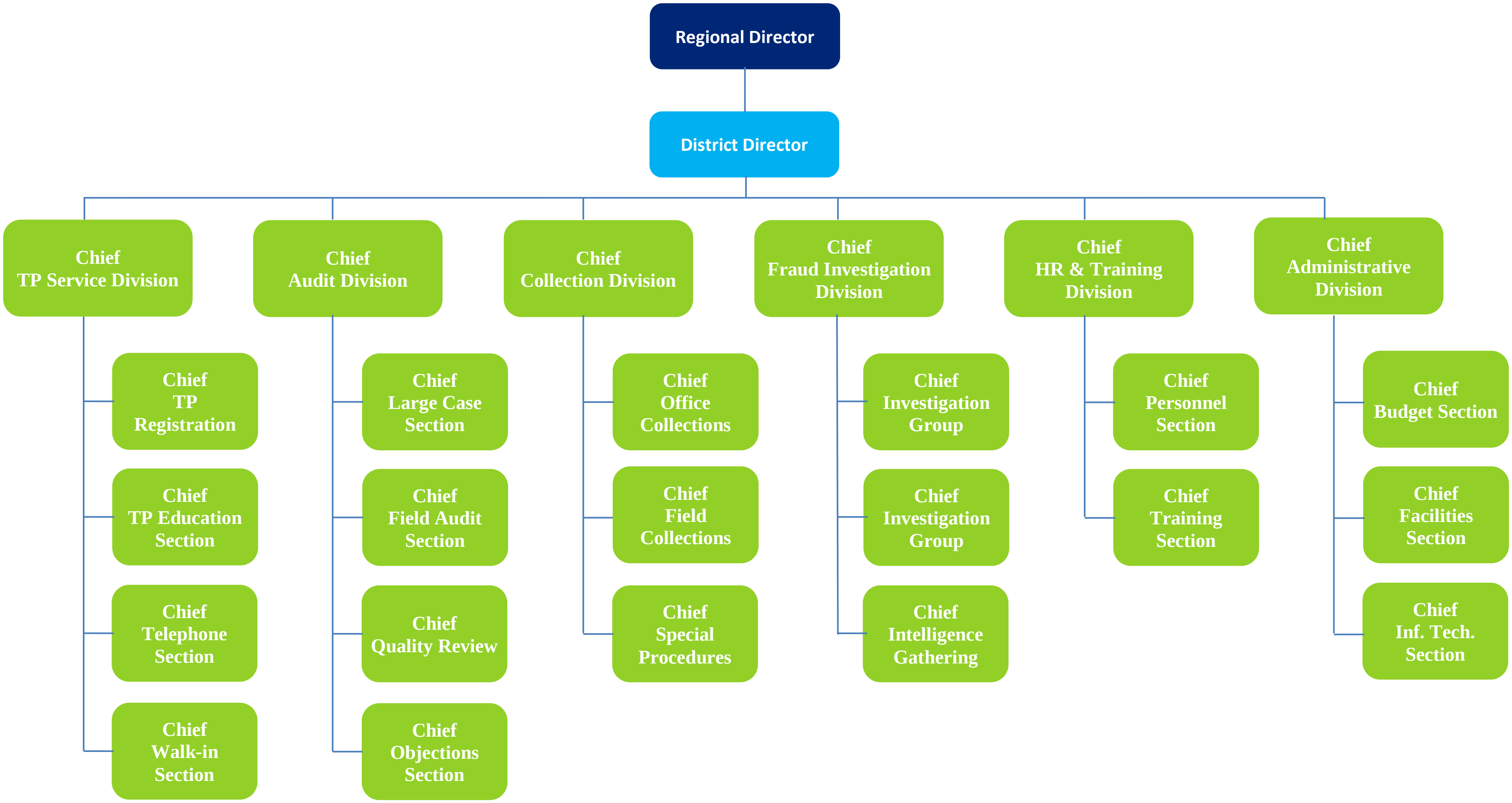
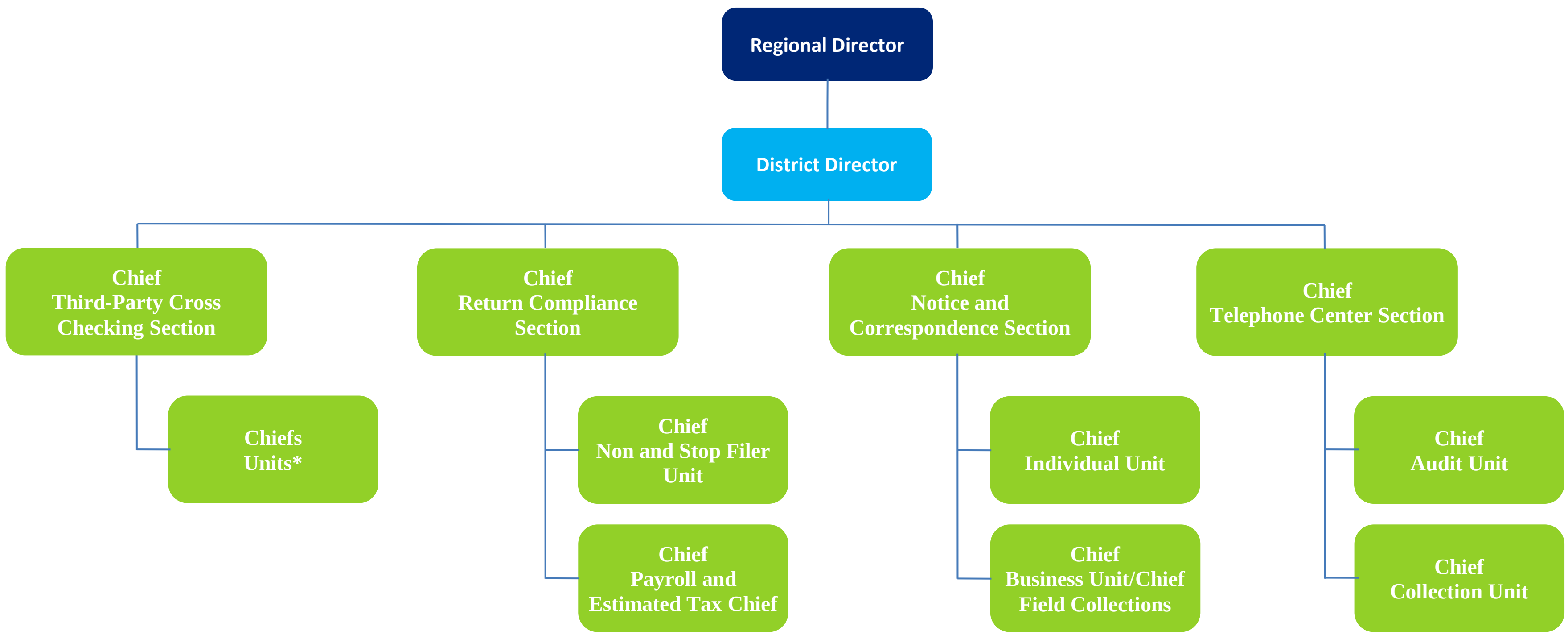


Figure 4-B.6. District/field office of a large tax administration



Appendix 4.C. Fiscal Compliance Division

Figure 4-C.7. Typical centralized fiscal compliance division[404]



Note: Each unit is responsible for different type of third-party data.

[404] As proposed by BearingPoint, Inc. to the Puerto Rico Department of the Treasury.

Appendix 7.A. VAT Refund Fraud

Types of Refund Fraud

Briefly, there are several methods and schemes involving false identities and identity VAT frauds such as:

- Creating or stealing a person's identity for the purpose of submitting false claims for refunds and rebates (e.g., filing of false individual income tax returns using false information and documents);
- Using false and stolen identities to set up businesses with the sole purpose of committing income tax and VAT refund fraud. These false and stolen identities can be used to set up a business that appears to be legitimate with even a legitimate corporate registration with another branch of government;
- Creation of an identity on the basis of a stolen/fraudulently used passport or other major source of identification, such as the documents found in a stolen wallet or purse. This "acquired" identity is used to obtain a national identification number, which in turn is used for tax or business registration, opening bank accounts, printing invoices, etc.;
- Hijacking a taxpayer's identity by a tax officer, who then uses it to commit fraud; and
- Filing a claim by a tax officer for a person who does not exist, taking advantage of the system by staying under the various internal thresholds that would trigger an audit.

In the United States, the problem is growing where the IRS has identified the numbers of identity theft cases[405] that have affected the tax system: 51,702 incidents in 2008, 169,087 incidents in 2009, and 248,350 incidents in 2010. In 2012, the IRS listed identity fraud as the largest type of tax fraud, and, in 2011, the IRS intercepted more than $1.4 billion[406] of tax refunds being paid out due to identity theft.

Identity theft cases occur because of:

- The inability of a tax administration to share information with other law enforcement agencies because of the confidentiality provisions of the tax law; and
- The elapsed time between paying a refund and identifying a fraud makes it difficult to find the perpetrator of the fraud.

Building on the false identity frauds described above, there is a potential for at least four different types of VAT refund fraud that can arise either with or without with the collusion of tax officials:

- In the least complex fraud, a fictitious company creates invoices from false, nonexistent, or fictitious suppliers, which are then used to request and obtain VAT refunds even though the company has not physically done anything at all;

[405] GAO 2011, p. 2.
[406] Internal Revenue Service (2012), para. 9.

- A slightly more complex and harder to identify fraud is where a series of false companies are created. These false companies generate false invoices selling to each other and ultimately the goods are claimed to have been exported. When checking to ensure a supplier is registered, the auditor will see a valid registration, and even a good compliance history of returns filed on time;
- A bona fide company can purchase inputs or services without any tax invoices by negotiating a cash deal and thus avoiding paying tax on these inputs. The supplier suppresses the cash sale but claims the input tax. The purchasing company then uses false invoices from false, nonexistent, or fictitious suppliers with inflated tax amounts to request VAT refunds; and
- A bona fide company may buy goods or services but sell them in the domestic market instead of exporting them, while using the invoices to obtain VAT for exported goods.

"Missing trader fraud" builds on the above types of fraud and is probably one of the more prevalent forms of VAT fraud.

Box 7-A.5. Missing trader fraud

Missing trader fraud takes advantage of a structural flaw in the system of accounting for VAT. Importers are required to account for output VAT to the tax administration on their purchases from local traders. Exporters are able to reclaim input VAT paid on purchases, but are not required to account for VAT in respect of the goods exported, since these goods are zero-rated. If goods that are imported into a country are subsequently exported by a different person, the overall VAT position should be essentially neutral. However, perpetrators of fraud can exploit timing gaps in tax return and refund processes. Many administrations process and pay VAT refunds quickly, with some paying within 30 days of receipt, whereas for domestic sales it is frequently the situation that the return for any given month is due anywhere from 15 days following the close of the month, in which the taxpayer became liable to collect the tax, to a month later. If a taxable domestic sale was made on the first day of the month, the taxpayer has almost two months before it must be reported in many instances. This provides the opportunity to claim a refund as though the goods were exported, not remit the tax on domestic sales, and collect the full amount from the domestic customer before disappearing. This type of fraud can be a one-off using the bogus registration for a single, relatively large fraud (but still below the limits that would freeze the payment until an audit has been conducted), or it can be repeated for many months, with the fraudster disappearing only when the tax administration calls for records.

Unfortunately, the tax administration is generally late discovering a missing trader fraud. The refund(s) has been long since paid, and they may only just be in the early stages of notifying the VAT refund claimant that an audit is being conducted. Often, the suppression of taxable domestic sales not being reported goes unnoticed for a considerable period. The use of a false identity makes the fraud extremely difficult to trace.

All tax administrations face fraud. For example:

Canada: False and stolen identities have been used to set up businesses to commit goods and services tax (GST) fraud and to file false income tax returns to take advantage of refund programs under both taxes. Initially, the registration system for GST was lax, allowing a taxpayer to register over the telephone and, due to an overwhelmed system during the early years of the GST, the verification of these registrations was minimal. The Canada Revenue Agency has since instituted a series of internal verification procedures on registration applications.

South Africa: In a sophisticated and large fraud scheme, duplicates of well-known companies were set up with the Companies and Intellectual Property Registration Office (CIPRO). Bank accounts were then set up in the duplicates' names by individuals using fraudulent company and identity documents obtained from CIPRO. Members of the syndicate then hacked into the central South African Revenue Service (SARS) system. The bank account details of the legitimate companies were changed to those of the duplicates. When SARS paid out tax refunds these went to the accounts of the duplicate companies, not the real ones.

Fraud Detection

Countries are devising methods to detect refund frauds and most use a combination of intelligence gathering, risk analysis, risk profiling, and data matching to detect cases of tax fraud. Fraud investigations are addressed in detail in Chapter 9, and the following are examples specific to refund fraud:

- Verifying the integrity of registration information against risk criteria, such as checking registered taxpayers that do not appear to have the income to start a business or appear too young to start a business;
- Using specialized database searches looking into relationships and commonalities between taxpayer accounts (addresses, phone numbers, banking details) and validating information with external databases;
- Carrying out computerized validity checks to identify duplicate returns or information that is repeated in other returns; and
- Profiling of known cases to identify the characteristics of the fraud and then searching the refund data for these characteristics (for example, a pattern in return filing).

Audit verification action will normally follow the lines of a conventional desk (in-office) audit/verification, although activity may be restricted to the refund in question. The credibility of the business operations itself should be examined, together with the documentation used to support the claim.

Some of the lessons learned in examining refunds are:

- The existence of an invoice does not prove that a transaction has taken place. It is important that tax auditors are satisfied that there is evidence of an actual transaction (e.g., contract, import/export documentation, settlement, bank deposits, etc.);
- There should be evidence of trading apparent. For example, if inventory controls show that goods came into stock, there should evidence of a payment for the goods to the supplier. If materials in a manufacturing process are present, sufficient raw materials that roughly equate to the finished goods being claimed should have been exhausted, and the machinery should be capable of producing the goods;
- There should be evidence of involvement with Customs, including, in the case of exports, a letter of credit from the purchaser, shipping invoices from an independent carrier, bills of lading

from the transport company, insurance documents, mirroring import documentation for the country to which the goods were exported, such as the customs entry, and a customs broker invoice for services;
- There may be other supporting commercial documents besides the purchases and sales invoices, such as orders, warranty claims, insurance claims for damages, and inbound freight bills;
- Purchases, sales, and even employee payroll should supported by bank statements, deposit slips, and cancelled checks;
- Transaction cross-checking to verify purchase and sales invoices should consist of sampling the largest transactions, repetitive transactions, and irregular transactions. Part of the verification should also test transactions with suppliers to verify VAT has been paid by the supplier. This cross-checking entails visiting the supplier and verifying their records to ensure that they match the details contained in the claimant's records.

Sometimes, due to the stringent controls banks now have as a measure against money laundering, once a bank account is set up, it will be used for multiple fraudulent businesses. This can be detected by simply running a query of the refund database or treasury listing for duplicate bank accounts.

Some countries do not process refunds centrally and various district offices process claims for their own taxpayers. Many tax administrations do not coordinate refund claimant information, and it becomes possible to lodge claims in different offices, in some cases only changing the address of the claimant. It is necessary to check the databases in the district offices for details that repeat in other offices.

Combating Refund Fraud

The following are general guidelines.

- Refund procedures should use IT to check registration and payment information for anomalies, such as payments made into the same bank account number for different claimants;
- Refund claimants should be scrutinized according to risk criteria. As the administration becomes more experienced with risk assessment, the criteria should become more sophisticated;
- Where there is a reason for additional verification of a refund, the refund claim should be referred to a senior auditor/investigator for field audit;
- Field audits should be authorized for high risk refunds. In many instances, the tax administration lacks funds and logistical support which must be addressed; and
- Claims referred for field audit should not be subject to the same stringent time limits for processing and should be relaxed to allow for extra time, if necessary.

Where the checks on a questionable refund do not provide evidence to justify the refund claim, the tax auditor will need to consider the reasons. If the auditor is satisfied that there has been an unintentional error or a genuine misunderstanding, an audit assessment should be issued to bring the right amount of tax to account. In other circumstances, consideration should be given to the possibility of fraud. The auditor making the examination must have received fraud training and be knowledgeable about the standards set for case preparation and for gathering and protecting evidence.

Combatting identity fraud requires changes in the way tax administrations process data. For example, before a refund of PAYE is authorized, the tax administration should require employer information returns to be submitted electronically on a regular basis, with this data being matched with tax returns before refunds are issued. This type of change would require improvements in the tax administration's automated processing systems and working with employers to implement this change.

Refunds – Identity Theft

Refund fraud can occur when a thief uses a legitimate taxpayer's name and TIN to file a return claiming a refund early in the filing season, before the legitimate taxpayer files. The tax administration will issue the refund to the identity thief after determining the name and TIN on the tax return appear to be valid. The thief requests that the refund be paid into a bank account which is then promptly emptied and the thief disappears. The tax administration will only become aware of a problem after the legitimate taxpayer files a return and the computer system identifies that two returns have been filed using the same name and TIN.

Appendix 8.A. Risk Scoring Criteria

The following are example criteria that may be considered when selecting returns for audit. The audit division at headquarters may consider all or some of the below criteria, depending on available data and resources, and may use additional criteria not listed below.

- The taxpayer was / was not previously audited;
- The taxpayer is / is not newly registered;
- Length of time since last audit;
- The taxpayer had / did not have substantial assessment during previous audits;
- The size of the taxpayer's turnover / net profit;
- The size of the taxpayer's loss, if any;
- The size of the taxpayer's refund, if any;
- The size of change in the taxpayer's turnover/net profit from the previous year;
- The size of the impact detected mistakes had on the taxpayer's turnover / net profit;
- The ratio expenses/turnover;
- The ratio turnover/total assets;
- The ratio loans/total assets;
- The size of income from high risk activities (e.g., real estate income);
- The size of exemptions, if any;
- The percent of the net profit in comparison to the activity average;
- The percent of the total profit compared to the activity average;
- The taxpayer requested waivers, is departing, or is bankrupt;
- The taxpayers files inconsistently / files consistently;
- The taxpayer is / is not currently involved in legal disputes;
- The taxpayer's return was / was not previously investigated for evasion;
- The taxpayer received notifications from other governmental entities;
- The quality of the taxpayer's books and records (manual / automated; well-kept / not well-kept);
- The taxpayer's returns is / is not prepared by questionable accountants;
- The specific sector, in which the taxpayer operates (e.g., typical high-risk activities include restaurants and hotels, apartment rentals, professionals, car rental, spare parts for vehicles, chemicals, telecommunications, retail);
- The form of the legal entity (e.g., corporation / partnership);
- The multitude of the taxpayer's legal relationships with other entities;
- The taxpayer has / does not have multiple branches;
- The taxpayer has / does not have multiple activities;
- Audit differences (past audit assessments).

Appendix 8.B. Information Collected during the Initial Stages of Audit

The list is not intended to be comprehensive and, indeed, some of this information may not even be available to the auditor. Information that might be collected during the pre-contact stage includes:

- The tax return.
- Information on the taxpayer's activity, the taxpayer's industry, and commercial issues affecting the taxpayer's industry (e.g., commercial statistics). Virtually all businesses operate in a sector that has certain characteristics. These characteristics usually form the basis for commercial or governmental analysis of key ratios and trends. Examination of the key sector trends and comparison to the business under review may reveal unexpected variances that will call for further inquiry and explanation;
- Information on the legal structure and capital of the taxpayer, including any debt financing;
- Financial performance of the taxpayer, including profitability (e.g., annual accounts);
- Location(s) where the taxpayer operates business;
- Number of employees and names of responsible accounting staff;
- Summary of tax compliance record, including copies of tax returns;
- Details of prior audits. Other audits may generate routine verification requests based on the premise that one person's sale is another person's purchase. The auditor should note large or unusual transactions and forward details for inclusion in the supplier/customer's tax file for examination on the next planned audit. In addition, a definite case of tax evasion discovered at a business can often generate suspicion about the customers or suppliers of that business, which should generate a specific reference for immediate query;
- Third party information held on file. It is not unusual for informers, such as disgruntled employees, to tip off the tax administration about undeclared business activities. Informers' letters vary from the extremely specific to the vague. While an interesting source of information, informers' letters need to be treated with some caution as they can simply be used as a method to damage a business competitor or personal enemy of the writer. As a general rule, specific attributable information should be treated as reliable and action should be taken to verify the information given, if serious, through the implementation of a control audit; if minor, through a desk audit inquiry. Non-attributable or vague information should be treated as unreliable and the reference left on the taxpayer's file to be dealt with during the next routine audit. Audit management will decide which action should be taken;
- Customs data;
- Business registry data;
- Supplier and customer businesses. Sales are made to customers and purchases made from suppliers. Direct inquiry of suppliers and customers may reveal differences in declared and actual transactions;

- Newspaper and magazine articles. Many firms in the public sector are the subject of media attention. Sales, acquisitions, and other important milestones are reported in areas such as the financial press and trade magazines. These can be a valuable source of information when building up the background of the company.

The auditor looks for any large, unusual, or questionable items (LUQs) on the return. Some factors to be considered when identifying LUQs are:

- Comparative size of the item — an expense item of $6,000 with total expenses of $30,000 would be a large item; however, if total expenses are $300,000, the item would not be generally considered a large item.
- Absolute size of the item — despite the comparability factor, size by itself may be significant. For example, a $50,000 item may be significant even though it represents a small percentage of taxable income.
- Inherent character of the item — although the amount of an item may be insignificant, the nature of the item may be significant; e.g., airplane expenses claimed by a tradesman.
- Evidence of intent to mislead — this may include missing schedules, incomplete schedules, misclassified entries, or obviously incorrect items on the return.
- Beneficial effect of the manner in which an item is reported — expenses claimed on a business schedule rather than claimed as an itemized deduction.
- Relationship to other items — incomplete transactions identified on the tax return. For example, the taxpayer reported purchases of stock but no dividend income.
- Missing items — consideration should be given to items which are not shown on the return but would normally appear on the returns of similar taxpayers. This applies not only to the examination of income, but also to expenses, deductions, etc., that would result in tax changes favorable to the taxpayer.

The auditor may use financial ratios for the taxpayer's business to highlight potential issues for further review. Such analysis can focus on both:

- External ratios: Do the taxpayer’s financial ratios vary significantly from industry norms? The auditor may use external ratios for understanding how participants in the taxpayer’s industry generally perform and compare the taxpayer's performance to the industry standards looking for significant variations;
- Internal ratios: Does the relationship between various internal financial data (e.g., sales and cost of goods sold) or between financial and non-financial information (e.g., salary expenses and headcount) make sense, given the nature of the taxpayer’s business? The auditor may use internal ratios to review whether the taxpayer's reporting is consistent from period to period and to determine whether the taxpayer's performance is consistent with what one might expect based on the actual business operated by the taxpayer. Although variations do not mean that there is necessarily a problem, the auditor may use variations to form a line of inquiry that might be pursued in the audit.

Poor financial ratios do not necessarily mean that a taxpayer has underreported tax. As such, the auditor may pursue inquiries to determine whether a reasonable or logical explanation for the variance exists.

Appendix 8.C. Checklist of Possible Questions for the Taxpayer Interview

The auditor should structure the interview to obtain the following information:

- A summary of the business;
- An understanding of who does what in the business;
- Details of the targets of the business, especially for profitability, and how the business intends to meet those targets;
- Details of the private financial affairs of the directors/partners involved;
- Clarifying any points of information already established which do not seem to correlate with the information being given;
- Probing for any perceived weaknesses in the control system or business records that may subsequently throw doubt on the tax accounts submitted; and
- Establishing what further information is required and a timetable for its provision.

Figure 8-C.4. Checklist of possible questions for the first interview

FIRST INTERVIEW : Checklist of possible questions	
The pre-prepared questionnaire should include standard questions that are posed in all interviews as well as non-standard questions concerning specific issues identified in the audit work plan.	
Business Background and Future	When registered? Business purpose? Has method of producing income changed? History of the business, i.e., how started, by whom, why? How long at present location? How long at previous locations? Where? Have there been any unusual or extraordinary events during the past three years? (Reorganizations, major acquisitions, dispositions, decline in income due to casualty, loss of prime customers/clients or other economic/business conditions.) Has there been any expansion or re-modeling of the facilities in recent years? Any asset dispositions? What was disposed? Method of disposition? Any asset acquisitions? What assets were acquired? Amount paid and source of capital to purchase? Any asset acquisitions or dispositions to related parties? If yes: When? Any future plans to re-model or expand? If yes: When? Source of capital for expansion? Dividend history (why or why not)? Has the stock of the corporation or interest of ownership been sold or exchanged since incorporation? If yes: When? Parties involved? How recorded?
Business Current Activities	Any branches or related companies (domestic and foreign)? If yes: Where? Any business activities with these entities--purchasing, sales, loans, and borrowing? Principal customers/clients? Principal suppliers/vendors? What stockholders (owners) are actively involved in the business? What are their duties? Who are the managers of the corporation? President, Vice President,

FIRST INTERVIEW : Checklist of possible questions	
	Secretary, Treasurer? How many employees of the company? Are any immediate family members/relatives employed by the company? If yes: Whom? Relationship? Duties, Compensation, Time devoted? Are separate life insurance policies maintained on the managers or stockholders (owners)? Policy amounts, Who are the beneficiaries? Any personal use of assets? Which assets? Percentage used? Fair market value of the assets? Rent expense/income (if any)? What is rented? By/to whom? Rental agreements? If related, how was fair market determined? Other sources of income: non-taxable, factory rebates, interest dividends, transactions with foreign parties, any other sources? Amounts? How recorded? Who opens the mail?
Sales	Who makes the sales? How is pricing determined? Percentage mark-up? Main customers? How is revenue received? Who receives the revenue? How is revenue recorded? Who records the revenue? Who disposes of revenue? Use of revenue? What activities occur once a sale is made, i.e., what documents are generated, who receives them, etc. What are the activities involved in the receipt of cash and payments? What is your policy on returns and allowances? How recorded? Scrap sales? How handled?
Purchases	How frequently are purchases made? Is a purchase journal maintained? Main suppliers? How are discounts handled? Are large purchases made at year-end? Is there a specific mark-up of merchandise? Are expenses paid by cash or check? How are cash purchases handled? Who maintains the petty cash fund? Any personal expenses paid? Which expenses? Amount paid? How recorded?
Inventories	What method is used and how often changed? How is the inventory priced? (mark-up) determined? How often is a physical inventory taken? By whom? When? Does the taxpayer or anyone else use any of the inventories for personal use? How is it accounted for? Amounts?
Financial and Accounting General Information	If applicable, what types of services are provided by the company's accounting firm: Certified financial statements? Preparation of tax return? Preparation of general ledger? Financial statements? Summaries? Management and/or consulting services? Who is responsible for recording: General bookkeeping, Accounts receivable, Accounts payable? Who records the payments/receipts? How frequently? Step by step check the recording of sales and purchase transactions from the beginning to end. Is the business involved in any litigation? Please explain nature? Attorney?

FIRST INTERVIEW : Checklist of possible questions	
	How much cash is kept on hand? Petty cash amount? Who has access to it? What is it used for? Other cash—stashed cash? Where kept: safe, register? How are gross receipts determined? What do they comprise of? Were there any barter transactions? If yes, what kind, and how were they recorded? Were there any goods/services exchanged in payment of loans? If yes: What amounts? How were they determined? How were they recorded? What types of bank accounts does the company maintain? Name of banks and location? Type of account(s)? Are any of the banks located outside of the country? If so, what countries? How often are deposits made and by whom? Who reconciles the bank statements? How often? Who has authority to conduct bank operations? What types of investment accounts are maintained and where? What is the policy regarding transfers between the accounts? Who is authorized to transfer funds? Who is authorized to withdraw funds? Who is authorized to take cash out of the daily register (if a cash business)? Is the withdrawal recorded on the books and how? What is the percentage of cash receipts as opposed to those obtained through the bank? Which credit cards are accepted? Which ones? How are these sales recorded? How frequently are deposits made? Who prepares the deposit slips? Who makes the deposits? Were there any receipts from third parties such as insurance proceeds? Did the company receive any loans? For what purposes? From whom? Did the company make any loans? For what purpose? To whom? Loan agreement? Amounts and repayment plan? What are the terms of repayment? Interest received? Were any repayments received? How recorded?
Tax Compliance	Who completes the tax return? Who signs it? Are all your sales taxable? Any income not taxable? Withholding? Who decides what deductions are allowable? How do you differentiate between allowable and non-allowable deductions?

Appendix 8.D. Checklist for Inspection of Business Premises

Figure 8-D.5. Checklist for the inspection of business premises

RESULT OF PREMISES INSPECTION		OBSERVATIONS
General description of facilities	Number of departments? Number of employees? Is the number of employees compatible with reported sales?	
Observation of raw material inventories	Are stocks of materials and parts consistent with reported sales? Note names of a few suppliers for cross checking with purchase records Any indications of manufacturing or products for personal use? What inventory records are maintained? (documentation in and out)	
Observation of production facilities	Note number of employees. How old is production equipment? Any new major capital additions? New assets?	
Observation of finished goods inventories	Are products consistent with reported business activity? Is inventory compatible with reported sales? What products are purchased from other manufacturers? What inventory records are maintained (documentation in and out)?	
Observations of shipping area	What modes of transportation are used (own vehicles, commercial trucks, etc.)? Number of vehicles and deliveries by day/week? Evidence of export goods - packing crates? Any indications of scrap material sales? Is the volume of activity in the shipping area consistent with reported sales?	
Observation of sales operations	Number of employees? How are prices established? Are prices indicated on products? Are products and observed volume of sales consistent with reported sales?	

RESULT OF PREMISES INSPECTION		OBSERVATIONS
	How and when sales are recorded (documentation)? Are cash registers used? Any indication of other business activities?	
Accounting department	How many employees? What use is made of computers? How are monies handled and deposited?	
General observations	Is the scale of operations consistent with reported revenues? Is there any evidence of business activities beyond those reported? Are the entire premises being used by the taxpayer’s business? Any sub-let? Is the investment in new capital goods consistent with reported revenues?	

Appendix 8.E. Internal Controls

Figure 8-E.6. Areas of management control of concern

Area	Concern	Established by	Notes
Management understanding	Is senior management aware of the risk of fraud in the business? Are prevention or detection controls in place?	Questioning management; obtain details of control	If controls are not present this indicates lack of awareness and therefore the response is unsatisfactory.
Attitude of management	Does management have an anti-fraud attitude?	Questioning management	The auditor should use his judgment in summing up the attitude – management may connive at fraud if this benefits management directly or indirectly.
Personnel policies	Does the company's personnel policy limit the risk of recruiting fraudulent employees?	Questioning management; examining the personnel policy	The policies examined should show the business takes up references. The high risk areas of employment should be noted in the personnel department with additional checks being carried out where the honesty of the employee is paramount.
Management Controls	Does senior management monitor the accounting systems? Does management obtain adequate information on matters that require further examination?	Questioning management; reviewing the controls in place and evidence of checks carried out; reviewing the provision of management information	Management should evidence all reviews carried out, and the management information available should be sufficient to point up unexplained variances for further investigation.
Security of assets	Are assets of the business at risk of loss through theft?	Questioning management; review of authorization, physical controls, division and rotation of duties, detection controls, and attitude of staff to fear of detection	The requirement for authorization and the existence of physical controls must be real. Authorization should be evidenced.
Asset disposal	Are asset disposed of at less than fair value?	Questioning management;	Great care must be taken for liquid assets and the controls should not only detect the fraud but also

Area	Concern	Established by	Notes
		examining authorization procedures for pricing and one-off transactions	prevent the fraud from taking place. This will involve physical measures as well as division of duties and regular examinations to promote the fear of detection.
Company income	Is there risk of diversion of income due to the company?	Questioning management; review of control system to prevent the fraud	The possibility of bribery and corruption should be borne in mind. Controls must prevent the fraud taking place that will involve effective authorization, division of duties, and regular examinations of payments made.
Purchase procedures	Does the payment reflect the value of goods and services or were goods and services not received?	Questioning management; review of control system to prevent the fraud	The possibility of bribery and corruption should be borne in mind. Controls must prevent the fraud taking place that will involve effective authorization, division of duties, and regular examinations of payments made.
Accounting records	The records may be falsified to conceal the evidence of theft that may not be apparent or detected too late to prevent loss	Questioning management; review the access to the records, division of duties, authorization, and investigation of exceptions.	The possibility of bribery and corruption should be borne in mind. Controls must prevent the fraud taking place that will involve effective authorization, division of duties, and regular examinations of payments made.
Computer security	The computer (if used) may be programmed to create fraudulent data to remove evidence of fraud.	Questioning management; reviewing the computer security system.	

Figure 8-E.7. Internal control structure

Function	Area	Concern
Control Environment	Organizational structure	Is the structure effective? Role of management and directors.
	Internal audit	Is internal audit honest, reliable, and independent?
	Management Information	Is the management information accurate and relevant?
	Business control	Are there adequate policies and procedures in place?

Function	Area	Concern
	Management fraud	Is it possible for management to override internal controls and intentionally manipulate the financial statements?
	Computer operations	Is there effective management control?
	Other operations	Is there effective management control?
Accounting Systems	Transaction control	Does the accounting system allow the transaction to be reflected in the financial statement?
	Compilation of financial Statements	Is the transaction description sufficient and accurate to ensure correct recording in the financial statements.
	Fraud	Is the accounting system adequate to limit irregularities?
Internal Accounting Controls	File controls	Do files remain correct and current?
		Are asset movements properly approved and recorded?
		Are records adequately protected from unauthorized amendment?
		Are records adequately protected from incorrect amendment?

Appendix 8.F. Audit Review and Quality Control

Quality Standards for Audits

The quality standards are concise statements of the tax administration's expectations for quality audits and are guidelines to assist auditors in fulfilling their professional responsibilities. These standards provide objective criteria against which audit quality can be evaluated. Each standard is defined by elements representing components that should be present in a quality audit. The standards consist of twenty-three quality attributes which are grouped as follows:

- Planning;
- Income determination;
- Audit techniques;
- Timeliness;
- Customer (taxpayer) relations/professionalism;
- Documentation/reports.

These groups are further sub-divided as follows:

1. Planning

i. Pre-planning: Required actions are taken prior to the commencement of audit.
ii. Requests for Information: Requests for documents from the taxpayer are made, as appropriate.
iii. Verification of Full Compliance: Required filing and payment checks are performed.
iv. Risk Analysis: The depth and scope of audit is appropriate.
v. Audit Work Plan: An appropriate audit work plan is included in the file.

2. Income Determination

i. Sources of Income: Appropriate techniques are used to determine the taxpayer's income.
ii. Analysis of Income: Thorough analysis of income and application of law; a correct determination is made of income that is subject to tax

3. Audit Techniques

i. Audit/Compliance Interviews: Planned interviews with clear questions are conducted throughout the audit with the taxpayer and appropriate third parties.
ii. Internal Control: The review of internal control is appropriate for the specific audit.
iii. Review of Records: The type of records requested and methodology for review is appropriate.
iv. Tax Law Application: Tax law is applied and interpreted correctly, and audit issues are developed correctly.
v. Anti-Evasion Determination: Anti-evasion is pursued and developed appropriately.

vi. Tax/Penalty Determination: Tax and penalty determination and computation are correct.

4. Timeliness

i. Time Commensurate with Complexity: Time spent on issues and the audit overall is commensurate with complexity.
ii. Actions Taken in a Timely Manner: Timeframes on audit actions are efficient and in accordance with standards.

5. Customer Relations/Professionalism

i. Clear/Professional Written Communication: All correspondence is businesslike and professional in tone, appearance and content.
ii. Taxpayer/Representative Kept Appraised: The taxpayer and/or representative are kept well informed throughout the audit.
iii. Taxpayer Rights: The taxpayer and/or representative is advised of all rights.
iv. Taxpayer Confidentiality: The confidentiality of the taxpayer's return and information are appropriately protected.
v. Managerial Involvement: The level of managerial involvement is appropriate for the audit.

6. Documentation/Reports

i. Auditor File History Documentation: Auditor activity record is used to document audit activity and time charges.
ii. Work papers: Work papers support the conclusions of the audit including the scope, depth, and techniques used during the audit.
iii. Report Writing: The appropriate audit report writing procedures are followed, and the quality/necessity of the information therein is appropriate.

Application of Quality Standards during Audit Reviews

For each of the standards, the answers to certain key questions should be considered by the reviewers as they go through the audited files. Reviews of audited files are made for the purpose of determining compliance with the standards. The review includes, but is not limited, to these key questions:

1. Planning

- Pre-Planning
    - Were there any reasons why the auditor should not perform this audit?
    - Was risk analysis properly used in determining scope of the audit?
    - Was information available within the tax administration properly utilized?
    - Did the auditor make inquiry as to tax administration's internal data?
    - Was the data appropriately utilized?

- Requests for Information
    - Was the initial request to the taxpayer appropriate?
    - Were additional information requests discussed with the taxpayer and clarified where needed?

- Risk Analysis
    - In office audit, were all classified issues properly developed?
    - Were issues selected that have the most audit potential and probability of error?
    - Was materiality of the issue appropriately considered?
    - Was the analysis of the return properly utilized to determine whether or not to expand the audit?

- Audit Work Plan
    - Was the audit work plan prepared in a timely manner (consider date on the audit work plan)?
    - Does the content of the audit work plan address all required aspects of the audit, such as required filing checks, specialist referrals, tour of the business, etc.
    - Was the audit work plan approved in a timely manner?
    - Were there types of tax issues that should most appropriately be audited by specialists, and, if so, were the specialists requested?
    - Was the request for specialists made early enough in the audit to ensure timely completion of the audit?
    - Was there oversight on the audit to ensure that the specialists' issues were resolved in a timely manner?

- Verification of Full Compliance
    - Were prior and subsequent years' returns reviewed for audit potential?
    - Were related tax returns reviewed for audit potential?
    - Were referrals made as appropriate for specialists needed on the audit to ascertain return filing requirements?

2. Income Determination

- Sources of Income and Analysis of Income
    - Was the taxpayer asked about sources of income other than those on the return?
    - Was the taxpayer questioned about the source of accumulated funds?
    - Was the taxpayer questioned concerning the company's financial history?
    - Was the taxpayer questioned regarding currency kept on hand?
    - Was an analysis done to determine whether income reported is sufficient to support the taxpayer's activities?

- Was analysis of cash flow performed as appropriate?
- Were appropriate business analyses performed?
- Was income reported on the return reconciled to the books and records?
- Was a tour of the business performed as appropriate?
- Were financial status techniques appropriate and used to determine whether income was properly reported?

3. Audit Techniques

- Audit Compliance Interviews
  - Did the auditor interview appropriate persons?
  - Were questions asked in the interview clear and appropriate?
  - Were third party interviews conducted where appropriate?
  - Were the results of the interviews appropriately documented?

- Tax Law Application/Issue Development
  - Did the auditor secure data relative to prior audit activity?
  - Was the prior audit information appropriately utilized in the current audit?

- Review of Unpaid Debt
  - Did the auditor review the taxpayer's servicing of any debt?
  - Did the auditor review the changes in the taxpayer's debt where appropriate?
  - Was the pay down of debts by the taxpayer consistent with the income sources available?

- Review of Records
  - Did the auditor determine methods of handling cash?
  - Did the auditor make appropriate tests of sales or gross receipts?
  - Did the auditor trace entries in original books and records to documentation?
  - Were appropriate business ratios computed to determine if sales reported appear valid?
  - Was the volume of sales compared to prior years and appropriate action taken regarding unusual variances?
  - Was third party data regarding sales used appropriately?

- Review of Internal Control:

  The reviewer will consider whether or not the auditor reviewed the taxpayer's system of internal control.
  - Were discussions held with the taxpayer about the taxpayer's procedures for business operations?
  - Were discussions held with the taxpayer relative to the accounting systems in place?

- Were tests made of the business operations system and the accounting system?
- Were significant changes in assets identified in analyses and the impact on taxable income appropriately considered?

- Review of Anti-Evasion:

  The reviewer will consider whether or not the auditor considered the indicators of evasion.

  - Did the auditor ask appropriate questions in documented interviews with the taxpayer to identify areas of suspected tax evasion?
  - Were suspicious areas properly pursued to appropriate conclusions?
  - Where evasion was present, did the auditor follow existing procedures for referral and development?

- Review of Tax and Penalties:

  The reviewer will consider whether or not the auditor considered the applicability of penalties in the specific audit.

  - Did the auditor ask appropriate questions of the taxpayer and/or third parties to determine the applicability of penalties?
  - Did the auditor correctly apply the law with respect to penalty considerations?
  - Did the auditor appropriately secure the taxpayer's explanation in matters potentially requiring the application of penalties?
  - Did the auditor correctly compute the tax and penalties, when applied?

4. Timeliness

The reviewer will consider whether or not the auditor's actions were timely.

- Was the elapsed time from file assignment to first appointment appropriate?
- Were large gaps of time between audit actions explained?
- Was the auditor's report prepared in a timely manner?
- Were closing actions on the audit timely?

The reviewer will consider whether or not the time spent on the audit by the auditor is commensurate with its complexity.

- Do the tasks performed on the audit by the auditor support the time charges to the audit?
- Were the auditor's work practices appropriate for efficient completion of the audit?

5. Customer Relations/Professionalism

- Communications with the Taxpayer and Taxpayer's Representative

The reviewer will consider whether or not the auditor’s communication with the taxpayer was professional.

- Was correspondence to the taxpayer of appropriate tone, appearance, and content?
- Was the auditor responsive to written correspondence from the taxpayer?

The reviewer will consider whether or not the auditor provided customer focus to the taxpayer and the taxpayer’s representative.

- Were the taxpayer and the representative kept apprised about the audit status and issues throughout the audit?
- Did the auditor ensure that questions from the taxpayer, even if not part of the audit, were appropriately coordinated with other areas of the tax administration?

The reviewer will consider whether or not the auditor kept the taxpayer and the representative informed of their rights.

- At the initial phase of the audit, were the taxpayer’s rights explained by the auditor?
- Throughout the audit, was the taxpayer informed of the tax administration's procedures and taxpayer’s rights, as appropriate?
- Throughout the audit, were taxpayer’s rights honored by the auditor?

The reviewer will consider whether or not the auditor safeguarded the taxpayer’s privacy and confidentiality.

- Did the auditor ensure that tax returns and return information was safeguarded?
- Did the auditor refrain from disclosing information about the audit in accordance with the law and the Audit Procedures Guide?

- Supervisor's involvement with the audit

  The reviewer will consider whether or not the supervisor was appropriately involved in decisions in the audit.

  - Was the audit work plan approved in a timely manner?
  - Were expansions of the audit or limitations on scope approved by the manager?
  - Was the manager present for taxpayer meetings, as appropriate?

6. Documentation and Reports

The reviewer will consider whether or not the auditor documented actions in the audit.

- Did the auditor prepare an audit report?

The reviewer will consider whether or not the work papers support the conclusions reached in the audit.

- Were the work papers legible and prepared in accordance with the audit procedures?
- Do the audit issues in the audit report agree with the issues in the work papers?
- Do the work papers contain sufficient information to reach the conclusions presented in the audit?

The reviewer will consider whether or not the auditor’s report was correct.

- Did the auditor use the appropriate report writing procedures as per the audit procedures guide?
- Is the explanation of the issue in the auditor’s report clear and concise and in accordance with the law?
- Is the tax computation correct in the report?

Appendix 8.G. Audit Report

Figure 8-G.8. Audit report

Audit Report	
Taxpayer Name: *Business name*	**TIN:** *Taxpayer identification number*
Taxpayer Address: *Address where the business is registered with the tax administration*	
Taxpayer Contact Details: *this should include the name and telephone contact of the taxpayer*	
E-Mail: *e-mail address of the key person to contact at the business*	
Taxpayer's Accountant / Representative: *insert the name, address and contact of the taxpayer's accountant or representative*	
Principal Business Activity: *Main business activity of the taxpayer (by turnover if more than one activity)*	
Subsidiary Business Activity (if any): *Secondary business activity of the taxpayer (by turnover)*	
Associated Businesses: *Note the names and TINs of any businesses that are associated with this taxpayer and the type of association.*	
Branches: *Note the details of any branches operated by the taxpayer or any other premises used in the operation of the taxpayer's business*	
Description of the Business: *Insert here a summary description of the business, its scope, age, sector, main customers, staff numbers, etc.*	
Description of the Accounting System: *List here the key books and records maintained by the taxpayer as part of its accounting system. If an automated system is used, the name of the software package should be noted.*	

Audit Report	
Key Internal Controls: *List here the key internal control functions, noting any particular strengths and weaknesses.*	
Audit Start Date: *Date when pre-visit checks commenced*	**Type of Audit:** *Office, field, or other control activity*
Tax Year(s) Under Audit:	
Place of Conduct of Audit: *location where the auditor conducted the audit*	
Persons Interviewed: *note who was interviewed by the auditor and when*	
Business Premises Inspected: *Yes/no and any noteworthy comments resulting from the inspection*	
Description of Audit Activity: *Note all key actions taken during the audit, including records examined, creditability checks performed, and the summary results. Pre-contact analysis and any calculations should be attached to the report as separate sheets.*	

Audit Report	
Rulings: *note details of any rulings given to the taxpayer (verbally or in writing) e.g., liability ruling, interpretation of legislation, etc. If none, state 'none.'*	
Assessment Issued: *Provide details on the proposed assessment measures and justify each measure separately; also provide justification if no measures were proposed.*	
Penalties Imposed: *calculate the penalty and interest payable, if any.*	
Future Audits: *list any issues that may be relevant to future audits.*	
Final Result of Audit: *note total tax and total penalties/interest assessed.*	
Date Audit Closed: *this should be the date when the assessment was issued to the taxpayer*	
Name of Auditor:	**Signature:**
Name of Auditor:	**Signature:**
Name of Auditor:	**Signature:**
Name of Auditor:	**Signature:**
Name of Supervisor:	**Signature:**
Name of Audit Section Head:	**Signature:**

Appendix 8.H. Audit Quality Review Report

Figure 8-H.9. Audit quality review report

Taxpayer______________________ **Registration No. /File______________________**

File Type______________________ **Auditor___________________________________**

Date of Audit Period: _________to ____________

Audit Type: Field_____ Office_____

ITEM REVIEWED	YES	NO	N/A	COMMENTS
A. PLANNING				
A1 Were pre-audit activities appropriate?				
A2 Was the audit work plan appropriate?				
A3 Were appropriate requests made for documents and/or information from the taxpayer?				
A4 Were required filing and payment checks performed?				
A5 Was risk analysis performed to set the scope of the audit?				
B. INCOME DETERMINATION				
B1 Was the taxpayer interviewed concerning sources of income other than those reported?				
B2 Was an analysis performed of the file regarding income?				
C. AUDIT TECHNIQUES				
C1 Were interviews with clear questions conducted throughout the audit with the taxpayer and appropriate third parties?				
C2 Were the taxpayer's internal control procedures reviewed and				

ITEM REVIEWED	YES	NO	N/A	COMMENTS
described?				
C3 Were the type of records requested and the methodology for review appropriate?				
C4 Was the law interpreted and applied correctly in all aspects of the audit?				
C5 Were indicators of anti-evasion pursued and developed?				
C6 Were penalties and tax properly identified and computed?				
D. TIMELINESS				
D1 Was the time spent on the audit commensurate with its complexity?				
D2 Were all actions taken in a timely manner?				
E. TAXPAYER RELATIONS				
E1 Was correspondence businesslike and timely?				
E2 Was the taxpayer/rep kept informed throughout the audit?				
E3 Was the taxpayer advised of all rights?				
E4 Was the confidentiality of the taxpayer's return and information protected?				
E5 Was the level of managerial involvement appropriate?				
F. DOCUMENTATION AND REPORTS				
F1 Do the work papers document the activities and time charges throughout the audit?				
F2 Do the work papers support the conclusions reached in the audit?				

ITEM REVIEWED	YES	NO	N/A	COMMENTS
F3 Were the appropriate report writing procedures followed?				

KEY RECOMMENDATIONS (if any):

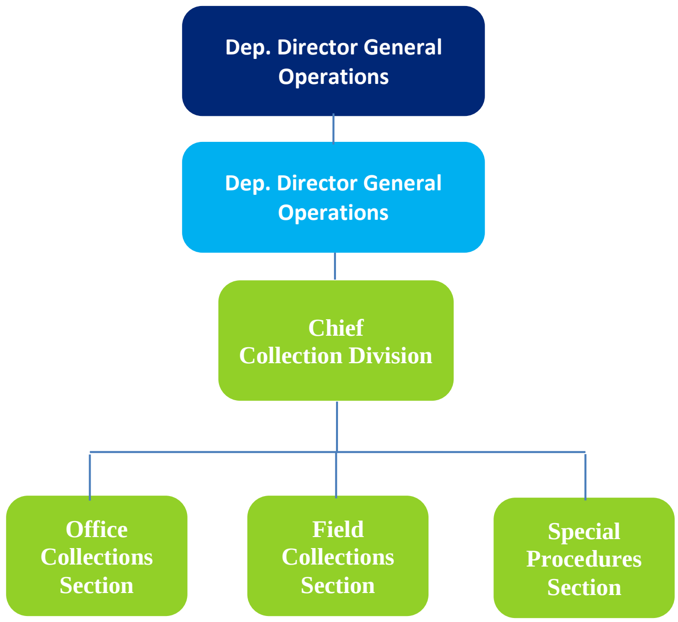
Reviewer Name ___________________________________

Signature____

Date_____________________________

Appendix 10.A. Organizational Structure of the Collections Division

Figure 10-A.10. Collections function organization in headquarters



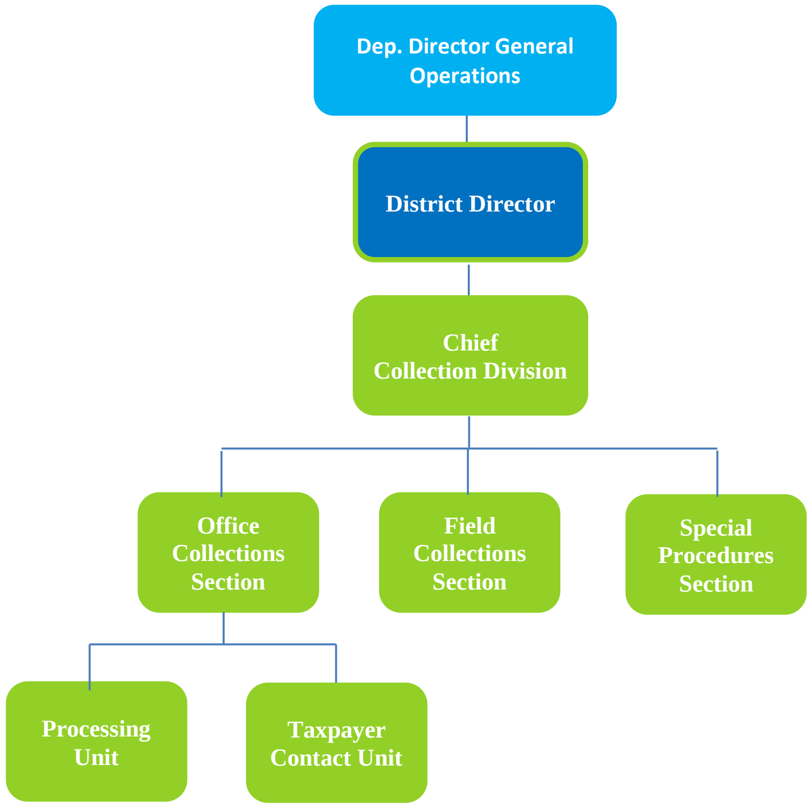
The responsibilities of headquarters offices are to:

- Develop and continually update all programs, policies, guidelines, and procedures (including manuals) for all district/field collections functions;
- Design and implement the case selection system;
- Develop consolidated strategic and annual collections work plans and similar plans for all district/field offices;
- Allocate collections resources (equitably) to district/field offices;
- Evaluate the district/field office collection programs from reviews of periodic Management Information System reports and on-site field visits;
- Perform on-site reviews of work quality of district/field offices;
- Design controls and programs to accurately account for all revenue collections;
- Determine training needs for collection staff in all district/field offices; and
- Develop employee evaluation standards for performance of all collections staff.

The responsibilities of each section are described below.

In addition, the collections division in many countries includes a cashier section. Such a section should be discontinued as soon as tax collection contracts with commercial banks can be executed, as discussed in Chapter 3 and Chapter 7.

Figure 10-A.11. Collections function organization in district/field offices



The principal role of the Chief of the collections division and his or her staff in the district/field offices is simply to perform the collections operations role and execute the annual collections work plans developed by headquarters. All collections staff is also responsible for recommending programs for preventing taxpayers from being delinquent in payment of their taxes.

The Office Collections Section is the first point of contact with those individuals or enterprises that fail to resolve their delinquent payment or delinquent return status in response to notices or letters issued to them. The contact with the taxpayer is by correspondence, telephone, or in person, when the taxpayer visits the office. For efficiency and effectiveness, there are two specialized units – the Processing Unit and the Taxpayer Contact Unit.

- The Processing Unit initiates correspondence to taxpayers and third parties in order to collect delinquent tax arrears, secures non-filer and stop-filer returns, or obtains information about taxpayers or their location. The Unit may initiate limited enforcement action to collect tax arrears or secure returns and then determine whether or not the case should be handled by the office contact section or someone in the field collection branch.
- The Contact Unit is responsible for contacting taxpayers by telephone or interviewing them in the office, when the taxpayer responds to an appointment letter sent by the Processing Unit. Personnel of the Contact Unit discuss payment of the tax in full, establish partial payment

agreements and take simple enforcement actions, such as mailing a Notice of Levy (attachment) to an individual's bank account. They secure financial statements, determine ability to pay, or identify the need for the Field Section to take further enforcement action.

The Field Collections Section is the final source of collection actions in the division. The field personnel are called collectors, or collection or revenue Officers and are organized into groups of 10 to 15 individuals, who are supervised by a manager and may have clerical support. The collectors have the responsibility to locate taxpayers and any of their assets, secure delinquent tax returns from stop-filers, identify non-filers, and estimate the tax due and sign the return, if that latter authority is delegated to them. As the title of the section indicates, major duties are carried out not in the office, but in the field, at the taxpayer's residence or business. Collectors may file tax liens, serve levies, and, with appropriate approval, seize and sell movable and immovable assets of the taxpayer.

The collector should be given broad legal and administrative authority, and is generally assigned to a specific geographic area or alphabetic section of taxpayers. He/she is expected to work all cases in the geographic area and assure compliance with all tax laws. As a result of their work in the field, collectors are exceptionally well-placed to identify fraud or cases to recommend in-depth examination to the appropriate criminal investigation or audit divisions.

The Special Procedures Section coordinates all legal and technical information, and it serves as a legal or paralegal advisor to the division and the entire district/field office on collection issues. It generally assumes the quality review function for the collection division and monitors all court cases, including bankruptcies, and files appropriate legal documents to ensure that the interests of the government are protected.

In some countries, the Non-filer/Stop-filer Section is a separate section. In others, the staff of the office and field sections have the respective responsibility to secure delinquent returns. In addition, as discussed above, the collections division in many countries includes the (now obsolete) cashier section.

Appendix 10.B. Third-Party Information on Non-Filers

The following is a list of potential sources of information that can be used to assist the tax administration in locating non-filers, as well as stop-filers and tax debtors. In addition to these, there will always be information from informants, who write or call the tax administration about non-filers, the old fashioned method of door-to-door canvassing operations (walkabouts), and scanning newspaper articles and advertisements to identify potential non-filers.

Corporate or company registry: The country's "Corporations Act" or "Companies Act" often provides that certain information pertaining to the purpose, ownership, and administration of corporations be available through the corporate registry office. A request for records, related to a particular corporation, may elicit the following:

- Corporate name, address, and date of incorporation;
- Name, address, and occupation of directors;
- Name and address of officers; and
- Number and class of shares authorized, issued, and outstanding.

The tax administration should also obtain a listing of newly registered companies and their principals and compare it to the tax registration database to ensure that these companies have also applied for a tax registration.

Court (Attorney/Solicitor General): It may be useful to obtain records on bankruptcies, liens, judgments, and court cases.

Customs: Customs can provide information on brokers and importers, what they import, whether they have paid duties regularly, current addresses, and even the bank details, when checks are drawn to pay customs duties. In many countries, clearing agents are often non-filers or stop-filers. Customs import data should be analyzed for non-filers on a regular basis. In addition, import information should be sorted and made available to audit as a regular source of information that will assist with VAT refunds and other purchase verifications.

Government suppliers (finance department): The various government departments often have supply contracts with private businesses for goods or services. Some government departments issue a list of these contracts by territory. This is a valuable work tool, since it may provide information on a taxpayer's accounts receivable, which the officer can then seize, if applicable. It may be possible to obtain the following information:

- The names, addresses, and internal numbers of the suppliers;
- The year and number of the last contract awarded; and

- The monetary value of the contract.

This information is used to identify non-filers, but should also be matched against tax records to determine if the monetary value of the contract is roughly reflected in their tax filing.

Tax returns and other documents: All types of tax returns filed by the taxpayer should be reviewed and cross-referenced for leads on addresses, assets, sources of revenue, names of relatives, and names on assets. A taxpayer's name that appears on the sale or transfer of an asset may be an indication of a fraudulent conveyance of property.

Land title/registry office: The land registry usually contains the ownership, encumbrances upon, and transactions of land. It is important to review information that can have an impact on the equity of the property and whether the property was transferred in a non-arm's length transaction. Available information may include:

- Legal description;
- Size of the property;
- Name of the owner;
- Date of purchase or sale (how long taxpayer owned property);
- Purchase or sale price;
- Records of outstanding mortgages or liens, foreclosures, seizures, etc.;
- Details of registered leases and type of ownership (joint, common); and
- Any rights or notice of sale by creditors.

Few countries have fully computerized their land registry systems, but a computerized registry can be a good source of information to detect non-filers. Where the registry remains a manual system, it is a source of information when searching for taxpayer assets.

Motor vehicle branch: Governments maintain records related to vehicles and drivers. A search can be conducted against a vehicle plate, identification, or registration number, as well as a registered owner's name, to:

- Verify the address of an individual or company;
- Find out if other vehicles are registered to an individual or company;
- Find out the registered owner of a particular vehicle; and
- Provide, for a particular car, the license plate number, year/make/model, car serial number, and information about the previous owner.

This is a good source of information when using high-value vehicles (i.e., vehicles that are less than 2 years old) as a proxy to locate non-filers. In addition, it may be worthwhile verifying if there are vehicles in the name of family members.

Municipality records: Among other responsibilities, municipalities may have the authority to issue business licenses and building permits. The amount of information available will vary from municipality to municipality. However, the response to a request may include the following:

- Name and address of the individual or business to whom the license or permit was issued;
- The job location where the license or permit will be used;
- Consumer complaints about the business;
- Applications for the license or permit;
- Any final inspection reports; and
- Any information about trades or sub-trades related to the business.

Personal property registry/registry of deeds: A government may maintain a branch or division responsible for the recording and formal registration of certain types of encumbrances against assets. Details, such as the amount of the loan or the amount of the remaining indebtedness, will probably not be provided. However, a search of records related to a particular taxpayer may produce the following information:

- The existence of encumbered assets;
- The type of security agreement;
- The date of registration and reference number;
- The name and address of the secured party;
- The name and address of the debtor(s); and
- A description of the collateral.

Postal authorities: If the taxpayer has moved or the collector is unsure as to the exact location of the address listed, the postal authorities can often provide a new address. In many jurisdictions, postal officials are required to provide other governmental agencies with taxpayer address information. If changes of address are computerized and businesses can be separated from individuals, then new business addresses can potentially be a good source of identifying non-filers.

Police: If the taxpayer has been non-compliant in filing returns and/or paying taxes, they may also have had contact with the police for other infractions. This may be another source of the whereabouts of the taxpayer.

Production/marketing agencies for natural resources and primary products: In a number of natural resource and primary product industries, such as agriculture, forestry, fisheries, dairy products, and mining, the producers must abide by the various acts and regulations instituted by the various levels of government. When it comes to determining production quotas, resource rights, or simply operating permits, there is often a government department or agency responsible for enforcing the applicable regulatory framework. This body provides information about the particular features of this type of industry and information about individuals or businesses involved in the industry.

This information can be used to identify non-filers. In addition, production quotas or resource rights are often assets, which the tax administration can seize and sell if the person is a tax debtor. The following information may be available:

- Type of operation;
- Potential buyers for the product;
- Regulations which limit the taxpayer's distribution network;
- Production quotas; and
- Application documents.

Property tax: This may be a division within the tax administration and may contain the following information:

- Legal description from a civic address;
- Name of property owner;
- Address, to which the tax bill is normally mailed (may be different);
- Payee (mortgage company or owner);
- Cross-references to other properties owned by the same owner; and
- Status (paid or in arrears).

This information is useful in locating non-filers, stop-filers, and the assets of tax debtors.

Accountants: In some instances, a non-filer may have sufficient resources to employ an accountant. The tax administration should be tactful when approaching the accountant, as the taxpayer is his/her client. Records from an accountant are useful when a non-filer, stop-filer, or tax debtor has moved and cannot be located. Information that can be acquired from an accountant may include:

- A forwarding address, if the taxpayer has moved;
- Working papers related to statement preparation;
- Financial statements; and
- The location of current accounting records.

Associations/Chambers of commerce: Professional, trade, social, tourist, hotel, or union associations can be significant sources of information. Certain types of associations are compulsory, particularly professional associations. These types of associations can be very well structured and may provide the taxpayer's employer, personal and business address, as well as membership status. The following information may be available:

- Address and other contact details;
- Whether the taxpayer is a member in good standing with paid-up dues;
- When dues were last paid;
- The taxpayer's last employer; and
- Information about specific manpower needs (e.g., large project, certain area).

Credit bureau: These organizations can provide considerable information regarding the credit viability of a taxpayer. Most large creditors, such as banks and large businesses, use these organizations to confirm the ability of the taxpayer to maintain monthly payments, before agreeing to provide the taxpayer with more credit. For example, the Caribbean Credit Bureau, located in Barbados with offices in a number of countries in the Caribbean, offers a range of credit services and, for a fee, can offer information about the credit history of specific taxpayers. Credit bureaus will not allow tax administrations to obtain general listings to go "fishing" for new potential taxpayers, but, if a taxpayer is in arrears, credit bureaus can provide good information to assist the tax administration in determining the taxpayer's revenue risk.

Dealers/suppliers: These are important sources of financial information that can assist in determining the potential size of a person's business, whether they are a non-filer for, say, VAT, which has a threshold requirement, and in determining revenue risk in the case of a tax debtor. In some instances, they can provide important insights, such as:

- Whether the taxpayer uses cash or charge and, if cash, whether checks are accepted;
- If charge, whether the account was billed, there was a credit application, and how the customer paid;
- Whether the taxpayer passes 'non-sufficient funds' checks;
- The frequency and size of orders to determine the size of the person's business, in the case of non-filers;
- Knowledge of other possible dealers or suppliers;
- Ship-to address for supplies;
- The names of the taxpayer's clients;
- Details of the taxpayer's financial situation;
- Available invoices with information on the company name or personal name;
- Balance payable by the taxpayer; and
- Collateral or liens against the taxpayer's assets.

In some countries, it is a requirement to submit lists of both sales and purchase invoices in support of VAT returns. This may only be in cases of refund returns, but this information can also be used to identify non-filers.

Telephone and other directories: More and more of these directories are now online, and some may be downloaded so that the information can be consolidated into a database when searching for non-filers.

Financial Institutions: Without either a "written authorization" from a taxpayer or the legal formality of a "requirement/demand to provide information and documents," most financial institutions will not cooperate with tax administrations, citing their confidentiality with clients. However, under money laundering legislation, the tax administration may be able to obtain some information.

Internet: Once a potential non-filer has been identified, the internet can be a good source of verifying a person's details, such as their identity and contact information.

- See if the taxpayer has a personal home page, by keying in his/her first and last names into an internet search engine.
- If the taxpayer is or was attending a college or university, visit the school's website and check the campus directory. The taxpayer may have, or have had, an email address.
- See if the taxpayer has an e-mail account through his or her job by visiting the company's website and searching its directory. If the site has no directory, try sending an e-mail message to the person at firstname.lastname@company.com.
- Try the taxpayer's name @ any major ISP provider's address.
- Try any of a number of online directories.
- Search social networking sites like Facebook or My Space.
- Try "Googling" the taxpayer's name (in quotations) and examine all the sites that are associated with that name.
- Use free sites, such as mylife.com in the United States, to go through different social networking sites and search for photos, addresses, phone numbers, and other relevant information.

Lawyer/notary: Lawyers and notaries are often reluctant to provide information about the transactions they handle for a taxpayer. Although most tax acts contain information requirement provisions, where the tax administration can consult the accounting records of lawyers and/or notaries (supporting documents or checks only), lawyers may refuse to provide copies, citing "solicitor-client privilege." It is therefore preferable to secure the cooperation of these professionals before issuing a formal demand or requirement.

The relationship between a taxpayer and his legal counsel may be quite varied in nature, depending on the relevant legal system (civil law, criminal law, commercial law, etc.). However, regardless of the nature of this relationship, the primary concern is with the financial aspect of the transactions, namely:

- The names of the parties involved;
- The purpose of a financial transaction;
- The date of the transaction, which concerns the tax administration;
- The assets in the transaction (e.g., if a building is involved, the legal registration information);
- Whether money changed hands between the parties;
- Copies of the checks issued, with information on persons, to whom amounts are payable and amounts and dates of the payments; and
- Whether these amounts were all distributed.

Information held by lawyers can only be accessed on a case-specific basis, where the tax administration is gathering information in the case of a non-filer, stop-filer, or tax debtor.

Landlord: Information from landlords can assist in identifying non-filers and may also be useful in cases of tax debtors. In identifying small and medium enterprises that are non-filers, the tax administration should keep in mind that some level of government often serves as the "landlord" of physical marketplaces and incubator sites where businesses function. Some questions that can be asked of landlords include:

- Whether a copy of the rental application can be provided;
- What employment information was provided on a rental application;
- Whether there was any logo or business name shown on any vehicles driven;
- Whether there was any equipment (rolling stock or otherwise) that might indicate the taxpayer's line of work; and
- Whether the taxpayer moved for employment reasons.

Neighbors: Some information can be obtained from current or former neighbors. Questions should include:

- When the taxpayer moved;
- Whether their new address is available;
- How the taxpayer moved and, If a moving company was used, which one it was;
- Whether taxpayer lived alone;
- The spouse's name (whether married or common-law);
- The name of the spouse's employer;
- The type of work performed by the taxpayer (and name of employer);
- The make and year of the taxpayer's car;
- Other assets owned by the taxpayer;
- Whether the taxpayer had friends on the street or in the neighborhood; and
- The name of the school attended by the taxpayer's children.

Newspaper subscriptions: When the taxpayer has subscriptions to newspapers or magazines, this information will ensure that the address is current. This can be a very accurate source of information.

Real estate agents: When the taxpayer has recently completed a real estate transaction, it is possible to obtain certain worthwhile items of information from the real estate agent. These can include:

- The name of the notary or lawyer who handled the transaction;
- The name and address of the financial institution;
- If it was a principal or secondary residence;
- The amount of the transaction;
- The date of the transaction;
- If the property was jointly owned; and
- The taxpayer's new address, if it was a property sale.

This can be important information in determining whether the person is a non-filer and discovering assets in the case of debtors.

Religious organizations: The main purpose is to get the address and/or telephone number of the taxpayer. Questions similar to those posed to a neighbor or school can be posed to a religious organization.

Schools: The schools attended by the taxpayer's children can lead to information. This is a potentially excellent source of identifying non-filers in the case of children attending private schools. However, schools may be reluctant to provide the requested information. The following are a few items of information which may be available:

- Taxpayer's name, address, and telephone number;
- Dates and period of attendance at the school, whether full-time or part-time;
- Whether the taxpayer works at the same time and where the taxpayer works;
- Amount of tuition and terms and conditions of payment;
- Ages of the children and name and contact information of the caregiver; and
- Name and contact information of the other parent, if a former spouse.

Utilities: Utility companies, such as telephone, electricity, gas, cable, or protection services (alarm systems), may enable location of a taxpayer, particularly if she/he has just moved. The following are a few items of information they may provide:

- The type of business and owner;
- The address of the taxpayer or the place of business using the service;
- The billing name and address; and
- The financial institution where the pre-authorized payments are deducted.

Electrical consumption can be used as a proxy for estimating the size of a business.

Appendix 10.C. Recent Tax Amnesties around the World

Figure 10-C.12. Tax amnesties around the world (2008-2011)[407]

Country	Amnesty regime
Australia	An offshore disclosure initiative for foreign income and capital gains ran until June 30, 2010 and required the full amount of tax to be paid, but offered an elimination of interest penalties up to and including the 2002 tax year.
Belarus	In March 2010, a five-year tax exemption from income tax on dividend, interest, royalties, and securities, or from the sale of real estate, was introduced to help simplify and improve tax payment in the state. Appling to both Belarusian citizens and foreign residents, the amnesty aims to encourage taxpayers to repatriate income generated from abroad.
Belgium	In 2008, a change in Belgium law extended the statute of limitations which saw the extra-ordinary assessment period increased from five to seven years, enabling the Tax Authorities to more efficiently combat Income Tax Fraud. In 2010, a circular was published that clarified the tax amnesty regime and introduced an additional voluntary declaration for individuals.
Brazil	In 2009, the government expanded a program designed to facilitate the payment of back taxes including federal taxes and social security. Companies with tax debts were given up to 15 years to pay them off, with reductions to penalties and interest rates, including zero penalty and interest reduced by 45 percent for those liquidating their total debt in a single payment. In 2010, changes to the tax law included an additional federal amnesty program for debts owed to the Federal Revenue Service and the Federal Tax Attorney's Office.
France	In 2009, resident taxpayers were given the opportunity to regularize their tax position by December 31, 2009 through the creation of a new specialized unit within the French Tax Department. The cellule de regularization enabled taxpayers to disclose legal, but previously undeclared, foreign funds and assets situated in tax havens, thereby avoiding criminal prosecution and potentially benefiting from more lenient penalties.
Czech Republic	Beginning in 2011, taxpayers had an opportunity to pay tax on undeclared funds in order to avoid criminal charges and penalties.
Gibraltar	Beginning in 2011, a moratorium and amnesty was introduced to ensure advance payment of taxes and correct filing of corporate tax returns. New surcharges and penalties were introduced. There is a moratorium for 18 months, during which fines and penalties will not be incurred. The moratorium does not apply to interest on unpaid tax. In addition, an amnesty scheme with respect to past non-compliance was introduced to enable taxpayers to begin the new tax regime with a "clean slate."
Greece	In 2010, there was a six month amnesty for the repatriation of funds held in foreign banks. Taxpayers who transferred funds from foreign accounts into Greek bank accounts of at least one year could pay a 5 percent tax on the value of the funds at the time of their transfer back into Greece. If the funds were declared but remained abroad, an 8 percent tax applied.
Hungary	In March 2009, a partial amnesty to repatriated income accumulated in controlled foreign companies was introduced. 75 percent of the dividends derived from investment income were exempt if a taxpayer invested at least half of the repatriated income into treasury bonds held for a minimum of two years. A tax amnesty for individuals was also introduced.

[407] Ernst & Young (n.d.), n.a.

Country	Amnesty regime
Ireland	An investigation into taxpayers who have undeclared tax liabilities in trusts and offshore structures began in September 2009, with the opportunity to make a qualifying disclosure to Revenue.
Isle of Man	In 2010, a disclosure amnesty was in effect for three months, during which penalties were waived in respect of any relevant voluntary disclosures. Interest charges remained applicable.
Italy	In 2009, a "tax shield" for individuals and small-and medium-sized businesses was created. Under the scheme, taxpayers could pay a one-time 5 percent penalty on repatriated funds from offshore tax accounts and be pardoned any potential back taxes. The amnesty also introduced a rebuttable presumption for undeclared funds and assets held abroad, doubling the penalties for any failure to report or pay taxes. A new specialized audit team within the Italian Tax Authority was created to encourage international cooperation and deal with international tax evasion and avoidance.
Kyrgyzstan	In 2009, an amnesty scheme was introduced whereby movable and immovable property of Kyrgyzstani individuals and companies legalized during that period would be exempt from tax, customs, and social security. In addition, certain criminal and administrative liabilities and penalties for violations committed before December 31, 2008 would be waived.
Latvia	In 2010, a Shadow Economy Reduction Plan was introduced which included the ability to legalize undeclared savings by paying a tax amnesty. In addition, late interest and monetary penalties were waived if the outstanding tax due was paid within a certain time frame. The tax authority was granted additional administrative rights, such as access to information, and the penalty system was strengthened so that the application of penalties would be decided on the severity, frequency, and regularity of breaches.
Liechtenstein	In 2009, Liechtenstein and the U.K. agreed on a package of measures to improve tax compliance in an attempt to clear up the tax arrears of U.K. clients of Liechtenstein financial services and ensure that future tax liabilities would be properly met. Penalties on unpaid tax were capped at 10 percent of tax evaded over the last ten years, providing the taxpayer disclosed everything to Her Majesty's Revenue and Customs. Those who failed to make a full disclosure by the end of the program faced their accounts being closed down.
Mexico	A Tax Amnesty Repatriation Program was brought into operation in 2009, applicable on income earned in 2009 and preceding years. Capital returned to Mexico could benefit from the rate of 4 percent for natural persons and 7 percent for juridical persons with taxes owing at the moment of voluntary disclosure.
Netherlands	In 2009, a voluntary disclosure program enabled taxpayers to declare their money in foreign bank accounts and avoid penalty and criminal prosecution. A new law made tax advisors and tax directors, as well as the taxpayer, liable for penalties, the maximum amount of which is 100 percent of the tax which has not been paid. In July 2010, the penalty imposed upon the voluntary disclosure of foreign bank accounts was increased from 15 to 30 percent.
Netherlands Antilles	During April–June 2009, taxpayers could report without fear of penalty any interest received from an EU Member State in the years 2005 to 2007. In Bonaire, St. Eustatius, and Saba, a new tax legislation bill also contained a general tax amnesty provision, with a penalty reduction to 15 percent if the taxpayer made a voluntary correction.
Norway	A temporary amnesty scheme for high-net-worth individuals was introduced to report on hidden wealth abroad without tax penalties.
Portugal	In 2009, taxpayers could disclose and regularize assets held abroad and were entitled to pay a tax levied at 5 percent of the value of relevant investments as disclosed in the confidential statement, but were not subject to interest payments. Payment had to be made at the same

Country	Amnesty regime
	time or within 10 working days of receipt of the statement in order to qualify.
Singapore	In 2009, a program was launched that was designed to encourage taxpayers who had made errors in their tax matters without willful intent to evade taxes to come forward and voluntarily disclose any omissions. Provided certain qualifying conditions were satisfied (the disclosure had to be timely, accurate, complete, and self-initiated by the taxpayer), the penalties on the undercharged tax were reduced to 5 percent per year of delay.
South Africa	For a 12 month period, starting in November 2010, taxpayers had the opportunity to disclose their defaults, regularize their tax affairs, and receive total relief for monetary penalties. The full amount of tax was still payable, but the relief of interest was staggered from 100 percent in cases where no audit was pending or commenced, to 50 percent where an investigation had already begun.
Switzerland	In 2010, an amnesty was announced for income tax and inheritance tax evasion on condition of voluntary, spontaneous disclosure and full cooperation with the authorities. With limited scope, the scheme covered only penalties and fines and the principle amount — interest and arrears were still applicable.
Turkey	A tax amnesty set to encourage the legitimization of domestic and foreign assets was extended multiple times throughout 2009 and enabled taxpayers to benefit from reduced levels of tax and interest of either 2 percent or 5 percent of the tax base.
United Kingdom	In 2009, various disclosure schemes were announced including: 1) corporates and individuals with unpaid taxes linked to offshore accounts or assets could settle their tax liabilities at a favorable fixed penalty rate of 10 percent, subject to certain conditions; and 2) according to the Tax Health Plan, doctors and dentists were given the opportunity to give full disclosure of any undisclosed tax liabilities and benefit from a fixed penalty. Her Majesty's Revenue and Customs was obtaining information from various sources, including National Health Service trusts, private hospitals, and medical insurers, and those failing to take advantage of the scheme stood to face much larger penalties
United States	In 2009, the Voluntary Disclosure Program was set up to enable taxpayers to disclose unreported income from offshore accounts and offshore accounts not previously reported for the years 2003 to 2008. All taxes, interest, and penalties were still payable, along with any other previously assessed liabilities, but criminal prosecution would not be recommended.

Appendix 12.A. Sample of COTS Vendors and Products

Multiple vendors provide COTS software for tax administration. This section contains descriptions of some of those vendors and details of their offerings. This is not an exhaustive list of vendors, but represents a sample of some of the more established vendors in the market.

Figure 12-A.13. Sample of COTS vendors and products

Vendor / product	Description of services	Sample implementations
Bull / e-ris	• A company known for its hardware solutions. • In the last decade, expanded into tax administration. • Products include tax administration (e-ris) and Customs. • Product components include: FlexStudio (interface management), FlexFlow (workflow management, FlexForms (form customization) and FlexRules (rules engine). • There is a rules engine called FlexRules. • Integration with other technologies can be managed using XML Web Services.	e-ris: Namibia, Zambia, Saudi Arabic, Morocco, and Egypt Previous versions: Botswana, Rwanda and Ethiopia
CRC Sogema / SIGTAS	• Known for international development projects with 25 years of experience in emerging markets. • Tax administration product is SIGTAS (Standard Integrated Government Tax Administration System) • SIGTAS is part of CRC Sogema's public finance and tax reform portfolio. • SIGTAS has all of the core tax administration services including case management, audit, appeals and interest and penalty functionality. • SIGTAS can be implemented in client-server architecture or a web environment.	Twenty countries on three continents and the Caribbean
Crown Agents / TRIPS	• International development company working in the public and private sectors. • TRIPS was introduced in 2003 and forms a small part of a much larger business. • Uses Oracle as its foundation and is considered more of a portable solution that a fully configurable COTS. • Includes integrated taxpayer view containing information from VAT, direct taxes, duties, permits, licenses and other taxes when all implemented.	VAT in Jordan, Ghana, Guyana, Philippines, Mongolia
Fast Enterprises / GenTax	• Developed in 1997, occupies a significant position in the U.S. tax administration marketplace • COTS solution, GenTax®, has a series of taxpayer services that allow account status viewing, filing and payment history, and file and pay online. • Supports core tax administration functions and is designed to support full configuration including returns, letters,	Approximately 15 U.S. states, three Canadian provinces and Trinidad and Tobago.

Vendor / product	Description of services	Sample implementations
	penalties, interest, transactions, taxpayer types, workflow, screen layouts, window flow and more. • Developed on Microsoft technologies it can be adapted for client needs	
Oracle / ETPM[408]	• A global enterprise software company. • In 2006, Oracle purchased SPL WorldGroup. • Although SPL WorldGroup was focused on revenue and operations management for utilities, this was the beginning of Oracle's commitment to developing a COTS solution for tax and revenue departments. • COTS solution is Oracle Enterprise Taxation and Policy Management and includes all the core tax administration functions. • Functionality includes: single taxpayer view, revenue legislation automation, business process configurability, upgrades, and self-service.	Dutch TA, Vermont, Kentucky, and New Zealand in process
SAP / TRM[409]	• A global company with clients in 50 countries • With 300 customers worldwide, SAP can be considered a market leader in enterprise application software. • SAP provides a number of revenue and taxpayer solutions including services to implement, support, and maintain a tax administration system directly or through global partners. • COTS product is PSCD (Public Sector Collection and Disbursement) • PSCD includes all core tax administration functions • Functionality is divided into modules. At the core is SAP Tax and Revenue Management. Taxpayer registration and case management is added through SAP Customer Relationship Management. Taxpayer online services comes from Taxpayer Online Services, SAP 2.0.	Most recent Slovenia, Costa Rico, Pennsylvania, Zimbabwe, and Queensland
TCS / DigiGov	• Estimated by some analysts to be the largest provider of information technology in Asia and the second largest provider of business outsourcing in India. • Located in 42 countries with more than 145 offices. • Primary focus for tax products to date has been India and North America • COTS product is DigiGov which provides a comprehensive tax administration solution • Functionality includes business process automation, controls on tax evasion, manual errors management, and a taxpayer service.	13 state departments in India, Uganda

[408] Oracle Enterprise Taxation and Policy Management.
[409] Tax and Revenue Management.

Appendix 13.A. HR Performance Questionnaire[410]

Communications Questions

1. I receive regular briefings and verbal updates from my manager which keep me well informed of news and developments within the organization which are relevant to me and my team.
2. I receive regular briefings and verbal updates from the appropriate Director which keep me well informed of news and developments within the organization and its performance which are relevant to me and my team.
3. In the course of my work, I feel that the quality of communication between teams and functions works well and that this helps me and my team achieve our targets.
4. My team has regular team meetings, and these are useful in keeping me up to date on our performance and other aspects of our work which are relevant to me.
5. The written and verbal communications I receive within the organization are clear and understandable.
6. The written and verbal communications I receive within the organization are relevant to me and to my job.
7. I fully understand the strategic objectives of the organization and feel well informed about our institutional performance throughout the year.
8. I believe that the relationships between Headquarters functions/teams and outfield (Regional) functions/teams generally are very productive and help the organization as a whole to perform its duties effectively.
9. I believe that the relationships between the teams in the Regional Offices are positive and the coordination between them helps the organization to perform well as a whole.
10. I am satisfied with the standard of communication within the organization as a whole.

Education, Training, and Career Potential Questions

1. I have sufficient education to enable me to conduct my work to the required standard.
2. I have received sufficient training to enable me to conduct my work to the required standard.
3. The training I have received has helped me to conduct my work to a better standard.
4. My immediate supervisor provides on-the-job training and development which enables me to work to a higher standard.
5. I have good training opportunities to improve my skills and qualifications.
6. My immediate supervisor works with me to develop my professional skills.
7. I feel a sense of ownership for my own development and my career.

[410] Source: author Diana Osinski.

8. I am well trained to carry out my duties and responsibilities.
9. I have satisfactory prospects for career development and promotion within the organization.

Equipment, Working Conditions, and Miscellaneous Questions

1. I have the equipment that I need to do my job properly.
2. I have good working conditions.
3. I have sufficient training to effectively, efficiently, and productively use the organization’s equipment.
4. I can effectively, efficiently, and productively use the organization’s computer systems and software.
5. I am fully proficient in the use of all systems and programs (e.g., Microsoft Outlook, Excel, Word, PowerPoint, etc.) that are necessary to do my job properly, and I utilize this proficiency to deliver a good standard of work performance.

Management and Senior Management Questions

1. My achievements and contributions are valued by my immediate supervisor.
2. My immediate supervisor sets and communicates clear goals to me and takes the time to explain my role and the results for which I will be held accountable
3. The organization values my work and my contributions.
4. I am fairly compensated for my work.
5. I am satisfied with the relationship I have with my immediate supervisor.
6. My immediate supervisor measures the performance of everyone on my team accurately, fairly, and consistently.
7. My immediate supervisor directs and assigns work to members of my team effectively, fairly, and consistently.
8. I feel encouraged to make suggestions to enhance the efficiency and effectiveness of my team and feel that my ideas are valued and appreciated.
9. I feel that I have an appropriate degree of control over my work and influence the outputs of my work.
10. My immediate supervisor is good at managing people.
11. I feel comfortable asking for help from my supervisor whenever I have a problem to solve at work.
12. I know what is expected of me in performing my job.
13. Change is well managed within the organization.
14. I am treated fairly.
15. My line manager helps me to manage the pressure I come under in my job.
16. I would speak highly of the organization as an employer.

Mission Delivery Questions

1. I receive sufficient training to be able to deliver high quality customer service internally and externally (as applicable).
2. I understand what is expected of me in terms of the standards of service that I am expected to provide to external customers (if applicable).
3. I am fully aware of who my internal customers are (i.e., internal customers to whom I provide a service) and the scope and standard of services which I am expected to provide (if applicable).
4. I am fully aware of whom I receive customer services from and the scope and standards of service I expect to receive.
5. My manager places sufficient emphasis on the importance of the team providing excellent internal and external customer service.
6. Customer complaints are well managed by my team.
7. I would speak highly about the standard of customer service that I and my team provide.
8. I would speak highly about the standard of customer service provided by the organization.
9. Customer complaints are well managed by the organization.
10. My immediate supervisor continuously encourages me to provide good internal/external customer service.
11. I believe that our customer service standards are well known such that customers always know what to expect from myself and my team and therefore have their expectations managed well.
12. I believe that the standard of customer service provided to external customers is satisfactory.
13. I believe that the standard of internal customer service within the organization is satisfactory.

Policy and Procedures Questions

1. I have a comprehensive, up-to-date job description which accurately reflects what I do and need to achieve.
2. I have formal written policy and procedures on how to conduct my daily work.
3. I know the expected quantity of my work and what I need to achieve for my manager to confirm that my performance is satisfactory.
4. I know the expected quality of my work and what I need to achieve for my manager to confirm that my performance is satisfactory.
5. I perform work in an effective, efficient, and productive manner.
6. I am clear about the long-term goals and objectives of the organization.
7. I am clear about the long-term goals and objectives of my department.
8. I fully understand the standard of performance which is expected from me each year.
9. My performance is formally evaluated in a thorough way at least once a year.
10. I am fairly rewarded for my performance.

Appendix 14.A. The Twelve Steps of a High-Quality Cost Estimating Process

Figure 14-A.4. The twelve steps of a high-quality cost estimating process

The Twelve Steps of a High-Quality Cost Estimating Process[411]	
1. Define the purpose of the estimate	a. Determine the estimate's purpose, required level of detail, and overall scope; b. Determine who will receive the estimate.
2. Develop estimating plan	a. Determine the cost estimating team and develop its master schedule; b. Determine who will do the independent cost estimate; c. Outline the cost estimating approach; d. Develop the estimate timeline.
3. Define program characteristics	In a technical baseline description document, identify: a. The program's purpose and its system and performance characteristics and all system configurations, as well as any technology implications; b. Its program acquisition schedule and acquisition strategy; c. Its relationship to other existing systems, including predecessor or similar legacy systems; d. Support (manpower, training, etc.) and security needs and risk items; e. System quantities for development, test, and production; f. Deployment and maintenance plans.
4. Determine estimating structure	a. Define a work breakdown structure (WBS) and describe each element in a WBS dictionary (a major automated information system may have only a cost element structure); b. Choose the best estimating method for each WBS element; c. Identify potential cross-checks for likely cost and schedule drivers; d. Develop a cost estimating checklist.
5. Identify ground rules and assumptions	a. Clearly define what the estimate includes and excludes; b. Identify global and program-specific assumptions, such as the estimate's base year, including time-phasing and life cycle; c. Identify program schedule information by phase and program acquisition strategy; d. Identify any schedule or budget constraints, inflation assumptions, and travel costs; e. Specify equipment the government is to furnish, as well as the use of existing facilities or new modifications or developments; f. Identify the prime contractor and major subcontractors; g. Determine technology refresh cycles, technology assumptions, and new technology to be developed;

411 Adapted from U.S. Government Accountability Office (2009), p. 9.

The Twelve Steps of a High-Quality Cost Estimating Process[411]	
	h. Define commonality with legacy systems and assumed heritage savings; i. Describe the effects of new ways of doing business.
6. Obtain data	a. Create a data collection plan with an emphasis on collecting current and relevant technical, programmatic, cost, and risk data; b. Investigate possible data sources; c. Collect data and normalize them for cost accounting, inflation, learning, and quantity adjustments; d. Analyze the data for cost drivers, trends, and outliers and compare results against rules of thumb and standard factors derived from historical data; e. Interview data sources and document all pertinent information, including an assessment of data reliability and accuracy; f. Store data for future estimates.
7. Develop point estimates and compare to an independent cost estimate	a. Develop the cost model, estimating each WBS element, using the best methodology from the data collected, and including all estimating assumptions; b. Express costs in constant year dollars; c. Time-phase the results by spreading costs in the years they are expected to occur, based on the program schedule; d. Sum the WBS elements to develop the overall point estimate; e. Validate the estimate by looking for errors like double counting and omitted costs; f. Compare the estimate against the independent cost estimate and examine where and why there are differences; g. Perform cross-checks on cost drivers to see if results are similar; h. Update the model as more data become available or as changes occur, and compare results against previous estimates.
8. Conduct sensitivity analysis	a. Test the sensitivity of cost elements to changes in estimating input values and key assumptions; b. Identify effects on the overall estimate of changing the program schedule or quantities; c. Determine which assumptions are key cost drivers and which cost elements are affected most by changes
9. Conduct risk and uncertainty analysis	a. Determine and discuss with technical experts the level of cost, schedule, and technical risk associated with each WBS element; b. Analyze each risk for its severity and probability; c. Develop minimum, most likely, and maximum ranges for each risk element; d. Determine the type of risk distributions and reasons for their use; e. Ensure that risks are correlated; f. Use an acceptable statistical analysis method (e.g., Monte Carlo simulation) to develop a confidence interval around the point estimate;

The Twelve Steps of a High-Quality Cost Estimating Process[411]	
	g. Identify the confidence level of the point estimate; h. Identify the amount of contingency funding and add this to the point estimate to determine the risk-adjusted cost estimate; i. Recommend that the project or program office develop a risk management plan to track and mitigate risks.
10. Document the estimate	a. Document all steps used to develop the estimate so that a cost analyst unfamiliar with the program can recreate it quickly and produce the same result; b. Document the purpose of the estimate, the team that prepared it, and who approved the estimate and on what date; c. Describe the program, its schedule, and the technical baseline used to create the estimate; d. Present the program's time-phased life-cycle cost; e. Discuss all ground rules and assumptions; f. Include auditable and traceable data sources for each cost element, and document for all data sources how the data were normalized; g. Describe in detail the estimating methodology and rationale used to derive each WBS element's cost (more detail is better than less); h. Describe the results of the risk, uncertainty, and sensitivity analyses and whether any contingency funds were identified; i. Document how the estimate compares to the funding profile; j. Track how this estimate compares to any previous estimates.
11. Present the estimate to management for approval	a. Develop a briefing that presents the documented life-cycle cost estimate; b. Include an explanation of the technical and programmatic baseline and any uncertainties; c. Compare the estimate to an independent cost estimate (ICE) and explain any differences; d. Compare the estimate (life-cycle cost estimate (LCCE)) or ICE to the budget with enough detail to easily defend it by showing how it is accurate, complete, and high in quality; e. Focus in a logical manner on the largest cost elements and cost drivers; f. Make the content clear and complete so that those who are unfamiliar with it can easily comprehend the competence that underlies the estimate results; g. Make backup slides available for more probing questions; h. Act on and document feedback from management; i. Request acceptance of the estimate.
12. Update the estimate to reflect actual costs and changes	a. Update the estimate to reflect changes in technical or program assumptions or to keep it current as the program passes through new phases or milestones;

The Twelve Steps of a High-Quality Cost Estimating Process[411]	
	b. Replace estimates with earned value management (EVM) estimate at completion (EAC) and independent EAC from the integrated EVM system; c. Report progress on meeting cost and schedule estimates; d. Perform a postmortem and document lessons learned for elements whose actual costs or schedules differ from the estimate; e. Document all changes to the program and how they affect the cost estimate.

Appendix 15.A. An Example of the Process for Estimating the Cost of a Program in the Strategic Plan

Program: Collect domestic revenue

Sub-Program 1: Assess initial tax liability and process tax declarations

Officer in Charge: Name

Goal: All registered taxpayers submit their tax returns

Action:

- Issue remittances to taxpayers for payment of their taxes;
- Review returns for completeness/mathematical correctness;
- Capture data from returns in computer system;
- Create a list of non-filers by tax type; and
- Take follow-up action to secure missing tax returns.

Objective:

1. Tax returns are entered in the automated system for Personal Income Tax within 90 days of the filing date, and for 100 percent of VAT/PAYE returns within 30 days of filing.
2. 90 percent of targeted taxpayers file returns within 60 days of appearing on the non-filers list.

Figure 15-A.3. Goal / global objective: All registered taxpayers submit their tax return

	Expenditure Actual 20XX	Expenditure Estimated 20XX	Expenditure Planned 20XX	Expenditure Projected 20XX	Expenditure Projected 20XX
Recurrent					
Compensation of Employees					
Personnel – Direct					
Personal Benefits					
Wages					
Use of Goods and Services					
Goods and Services - Overhead					
Training					
Total					
Capital					

	Expenditure Actual 20XX	Expenditure Estimated 20XX	Expenditure Planned 20XX	Expenditure Projected 20XX	Expenditure Projected 20XX
Non-Financial Assets					
Capital Expenditures					
Purchase of Equipment/Vehicle					
Total					

Appendix 15.B. Performance Measurement

There are a variety of statistical measures that can be used when attempting to gauge the performance of the tax administration. The decisions reached in establishing measurement criteria not only define how performance will be measured, but also influence how the organization behaves. Large organizations, as discussed above, tend to devote resources toward achieving what gets measured. If the established criteria only measure some portions of a tax administration, then those will probably get attention and resources, possibly at the expense of other, equally, or more important, dimensions of work. For example, if the measure in a tax collection unit is the number of telephone calls made to stop-filers within 30 days of their filing date, the context of the call may become skewed to requiring the return, without digging deeper to ascertain the problem and being helpful, as well as gathering facts in case further contact is necessary. The object would be to make the call brief, so the collector can make as many calls as possible to fulfill the criteria that the collector is measured by.

The second problem with measuring is that things that are difficult to measure can be neglected, while things that are easier to measure may enjoy exaggerated importance within the tax administration. One of the most common performance measures that falls into this category is revenue targets. The amount of money collected during a period is easy to measure and necessary to meet the government budget objectives. Revenue targets are necessary for the tax administration to closely monitor the revenue inflows and to sensitize management to its primary responsibility of revenue collection. There is, however, a downside that should not be ignored. Often, disproportionate attention and resources are devoted to meeting monthly revenue collection targets at all costs, which can cause major distortions. Some possible distortions include:

- Legitimate refund payments are withheld, as payment would cause the target not to be met;
- Collections from some large taxpayers are held back until they are needed to meet the target;
- Some taxpayers are known but not officially registered, and these hidden taxpayers are asked to "contribute" when revenues are low;
- Upon achieving the target, staff stop activities and leave the remaining taxpayers "in reserve" until the next period;
- Fear of not meeting the target leads to harassment, inflated assessments that target ability to pay rather than the true tax liability, and misdirection of enforcement efforts away from difficult cases; and
- When targets are in danger of not being met, some taxpayers may be offered an inducement to pay their liability in advance of the legal due date.

Establishing Indicators

The tax administration can make better decisions regarding measurement by following a process that involves many people and their knowledge, experience, and wisdom. It is recommended that everyone involved submit written ideas, exchange those ideas, and come together as a group, including advisors, key members of functions, and key executives, to come to an agreement on what to measure. This process can be long, but the results are worth the time, as there is participation in the process by those who will be directly involved in compiling the statistics and using them. The quality of the decision and the understanding of those that must implement the decision are important.

Fortunately, there are shortcuts to the process of determining what measures to consider, such as the experience of other countries. There is also an appropriate sequence of steps to choosing measures. The first question in measuring performance is to look inward at the information that is currently produced to determine the reliability of the data. A second question to ask is whether the reports produced, if any, are relevant. Finally, to the extent that such reports are actually being analyzed, it should be verified whether this analysis leads to outcomes. Too often, senior management is inundated with spreadsheets of statistics with variances indicated for many items, but what is often lacking is the analysis that provides why a change has occurred, if there is a trend or pattern, what the report suggests for the future, and what recommendations can alter these projections.

The objective when establishing performance reports should not be to compile a comprehensive set of measurements but, rather, to concentrate on a select, small number of reports that can be produced with reasonable accuracy and that are meaningful.

Figure 15-B.4. Examples of measures used by selected countries[412]

Measurement	Country results
Percent of taxpayers that file their returns on time	1) Ireland: large cases – 95 percent by the due date; 99 percent by the due date + one month; 2) medium cases – 90 percent by the due date; 95 percent by the due date + one month; 3) other cases – 75 percent by the due date; 85 percent by the due date + one month; 2) Canada:[413] 91 percent of individuals filed their tax return on time; 85 percent of corporations with taxable income filed their tax return on time.
Degree to which taxpayers report complete and accurate information for determining their tax liability	Canada: trend[414]
Percent of taxpayers that paid amounts due on time, by tax type	1) United States: 86 percent of all taxpayers; 2) Canada: 94 percent of individuals and 90 percent of corporations.
Ratio of year-end outstanding tax debts to gross tax receipts	Most countries: trend
Level of debt available for collection as a percent of annual gross collections	1.3 percent Ireland; 2.7 percent Latvia
Percent of VAT and corporate tax refunds paid in 30 days	Most countries: 90 percent

412 Information adapted from OECD (March 2011), p. 73, 110-160.
413 Canada Revenue Agency (n.d.), p. 19.
414 Rather than a specific number – e.g., the exact percent of taxpayers, who report complete and accurate information – the tax administration should be looking for whether this percentage has improved.

In order to monitor performance, targets should be set against a given baseline level of performance. This is followed by establishing a future target to be achieved. For example, one of the "core" performance indicators in most tax administrations is the time it takes to process a return. The first step is to set up a system for measuring the average amount of time it takes to process a return. After some time spent observing, it may be determined that, for example, the average return is processed within 18 working days. The administration would use this data, as well as information on expectations from taxpayers and consultation with managers and supervisors involved with processing, to set a realistic future performance standard, such as "returns will be processed within 14 days after the return is filed." After the baseline has been established and standards are in place, the annual performance reports show the new average time and the percentage of times the standard was or was not met. After the system is in place, the tax administration will have a historical perspective of actual data, will establish reasonable targets, and will monitor performance in order to adjust strategies and actions where needed.

There are a number of problems associated with setting performance targets. While it may sound simple, countries struggle with developing an appropriate target level that should be achieved. One problem is setting a realistic target level and ensuring that it is not too low or too high. While a 90 percent compliance rate for individuals may be appropriate in Canada, it may not be realistic in a country that has poor communications and other challenges. If the target is set too low, it is easily obtained and the tax administration can relax. If it is set too high, it may be demoralizing to staff if it cannot be achieved.

The number of targets to set is always a debated issue. Tax administrations that are not used to measuring performance may be overwhelmed if they establish too many complex measurements. In these cases, the tax administration should determine the level of detail it needs in its measurements and, more importantly, whether management will actually use the information. The best approach for an organization that is starting with minimal performance measurements is to begin with a small number of targets that can be increased when a need for more detail is identified.

Some Common Measurements of Performance

Typical "core" measures used by tax administrations include:

- Number of returns received by tax/by type and total tax base;
- Number of stop-filers by tax and total tax base;
- Number of stop-filers by taxpayer size (small, medium, large);
- Number of returns processed (paper, e-filed);
- Time for processing returns;
- Number/value of refund claims received;
- Number/value of refund claims approved; and
- Time for processing refunds.

It should be noted that few international standards are available, as these measures are influenced by tax policy, politics, geography, history, culture, and many other factors; however, the few benchmarks below are generally accepted as international standards.

Figure 15-B.5. Typical core measures used by tax administrations around the world

Measure	International Benchmark[415]
Percent of large taxpayers declaring via Internet	100
"Stop-filers" as percent of active taxpayers	5
Late payments as percent of total tax receipts	5
Business days for VAT refunds	25

Other common measures are:

Tax revenue gap: Where there is reliable data, it may be possible to estimate the potential tax revenue that can be collected under the current tax policy. This modeled revenue expectation is then compared with the tax revenue actually collected. The resulting difference indicates the tax revenue lost due to non-compliance, corruption, inefficiencies of the tax administration, etc., which is an indication of the overall effectiveness and efficiency of the revenue administration.

Total tax revenue/GDP: This is a readily available indicator that gives a sense of the fiscal pressure. Comparing the tax to GDP ratio of countries with similar economic and tax structures gives a sense of the relative effectiveness of the tax administration. This measure is not without its problems and should be used cautiously. For example, GDP estimates can be widely inaccurate, depending on the extent of the underground economy in a country.

Actual tax revenue/tax revenue estimated in the budget: This is often used, but the tax administration should be careful to ensure that it can demonstrate that there is some validity to how the target was set.

Value of year-end tax debt/ annual net revenue: The use of this measure is questionable when attempting to compare countries. In recent OECD statistics,[416] inventories of tax debts were shown to vary widely across the countries in the survey. When the benchmark ratio of the value of year-end tax debt/annual net revenue was used as a broad indicator of the relative magnitude of the debt inventory, 16 countries had a ratio of less than 5 percent, 8 countries were between 5 and 10 percent, 4 countries were between 10-20 percent, and 4 countries were over 20 percent. This same survey observed that management information systems (MIS) in many of the revenue bodies that responded were weak, with almost one third unable to report the amount of tax collected resulting from enforced debt collection activities, and just over one quarter unable to report the number of debt cases and associated tax amounts.

[415] Gallagher (2004), p. 8-20.
[416] OECD (January 2008), p. 8.

Returns: Measures that could be considered are usually the number of cases received (intake), number of contacts, number of returns secured, number of non-filing taxpayers identified (and registered), number of cases in inventory of each of these, average processing times, and the average age of cases.

Payments: Payments categorized by tax type that are received on time as a percentage of total expected payments. This statistic is often by number of payments and the value of the payments – often, this measure is further refined by taxpayer size.

Collections: In collecting arrears, there are several measures of accomplishment. The longer a debt is owed, the less likely it will be collected, so prompt contact and action is important. Therefore, some measure of prompt contact is necessary, such as the number of cases received in a given month and the number of taxpayer contacts that are made. Others might include the average age of cases, monetary value of cases, money collected, cases over one year old, number of cases closed, number and value of garnishees and liens, number and value of assets seized, and other enforced collection actions. Each of the measures should ideally be stratified for businesses versus for natural persons, size of taxpayer, and tax type.

After deciding the performance measures, to ensure that all persons creating and using the information have a clear understanding of how the information is gathered and what it means, a chart similar to the one below should be developed to explain each measure.

Figure 15-B.6. Defining performance measures

Defining performance measures	
Percentage of taxpayers filing their VAT returns on time	Repeated for each tax type – personal income tax, PAYE, Excise, Property, etc.
Definition: a clear explanation of what the measure means.	Indicator of the effectiveness of tax administration efforts to gain compliance
Formula/Methodology: an explanation of how the measure is calculated.	Calculated by dividing the number of taxpayers who file on or before the legal due date by the total number of taxpayers who are required to file a return.
Data Source: identification of the systems or processes compiling the data.	Returns and payments module of the tax administration IT system
Frequency of Data Availability: how frequently the data is available or updated.	Data is available from the computer system usually XX days after the due date, which allows for data processing returns that have been received.
Reliability of the Data: an assessment of the reliability of the data (poor, fair, good, excellent).	Data reliability is good to excellent. Delays can occur in data entry due to leave and system problems.
Number of stop-filers by tax and total tax base	Separate indicator for each tax type (VAT, Property, Income Tax, PAYE, Excise, etc.)
Definition: a clear explanation of what the measure	Indicator of the effectiveness of tax administration

Defining performance measures	
means.	efforts to gain compliance
Formula/Methodology: an explanation of how the measure is calculated.	Calculated by subtracting the number of taxpayers who file on or before the legal due date from the total number of taxpayers who are required to file a return for the tax period.
Data Source: identification of the systems or processes compiling the data.	Returns and payments module of the tax administration IT system
Frequency of Data Availability: how frequently the data is available or updated.	VAT, PAYE, Excise are monthly; Personal Income Tax is annual on X date; Corporate Income Tax is annual on X date.
Reliability of the Data: an assessment of the reliability of the data (poor, fair, good, excellent).	Data reliability is good to excellent. Delays can occur in data entry due to leave and system problems.
Percent of tax paid tax on time	
Definition: a clear explanation of what the measure means.	Provides insight to the compliance of taxpayers in paying their tax obligations on time. The trend over time gives a good indication of any changes in compliance patterns.
Formula/Methodology: an explanation of how the measure is calculated.	This indicator is calculated by comparing the amount of tax paid for a tax liability period by the due date with the overall amount of tax debited for a given period. It measures the extent to which taxpayers comply with their statutory obligation to pay each tax liability by a date prescribed in the law.
Data Source: identification of the systems or processes compiling the data.	Returns and payments module of the tax administration IT system
Frequency of Data Availability: how frequently the data is available or updated.	VAT, PAYE, and Excise are monthly; Personal Income Tax is annual on X date; Corporate Income Tax is annual on X date.
Reliability of the Data: an assessment of the reliability of the data (poor, fair, good, excellent).	Excellent