



SECOND MEETING OF THE FORUM ON TAX ADMINISTRATION

**1-2 June, 2005
Dublin Castle, Dublin, Ireland**

Conference Note

- 1) Successful strategies for striking the balance between service and enforcement activities**
- 2) Dealing with tax professionals to achieve improved compliance with the laws**

Second Meeting of the Forum on Tax Administration—Dublin, 1-2 June 2005

Managing Compliance Risk

Background

The Forum on Tax Administration held its second full meeting in Dublin on 1-2 June 2005. The primary objective of the meeting was to have a substantive discussion among senior tax officials on two compliance-related themes:

- *Successful strategies for striking the balance between service and enforcement activities.*
- *Dealing with tax professionals to achieve improved compliance with the laws.*

Through a combination of country presentations and associated materials¹ and discussions in panel and plenary format, the meeting explored a number of issues and themes related to these topics. This note summarises the key points raised during the Forum's proceedings.

Topic 1: Successful strategies for striking the balance between service and enforcement activities

Introduction

With limited resources and demands to maximize tax revenue collections, revenue bodies face a considerable challenge in ensuring that the balance (or mix) of their service and enforcement activities achieves an optimal compliance outcome. As noted in the introduction to Australia's presentation..... "We are required to make intelligent choices about what compliance risks will be treated and how, and consistent with that, where best to apply the resources available to us". In practice, such activity does not "just happen"—it is a challenging and complex undertaking that requires a strategic and well-thought process that is systematically-executed as part of a revenue body's overall strategic management system. This context serves as a backdrop to the key points raised:

Country presentations²

- Regardless of whether the business model in place is based on administrative assessment (Norway) or self assessment principles (Australia), the fundamental approach of revenue bodies should be framed around two complementary objectives:
 - Making it as easy as possible for taxpayers (and their representatives) to comply with the law.
 - Verifying and enforcing compliance using a risk management approach.
- The objective of making it easier to comply has led to substantially greater attention being given to the range, nature and quality of services being given to taxpayers, assisted in large part by advances in modern communications technology. Some specific examples highlighted in the presentations and discussions were:

¹ Individual country presentations and discussion notes on topic 1 (Australia, Norway, and UK) and topic 2 (Ireland and United States) can be found at <http://www.oecd.org/ctp/fta>

² The presentations by Australia and Norway raised a number of similar themes. For simplicity purposes, these are presented in summary form.

- Provision of a comprehensive range of information provision services and electronic filing and payment facilities using the Internet and other electronic media.
- Accessibility to on-line personal accounts information for taxpayers and their representatives via the Internet.
- Making information reported by third parties (e.g. employers and financial institutions) available to taxpayers at the return preparation stage, in the case of Norway via a system of pre-populated returns (also known in some countries as ‘tax proposals’).³
- Development of a common channel across government for all interactions with citizens and businesses, in the case of Norway through its government Internet portal (i.e. ALTINN).

Optimal use of technology to modernize the basic processes of tax administration can have a secondary but nevertheless highly important spin-off for revenue bodies—providing increased resources for proactive compliance activities.

- Australia noted that the evolution of service standards, with both time and quality dimensions and that are made public, has served to set behavioural and performance expectations for tax officials in their dealings with taxpayers.
- In the case of Australia, the Forum heard of its strategic approach to compliance risk management, encompassing:
 - Systematic assessments of the “health” of the major revenue products (e.g. GST/VAT) administered both in an overall sense and across specific segments of taxpayers.
 - Examination of the status of particular compliance risks and consideration of the effectiveness of the current mix of strategies in dealing with them.
 - Use of a compliance model to guide the formulation of the mix of strategies to address specific compliance risks to be treated.
 - Innovative strategies that have been implemented or are being contemplated in specific market segments (see later comments)
 - The publication of an annual compliance program that discloses in considerable detail the major risks by revenue product and taxpayer segment and the strategies for treating those risks, as well as the results of each year’s compliance program activities.

For more detailed information on the Australian approach and methodology, readers are directed to the document ***Striking the Balance between Service and Enforcement: The Strategies We Use to Determine our Approach*** (see <http://www.oecd.org/ctp/fta>)

- As a practical example of the use of compliance risk management techniques in a strategic context, the Forum heard of the systematic efforts undertaken by the UK over the last 2-3 years to address serious VAT abuse, and associated revenue leakage. This has entailed efforts to: 1) understand the size, nature, and dynamics of the problem; 2) identify tactics and resources needed to address the issues; 3) quantify realistic outcomes; 4) agree and implement tactical plans, both to facilitate compliance and to treat the major risks, with clear accountabilities; and 5) continuously monitor, direct, and adjust policies and tactics as needed. Concerning 5), the Forum learnt of the UK’s

³ This concept originated with countries in the Nordic region and is now firmly established in Denmark, Estonia, Finland, Norway, and Sweden. More recently, it has been implemented in Chile. The use of these systems is currently the subject of a small study being carried out by the OECD Secretariat on behalf of the FTA’s Taxpayer Services Subgroup. A preliminary draft report is expected to be available by end-August 2005.

experience in measuring and reporting on the positive impact of its activities in both 'revenue' and 'compliance improvement' terms.⁴

- The risk management approaches adopted in both Australia and Norway, which both emphasize segmentation as an important tool, are underpinned by organizational structures in both countries based on taxpayer segment principles (i.e. Australia—separate organization units for large business, small/medium businesses, and personal taxpayers; and Norway—separate organizational units for large enterprises, petroleum enterprises, and foreign taxpayers).
- As evidence of the need for a differentiated approach to managing taxpayers' compliance, numerous examples were cited:

Large taxpayers

Australia and Norway reported in their presentations on the relatively intense level of scrutiny being given to large taxpayers, and the associated resource commitments. Related to this, Australia reported on its initiative and ongoing efforts to raise the issue of tax risk management as an aspect of corporate governance with the boards of many large corporate taxpayers.

Related to the issue of tax risk and the general desire of taxpayers (including corporate boards) for greater certainty in their tax affairs, Australia also reported on its intent to develop a more current model of administration, initially for the largest of corporations. While still at the early stages of thinking, this model might include: 1) an agreed plan on clearing the past and moving to a more current basis for tax risk management; 2) a process for verifying that large corporates' existing systems, especially for transactions-based taxes such as VAT, accurately record tax obligations and that there are processes in place to maintain that accuracy; 3) forward arrangements designed to encourage collaborative and co-operative tax risk management practices; 4) agreements on disclosure and reporting requirements; and 5) reduced penalties and interest on any past or future adjustments reflecting the open and co-operative approach to tax risk management.

Small business

Australia described its emphasis on improved record-keeping by micro-businesses and its integrated approach to improving compliance in this area with a mix of service and enforcement initiatives (e.g. free record-keeping workshops, record-keeping fact sheets tailored to specific industries, and free record-keeping software).

Norway reported on the special co-operative efforts being made with other arms of government to tackle serious tax crime, and accompanying efforts to re-organize its activities in this area by creating dedicated units of specialists. Part of this effort entails a special collaborative effort with the building and construction industry to deal with serious tax compliance issues with sub-contractors, a persistent compliance risk area in many countries. In addition to a substantial increase in service and information efforts, an initiative under consideration is the idea of special ID cards for all subcontractors on building and construction sites.

Individuals

Norway described its system of pre-populated tax returns introduced in 1999, targeted initially at employee taxpayers (but now being extended), and the efforts being made to improve its precision and efficiency. By making third party information available to taxpayers at the return preparation stage, a number of important objectives are served: 1) the compliance burden for taxpayers is reduced; 2) reporting compliance by taxpayers is improved; 3) taxpayers have greater certainty

⁴ A fairly comprehensive description of the UK strategic approach to dealing with VAT abuse is contained in the recent CFA report—*VAT Abuses- 2004 Report* (CTPA/CFA(2005)8/FINAL/CONF).

that they have fully declared their income; 4) more resources are available for enforcement; and 5) costly post-assessment adjustments are avoided.

Australia reported on their plans to implement similar arrangements, initially by making specific third party data available on-line to taxpayers to assist them complete their returns, as part of an overriding objective to give individual taxpayers greater certainty concerning their tax affairs.

Panel and plenary discussions

- There was wide acceptance of the notion that trust, community confidence, and respect are critical aspirational outcomes that must underpin how a revenue body goes about carrying out its mission, in particular, how it makes choices about what risks will be treated and the treatments to be applied, and how it goes about implementing those choices.
- There was a considerable interest in the systematic approach outlined by Australia and detailed in its background paper, in particular the emphasis it placed on differentiated treatments across different products and segments; also recognized here was the capabilities needed to plan and deliver along the lines described.
- While countries are at varying stages of development in their approach to compliance risk management in general, segmentation of the taxpayer population for risk assessment and treatment purposes is widely adopted.
- Countries are at varying stages in their implementation of the service/enforcement continuum. A number of countries expressed the view that for the medium term there would be a stronger service orientation while others felt that there had been sufficient investment in this direction and that the time was ripe for a more intensive level of enforcement across the major compliance risk areas.
- Some thought that the overall size of the tax burden and factors such as complexity also played a role in determining the service/enforcement mix; the greater the burden or complexity, the greater the importance of a facilitation emphasis.
- There is growing interest in the idea of using third party information to assist taxpayers at the return preparation stage. In addition to countries in the Nordic region which already have well established systems for issuing pre-populated returns, a number of other countries (i.e. Australia, Chile, France, Netherlands, Singapore, and Spain) indicated that they had implemented or were planning to implement similar arrangements, either by introducing a system of pre-populated tax returns or through enabling access (via the Internet) to selected taxpayer information captured from third parties.
- A number of countries emphasized the importance of flexibility in effecting resource shifts to address particular risk issues; allied with service role, others thought that notions of “nation building/ social responsibilities” should form part of a revenue body’s marketing strategy.
- A number of countries expressed the view that the efforts made to bring more innovation to service delivery had not been matched on the enforcement front and there was a need for much more innovation in the tools available to detect tax non-compliance.

Conclusions

- Concluding comments on this theme centred on:
 - As to what constitutes the right balance (or mix) of service and enforcement will vary substantially from country to country and pay regard to many factors, including the stage a revenue body has reached in developing its respective service and enforcement programs.

- The majority of taxpayers will comply with their obligations if they are given appropriate assistance; key challenges are, on the one hand, to facilitate this willingness to comply by supporting those voluntary participants with the right tools and products and, on other hand, properly targeting verification and enforcement programs to those most in need of such attention.
- The importance of transparency in building trust and community confidence.
- A desire for new operational tools to achieve improved compliance.
- There is a considerable amount that countries can learn from exchanging experiences in this area.

Topic 2: Dealing with tax professionals to achieve improved compliance with the laws

Introduction

Tax professionals play a significant role in the tax systems of many OECD countries⁵ and thus are potentially highly influential parties to administrative efforts to improve overall tax compliance. The presentations and discussions, in addition to canvassing details of the nature and scope of administrative programs to foster, and obtain leverage from, this relationship, provided some insights as to the circumstances currently prevailing in a number of countries.

Country presentations

- With over 1 million tax return preparers in the US responsible for over 50% of personal tax returns and an even greater share of business returns, the tax profession plays a significant role in the operations of the federal tax system in the US.

Over the last 4-5 years, the US has made considerable efforts and investments to improve key elements of its service delivery for both tax professionals and taxpayers, with successful outcomes being achieved in a number of important areas, e.g.:

- significant improvements in toll free telephone access capabilities;
- growth in Internet usage over the last 3 years of almost 150%; and
- growth in electronic filing of personal tax returns over the last 3 years of around 66%.

However, these successes have come at some considerable cost to the tax system in an overall sense, with a significant downscaling (around 25%) of the enforcement effort over that same period. This decline in the enforcement effort has created considerably increased opportunities for non-compliance to go unchecked, a particular concern being an upsurge in the marketing of abusive tax shelters and aggressive tax schemes.⁶⁷ A particularly worrying development in this

⁵ In relation to personal tax returns, tax professionals prepare over 30% of returns in around half of member countries; for corporate tax, the corresponding figures are over 50% of returns in around 2/3rds of member countries.

⁶ As noted in a recent report US Senate Subcommittee report *“The sale of potentially abusive and illegal tax shelters is a lucrative business in the US, and some professional firms such as accounting firms, banks, law firms, and investment advisory firms have been major participants in the development, mass marketing, and implementation of generic tax products sold to clients”* (Report of the US Senate Permanent Subcommittee on Investigations (February 2005)).

area had been the misuse/abuse of tax exempt bodies to gain unintended tax benefits. More broadly, the results of recent IRS research efforts over the last few years pointed to an overall tax gap in the region of \$312-350 billion in tax revenue for 2001, around 15-16% of the estimated theoretical tax base. This is a significant level of non-compliance which clearly warrants a stepped-up enforcement effort. For these reasons, the US was refocusing and strengthening its enforcement activities, while keeping service delivery at its current level of investment.

Concerning the upsurge in aggressive tax planning behaviour, the US observed that standards of professional conduct by tax professionals had clearly eroded in the late 1990's and that, in its view, this erosion had accelerated in more recent years. For this reason, and more broadly as part of its stepped-up enforcement effort, it had struck four clear objectives to guide administration:

- Discourage and deter non-compliance with emphasis on corrosive activity by corporations, high income individual taxpayers and other contributors to the tax gap;
- Ensure that attorneys, accountants and other tax practitioners adhere to the professional standards and follow the law;
- Detect and deter domestic and off-shore based tax and financial criminal activity;
- Deter abuse within tax-exempt and governmental entities and misuse of such entities by third parties for tax avoidance and other unintended purposes.

To reinforce the need for improvements in professional standards, the US highlighted some of the more important measures it had introduced/initiated:

- Its Office of Professional Responsibility (OPR) has been revitalized with new leadership, and given an enhanced mandate to pursue cases of professional misconduct and additional specialist resources.
 - A new code of conduct/ professional standards (known as Circular 230) has been developed and is aimed at accountants and lawyers who help clients with aggressive tax avoidance schemes.
 - New standards for written advice have been established, which build on recent victories in the courts over claims of professional privilege.
 - A new regime of fines for misconduct has been implemented: tax professionals can be subject to monetary fines up to the gross income derived from misconduct, while firms may be fined if they knew or should have known of misconduct.
 - Legislation is pending which is designed to expand the OPR's jurisdiction to cover all tax preparers, to enable OPR proceedings to be made public, and to achieve greater transparency with what are known as refund anticipation loans (which in some cases are seen as encouraging abuses).
- Ireland reported that it has worked hard over the last 15 or so years to move from what it describes was “an adversarial relationship based on mutual distrust and suspicion” to one today based on support, service and consultation. In large part, this change has been driven by a mutual understanding that both parties stand to gain by a more partnership-oriented approach in carrying out their respective responsibilities, particularly in circumstances where tax professionals, who number over 5,000, are responsible for preparing the vast majority of tax returns. To foster this

⁷ As an indication of the scale of abuse scheme activity in the US, it was reported that tough actions in relation to just one clearly abusive transaction (i.e. Son of BOSS) had led, to date, to settlements by 1,165 taxpayers with over \$3.5 billion paid to date (both tax and penalty).

relationship, a comprehensive range of measures has been put in place to facilitate interactions with tax professionals:

- simpler organizational arrangements enabling a ‘whole of taxpayer’ approach to administration;
- special contact points for dealing with problem issues;
- comprehensive information services that are targeted to tax professionals;
- a modern transactions processing capability (covering both tax returns and payments);
- establishing appropriate codes of conduct (e.g. for internal and external review); and
- a formal consultative mechanism with key stakeholders to raise issues and developments of mutual interest.

Panel and plenary discussions

- US concerns for the erosion of professional standards and the associated upsurge in aggressive tax planning behaviour, particularly among large corporations and high wealth individuals, were echoed by many participants. The discussions in panel and plenary raised a number of related issues and possible responses:
 - The use of tax avoidance participation disclosure provisions (as applies in the US and UK).
 - The emergence of new legislative safeguards (for some, these were general anti-avoidance provisions in the law; the UK cited the development of an approach described as “prospective retrospectivity” which will inevitably be tested in the courts).
 - Promoting/supporting moves for self-regulation among the profession, or regulation, if self-regulation was deemed impracticable. (However, some questioned whether self-regulation at a national level would be sufficiently effective in a global environment and raised the notion of some form of global governance.)
 - Establishing codes of conduct against which tax practitioner performance could be assessed.
 - The need for new monitoring tools (e.g. more sophisticated profiling of tax professionals’ clientele to identify abnormal patterns of tax payment).
 - Support for greater independence of the auditing function.
 - Promoting tax risk management as part of the corporate governance agenda, starting with the boards of the largest taxpayers and then progressively moving down the large and medium-sized business segment.
 - Facilitating real-time sharing of information on newly-detected schemes among members (see later comments).
 - The importance of ensuring that administrative responses differentiate tax professionals with “old-fashioned values” from those who behave in a more perverse manner.
- A number of countries (e.g. Japan) referred to the advantages of regulatory requirements for tax professionals in their own jurisdictions. These included the use of examinations to test technical competence, and a capacity to exercise some degree of control through the ability to have disciplinary action imposed for professional misconduct. Other countries reported on likely moves to greater regulation (e.g. South Africa). However, for many other countries, there was a lack of regulation and for some, little political will for change.

- From a risk management perspective, comments were made along the lines that revenue bodies need to be vigilant and responsive to those tax professionals who were prepared to test the limits of the tax laws, or alternately were involved in fraudulent schemes and practices. Meeting both of these objectives required specialized risk management approaches (e.g. good forensic skills, risk profiling of the returns prepared by tax professionals to detect abnormal patterns/ cases) and for some countries (e.g. UK and USA) were facilitated by legislative requirements for the disclosure of tax schemes/ arrangements.

At a more global level, the view was expressed by a number of Commissioners that considerably more should be done to exchange information on a real-time basis between members, particularly concerning new tax schemes and tax planning arrangements detected. The idea of a 'scheme alert' system (as raised in Seville) was again mentioned.⁸ This was, after all, how the major players in the tax profession themselves shared knowledge of, and promoted, new schemes within their own organizations. A number of Commissioners have initiated reviews of the confidentiality provisions in their legislation, questioning how far these are appropriate in today's environment.

Conclusions

- Concluding comments on this theme centred on:
 - The need for revenue bodies to be more agile and responsive to the apparent challenges.
 - A recognition that dealing with tax professionals was an integral part of the service/enforcement continuum applicable to all taxpayers.
 - The value of on-going efforts to promote good working relations with the broader tax profession.
 - The importance of efforts to promote tax risk management with corporate boards as part of their corporate governance agenda.
 - The need for more effective and timely exchanges of information between revenue bodies.
 - The potential merits of self-regulation that should be promoted and supported by revenue bodies.

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⁸ An initiative in this area is currently being developed by WP8. The Secretariat will undertake to have this work accelerated and given more prominence.