GUIDANCE NOTE

Compliance Risk Management:
Managing and Improving Tax Compliance

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ABOUT THIS DOCUMENT

Purpose

The purpose of this guidance note is to provide a framework for the application of modern compliance risk management principles to the management of tax compliance risks. It identifies and discusses the general principles found in both the identification and treatment of compliance risks within a wide variety of taxation jurisdictions. It provides information about the way in which treatment strategies influence the behaviour of small businesses in relation to their taxation obligations.

The approaches described in this document have been informed by research and information of compliance strategies contributed by OECD member countries. The Compliance Research Projects catalogue and the Compliance Strategies catalogue are companion documents to this guidance note and should be referred to in conjunction with this document.

The note was prepared with the assistance of officials from revenue authorities in Australia, Austria, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Japan, Korea, New Zealand, Norway, Sweden, Switzerland, United Kingdom (both Inland Revenue and Customs and Excise), and United States.

Background

Sharing knowledge within and beyond the OECD

With globalisation comes the increasing need for revenue authorities around the world to cooperate to help each country administer their revenue system. The work of the Organisation for Economic Cooperation and Development (OECD) and other international organisations aims to find ways to ensure the correct tax is paid in the correct jurisdiction. OECD members need to continue to explore ways of sharing experience and contributing to ongoing research.

Focus on issues of risk management

In July 1997, the Committee on Fiscal Affairs approved the practice note titled Risk Management. In addition to providing a generalized description of risk management, the Note acknowledged that a number of national revenue authorities had started to use risk management principles in order to better allocate scarce resources to achieve an optimum tax compliance strategy — one aimed at achieving the best overall tax compliance outcome for the resources employed. The note went on to describe, in brief, the concept of revenue risk management in a tax administration context, discussed some practical considerations in undertaking revenue risk assessments, and provided a brief description of a model for the application of risk management in a tax administration context — described as the ‘Revenue Risk Management Cycle’.

Recent years have witnessed major reforms in public sector administration as governments strive to improve the efficiency and effectiveness of their operations.
Managing and Improving Tax Compliance

Central to these reforms has been the establishment of sound corporate governance practices, including the application of modern risk management approaches. As a result, national revenue authorities in a number of countries have given considerable attention to the development of sound compliance risk management practices, resulting in their further evolution. During meetings of the CFA’s Forum on Strategic Management in early 2002, it was agreed that further work should be carried out by country tax officials to share experiences and to provide more comprehensive guidance on compliance risk management practices, particularly for small/medium enterprises (SMEs).

The Forum on Tax Administration Compliance Sub-group

In May 2002, tax officials from a number of OECD countries convened in London — as the Forum on Tax Administration’s Compliance Sub-group — to consider what actions could be taken to exchange experiences in the area of compliance risk management and to agree on a strategy for documenting guidance on this important topic. The scope of the Sub-group’s work was to be domestic compliance issues affecting medium and small businesses. At that meeting, a number of task groups were established and a series of subjects were identified for consideration and research. At around this same time, the FTA’s work in the area of electronic commerce suggested that there would also be value in undertaking a study of country experiences with the development of Internet search tools for compliance risk management purposes. It was therefore decide to bring this study within the work programme of the Compliance Sub-group, given its focus on compliance risk management matters.

The work of the Compliance Sub-group has now culminated in the development of a number of products that, following approval by the CFA, will be disseminated to all OECD countries. These products, all relating to Compliance Risk Management, are:

- Guidance Note: Managing and Improving Tax Compliance
- Information Note: Catalogue of Compliance Research Projects
- Information Note: Catalogue of Compliance Strategies
- Information Note: Audit Case Selection Systems
- Information Note: Use of Random Audit Programs
- Guidance Note: Progress with the Development of Internet Search Tools

Caveat

Each revenue authority faces a varied environment within which they administer their taxation system. Jurisdictions differ in respect of their policy and legislative environment and their administrative practices and culture. As such, a standard approach to tax administration may be neither practical nor desirable in a particular instance.

The documents forming the OECD tax guidance series need to be interpreted with this in mind. Care should always be taken when considering a country’s practices to fully appreciate the complex factors that have shaped a particular approach.

Inquiries and further information

Inquiries concerning any matters raised in this guidance note should be directed to Richard Highfield (Head, CTPA Tax Administration and Consumption Taxes Division), phone ++33 (0)1 4524 9463 or e-mail (richard.highfield@oecd.org).
SUMMARY

All revenue authorities are generally required to achieve as good a compliance outcome as possible (i.e., to maximise the overall level of compliance with the tax laws). For this purpose, they are appropriated a finite level of resources, meaning that careful decisions are required as to how and in what ways those resources are to be applied to achieve the best possible outcome in terms of improved compliance with the tax laws. Directly related to this issue is the critical matter of deciding the priorities for compliance action and the specific actions to be taken. In short:

- What are the major compliance risks to be addressed?
- Which taxpayers do they relate to?
- How should these risks be treated to achieve the best possible outcome?

In practice, there are many factors that complicate answering these important questions (e.g., the diversity of taxpayers’ compliance behaviours, a lack of knowledge concerning the nature and incidence of non-compliance across the different segments of taxpayers, and the complexity of many taxpayers’ tax affairs). For these sorts of reasons, revenue bodies require a systematic process for deciding what is important in a tax compliance context and how major compliance risks will be addressed.

The guidance note provides a step by step description of a strategic process for the identification and treatment of tax compliance risks, and associated monitoring and evaluation activities that are required to gauge the effectiveness of the treatment strategies implemented. In addition to describing the basic principles of risk management in a tax compliance context, the guidance note includes many practical examples drawn from revenue authorities in member countries to illustrate particular approaches and their impacts.

The guidance note has been derived from a review of the practices of national tax authorities in a number of OECD countries and generally represents the consensus of opinion among expert officials of an effective process for managing tax compliance risks. It is broadly in accord with models of risk management observed in management literature.

The note concludes with the following guidance:

- Revenue authorities are encouraged to follow the compliance risk management processes described within this guidance note. More details on the practical application of approaches described in this note can be found in the accompanying set of papers described at the beginning of this note.

- Revenue authorities are encouraged to utilise the research papers and compliance strategies contained within the catalogues of Compliance Research Projects and Compliance Strategies.
INTRODUCTION

Managing and improving compliance

1 The primary goal of a revenue authority is collect the taxes and duties payable in accordance with the law and to do this in such manner that will sustain confidence in the tax system and its administration. The actions of taxpayers — whether due to ignorance, carelessness, recklessness, or deliberate evasion — as well as weaknesses in a tax administration mean that instances of failure to comply with the law are inevitable. Therefore, tax administration should have in place strategies and structures to ensure that non-compliance with tax law is kept to a minimum.

Monitoring compliance in four domains

2 Revenue authorities have a central role (and vested interest) in ensuring that taxpayers and other parties understand their obligations under the revenue laws. For their part, taxpayers and others have an important role to play in meeting their obligations as, in many situations, it is only they who are in a position to know that they may have an obligation under the law.

3 While the exact obligations placed on a taxpayer are going to vary from one taxation role to another and from one jurisdiction to the next, four broad categories of obligation are likely to exist for almost all taxpayers, irrespective of jurisdiction. ‘Compliance’ will essentially relate to the extent to which a taxpayer meets these obligations.

4 These broad categories of taxpayer obligation are:
   - registration in the system;
   - timely filing or lodgement of requisite taxation information;
   - reporting of complete and accurate information (incorporating good record keeping); and
   - payment of taxation obligations on time.

5 If a taxpayer fails to meet any of the above obligations then they may be considered to be non-compliant. However, there are clearly different degrees of non-compliance. So how should compliance risks be prioritised? How should a revenue authority decide which non-compliant behaviour can be tolerated and which requires immediate action? For example, under the definition given above, non-compliance may be due to unintentional error as well as intentional fraud — and might include overpayment of tax. In addition, a taxpayer may technically meet their obligations but compliance may be in question due to interpretational differences of the law. In such circumstances, clarity of the taxation law represents a category of risk to be addressed — either by changing the law or changing the way in which it is administered.
Pursuing a risk management approach

6 All revenue authorities are appropriated a finite level of resources, invariably well short of what is required to ensure full compliance from each and every taxpayer as tax liabilities arise. This means that effective tax administration has to be about optimising collections under the tax laws in ways that sustains community confidence in the tax authority and in ways that demonstrate that the system is operating correctly. As a result, revenue authorities require a methodology for determining the most rational allocation of their resources. This is by no means a straightforward proposition.

7 Intertwined with resource allocation decisions are the issues of deciding the priorities for compliance action. What are the major risks? Which taxpayers do they relate to? How ought these risks be treated to achieve the best possible outcome? The answers to these questions are complicated by the diversity of taxpayers’ compliance behaviours (and the factors underpinning such behaviours), the complexity of many taxpayers’ tax affairs, and numerous other influences.

8 For all of the above reasons, revenue authorities require a structured and systematic process for deciding what is important in a tax compliance context and how major compliance risks will be addressed. The compliance risk management process described in this guidance note is designed to assist senior revenue officials to answer these questions in a comprehensive and defensible way.

9 The benefits of pursuing a risk management approach are well established. For a revenue authority they include:

- a structured basis for strategic planning;
- a focus on the underlying drivers (not symptoms) of non-compliance, and promotion of diversity in the treatment of major tax compliance risks, rather than the adoption of a ‘one size fits all’ approach;
- better outcomes in terms of programme efficiency and effectiveness (e.g. improved compliance with tax laws leading to increased tax collections and improved taxpayer service);
- a defensible approach that can withstand external scrutiny (e.g. by external audit officials); and
- a stronger foundation for evidence-based evaluation.

Introducing the compliance risk management process

10 In formal terms, compliance risk management is a structured process for the systematic identification, assessment, ranking, and treatment of tax compliance risks (e.g., failure to register, failure to properly report tax liabilities etc). Like risk management in general, it is an iterative process that consists of well-defined steps to support improved decision-making.

11 A model of the compliance risk management process as it may be applied by a revenue authority is shown in Figure A. The process outlined is generally consistent with existing management literature and risk management standards as espoused by various international bodies and by member OECD countries.
In an environment in which resources are limited, operating in accordance with a process framework of this kind assists revenue authorities to:

- respond quickly to changing circumstances;
- ensure that treatment strategies are applied to activities of the highest priority, and that those strategies have a high probability of success;
- leverage the impact of interventions; and thus ultimately;
- meet their business intent (to optimise collections under the law while maintaining community confidence in the system).

**Changing environments demand new treatment approaches**

Several factors have substantially increased revenue risks and the complexity and volume of service, audit and other compliance interventions by revenue authorities. These include the growth in international trade, supported by e-commerce developments, changes in employment patterns and growth in the numbers of contractors, innovations in business structures and financial products, and the commoditisation of tax schemes.

Improved levels of education, increasing impact of travel and immigration, and worldly sophistication of citizens brings with it higher community expectations of administrations and of Governments. As a consequence, revenue authorities are witnessing increased demands on their resources that necessitate different treatment approaches and interactions.

Historically, many revenue authorities have addressed compliance risks only in terms of enforcement programmes. Traditional reactive intervention strategies such as comprehensive audit represent expensive though necessary approaches to addressing some aspects of non-compliance. However, the guidance contained in this Note recognizes that the factors underlying taxpayers’ compliance behaviour in any specific risk area are frequently quite complex and, as a result, are unlikely to be treated successfully with a ‘single action’ strategy — particularly one based solely
on verification and enforcement actions. In this regard, the guidance encourages revenue authorities to give greater attention to understanding the factors that shape taxpayers’ compliance behaviour so that a potentially more effective set of responses — ones that deal with the underlying non-compliant behaviour rather than focussing on treating the symptoms — can be crafted and implemented.

**Focusing on small business**

16 The content of this guidance note is valid across the entire compliance risk spectrum. However, many of the examples used throughout the document focus on Small and Medium sized Enterprises (SMEs) and particularly on the risk of their under-reporting income, for either direct or indirect taxes. The principles and key elements are equally applicable for identifying risks associated with non-registration, non-filing, and non-payment.

17 Definitions of what is an SME vary between administrations but a useful summary can be found in the companion paper in this series, *Use of Random Audits* (where they are called Small & Midsize Businesses):

A small and midsize business is any for-profit commercial entity other than those that exceed a given (high) asset threshold. Small businesses include sole proprietor, partnership and corporate forms of organisation. They also include individual return filers who have income from self-employment, even if self-employment income is not their primary source of income.

18 SMEs represent a high risk group in most countries because they are numerous and because their income is neither fixed nor, in most cases, capable of easy verification against third party data. In addition, their commercial set-ups can lack the well developed structures for record keeping, independent audit of accounts and cash handling that help to minimise risks of under-reporting in larger businesses.

**Providing a snapshot of current practice**

19 The objective of tax administration may be constant — optimising collections under the law and increasing the levels of voluntary compliance in ways that sustains community confidence — but the means to achieving it are not. Success is founded on innovation and cooperation in understanding the market place, recognising differences and devising approaches accordingly.

20 This guidance note represents a synthesis of the ideas, compliance strategies and research initiatives of a number of OECD member countries. It provides a practical insight into how improvements to taxation system compliance might be achieved. The document is not a prescriptive plan to be followed slavishly but is, as suggested by its form, a guide to assist revenue authorities to reconsider and to improve their compliance programmes by making available the collective compliance knowledge of other OECD countries. It is important to understand that the approaches described in this document represent a desired end state. The journey to arrive at this end state is an important component in the development of the organisational culture necessary to support a risk management approach to compliance management.
1 ESTABLISHING THE CONTEXT

KEY POINTS

- Compliance risks can only be discerned within the operating context in which tax administration takes place.
- Establishing the context sets the boundaries within which compliance risk mitigation or monitoring strategies can occur.
- The context needs to be continually monitored in an effort to detect changes that might consequentially affect compliance risks.

- The business objectives of the revenue authority represent a key component of the operating context.
- Both enabling technologies and organisational commitment support systematic risk identification and risk assessment.

KEY PRODUCTS

- A statement of the environmental operating context.
- A statement of organisational priorities from senior revenue authority executives.

Recognising the operating context

21 If compliance risk management is about ensuring the appropriate application of scarce resources, then what represents a compliance risk must be determined in the light of an authority’s broader objectives. For that reason, clarifying organisational objectives is critical to bringing a compliance risk management approach to life.

22 In turn, organisational objectives reflect the context in which an authority operates. As Figure A suggests, the scope and tenor of any individual revenue authority’s approach to administering the taxation law is shaped in broad — and sometimes quite specific ways — by the specific political, socio-economic and organisational context in which it operates. In turn, the activities of the revenue authority in themselves modify and shape the operating context.

23 It is important, however, to recognise that compliance risk management — the focus of this guidance note — takes place within the broader scope of a revenue authority’s total risk management activity. Such activity would clearly involve analysis of risks that relate to the operating context of the organisation — whether risks internal to the organisation, such as internal capabilities that could affect public confidence, or risks external to the organisation, such as the legislative framework or the health of the economy. Specific risk management strategies would then be applied, as appropriate, to mitigate those risks to the extent feasible.

24 Compliance risk management looks at risks that affect compliance with registering, filing, reporting, or remitting of tax obligations. This narrower focus differentiates
compliance risk management from the wider concept of integrated risk management. As an example, the turnover of the organisation’s knowledge workers because of demographic factors — a risk affecting the operating context — may be addressed within an organisation-wide, ‘integrated’ risk management process. However, transfer pricing, the act of inappropriately shifting profits in a multinational setting to gain a tax advantage, is a compliance risk and would be addressed by the compliance risk management process.

**Focusing on compliance risks**

25 In practice, many environmental or contextual factors may directly bear on compliance risk management decision-making. These factors include:

- variations in a revenue authority’s financial resources that may substantially affect its capacity to deal with all of the major compliance risks identified;
- likely government positions on specific tax legislation changes (e.g. increased powers for revenue officials) that may represent a positive (or negative) opportunity to deal with a compliance risk; and
- weaknesses or shortages in staff skills that may seriously impede a revenue authority’s ability to deal with certain major compliance risks.

26 In a very practical sense, understanding the context in which the tax administration is to take place allows the authority to assess its sphere of influence — making clear what can or cannot be affected. Knowing what can be affected helps to define what represents a risk and what does not, what risks require a mitigation strategy versus those that might require monitoring or those that can simply be ignored.

27 Compliance risk management is therefore a continuous process demanding awareness and proactive action. It is based on reducing the likelihood and consequences of adverse impacts on agreed objectives and on increasing the opportunities for improvement through innovation. The challenge for the future is to infuse risk management into organisational culture and everyday business operations including planning, reporting and governance. The journey itself is an important aspect in the development of the organisational culture necessary to support a risk management approach to compliance management.

**Monitoring the external environment**

28 A number of factors in the external environment affect the operating context, including legislation, government policy, public opinion and economic conditions. These factors all potentially impact upon the compliance risks being faced, the allocation of resources or the manner in which the compliance risks might be addressed.

29 While sound legislation is the cornerstone of achieving a good compliance outcome, it is nevertheless often a costly response to any given non-compliance situation. As a consequence, consideration of the external legislative context represents an attempt to look at existing legislation in action in an effort to identify weaknesses and threats that may need to be addressed or mitigated through administrative practices. The role of the authority is to operate within the law. Whilst recommending changes to legislation does represent a legitimate compliance approach for revenue authorities, this guidance note concentrates on administrative rather than legislative solutions.
Revenue authorities throughout the world operate within socio-political contexts. From time to time, governments will place obligations upon authorities that might not have otherwise represented a compliance risk worthy of administrative intervention. These additional obligations nevertheless form part of the context within which the authority must operate and represent a very real impost on resource allocation and usage that must be managed.

Public opinion represents an important consideration for revenue authorities. The regard in which an authority is held within the community has a direct impact not only upon the community attitude towards compliance but also upon the ability of the revenue authority to successfully administer the taxation system — and upon the morale of revenue agency staff.

In a world of limited resources, the manner in which a compliance risk is to be addressed must be taken into consideration. This is not only because of the need to spread resources to achieve a balanced programme of compliance activity but also to ensure that the manner of treatment is acceptable to community standards. The costs of compliance to the community need to be commensurate with the level of compliance risk exposure if the authority is to be able to meet its global objectives of collecting the revenue in a manner that sustains community confidence. Community standards and the potential impact of compliance obligations are aspects of the operating context that an authority must clearly understand in order to frame an effective compliance treatment programme.

**Shaping internal capability**

A number of key internal capabilities impact upon risks associated with the administration of a taxation system. These include:

- organisational culture;
- organisational structure;
- information technology and business systems; and
- staff and business capabilities.

**Culture**

For compliance risk management to be effective, it is important for the compliance risk management methodology to be central to organisational reporting, governance and decision-making processes. Quality improvement serves as a useful analogy for compliance risk management. A quality control step would not seriously be imposed as the final step in a process. Instead, quality control is embedded in the conduct of the process itself. The same applies to compliance risk management. It needs to be a part of ‘the way we do business’.

Organisational commitment is imperative. Staff and management buy-in is essential for the effective operation of any compliance risk management system. This in turn is created by a clear and demonstrable commitment from the organisation and its leaders to any new compliance strategy, as well as sensitive management to foster common understanding and acceptance.
Structure

36 There are many different organisational structures amongst revenue authorities, and all have validity. Nevertheless, authorities need to maintain an ongoing evaluation of the operational context in light of the compliance risk management process and its outcomes. Overriding considerations within the organisation or country, such as size of the taxpayer population or a lack of resources, may well help to shape this process.

37 Compliance risk management is intended to ensure that organisational objectives, rather than objectives of specific organisational elements are achieved. The impact of organisational structures on the compliance risk management process should not be underestimated. Processes need to exist to deal with the potential adverse affects of organisational fiefdoms or 'stove pipes' which have the ability to lead to the sub-optimization of organisational compliance responses.

38 Similarly, deliberate cross organisational mechanisms and forums (sometimes referred to as horizontal management) need to be established and utilised in an effort to ensure that organisational strategies are integrated, that maximum use of intelligence is made and that well founded decisions can be made.

Example

In Canada, deliberate steps were taken to develop a community of interest in risk assessment within the Customs and Revenue Agency. In 2003, a symposium was held to address common challenges faced in identifying and assessing tax compliance risks. One hundred participants attended the symposium, representing several compliance programme areas. Discussions focused on methodologies, common infrastructure, cross-programme compliance profiling, performance evaluation, data integrity, privacy issues and creating strategic information from risk identification outputs.

In Austria several measures have been taken to join organisationally ‘distant’ units in order to focus on practical compliance problems and their quick and all-encompassing solution. These measures include the following:

- the establishment of a joint approach by the Ministry of Finance (withholding tax on wages and salaries; including a surcharge for Chamber of Commerce members), the Social Security Authorities (social security contributions) and local communities (payroll tax) to the field audit of wages and salaries; and
- a new unit with travelling teams has been established to combat illegal foreign workers’ activities in a targeted way, especially in the construction industry. Their field of responsibility has been enriched by issues of the foreign labour law, in order to be able to react ‘comprehensively’ (not just to issues of taxation). The special focus of another specialist group is the ‘quick’ reaction in the VAT and wage tax field in the construction industry (S.E.G.) to combat tax fraud (e.g. with bogus companies, carousel fraud, etc.).

Further organisational improvements will be established by introducing ‘matrix organisation style’ (organisational hierarchies, as

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1 Refer to “Tax Administration in OECD Countries: Comparative Information Series (2004)” for a further discussion of revenue authority organisational structures.
well as tax-topical responsibilities) in tax administration, thus allowing a more flexible, accurate and expert handling of emerging tax compliance problems.

**IT and business systems**

39 Compliance risk management is fundamentally founded on the ability of the authority to receive multiple pieces of disparate information and to combine and interpret them to form intelligence about the environment. From this aggregated intelligence, combined with contextual scanning, comes strategic level understanding that informs strategic compliance risk management.

40 The routine conversion of the huge volumes of often disparate compliance data to intelligence would be impossible without an Information Technology (IT) capability. It is often impractical for administrations to manually examine every single return.

41 In addition, specific resources funded to provide risk management specialty support are critical in underpinning organisational commitment and in providing a corporate-wide knowledge base and intellectual capital which facilitate continuous improvement.

**Skills**

42 An organisation’s existing compliance skills continue to be valuable even after the implementation of sophisticated IT systems. Skills and research capabilities are key elements and efficient risk identification is highly dependent on investment in analytical and research competencies. In addition, skills in areas such as mathematics and statistics, skills that are perhaps not immediately associated with revenue administration can be particularly valuable in the identification and sizing of risks. Developing an organisation’s skills involves both training people to design and operate systems and in research and intelligence activities. Staff experience can serve to prevent staff alienation, alongside the establishment of new skills.

43 The use of centralised risk identification and case selection methods can be a big cultural change for frontline compliance staff. The introduction of risk identification systems and in particular the recognition of staff that have an important compliance identification role to play is crucial. The system will only be fully effective when intelligence, analysis and front-line users understand how they contribute to the process as a whole.

44 On-going attention to staff development, not just in their knowledge of the law but in their understanding of taxpayer behaviour, their understanding of running a business and the issues faced by business people such as cash flow management, cannot be over emphasised. There must be confidence that staff have the necessary compliance capabilities to permit them to identify non-compliance where it occurs.
2 IDENTIFYING RISKS

### KEY POINTS

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<td>Risk can be identified using either top-down techniques such as macro-economic analysis or by bottom-up processes such as case-based risk assessment systems.</td>
<td>A more complete understanding of risk will occur through taking a multi-level approach to risk identification and assessment.</td>
<td></td>
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<tr>
<td>Appropriate client segmentation is fundamental to achieving a thorough identification of risks.</td>
<td>Risk identification processes that offer linkages to understanding the drivers of compliance behaviour offer the most effective leverage of intelligence.</td>
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### KEY PRODUCTS

- A comprehensive register of all risks.

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**Starting with the big picture**

45 The aim of compliance risk identification is to identify the specific compliance risks that a revenue authority must confront as comprehensively as possible, minimising the possibility of oversight, and facilitating the subsequent in-depth analysis. The 'source' and 'impact' of risks form two dimensions to the risk identification phase. It is important to determine the source of the risk in order to understand what could cause it. How to assess the impact of a risk is considered in the next chapter.

46 In a dynamic environment, an organisation needs to be alert and responsive to risks that impact on its strategic direction and which, if left unchecked, may impact on its future viability. It is obvious that any risk to the future viability of a revenue authority will impact on its capacity to manage and improve compliance with the revenue laws. Compliance risk management must therefore begin — in executive level forums — by identifying risks to the vision or strategic objectives of the organisation. These risks are part of the operating context of the authority, as we have seen, and while many relate to routine aspects of organisational management — such as limitations in corporate capability — some will have a more direct compliance perspective — such as globalisation of world economies eroding the tax revenue base.

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**Identifying strategic and operational risks**

47 Compliance risk management can be applied at the strategic (top-down) or operational/tactical level (bottom-up) or both. Risks identified at the strategic level usually require extensive and carefully managed interventions, whilst risks identified at the operational level can usually be dealt with as day-to-day business.

48 At the strategic level, compliance risk management focuses on identifying specific categories of non-compliant behaviour that are likely to have significant tax
revenue consequences if left untreated. It needs to inform evidence-based policy making and the development of legislative treatments for risk as well as the quantification of revenue risk. Recently, attention to the latter has centred on the quantification of compliance levels. In some countries defining the levels of non-compliance is taking place through the use of random audits\(^2\) in an attempt to compare compliant taxpayers with non-compliant payers at a general level. Work in this area is continuing in many member countries.

49 Consideration of existing taxation legislation often represents the most appropriate place at which to begin consideration of strategic risks. Revenue product experts can reliably identify areas of the legislation that represent the most likely risk areas requiring further consideration. Often referred to as a ‘product’ view of the environment, strategic risks identified at this stage can then be considered through other strategic lenses such as market segments or organisational capabilities.

50 As a generalisation, it would be reasonable to state that the majority of taxation law throughout the world is of a highly prescriptive nature. The law itself attempts to cover all possible consequences of the law in action. Unfortunately, the problem with prescriptive legislation is that it is rare to be able to conceive of all possible situations that might arise as a result of the application of the law. It is therefore almost impossible to create law that is both clear and entirely unambiguous. This ambiguity provides scope for non-compliance as taxpayers seek to operate in those ‘grey’ areas of the law. There will always be taxpayers determined to identify and exploit the chinks in the legislative armour in their efforts to gain personal advantage. Furthermore, prescriptive legislation tends not to allow sufficient flexibility to keep pace with developments in the business community.

51 A very useful aid to assist senior management in their consideration of strategic risks is the existence of a common language framework. Such a framework can serve to ensure that the entire risk spectrum is considered and that all participants to the risk identification conversations can participate knowledgeably about all risks raised. At the simplest level, this language framework might be represented by a matrix of compliance risks related to the major compliance obligations for the major segments of taxpayers, namely failure to register, failure to file, failure to report tax liability and failure to pay.

52 Whilst this approach provides a comprehensive mechanism to assure coverage of the entire compliance risk spectrum, it is nevertheless not often the way in which an organisation will ultimately structure itself in order to address the risk. It might be more usual to build treatment strategies for strategic risks around more aggregated project-based categories such as transfer pricing, aggressive tax planning, the underground economy and VAT refund fraud.\(^3\) However, using project-based structures or organisational structures as a vehicle for risk identification conversations is risky: it does not guarantee that the entire strategic risk spectrum is considered and it may effectively serve to limit senior management participation on the basis of a lack of business knowledge.

53 Risk identification will often entail identifying matters that, if left untreated, could pose a risk to the long term viability or sustainability of the revenue collection. Community confidence in the authority’s ability to appropriately and fairly administer the taxation system potentially strikes at the heart of sustainable revenue collection into the future. Similarly, if the administration costs to the

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\(^2\) For a more thorough discussion of the use of random audits refer to the Information Note companion to this.

\(^3\) For a definitive summary of one national revenue authority’s compliance risk identification outputs, see *Compliance Programme 2003-04*, Australian Taxation Office.
community are perceived by the community to be too onerous then once again this sentiment will progressively erode community confidence and negatively affect future revenue sustainability.

Finally, strategic consideration needs to be given to the consequences of policy expectations of the government of the day and the risks of non-delivery.

At the case-based or operational level, the aim is to identify individual cases or taxpayers that represent specific examples of clients who collectively make up the strategic level risks that the authority is proposing to address.

In essence, in case-based or operational systems the characteristics of selected taxpayer characteristics and account transactions are examined to produce an objective measure that reflects the comparative level of risk that is posed by that taxpayer relative to other taxpayers.

Some case-based systems identify the type of risk involved and may estimate the amount of tax that is at risk. However, on its own, the value of a single piece of data in determining a compliance risk is somewhat questionable. There is the very strong possibility that a single transaction may result in a potential compliance risk being identified. However, the value of these single pieces of data is magnified if the authority is able to aggregate transaction or case level data at the client level in order to build up a more comprehensive picture of compliance in relation to that client. The more sophisticated systems effectively serve to more accurately identify examples of persistent non-compliant behaviour that warrants more immediate priority.

A fundamental point of the compliance risk management process is that the strategic risk identification needs to occur and be settled prior to operational or case-based risks being identified. In the same way that the environmental scanning sets the context within which strategic risks can be effectively identified, the identification of strategic risks represents the context within which operational or case-based risk identification occurs. Nevertheless, the strategic risk identification process is informed through the continuous accumulation of data which is progressively transformed into intelligence and knowledge. This data accumulation often occurs, in part, as a result of past operational risk treatments.

In Austria there are two specific ways to aggregate information on a case level for further identifying risk (structures). The one is to collect and store standardized findings of audit activities for getting statistical data and frequencies in relation to standardized framework conditions (also published regularly). The other one concerns the behaviour of a single taxpayer in the order of successive events.

**Narrowing the perspective**

Ultimately, compliance risks need to be identified at a level of granularity that allows them to be treated. Although the ‘underground’ or ‘cash’ economy is recognised almost globally as a problem for revenue authorities, it is only when the...
concept is broken down into more specific behaviours which can be attributed to specific Sub-groups within the community that appropriate mitigation strategies can be devised.

60 In pursuit of narrower definition, compliance risk can be analysed from a number of perspectives. Most commonly, it is analysed from the perspective of the individual taxpayer. However, it can also be analysed from the perspective of an industry grouping, or from a socio-economic or even psychological perspective.

61 Because taxpayer populations are not homogeneous, many revenue authorities turn to segmenting the taxpayer population into groups with similar characteristics and identify compliance risks at these segment levels. Such action is strongly encouraged by this guidance note.

Segmenting the market

62 Market segmentation is a tool borrowed from marketing to help an organisation to better understand its client base.

63 Market segmentation breaks down the client base into sub-populations or segments with similar characteristics and features. Differentiation in this way enables an organization to better understand the behaviours and demands of its clients. In a tax administration context, segmenting the taxpayer population into sub-populations of taxpayers with similar characteristics and behaviours facilitates more precise identification and categorisation of compliance risks. This, in turn, leads to a richer understanding of the true compliance risks and should ultimately assist in the specification and delivery of risk treatments.

64 In a taxation context, the client base is often segmented from the perspective of business. Common segments include ‘small’ businesses, ‘medium-sized’ businesses, and ‘large’ businesses, and these are often defined on the basis of turnover or gross revenues, but may also be defined on the basis of assets or number of employees.

65 Other segments may be based on industry type (farming, professional, and business), the type of tax (direct, indirect) or the type of risk (domestic versus international tax, tax avoidance). Consideration of these other market segments provides insights into cash flow, market behaviours and other idiosyncrasies that may be beneficial to the administrator.

Examples

In the United Kingdom business segmentation is based on gross turnover (<£15k, £15-250K, £250k+), and individual taxpayers completing returns are categorized based on the complexity of their affairs, their public profile, and their risk status. Employers are grouped according to whether they are incorporated or unincorporated companies, and by number of employees (0-5, 6-50, 50-500, 500+).

In Denmark businesses are segmented on the basis of gross turnover, complexity in affairs and whether they are incorporated or unincorporated companies. The compliance history of the taxpayer is also planned to be integrated into this model. Individual taxpayers are categorized based on the type of the tax return, either preprinted (wage earners, pensioners etc.) or completed tax return.
In Austria taxpayers are segmented by their turnover and their number of employees. Categories include:

- largest taxpayers (G1): more than 500 employees OR turnover higher than (generally) €18.2 mill;
- large taxpayers (G2): more than 100 employees OR turnover higher than €6.25 mill;
- medium to large taxpayers (G3): more than 50 employees OR turnover higher than (generally) €2.181 mill; except for self employed professionals: €0.727 mill;
- medium taxpayers (M): more than 25 employees OR turnover higher than €0.364 mill;
- small taxpayers (K1): more than 10 employees OR turnover higher than €0.11 mill; and
- smallest taxpayers (K2): both threshold values below K1.

The important point to understand is that there are not necessarily any right or wrong approaches to market segmentation, so long as the process produces segments where the members have similar tax compliance or business qualities and/or characteristics. It is these homogeneous features that permit an authority to more accurately identify appropriate treatment strategies and to effectively target their application.

**Recognising a continuum of risk**

A revenue authority must have sound compliance risk management processes at both the strategic and operational level. There must be a close alignment of the strategic and operational compliance risk management processes. However, compliance risk management is not an ‘either/or’ proposition between strategic and operational risk identification. Instead, compliance risks lie along a continuum with strategic risks lying at one end and operational or individual case-based risks lying at the other. Along this continuum lies any number of intermediary risk categories.

The Risk Identification Diagnostic model shown in Figure 2.1 illustrates this continuum. It shows the relationship between the organisational perspective of risk and the knowledge perspective required to sustain that organisational objectives. It demonstrates that as the level at which risks are managed increases, there is a need for a commensurate increase in the level of knowledge that both informs and substantiates the strategic risks identified for treatment.
Figure 2.1 shows that as the combination of identification approaches increasingly cover the territory of the chart, so does the comprehensiveness of risk identification capability. Authorities progressing along each axis find they obtain a wider view and a greater level of understanding of their risk landscape as their identification perspective evolves. This evolution also expands strategy options, providing the ability to treat the causes of risk in a strategic, proactive way rather than treating the symptoms in a reactive way.

The model highlights two key dynamics. Coupled with the progression toward a strategic intelligence capability (top right hand corner) is an escalation in the requirement for sophisticated identification tools and technologies. Secondly, accompanying the progression from data to intelligence on the Knowledge axis is an associated progression from past to future. Data tends to be a reflection of past events, information can supply understanding of patterns and trends across data sources, and intelligence can add value by providing insight into the future. The following chart (Figure 2.2) provides practical examples to allow revenue authorities to gauge what elements are present in their current risk identification capability.

The large arrow shown in figures 2.1 and 2.2 reflects the guidance for compliance risk management decisions to begin at the strategic level and to then proceed to the operational or case-based level.
Managing and Improving Tax Compliance

72 A fundamental point to convey is that in order to ensure that the most significant risks are being addressed the strategic risk identification needs to occur and be settled before operational or case-based risks should be identified. In the same way that the environmental scanning sets the context within which strategic risks can be effectively identified, the identification of strategic risks represents the context within which operational or case-based risk identification occurs. Nevertheless, the strategic risk identification process is informed through the continuous accumulation of data which is progressively transformed into intelligence and knowledge. This data accumulation can often occur, in part, as a result of past operational risk treatments.

73 The process of strategic risk identification is intimately entwined with risk assessment and risk prioritisation steps that are considered in the next chapter to this guidance statement. It is an iterative process by which strategic risks are identified, assessed in terms of their severity and ultimately prioritised.
Using relevant indicators to identify risks

74 Most authorities use a range of data sources and data manipulation techniques accompanied by analytical tools and indicators to identify emergent risks and assess their significance. The use and manipulation of data is an important activity for both risk identification and risk assessment and sizing. For a fuller discussion of the data and information requirements refer to chapter 3 on “Assessing and Managing Risks”. Most authorities use the analytical tools and techniques to evaluate the effectiveness of compliance treatment strategies (see Chapter 7 below). Trend analysis is one example of this process.

Trend analysis: macro level indicators

75 Macro economic analyses are performed to evaluate compliance trends, and to determine whether the trends in economic data may give an early indication of a change in the levels of compliance. They illustrate a relationship between an aspect of compliance and an external statistic, benchmark or similar point of reference that can be used for tracking macro trends.

76 For example, a revenue authority may simultaneously examine the economic time series for both VAT taxes collected and domestic retail sales. If changes in retail sales go up more rapidly than taxes collected, it may indicate a widening in the compliance gap. On the other hand, if the trends are comparable, there will be a better sense that general compliance levels have not changed.

77 Other examples of macro indicators include the number of individuals filing income tax returns in comparison to the number of individuals more than fifteen years old, and corporate income tax revenues in comparison to corporate profits.

Trend analysis: public opinion indicators

78 Public opinion-based compliance indicators draw the information from public opinion surveys and research results. This group of indicators generally deals with the public’s awareness, perception, attitudes, motivation and incidence of non-compliance.

79 Analysis of trends in public attitudes and behaviours towards compliance can support strategic risk assessment and can support the development of more focused compliance strategies.

Example

The Canada Revenue Agency used a behavioural survey to classify taxpayer’s compliance behaviour into groups, and analysed the types of compliance tools that might best be used for each of those behavioural groups. They used similar survey results to analyse trends in societal attitudes to support analysis of compliance risks.

Evaluating success in identifying risk

80 For case-based risk identification and assessment systems, it is important that evaluation criteria are determined at the time of development. Consideration of how to measure the effectiveness of the risk identification process is necessary to
understand and plan the correct indicators. Evaluation criteria are also necessary in order to establish baseline measures to help determine whether the risk identification systems are improving over time, and to improve the accuracy of corporate reporting.

81 The use of random audit-based methods provides for an unbiased measurement of the accuracy of risk identification systems. However, care should be taken to:

- minimise the opportunity cost of productive audit work forgone to perform audits on randomly selected cases without a known productivity outcome;
- ensure there is no excessive burden on the taxpayer population; and
- ensure audits are conducted uniformly otherwise the validity of results cannot be substantiated.

82 Research suggests many OECD countries use a variety of criteria based on actual audit results (random or operational). Criteria may include:

- percentage of audits where adjustment is made;
- percentage of audits with a material adjustment (Canada); and
- the average adjustment amount.

Example

In Canada, the performance of the national risk identification systems is measured on an ongoing basis to determine effectiveness in identifying risk. This typically involves comparing audit results for different groupings of estimated risk. One expects that as the estimated risk increases, so too will the audit adjustment amounts. By examining that relationship the effect of targeting using the national systems can be compared to what might be expected if audits were selected randomly. Recent CRA studies show that the 'lift' factor from targeting using the national systems is 2.5 times to 4.4 times what one would expect without targeting, depending on the particular revenue product risk (individual income tax, corporate income tax, or goods and services tax). Lift is a measure of the effectiveness of a predictive model calculated as the ratio between the results obtained with and without the predictive model. It measures the degree of improvement in selecting files on the basis of the risk estimates provided.

On the basis of random audits of small and medium sized unincorporated businesses, 7.4 percent fell in the high-risk range. But 32.4 percent of the adjustments were in this group, 4.4 times higher than one would expect if there was no relationship between risk estimates and results. Comparable results were found for other criteria, such as 'hit rate' and 'high change rate'.

83 Analysis of anomalies is a useful way to ensure continuous improvement of risk identification systems. For example, analysing audit results where significant adjustments were made, but where no risk was identified, is a useful way to discover gaps in the risk identification processes. Similarly, analysing audit results with no adjustments but where high levels of risk were identified, can help refine the parameters used to detect risk.

84 Finally, good channels of communication between risk strategists and frontline compliance staff are necessary to ensure validation and identification of risk
processes. This two-way feedback process will enhance the overall risk identification strategy.
3 ASSESSING AND PRIORITISING RISKS

<table>
<thead>
<tr>
<th>KEY POINTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Authorities need a mechanism for objectively assessing the relative size of compliance risks in the context of organisational business priorities.</td>
</tr>
<tr>
<td>Assessment and prioritisation needs to be firmly based upon objective evidence.</td>
</tr>
<tr>
<td>Not all risks will necessarily be able to be addressed. What’s needed is a balanced approach to the treatment of a wide range of risks.</td>
</tr>
<tr>
<td>A balanced approach to risk prioritisation may see some risks being addressed that may not represent today’s highest revenue exposure.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>KEY PRODUCTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>A register of risks that has been quantified and prioritised according to the risk likelihood and consequence processes.</td>
</tr>
<tr>
<td>Documented organisational compliance priorities that form the compliance programme for the year of effect.</td>
</tr>
</tbody>
</table>

Establishing a sound framework for assessment

85 Central to the process of assessing and prioritising risks is the need for a sound framework within which compliance risks of all types can be comparatively assessed in a repeatable manner. Decisions concerning compliance risk acceptability and treatment need to be based on an agreed set of quantitative and qualitative criteria.

86 Assessing and prioritising compliance risks are thus principally about quantifying the risks identified in the previous risk management phase. The purpose of this step is to separate the major risks (that need to be treated specifically) from the more minor ones. This requires consideration of the sources of specific risk identified an assessment of its potential consequences in terms of achieving corporate objectives, and judgment as to the likelihood that the consequences will occur (in the absence of any specific treatment). It relies upon the use of data and information to substantiate the consequences that are likely to be incurred if the risk occurs and/or remains unaddressed.

Consequence

87 Consequence is measured in terms of the impact that a risk would have on the achievement of organisational objectives. This may be in the form of either qualitative or quantitative measurement or both but as a minimum should be relevant to the intended objective under consideration.
The intention of any consequence model is to provide the authority with a mechanism to allow the comparative assessment of otherwise disparate risks in a manner that is repeatable.

**Example**

In Australia, the Australian Taxation Office uses a framework similar to that shown in Figure 3.1 for assessing the consequences of a risk occurring. The figure shows that the authority considers not only risks of failing to deliver on government expectations today, but risks that might adversely affect the authority’s ability to deliver sustainable revenue to the government tomorrow.

**Figure 3.1 Indicative ATO Compliance Risk Consequence Matrix**

<table>
<thead>
<tr>
<th>Consequence Rating</th>
<th>1 Low</th>
<th>2 Medium</th>
<th>3 High</th>
<th>4 Very High</th>
<th>5 Extreme</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Deliver to Government</strong></td>
<td>Variation of...</td>
<td>Less than $50m</td>
<td>Between $50m and $250m</td>
<td>Between $251m and $500m</td>
<td>Between $501m and $1b</td>
</tr>
<tr>
<td>Revenue risks</td>
<td>Objectives achieved...</td>
<td>At least 95%</td>
<td>At least 85%</td>
<td>At least 75%</td>
<td>At least 50%</td>
</tr>
<tr>
<td><strong>Maintain community confidence</strong></td>
<td>Criticism which...</td>
<td>Is justified but minor and likely to last less than a week</td>
<td>Is justified but minor but if left untreated could cause loss of support</td>
<td>Results in moderate loss of support and small amount of adverse media coverage</td>
<td>Results in large amount of adverse media coverage and causes major damage to the authority’s reputation</td>
</tr>
<tr>
<td><strong>Minimise compliance costs</strong></td>
<td>We achieve...</td>
<td>Moderate decrease (&gt;10%)</td>
<td>Minor decrease (&lt;10%)</td>
<td>No change</td>
<td>Minor increase (&lt;10%)</td>
</tr>
<tr>
<td><strong>Be known as an efficient, adaptive organisation</strong></td>
<td>The general assessment is that...</td>
<td>Failures are of a minor administrative nature; we respond well to new requirements</td>
<td>Failures pose minor business or financial risk; we recognise, but have some difficulty responding to new requirements</td>
<td>Failures pose moderate business or financial risk; we recognise, but have great difficulty responding to new requirements</td>
<td>Failures pose considerable business or financial risk and need future attention; we are slow to recognise, and have great difficulty responding to new requirements</td>
</tr>
</tbody>
</table>

**Likelihood**

Likelihood is measured in terms of the probability of the risk occurring at all. The measures can be expressed in either qualitative or quantitative terms. Figure 3.2 shows a generic model that provides alternative definitions for the likelihood of a compliance risk occurring. The descriptions given to the likelihoods in Figure 3.2 are purely illustrative. In practice, the descriptions simply need to have meaning within the authority’s organisation and to be sufficiently distinct to allow them to be used for categorisation.

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5 This framework follows the format and general tenor of one used by the Australian Taxation Office, but differs from the actual framework in matters of detail and wording.
Figure 3.2 Sample Compliance Risk Likelihood Matrix

<table>
<thead>
<tr>
<th>Rating</th>
<th>Likelihood Description</th>
<th>Illustrative definitions to help determine the likelihood rating</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Subjective definitions</td>
</tr>
<tr>
<td>1</td>
<td>Rare</td>
<td>‘May occur only in exceptional circumstances’</td>
</tr>
<tr>
<td>2</td>
<td>Unlikely</td>
<td>‘Could occur at some time’</td>
</tr>
<tr>
<td>3</td>
<td>Moderately likely</td>
<td>‘Might occur at some time’</td>
</tr>
<tr>
<td>4</td>
<td>Likely</td>
<td>‘Will probably occur in most circumstances’</td>
</tr>
<tr>
<td>5</td>
<td>Almost Certain</td>
<td>‘Is expected to occur in most circumstances’</td>
</tr>
</tbody>
</table>

Prioritising risks

90 This step entails a comparison of the assessed compliance risks against the business objectives of the revenue authority. The end-product should be a summary of prioritized compliance risks that are to be subject to specific risk treatment consideration.

91 In practice, the prioritisation requires the consequences and likelihood assessments to be brought together in an attempt to determine a relative rating of the risks. Figure 3.3 is an example how this can be done using the rating terminology drawn from Figures 3.1 and 3.2.

Figure 3.3 Sample Compliance Risk Rating Matrix

<table>
<thead>
<tr>
<th>Consequence</th>
<th>Extreme</th>
<th>Very High</th>
<th>High</th>
<th>Medium</th>
<th>Low</th>
<th>Likelihood</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>High</td>
<td>High</td>
<td>Severe</td>
<td>Severe</td>
<td>Severe</td>
<td>Rare</td>
</tr>
<tr>
<td></td>
<td>High</td>
<td>High</td>
<td>High</td>
<td>Severe</td>
<td>Severe</td>
<td>Unlikely</td>
</tr>
<tr>
<td></td>
<td>High</td>
<td>Significant</td>
<td>High</td>
<td>Significant</td>
<td>Significant</td>
<td>Possible</td>
</tr>
<tr>
<td></td>
<td>Moderate</td>
<td>Moderate</td>
<td>Significant</td>
<td>Significant</td>
<td>Significant</td>
<td>Likely</td>
</tr>
<tr>
<td></td>
<td>Low</td>
<td>Low</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Significant</td>
<td>Almost Certain</td>
</tr>
</tbody>
</table>

92 It might be tempting to think that classification of identified risks according to a carefully constructed risk rating matrix is the end of the prioritisation process. However, such confidence would be premature: risk prioritisation cannot be reduced to an objective, mathematical science. The initial rating must be revisited and confirmed following consideration of other relevant, perhaps contextual, issues. Furthermore, compliance risk management is an iterative process and it is desirable that any one step in the process is influenced by other steps. As a whole, the compliance risk management process should be operated in a way that best fulfils the objectives of the organisation.
Decisions about which risks to treat and which to monitor will potentially be impacted by many different issues, including:

- internal capability;
- is there an effective treatment;
- is there an effective capability to implement the treatment;
- risk rating/level;
- the rate of risk infection or risk rating deterioration;
- the current return of treatment (only recover revenue this year);
- the ongoing return of treatment (recover revenue in every year into the future);
- public perceptions of administration around the risk;
- the cost/benefits of proposed treatments (this is a feedback loop from the next step); and
- the wider context of the risks as a group.

These issues form the basis on which the effectiveness of treatment strategies will ultimately be evaluated.

Definitive risk ratings usually inform who in the organisation is responsible for dealing with the risk. For example, it is appropriate that risks rated as highest on the scale of consequence and likelihood (e.g. a ‘severe’ risk) will be managed at the highest level of management in the organisation. This will typically involve close and detailed liaison with government representatives and perhaps other agencies as well. As the severity of the compliance risk exposure decreases the organisational level at which the risk can be appropriately managed can reduce. Figure 3.4 provides an example of the different organisational levels appropriate for the management of given compliance risk ratings.

**Figure 3.4 Sample Responsibility Table**

<table>
<thead>
<tr>
<th>Risk Rating</th>
<th>Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Severe</td>
<td>Executive management and possibly relevant government representative</td>
</tr>
<tr>
<td>High</td>
<td>Executive management</td>
</tr>
<tr>
<td>Significant</td>
<td>Senior management</td>
</tr>
<tr>
<td>Moderate</td>
<td>Middle management</td>
</tr>
<tr>
<td>Low</td>
<td>Management by routine procedure</td>
</tr>
</tbody>
</table>

Effective compliance risk assessment and prioritisation will be repeated at several levels of the organisation. For example, once the organisation’s strategic risks have been identified, these are then inevitably handed down to senior or middle managers to permit them to then further refine the broad strategic risks and to determine priority areas for action within their area of influence. Once these decisions and priorities have been assigned, operational line management can begin the process of identifying specific cases from within their area of influence for further action. At each step in the process, the extent of the risk being managed is progressively reduced and managed at an appropriate level within the organisation.

Effective compliance risk management requires considerable research, fact-finding, analysis, and judgment. For these reasons, a revenue authority may require some
time to establish an effective risk analysis/assessment and prioritisation capability.

Managing data and information requirements

97 Access to sufficient, accurate and timely data is the lifeblood of a revenue authority’s ability to successfully administer the taxation system. This data (in its raw and processed forms i.e. intelligence) informs the risk identification, risk assessment and risk prioritisation processes. In identification, the data is aggregated to inform the strategic risk identification process. In assessment, it is used to determine the extent of the risk and in prioritisation it is used to select cases. The management of this data and information therefore represents a critical component of the compliance risk management process and warrants specific on-going attention by the authority.

Adequacy

98 In order for risk identification and assessment systems to be effective, they must have sufficient data with which to assess compliance risk. Considerable effort is required to bring together the right data to evaluate risk.

99 Administrations must ensure that, in designing their risk identification processes, they have adequate legislative and physical access to the data they actually need. It is also vital they have the knowledge and experience to infer levels of non-compliance from that data.

100 For risk identification purposes, the following types of data are central:

- tax return data, including financial statement information;
- other tax data — industry classification coding, employer payroll data, GST/VAT (UK, Canada);
- third party information (TPI) — bank interest details, personal pensions data, company register data (Austria);
- other public data, in particular, internet information (company publications, news alerts);
- benchmark data (supporting interpretative and analytical work — net and gross profit norms for trade sectors (Canada, UK), ratio of expenses to turnover (UK), neighbourhood family income averages (Canada); and
- feedback from audit and other programmes — Employer Compliance Reviews, Random Enquiry programme (UK).

6 The companion document Compliance Risk Management—Information Note (Catalogue of Compliance Research Projects) gives examples of countries research projects to better understand the nature and incidence of specific types of compliance risks.
Example

The courts can be a source of valuable third party intelligence in the identification of discrepancies between declared income and actual income.

In Switzerland the civil courts are a useful source of information for example in cases such as divorce where a spouse often gives evidence of higher levels of income than those declared through the taxation system. The criminal courts provide good intelligence in the area of financial “scandals” that are often also reported through the media. It has been the experience of the Swiss Federal Tax Administration that victims of financial fraud often turn out to be fiscal frauds themselves. As a consequence of this experience, the Swiss Federal Tax Administration has established a specialist group tasked with carrying out investigations in this field.

In Denmark the business registration number is used not only for tax assessment, VAT, customs and excises, but as a unique registration number for the business in all situations. Third Party Information related to the business is connected to the business registration number of the informer. Internet solutions are available using the business registration number and an access code for reports on payroll data, and for declarations on customs and VAT.

The pre-printed tax return for individual taxpayers is based on Third Party Information reported in connection to the unique registration number for persons. The information is pre-printed on the tax return for the taxpayer’s own control. A correction to the tax return is possible not only in writing, but also by phone or internet using an access code. All taxpayers have their own electronic map, covering tax returns, third party information etc. This information is protected by the access code and is also available to taxpayers through the use of a digital signature.

In Korea another valuable source of third party intelligence comes from community or “whistle blower” tip offs. In many cases, the whistle blower provides the agency with very concrete evidence to corroborate non-compliance. Evidence such as duplicate accounts, hidden transaction, computer data and secret bank accounts etc. This kind of public monitoring of compliance is encouraged by the Korean tax administration through the provision of up to USD$91,000 in reward money to the “whistle blower” on the condition that the submitted information proves valuable in the conduct of a field audit on the evader. However, this money incentive does create unexpected dilemmas to tax administration such as the need to perform actual audit to verify that the information is of value before the reward can be awarded.

Accuracy

101 In order to avoid an erroneous assessment of risk, the data that underlies the assessment must be accurate to the extent possible. For example, keying errors during tax return capture can create data integrity issues, as can missing values.

102 Data should be cleansed as close to its source as possible. This ensures that different users of the data do not have to repeat data integrity routines.
Data validation and correction processes should be developed as a normal part of risk identification research.

**Example**

Australia has adopted the practice in call centres of amending basic details as part of 'proof of identity' phone contact policy. This provides ongoing quality assurance of identity data and information.

### Privacy

Data sources may have legal restrictions. The question then must be how to obtain required data without placing an undue or illegal burden on the provider.

**Examples**

In the United Kingdom, the *Data Protection Act 1998* prevents auditors from receiving information they know they are not entitled to receive.

In Austria there are several legal restrictions for data (sources) access for revenue authorities. The most important are the Data Protection Act, a legal professional privilege for doctors (MD) / lawyers / public notaries etc., and bank secrecy. This last restriction is not absolute; it may not apply in cases of opened proceedings against wilful tax fraud.

Typically, privacy considerations must be addressed prior to collecting and using certain classes of data. While these provisions vary across countries, they cannot be ignored. In addition, many jurisdictions work on the principle that information must generally be used only for the purpose for which it was collected.

### Utilising data analysis tools

**Data matching**

Mandatory use of a unique identifier has long been fundamental to a revenue authority's ability to track an individual's compliance with tax obligations. The principle can be extended to business, even to the extent that all entities carrying on a business enterprise may be required to quote the number in business-to-business transactions and in reporting to the revenue authority. Making the identifier openly accessible to the business community reinforces its value and assists in making it an integral part of normal business practice. The primary value to a revenue authority from the use of identifiers is the potential they offer for internal and external data matching to reveal areas of potential non-compliance.

**Example**

In 2000 Australia introduced a unique business number that is used by Government Agencies to identify businesses. This number is publicly disclosed via a Business Register for verification of a businesses authority to transact and is an essential element in matching data and information across Government Agencies and other external sources. This number must be present on every tax
invoice or else ‘No ABN’ withholding tax is incurred and no income tax credit for GST is available.

In Denmark the business number must be present on invoices and receipts according to the code of VAT. The number is publicly disclosed via a business register by name, address or number.

In Europe the VIES (VAT information exchange system) is in operation amongst all EU member countries. This network operates through a linked network / database structure and is supported by special liaison offices in each EU member country. An additional unique identifier, the VAT-ID that has to be used on tax invoices it allows to find out, if a supplier or customer is registered as a VAT entrepreneur or not, resulting in a different tax treatment (e.g. for VAT on services).

While the existence of a unique identifier is a valuable tool to assist the data matching process, it is not essential. Other data matching techniques that rely on the matching of combined pieces of data (for example, taxpayer name, address and date of birth) will also work.

Often data from disparate sources needs to be matched and linked together. The technology used needs to be sophisticated enough to create relevant comparisons from a large volume of data, if the value of that data is not to be diminished. Many techniques exist for the interpretation of data. Again, some may be more appropriate in some situations than in others.

Example

In Canada, a variety of linkages are made. Corporate income tax filers are linked to their major shareholders. They are also linked to their associated VAT, payroll, and importer accounts. Proprietors are linked to their spouses, and to the family income levels for the neighbourhoods in which they reside. Companies are also linked to foreign affiliates and foreign transactions that were non-arms length.

In Austria, there is a link to a taxpayer’s spouse and children through the use of the social security number (as a tax ID is regularly not available for this group). Furthermore any kind of company structures should be referenced to each other in the future by its ‘subject’-ID.

Relational databases and data warehouses facilitate risk identification and assessment by providing access to:

- disparate sources of data simultaneously;
- knowledge with which to make compliance inferences about the data using appropriate analytical techniques and methodologies; and
- strategic information and/or intelligence that allows rational prioritisation in researching and identifying risks.

Statistical analysis is often used to examine taxpayer data and to find the correlation between that data and non-compliance. It typically involves using the results of prior tax audits, which are then analysed in conjunction with taxpayer data.
Data mining

111 Data mining is the process of exploration and analysis, by automatic means, of large quantities of data in order to discover meaningful patterns and rules.\(^7\)

112 Typical techniques employed include such processes as neural networks and regression trees. Essentially, for a given set of data (including the results of past case audit activity), the data mining software is asked to distinguish the characteristics of taxpayers that have been non-compliant (usually on the basis of past audit results) from those that are compliant. The software can analyse thousands of characteristics simultaneously, and find patterns in the data that can be used to provide new criteria for identifying non-compliance. It is an example of how technology can be used to supplement human auditing experience.

113 Data mining typically involves the use of sophisticated computer software and integrated database structures.

Case review

114 Expert systems typically involve the use of experienced auditors to develop criteria that will identify possible non-compliance. When the developed criteria are matched against taxpayer data, potential non-compliance is identified and, in the case of some countries, the possible revenue risks estimated.

Example

In Canada, more than two hundred criteria-based risks have been identified. Here are two examples:

- an area of concern in the rental income sector is the failure of landlords to use fair market pricing when making loss claims on residential property. The revenue authority identifies these situations in a number of ways, including the use of property tax and interest expense data to estimate the true market value of the property and its associated rental value;
- unreported income is a key issue in the underground economy. A number of criteria are used to identify potential abuses, including comparison of the taxpayers reported income against what is reported from third parties, and comparison of taxpayers' reported family incomes with those of families living in the same neighbourhood.

115 As an adjunct to electronic analysis of data, case-based systems can be used to help determine which cases deserve further examination. Experienced auditors generally access these systems. They use their local knowledge in deciding whether further compliance actions, such as audit, are warranted.

116 Systems should not ignore the value of local knowledge and front line involvement in risk identification, particularly when being used to support individual case selection. For example, in Canada, unusually low farming profits may be recognised as normal in certain areas owing to the prevalence of weather damage. By definition, this knowledge is not available in national systems, so feedback

\(^7\) Berry and Linoff, 2000, Mastering Data Mining
generated by local analysis of risks identified in national systems is an invaluable aid in improving their quality.
4 ANALYSING COMPLIANCE BEHAVIOUR

KEY POINTS

- Understanding compliance behaviour is more than guesswork: several factors are now supported by robust empirical research.
- Individual taxpayers adopt a range of motivational postures in their response to the demands of revenue authorities.
- Both economic and non-economic explanations of compliance behaviour have predictive force.
- The tax system itself, both law and administration can be a significant shaper of taxpayer behaviour.

KEY PRODUCTS

- A suite of treatment strategies that collectively address non-compliant behaviours at all levels of the compliance model.
- Products and tools to support the treatment strategies.

Establishing a forward programme for treatment

117 It has been shown that before planning any response to non-compliance, risks need to be assessed in terms of their potential impacts — the likely cost to revenue, in the short term and the long term, the potential impact on other government programmes and the risk to the reputation of the authority and community confidence in its administration. Then, an authority needs to determine, in accordance with some standardised criteria, how the risks identified should be grouped and prioritised for treatment.

118 The end result of the risk identification and assessment process is typically an ordered programme of proposed activity aligned to corporate planning and funding cycles. The issue then arises, what action should be taken to address the risks identified? Confidence that any action taken will be successful grows from a clear understanding of what is motivating the non-compliant behaviour identified.

Understanding what influences taxpayer behaviour

119 The research literature identifies two broad approaches to the problem of compliance. The first stems from an economic rationality perspective and has been developed using economic analysis. The second is concerned with wider behavioural issues and draws heavily on concepts and research from disciplines such as psychology and sociology. Economic and behavioural approaches are sometimes regarded as competing explanations. However, each approach can be
valuable in terms of understanding tax compliance and the issue is to determine how the two approaches might be used to reinforce each other.\textsuperscript{8}

Many OECD countries have invested resources into research to help understand the factors that influence taxpayer behaviour. From this research the following factors emerge as significant.

### Economic factors

- **financial burden.** There appears to be a relationship between the amount of tax owed and compliance behaviour. For example, if a business owner has a tax liability that can easily be paid they may be willing to comply. However, if the liability is large — potentially threatening the viability of the business — the owner may avoid paying at all or try to adjust the data reported so as to incur a smaller (but incorrect) tax liability;

- **the cost of compliance.** Taxpayers appear to face a number of common costs of having to comply with their tax obligations over and above the actual amount of tax they pay. These include the time taken to complete requirements, the cost of having to rely on accountants and the indirect costs associated with the complexity of tax legislation. These can include ‘psychological’ costs such as stress that comes from not being certain that they have met all of the tax rules or even knowing what those rules are. Furthermore, small businesses often express resentment about being ‘unpaid tax collectors’ because of their role in collecting and paying both indirect and direct taxes;

- **disincentives.** Investigations into the impact of deterrents, such as financial penalties and threats of prosecution(s), suggest that they may have a time limited effect on compliance behaviour of taxpayers. However, studies have shown that those who are compliant want those who are non-compliant to be punished;

- **incentives.** Giving taxpayers incentives may have a positive effect on compliance behaviour (i.e. taxpayers becoming more compliant), though this needs further exploration.

### Behavioural factors

- **individual differences.** While many taxpayers comply with their tax obligations, some do not. Individual factors influencing behaviour include gender, age, education level, moral compass, industry, personality, circumstances, and personal assessment of risk;

- **perceived inequity.** Taxpayers who believe ‘the system’ is unfair or who have personal experiences of ‘unfair’ treatment are less likely to comply;

- **perception of minimal risk.** If a taxpayer has the opportunity not to comply and thinks that there is only a minimal risk of being detected, he or she will take the risk. This presumably accounts for the greater under-reporting of certain types of income. For example, salary and wage income is usually highly ‘visible’ to a tax authority because of third party reporting. However, other forms of income may be much less

visible and therefore subject to more 'creative' accounting. (See Figure 5.2 below.);

- Risk taking. Some people view tax avoidance as a game to be played and won: they like to test their skill in avoiding their obligations and avoiding being caught.

121 In a recent work, economic psychologist Paul Webley⁹ focuses on business tax compliance. Despite the relative scarcity of research in this area, he provides an overview of robust empirical findings which recur in relation to both individuals and businesses. According to Webley, the main reasons for non-compliant behaviour can be categorised as:

- **equity**
  the perceived fairness of a taxation system is important, with taxpayers’ behaviour influenced by two perceptions: that the system treats them unfairly compared to others, and that the government is doing too little with the revenue it collects.

- **opportunity for non-compliance**
  several studies report this as the most significant explanatory factor for non-compliant behaviour. However, it is unclear whether those who are pre-disposed to non-compliance seek work where there are more opportunities – for example, self-employment as opposed to Pay As You Earn (PAYE) employment.

- **individual differences**
  those who do not comply tend to be male, younger, egotistical and have positive attitudes towards tax evasion and negative attitudes towards taxation authorities. There is some evidence to suggest that education about the taxation system has a direct impact on reducing the propensity to evade.

- **social norms**
  If a person believes that non-compliance is widespread they are much more likely not to comply themselves. Studies indicate that it is effective in reducing non-compliant behaviour to ensure that taxpayers have an accurate understanding of the compliance behaviour of others.

- **dissatisfaction with revenue authorities**
  There is a positive correlation between belief by taxpayers that the revenue authority is inefficient or unhelpful and the likelihood of their non-compliance. However, it is unclear just how potent this is compared to other factors.

122 There is a clear alignment between those factors identified from the Compliance Research Projects catalogue and the factors identified by Webley.

**Understanding what influences small business behaviour**

123 It would not be sensible for a guidance note such as this to attempt to list all of the different factors that go together to influence the attitudes and behaviours of small businesses¹⁰. Instead, what is offered is a model for thinking about those factors: a

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¹⁰ An extensive, though not exhaustive list of factors that may influence compliance is presented by the Canada Revenue Agency (CRA) in an internal document entitled Compliance Measurement Framework (2003). The list
model that will allow the user to categorise the factors in a consistent manner and in a form that will aid understanding. Furthermore, a model which is sufficiently robust to stand up to applied and practical application in a tax administration environment.

This model shown in Figure 4.1 is an approach based on the understanding of the business and the context within which it operates, as an aid to understanding the behavioural motivation towards taxation compliance.

**Figure 4.1 The model of taxpayer influences**

The model in figure 4.1 covers Business, Industry, Sociological, Economic and Psychological. These 5 categories represent different views of the taxpaying entity. Taken in combination the 5 elements offer the means to determine behavioural drivers as a step towards the successful selection of compliance treatment strategies. The following table outlines relevant factors in each category and illustrates their application by reference to data from an Australian study.
### Table 4.1 Factors influencing the compliance behaviour of businesses

<table>
<thead>
<tr>
<th>Model Category</th>
<th>Generic characteristics</th>
<th>Partial Example – Small Business Building &amp; Construction industry in Australia</th>
</tr>
</thead>
</table>
| **B** Business profile | • Structure – sole trader, partnership, company, trust  
• Size and age of the business  
• The type of activities it carries out  
• Focus – local versus international  
• Its financial data – capital investment  
• Its business intermediaries | Over 98% of taxation returns are prepared by tax agents  
Variable record keeping quality |
| **I** Industry factors such as: | • The definition/size of the industry  
• Major participants in the industry  
• Profit margins  
• Cost structures  
• Industry regulation  
• Working patterns  
• Industry issues such as levels of competition, seasonal factors and infrastructure issues | Highly unionised  
Flexible working patterns  
Highly competitive  
Low education  
Low barriers to entry |
| **S** Sociological factors such as: | • Cultural norms  
• Ethnic background  
• Attitude to government  
• Age, Gender  
• Educational level | Low levels of literacy  
Commonly held view that not paying tax is OK  
Very large male populations |
| **E** Economic factors such as: | • Investment  
• Demographic interest rates  
• The tax system  
• Government policies  
• International influence  
• Inflation  
• Markets | Peaks and troughs of work  
Industrial disputes |
| **P** Psychological factors such as: | • Greed, Risk, Fear, Trust  
• Values  
• Fairness/Equity  
• Opportunity to evade | Fear of the tax authority |
Recognising a spectrum of compliance behaviour

Figure 4.2 A spectrum of taxpayer attitudes to compliance

There is no easy answer to what influences taxpayer behaviour either towards compliance or non-compliance. However, research undertaken by Australian academic Dr Valerie Braithwaite suggests that the factors identified in the Model of Taxpayer influences combine to cause individual taxpayers (individuals or businesses) to adopt sets of values, beliefs and attitudes that can be described as ‘motivational postures’. These postures, two broadly non-compliant and two broadly compliant, characterise the way individuals relate to a revenue authority and the tax system it administers. They are represented in Figure 4.2.

**The disengaged.** At the top of the pyramid is an attitude of disengagement. It characterises those who have decided not to comply. People with this attitude either deliberately evade their responsibilities or choose to opt out. Cynicism about the tax system is usually matched by cynicism about the role of government.

**Resisters.** The attitude of resistance characterises active confrontation. The system is seen as oppressive, burdensome and inflexible. This attitude characterises those who don’t want to comply but who will if they can be persuaded that their concerns are being addressed.

**Triers.** More positive is the attitude of those who are basically willing to comply but who have difficulty in doing so and don’t always succeed. They may have difficulty understanding or meeting their obligations, but their expectation is that, in any dispute, trust and cooperation will prevail.

**Supporters.** The attitude here is one of willingness to do the right thing. There is a conscious commitment to supporting the system and accepting and managing effectively its demands. There is an acceptance of the legitimacy of the role of tax officers and a belief that they are fundamentally trustworthy.

It is important to realise that an individual taxpayer is capable of adopting any of the attitudes described at different times. It is also possible to adopt all of the attitudes simultaneously in relation to different issues. The attitudes are not fixed characteristics of a person or group, but reflect the interaction between the person or group and those that impose demands upon them.

The value of the model therefore is that it contributes to a deeper understanding of taxpayer behaviour and lays the groundwork for the development of targeted
strategies which encourage the motivation to do the right thing and constrain the motivation to resist or evade compliance.

**Discovering what drives specific behaviour**

133 Understanding the general theory of taxpayer motivation can help the revenue authority to shape and manage its compliance programme in a strategic way. In the same way, understanding the factors that drive specific compliance behaviour is essential to guide the selection of appropriate treatment strategies. Taking time to analyse compliance behaviour will assist the tax authority to address the cause of the non-compliance rather than the symptom, thereby achieving a longer-term compliance outcome. This process can be illustrated as in Figure 4.3.

**Figure 4.3 Understanding taxpayer compliance behaviour**

134 For example, over claiming business expenses (failure to report accurately) may be the non-compliant behaviour that is observed and that needs to be addressed. However, the driver of the behaviour may be the taxpayer’s need to increase cash flow in an attempt to remain competitive in a business environment where competitors routinely under-report their income or deal in cash. Alternatively, the driver may be the taxpayer’s perception that the tax rates are too high and the desire to recoup some money as compensation.

135 In a situation such as this, treating the behaviour (the symptom) will only have an impact on the affected taxpayer and even then only for a limited period of time. Moreover, the taxpayer concerned may actually feel hard done by to have been singled out for attention when those around get away with the same behaviour. This may in turn simply serve to fuel feelings of resentment to the taxation system and provoke further acts of non-compliance. Thus, looking for the underlying cause of the behaviour and selecting the appropriate strategy to address it could account for a difference in outcomes between short-term, isolated compliance (or even aggravated non-compliance) and long-term sustainable compliance.

**Example**

Analysing the behaviour of those involved in Aggressive Tax Planning (ATP) in Australia led the ATO to identify differences in the reasons that drive taxpayers in the Micro business market (<$1m turnover) to engage in aggressive tax planning from those that drive taxpayers from Small to Medium Enterprises (SMEs; $1-10m turnover).

The research showed that the distribution across the roles within the segments is quite different. In particular:

- those people most likely to be the promoters of ATP schemes tend to come from the SME segment of the market rather than from the...
Micro segment. They tend to be marketing/sales personnel, financiers, legal advisors, and designers. As promoters, they are more likely to be aware of the law and can perhaps be categorised as ‘The disengaged’ or the ‘Resisters’;

- investors in ATP schemes are more common in the Micro segment than the SME segment predominately because they represent a far larger segment of the community in general. Whilst some are invariably ‘Disengaged’ or ‘Resisters’, they are also well represented in the ‘Triers and ‘Supporters’ categories. The motivational postures of these different categories demand different treatment strategies even though their behaviours are essentially the same.

Looking behind symptoms to causes

136 It should not automatically be assumed that the target population is able to change behaviour of its own accord. This is a further reason why a tax authority must understand where the cause of the behaviour problem lies.

137 For example, the behaviour of the target population may be to always submit tax returns late (failure to file). Further analysis and investigation might determine the cause to be third party entities not making necessary information (e.g. details of dividend distributions) available to the target population in a timely fashion.

138 In this situation, penalising the target population for their behaviour is not going to fix the underlying systemic problem. A more effective strategy would be to work with the third party information providers to improve the timeliness of their information distribution.

Recognising the effect of the tax system itself

Legislation

139 Good compliance outcomes begin with good legislation. Law that is clear and unambiguous with regards to its intent and interpretation provides a solid base upon which to build administrative compliance programmes and compliance risk management. Difficult or ambiguous law creates increased opportunities for taxpayers to behave in ways that were unintended by the law.

140 In many ways, good law underpins the tax authority’s ability to deliver procedural fairness in the conduct of its administration. If the community perceive the law to be unjust or inappropriate according to community mores then, inevitably, there is an increased risk of non-compliant behaviour. For example, some taxpayers in the UK refused to pay the poll tax of the early 1990s. This action was regarded by many of those refusing to pay the tax as morally right because the tax was perceived as unfair — it treated people on similar incomes in a different way. Further, the extent of non-compliance snowballed when the amount of tax payable increased as a result of non-payment by others\(^1\).

A variation on this theme is that the application of the law can sometimes have unintended consequences from an administrative perspective. Obvious examples of this are instances of the law that take effect at economic boundaries. The law is clear about its intent and application and yet we observe behaviour that indicates active effort on the part of the community to either avoid being covered by the law when it is deemed to be onerous or else to be covered by the law when it is considered to be desirable.

Examples

In New Zealand the marginal tax rate for individuals increased from 33% to 39% at the $60,000 threshold on 1 April 2000. In comparison, company and trustee income is taxed at a flat 33%. In response to this change, some small businesses have been setting up as companies and paying themselves a shareholder employee salary of $60,000. They then pay tax on the remainder of the income at 33%, pass it to a trust, keep it there for a year or two as trustee income (with imputation credits), and then remove it from the trust as a tax paid distribution.

Again in New Zealand, a threshold determines whether employers are required to pay PAYE tax (tax withheld on employees' income) on a monthly or twice-monthly cycle. The threshold is less than $100,000 gross annual deductions for monthly payments, and $100,000 and over for twice-monthly payments. New Zealand Inland Revenue is looking at testing whether the threshold may be an incentive for businesses not to employ additional staff, but to employ contractors instead.

Administration

Administration begins with the law in place. The law represents a component of the context or environment in which a revenue authority operates and it is from this environment that we discern the compliance risks associated with administration of the law. The challenge for revenue authorities is to administer the law in a manner that sustains community confidence in their administration.

To that end, the manner of administration must be commensurate with the level of exposure to compliance risk. Any compliance imposition on the community or sub-section of the community needs to be acceptable according to community standards. In general, the compliance costs to the taxpayer associated with administration must be appropriate. Perceived high costs in relation to a given risk can inadvertently lead to increased community dissatisfaction and therefore to a decrease in taxpayer compliance.

In short, as a participant in the community, a revenue authority must administer within community standards.

12 For further discussion, see Pronk, Peter (2000) *The Relation between the administrative burden for enterprises and their compliance with tax laws*, Dutch Tax and Customs Administration, available on the ITD website.
5 DETERMINING THE TREATMENT STRATEGIES

KEY POINTS

- Compliance programmes need to provide a graduated response to compliance behaviour—making it easy for those who want to comply and applying credible enforcement to those who don’t.

- Acting at all times with integrity and in a manner perceived to be fair and reasonable will encourage voluntary compliance.

- Treatment needs to address the underlying drivers of compliance behaviour.

- Enhanced capacity to influence taxpayer compliance behaviour often comes through strategic alliances and partnerships with other agencies, industry bodies and tax advisers.

- Sustainable improvement in compliance can only be achieved by influencing and changing social and personal norms.

- The most effective strategies are likely to be multi-faceted and systemic.

KEY PRODUCTS

- A compliance programme covering the current planning period.

- Products and tools tailored specifically to clients to be targeted through the compliance programme.

Developing a balanced programme based on sound principles

If the risk has been appropriately stated, and if the driver of the non-compliant behaviour for the selected target group has been clearly identified, then the next step is to select or develop an appropriate treatment strategy to address the behaviour.

Influencing taxpayer behaviour is not yet a science but nor is it just guesswork. Extensive research and the practical experience of revenue authorities have helped to shape a number of principles that underpin current administrative practice among member of the OECD. The principles highlighted below are not intended to be exhaustive but are likely to have application across a wide programme of compliance activity (such as that for a specific market segment) as well as for the treatment of a specific risk. What this guidance note does not do is make recommendations about which strategy is the best in a given situation. No comparative assessment of the effectiveness of compliance strategies has yet taken place. Furthermore, in a tax administration world, it is often not possible to apply a single strategy in all situations and so, because of the variability of situations, it is not possible to recommend any specific strategy.

An important insight in the development of a compliance programme is that it be well balanced. It should include a good mix of both proactive and reactive
Managing and Improving Tax Compliance

strategies as well as strategies that cover all aspects of compliance management from education through to prosecution. Furthermore, a good balance will see the inclusion of strategies to address risks relating to different taxes or revenue products, such as income tax (including tax collected through withholding arrangements) and VAT. Finally, because non-compliance may arise as a consequence of many different drivers and express itself in the form of different behaviour, a good compliance response will oftentimes be a suite of strategies rather than a single approach.

148 A good example of the interplay of the different drivers of behaviour leading to a need for a ‘suite’ of compliance strategies is the relationship between social and personal norms and the role of deterrence. Research indicates that most people are prepared to pay their taxes if everyone else pays theirs. In a non-compliant group, taxpayer behaviour can be influenced by increasing the risk of detection, but, as long as the norms that regulate the taxpayer’s behaviour remain unchanged, then tax evasion will increase as soon as the risk of detection is reduced.

149 Any sustainable improvement in the compliance level can only be achieved by influencing and changing the social and personal norms. It is very difficult to change norms by audit activities alone. It is, on the other hand, very easy to support and maintain existing norms (of compliance) by audit activities, not because people perceive a risk of detection but because people can trust that evaders (other than themselves) will get caught.

Building community confidence

Act with fairness and integrity

150 A number of empirical studies have shown that compliance is nurtured by trust\textsuperscript{13}. The key to creating trust for a revenue authority is to act in ways that the community will experience to be fair. People’s judgements about trust are linked to their evaluations of the procedures by which authorities act. The term ‘procedural justice’ is used to describe the perceived fairness of the procedures involved in decision-making and the perceived treatment one receives from the decision-maker. Evidence shows that people who feel they have been treated fairly by an organisation will be more likely to trust that organisation and be inclined to accept its decision and follow its directions.

151 The perceived fairness of an organisation is to a great extent based on personal experience from earlier encounters, other people’s experiences and media reports. This suggests that an authority should treat citizens fairly and respectfully, listening to them and providing clear explanations for different actions. Treatment must also be even-handed and consistent: the perception that one group has been dealt with more or less favourably than another will rapidly undermine trust.

152 Perception that an authority is trustworthy (or untrustworthy) has also been shown to be a function of whether the authority trusts (or distrusts) those from whom they are demanding cooperation and compliance. If those being regulated are treated as trustworthy, they will be more likely to repay this respect by voluntary compliance with fair requirements.

\textsuperscript{13} Murphy, K (2002) ‘Trust me, I’m the taxman: The role of trust in nurturing compliance’, Centre for Tax System Integrity, The Australian National University, Canberra
A very important conclusion is that the behaviour of the revenue authority should be regarded as a part of the overall treatment strategy for influencing taxpayer behaviour. Each encounter with a taxpayer provides an opportunity for the authority to strengthen the loyalty and support of members of the public. Trust is a resource like no other; it is not depleted through use but rather through lack of use.

A lack of integrity destroys trust. Corruption in any administration cannot be tolerated because trust and corruption cannot coexist.

**Pursue a flexible, customised approach**

If it is to build and sustain the confidence of the community, a revenue authority must respond appropriately to the actions and motivations of the community it serves. The model of compliance repeated here in Figure 5.1, some components of which were presented in Chapter 4 of this guidance note, presents a continuum of regulatory and enforcement strategies aligned to a continuum of individual taxpayer attitudes and motivations. By understanding the factors that influence taxpayer behaviours and the range of attitudes towards compliance, the revenue authority is able to select the most appropriate — meaning fair and just — response.

![Figure 5.1 A model of compliance](image)

The model shows that for the majority of taxpayers who choose to pay the correct amount of tax on time, the provision of ongoing assistance will be the most helpful response to encouraging continuing compliance. However, as we move up the continuum from taxpayers who are ‘willing to do the right thing’ to taxpayers who ‘have decided not to comply’, taxpayers must be made aware that the authority will detect their non-compliance and take credible enforcement action. Credible enforcement means the taxpayer will be in a worse position after the enforcement action than they would have been if they had complied in the first instance. Achieving this will require sufficient resources to maintain a sustained effort.

Revenue authorities must have at their disposal the tools to permit them to impose sanctions upon taxpayers for non-compliant behaviour. However, the research clearly shows us that taxpayers respond better to compliance efforts if they perceive that they have received procedural justice. In other words, they perceive that they have been treated fairly by the authority and can accept that the authority has the power to take the course of action that it has. If the model of compliance is consistently and appropriately applied, this in itself represents a significant step towards demonstrating procedural justice and, in turn, building community confidence.
Improving compliance

Compliance is most likely to be optimised when a revenue authority pursues a citizen-inclusive approach to compliance through policies that encourage dialogue and persuasion, combined with an effective mix of incentives and sanctions. The following discussion outlines principles that have been derived both from the research literature and the practical experience of revenue authorities. An enduring challenge for a revenue authority is to convert these principles of fair treatment into concrete operations and routines in the day-to-day practices of its officers.

Make taxpayers’ obligations clear

If taxpayers do not understand what their obligations are, any intervention to enforce compliance will be perceived as unfair. Thus, a first step in considering how to address a specific non-compliant behaviour should be to review whether or not the appropriate steps have been taken to make obligations clear — meaning transparent, easy to understand, simple and non-confusing. Such a process might include consideration of the following issues:

- is the law clear? If not, is an amendment or additional legislation required?
- are the authority’s administrative requirements clear?
- are clear interpretative products, such as interpretive rulings, readily accessible?
- are there clear information products available, at relevant levels of detail, in the language of the taxpayer? Are these products accessible in the taxpayers’ channels of choice (e.g. web-based, paper-based, CD-Rom)?
- has there been adequate communication and marketing of the information available? Has this included publication in relevant industry or community vehicles?
- are effective support services available to meet taxpayers’ needs? (e.g. telephone enquiry services, web services, educational field visits etc)
- have opportunities been taken to remind those potentially at risk of what their obligations are?

Example

In the United Kingdom, a number of initiatives were undertaken to help taxpayers without an accountant (‘self-preparers’) to meet their tax obligations. One initiative had the aim of ensuring that un-represented self-employed taxpayers were aware of the rules regarding the computation of profits for self-assessment.

Self-assessing businesses with no agent, a turnover under £15K (significant because they do not need to give a breakdown of expenditure and audits tend not to be cost-effective), and whose businesses appeared to have a high ratio of expenses to turnover were identified locally. The businesses were sent a letter giving contact points and a sheet of ‘frequently asked questions’. The questions covered some of the most common misunderstandings about setting expenses against profits.
The success of the initiative has been evaluated by comparing the behaviour of those people who had received the letter with that of a control group who weren't contacted. Initial results indicate that the people who received the letter returned an average of £600 more profit than the control group. This increase in reported profit was mainly due to the taxpayers in the letters group reporting reduced expenses rather than reporting increased turnover.

There are plans to continue to monitor the letter group and the control group to see whether the effect can be seen to last.

Make it easy to comply

Experience tells us that the majority of taxpayers want to comply with their taxation obligations (within cultural and social norms). The appropriate response from a tax administration perspective is, therefore, to make it easy for them to do so. The attention to new businesses in various jurisdictions is simply an example of attempts to make it easy for taxpayers to comply by clearly advising them of their taxation obligations at the commencement of their business lives.

Making it easy to comply can, potentially, include all the initiatives an authority might take to improve service delivery. For example, in recent years, many authorities have sought to expand the range of electronic services (e-services) provided and have seen a rapid increase in the number of taxpayers and tax advisers taking advantage of the ease and convenience they provide. In many countries, the administrative burden of tax compliance has been shown to fall more heavily on small businesses than on large businesses. This has prompted authorities to increase efforts to simplify administrative requirements, including exploring ways of more closely aligning tax reporting to the natural systems businesses use for their own banking, accounting and financial reporting. Such initiatives have the potential to save businesses time and cost and improve the reliability of information received by the authority.

Example

The Office of Taxpayer Burden Reduction (OTBR) was established within the Taxpayer Education and Communication unit of the Small Business/Self-Employed Division of the United States Internal Revenue Service in January 2002.

The mission of the OTBR is to achieve significant burden reduction for all taxpayers but, especially for SB/SE taxpayers by coordinating and implementing meaningful burden reduction efforts that are consistent with IRS's customer service and compliance goals.

Focus areas include:

- simplifying forms, publications and communications;
- streamlining internal policies, processes and procedures; and
- promoting less burdensome rulings, regulations and law.

One issue referred to the OTBR in 2002 related to substantiation of the amount of expenses for meals furnished by child care providers. The task of keeping track of food expenses could be extremely time-consuming, particularly when purchases had to be allocated between business and personal use.
Following extensive investigation and analysis and collaboration with providers and their representatives, the OTBR secured a change in administrative requirements. Family day care providers may now choose to use a standardized rate to claim the deduction for meals provided to children in their care instead of keeping detailed records and receipts of food purchased for use in their business.

Use of the standardized rate will significantly reduce the record-keeping burden of family day care providers. Specifically, it has been calculated that day care providers could collectively save an estimated 10 million hours by using the standard meal rate. If these providers decide not to use the rates, they can continue to take the deduction based on the actual cost of the meals.

Exercise sanctions when appropriate

162 Taxpayers move up and down the continuum of the compliance pyramid for a variety of reasons. These reasons (drivers) are what revenue authorities attempt to identify through risk assessment process. Experience has taught us that overall, it is a more cost effective proposition to achieve compliance by increasing the numbers of taxpayers at the lower levels of the pyramid. Thus, the challenge for authorities is to employ strategies that progressively move taxpayers down the continuum to the lower levels.

163 While the revenue authority's preferred strategy will be one of self-regulation or voluntary compliance (at the base of the pyramid), the greatest leverage the authority can exert towards that outcome comes from taxpayers knowing that the authority has the power and will use it (at the top of the pyramid) to punish those who do not comply.

164 According to Ayres and Braithwaite, the threat of severe punishment is most effective when it is used in conjunction with a hierarchy of lesser sanctions. ‘That is, regulators will be able to speak softly when they carry big sticks (and crucially a hierarchy of lesser sanctions). Paradoxically, the bigger and more various are the sticks, the greater the success regulators will achieve by speaking softly.’ Sanctions are important, not so much as a deterrent, but as a mechanism to convince people that others are complying.

Make your powers and activity visible

165 A revenue authority must not only have powers of credible enforcement, but must also communicate effectively its use of these powers. This ‘aura’ of power helps give the authority as an institution its credibility and allows individual officers more freedom to be co-operative with individual taxpayers.

166 How might perception of an authority’s legitimate power be enhanced? Strategies that may help to achieve this outcome include:

- encouraging media reports of successful prosecutions;
- publishing information that provides taxpayers with early warning of behaviour that may be regarded by the authority as non-compliant. This kind of ‘alert’ may, for example, provide reports of court or tribunal decisions or interpretive rulings by the authority on matters of law or administrative practice;
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- sending 'leverage' letters advising taxpayers that the authority is aware of a specific risk and inviting a specific response. Such letters have dual utility: they prompt compliant behaviour from the potentially non-compliant (deterrence) and they support the perception among the compliant that their compliance is not in vain: wrongdoers are being pursued (reinforcement); and
- exercising vigilance in follow-through of known defaults in relation to basic obligations of registration, filing, reporting and payment. At some point, leniency in extending time to pay becomes counterproductive in promoting voluntary compliance.

Emerging evidence suggests that the efficacy of the risk management process can be enhanced if the risks identified and the proposed treatments are given appropriate visibility not only within the administration but within the customer base as well.

**Example**

The Swedish Tax Agency arranges a press conference every year to outline planned compliance activities (together with results from the previous year). This receives a lot of attention in the media.

Since 2003, the Australian Commissioner of Taxation has published his entire programme of compliance activities. This programme has been well received by both the community and the media and serves to raise community awareness of taxation compliance.

**Provide incentives**

One area of influence that is not used to any great extent by revenue authorities is that of incentives as a tool to achieve compliance. However, initial research evidence that would suggest that “…individual responses to positive incentives are greater than the responses to deterrence factors.”

**Example**

In the United Kingdom an incentive scheme was introduced to improve compliance amongst those businesses which fail to register for VAT.

The incentive scheme was aimed at those businesses which, for whatever reason, have failed to register despite trading above the compulsory turnover limit (currently £56,000) for over 18 months. The scheme gave these businesses relief from the usual penalties and interest connected with substantially belated notifications, although importantly it gave no relief from arrears of tax due since the correct registration date.

The integrated strategy for addressing this risk included traditional enforcement methods of bringing businesses onto the VAT register, including covert and overt investigations, and use of intelligence. The rationale for including this scheme in the integrated strategy was that it made sense to give businesses which should have registered some

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time ago an incentive to come forward voluntarily rather than take the chance of waiting for these more traditional methods.

Aspects of the strategy of interest include:

- use of professionally produced publicity to advertise the scheme;
- a definite end date to the scheme (it ran for about 6 months) after which the authority promised to crack down on those found to be continuing not to comply;
- operation within the existing legislation which allowed waiver of penalties and interest but not arrears; and
- no discrimination between those businesses which deliberately failed to notify and those which failed because of ignorance of the regulations.

The scheme finished in September 2003. Over 3000 businesses took advantage of it, with arrears of tax of over £19,000,000. Included in this total were over 30 businesses with individual arrears each of over £100,000. In addition, the publicity connected with the scheme increased awareness of the registration rules and indications are that many businesses ignorant of the rules have come forward earlier than they otherwise might have done.

**Seeking additional leverage**

**Bolster integrity through identifier, withholding and reporting systems**

As noted earlier, businesses as well as individuals can be subject to mandatory use of a unique identifier, with all entities carrying on a business enterprise being required to quote the number in business-to-business transactions and in reporting to the revenue authority. Making the identifier openly accessible to the business community reinforces its value and assists in making it an integral part of normal business practice. The use of identifiers gives an authority the opportunity to undertake internal and external data matching to reveal areas of potential non-compliance.

**Example**

In the United States, a tax credit is a dollar-for-dollar reduction of the tax payable. The tax credit for child and dependent care expenses allows taxpayers to claim a credit for expenses paid for the care of children under age 13 and for a disabled spouse or dependant. In order to claim the credit, the taxpayer, child or dependent, and expenses must meet numerous requirements. There is a limit to the amount of qualifying expenses. The credit is a percentage of the qualifying expenses.

When a credit is claimed, certain information must be reported. The taxpayer must report details of the service provider, namely the name, address and Taxpayer Identification Number (TIN) of an individual, or if a business, the Employer Identification Number (EIN), as well as the amount paid for the service. This information is subsequently matched to ensure the accuracy for both parties, and to prevent fraudulent claims.
170  Withholding systems are effective tax collection mechanisms due to their inherent ability to collect tax at the point that income is earned, promote voluntary compliance through third party reporting and ensure stable and timely cash flows to government.

**Example**

In the United States, Information (Tax) Returns are the cornerstone of the IRS’s voluntary compliance system. With over one billion Returns filed annually, Information Returns affect compliance and revenue across every taxpayer/market segment. Accordingly, IRS’ Information Reporting Programme must employ a coordinated, corporate approach to ensure a high level of compliance with information reporting requirements, while minimizing the burden on stakeholders.

Activities that comprise the Information Reporting Programme are distributed across all IRS divisions. Programmes are designed to match salary and wage information with income reported by the taxpayer when a return is filed. These programmes include Automated Under-reporter and Automated Substitute-for-Return, Backup Withholding Programme, the Information Reporting Programme Penalty Programme, Combined Annual Wage Reporting Programme, Withholding on non-resident alien individuals and foreign persons and the Business and Payor compliance activities, including those involving federal, state, and local government agencies. Reported information is also matched against the records of other agencies such as the Social Security Administration, which uses the information to determine retirement and other benefits.

As depicted in the chart below, the impact of Information Reporting is significant in terms of the variance between the projected underreporting tax gap in the ‘visibility’ categories.
Promote effective record-keeping

171 One of the keys to more effective treatment of the risk to revenue collection from the ‘shadow’ or ‘cash’ economy is better record keeping by taxpayers and third parties.

172 Better record keeping increases the visibility of cash by creating an audit trail. One of the most effective counter measures to money laundering and tax evasion is for citizens and organisations to take steps to establish the identity of people they transact with and to keep adequate records of transactions such as invoices and receipts. The potential ‘win-win’ for the revenue authority is that good record keeping is an important element of running a successful business — the foundation of good financial control. The challenge for the authority in establishing record-keeping requirements is to strike the right balance between the value to the business and the cost of compliance. Demands must be consistent with what is required for good business practice.

173 The following example illustrates the significant leverage to be gained, including improved record-keeping, by the effect of linking tax incentives to the authority’s registration and reporting systems.

**Example**

In Finland, targeted tax incentives have been used to significantly influence taxpayer behaviour — though not just towards tax compliance.
Households are allowed a tax credit in their income taxation for maintenance and renovation on their homes or holiday residences as well as for housework, caring or nursing. The annual tax credit is limited up to 1,150 euro per year and up to 60% of the payment for labour (materials are not included) to a company (trader, partnership, limited liability or a non-profit organisation). Both spouses of the household may receive the full credit.

Most of the Finnish companies pay their income taxes by advance payments, through the prepayment system. As a result no withholding is usually made from the payments for labour or services for their customers. In order to avoid the withholding, the company must produce an extract that shows that the company is registered to the tax administration's prepayment register. The extract is valid for a year. In order to stay in the register and to receive a new extract from the register, the company must comply with all tax obligations (income taxation, VAT and employer's duties). In other words, showing an extract from the prepayment register enables a company to demonstrate overall credibility as a business partner. The work that entitles a taxpayer to the tax credit has to be performed by a company that is registered on the prepayment register, that is, an extract must be produced. The income must be taxable for the company.

In order to receive the tax credit the household must file a form designated for these situations, through which the tax administration receives information of the taxpayer, the nature of the work done by the company and most importantly, the name of the company, the business identification number of the company and the amount that have been paid to the company. Receipts on the payments must also be attached to the filed form.

After trialling the system in certain parts of the country for four years, the tax credit for households was introduced in its current form in the Income Tax Act for the tax year of 2001. The relatively high tax credit has obviously attracted many households, and usage has been on a growing trend. The tax credit for the households was first and foremost targeted to encourage the households to spend more on domestic help services and through that to reduce unemployment. It is obvious that this strategy also increases compliance by guiding business opportunities to compliant companies and making it more advantageous to make open payments in situations where moonlighting is regrettably usual. Unfortunately, there is no research yet available on the impact of the strategy on compliance of the companies in the business sector.

Build community partnerships

A revenue authority may gain significant leverage in its compliance activities by building and sustaining relationships with industry associations, tax practitioners, trade unions and other community groups. From a tax administration resource perspective, the use of trusted intermediaries to achieve a leveraged compliance outcome makes excellent sense. It makes positive use of the relationships that the taxpayers have with the trusted intermediaries to help balance the compliance outcome with achieving increased community support. Achieving this balance is, after all, what tax administration is all about.

The point of leverage in the relationship with industry associations is often that the businesses that fail to meet their tax obligations pose a threat to those businesses that do comply in the form of unfair price competition. One way of exercising this
leverage is when a revenue authority works with industry representatives to establish a range of relevant financial benchmarks and ratios relevant to the industry. These might include, for example, average gross profit, net profit and wages/turnover. Tax advisers can then use this data to identify businesses that vary significantly from industry norms. They can then enquire whether there are legitimate reasons for the discrepancies or whether steps should be taken to improve the accuracy of reporting, such as by improved record keeping.

**Example**

In Australia, the Tax Office identified the failure of taxi operators to keep records of their taxi income. Research by the ATO established national benchmarks for specific financial years for takings per kilometre. Where a taxi operator has not kept proper records the benchmarks can be used as a basis for estimating the gross income derived by the vehicle. The benchmark can also be used to select taxi operators for audit reviews and is a reasonable basis for raising default assessments of tax payable. Related strategies have included widespread publication within the industry of an ATO ruling on the recording of taxi takings. These initiatives have resulted in substantial improvement in record-keeping standards and reporting within the industry.

Alliances with trusted intermediaries may be crucial to challenging community or industry attitudes and influencing taxpayer behaviour. Network alliances allow for the development of an integrated approach to addressing compliance issues and mutual support which greatly increase the chances of success of any given strategy.

**Example**

In Canada, revenue authorities launched the Atlantic Canada Fishing Industry Initiative in 2000-2001 to address a serious underground economy problem in the local fishing industry.

Legitimate fish buyers, brokers, and fish processors were experiencing difficulties in obtaining product because the suppliers of products were insisting on payment in cash, and without documentation. The problem appeared to be growing rapidly, based on preliminary verification.

Consistent with the overall Canada Revenue Agency (CRA) compliance strategy with respect to the underground economy, a regional strategy was developed based on a balanced approach—a mix of education and enforcement. Combined with the leverage obtained from partnering with key stakeholders, it was felt this would have the most immediate and significant impact on the problem. The strategy included gaining a broader understanding of the problem and identifying all potential risks. This led to the authority:

- obtaining statistical information from the Federal Department of Fisheries and Oceans (DFO) on the dollar value of the various species of fish by region of the country;
- identifying jurisdictional responsibility for the various aspects of the industry;
- reviewing all provincial and federal acts and regulations relating to licensing and reporting requirements imposed on fishers, fish buyers and fish processors;
• holding discussions with Provincial and Federal Fisheries to develop partnership arrangements; and
• conducting harbour visits to meet fish buyers to identify potential problem areas and to discuss general tax compliance issues and concerns.

Positive results obtained so far include: increased prosecutions; Nova Scotia fish buyers are now required to maintain specific books and records in order to retain their licence; CRA has instituted a staff exchange programme with the DFO to improve knowledge levels and information flow; more stringent CRA reporting requirements; and positive reaction from buyer groups and processors, the accounting profession, provincial government authorities and other federal government departments (DFO), as well as from the media.

Escalating the severity of enforcement

While the overall strategy of a revenue authority should be to encourage voluntary compliance, it must have a range of tools, graduated in severity, to deal with non-compliance. These must be applied — and be seen to be applied — as appropriate, in relation to the level of risk.

Strategies that progressively escalate the level of sanctions might include some or all of the following:

• **customised letters** alerting taxpayers to the fact that information they have reported is unusual for their industry or appears not to include income of which the authority is aware from third parties. The taxpayer is encouraged to send more or more accurate information.

• **walk-in** (unannounced) visits to businesses. Such visits may provide the opportunity for a quick check of basic registration, record-keeping and reporting requirements.

• **income/sales reviews**. These focus on the income of a business, recording processes, business procedures, matching of purchases and sales and sales being made in cash or off the books.

• **comprehensive audits**. These are in-depth investigations seeking to identify the omission of income or overstatement of expenses, usually across more than one reporting period.

• **serious evasion audits**. Such audits may involve a range of compliance checks and lead to relatively higher penalties.

• **prosecution** for cases of non-compliance involving large sums, persistent evasion or criminal activity.

As with all strategies, these approaches need to be subject to review in terms of their effectiveness as the environment changes and new forms of non-compliant behaviour are uncovered.
6 APPLYING THE STRATEGIES

**KEY POINTS**

| ■ Strategies need to be applied in a way that demonstrates effective and efficient use of resources. | ■ Engagement of staff around the intent of the strategy will help ensure effective implementation. |
| ■ Involvement of those impacted by the strategy and leverage from partnership with industry and other trusted intermediaries can be a key to successful implementation. | ■ Fair, consistent and flexible treatment will reinforce the authority’s credibility and encourage voluntary compliance. |

**KEY PRODUCTS**

| ■ Administrative business processes describing the application of compliance strategies and the deliverables to be achieved. | ■ Industry consultative forums. |
| ■ Staff trained to carry out the compliance strategies. | ■ Project plan to guide implementation. |

**Building treatment capability**

180 Effective application of any specific compliance treatment strategy depends on three key capabilities: resources, design and execution.

181 A revenue authority is accountable to the government and the community in the cost-effective use of resources to achieve compliance outcomes. In terms of design, a revenue authority needs to be able to engage the relevant industry or market segment, tax intermediaries, its own staff and other stakeholders in a collaborative process. In terms of execution, the authority needs to ensure that implementation of its treatment strategies is well planned, managed and communicated, demonstrating in the process a high standard of professionalism. These capabilities cannot be taken for granted: they need to be consciously nurtured.

182 It is not sufficient for a revenue authority to be strong in only one or two aspects of capability. The challenge is to excel in all. That means that special attention may need to be directed to shoring up areas of weakness. However, any weaknesses may only be exposed if the authority is committed to rigorous evaluation of its compliance treatment programme and performance.

**Demonstrating efficient use of resources**

183 A revenue authority needs to maximise its use of the resources at its disposal to enhance client compliance. Resources are not only human but also include all other related outlays, expenditures and the use of our capital. Effective allocation
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of resources applies at the macro and micro level. First, it should determine how limited resources are spread across all programme areas. Second, it will determine how resources are allocated to individual client programme strategies. It will include the selection and training of staff necessary to carry out a treatment strategy and the use of corporate systems and equipment.

Engaging stakeholders in implementation

184 Collaborative design of a treatment strategy can contribute significantly to its ultimate success. Potential participants in the design process include representatives from the target industry, market segment or sub-group, tax professionals such as accountants and book-keepers, and representatives from other government agencies, lobby groups and community associations.

185 There are three main benefits of adopting a co-design approach. First, securing the support and co-operation of key stakeholders may be crucial in gaining the leverage you need to influence compliance behaviour. Second, the more that interested parties can engage in dialogue around a specific issue, the greater the potential for the strategies devised to be both innovative and workable. Third, if the authority is seen to be genuine in its desire to build partnerships with the community, the potential by-product is enhancement of the authority's credibility and trustworthiness. Dialogue provides feedback to the revenue authority on its performance and helps maintain perceptions of fairness and trust.

Example

The provisions of the GST legislation in Australia require that suppliers of taxi travel are required to be registered for GST regardless of business turnover. In effect this requires all drivers of taxis and limousines to apply for an Australian Business Number (ABN) and register for GST.

Monitoring of these arrangements during implementation raised some concerns that the necessary rigour was not being applied to this fundamental requirement. This anecdotal view was supported by a range of compliance verification activities which consistently identified around 10-15% of non GST registrants being detected.

The key risk to revenue grouping is those drivers who are transient, typically part-timers / or casuals. Considerable resources have already been expended locating drivers after the non compliance has been detected. Registration issues that have emerged include:

- driving without a ABN and GST registration;
- using false or borrowed ABNs; and
- providing addresses which are not valid.

A proposal was put to the Taxi Industry Partnership meeting in September 2002 that a Creative Retreat be conducted in the spirit of a collaborative approach with industry to identify processes that would improve compliance via the ‘cheaper, easier and more personalised’ platform announced earlier by the ATO Commissioner. The Creative Retreat was a two day residential workshop led by a professional facilitator. Small groups of participants brainstorm ideas and develop them into tangible prototypes.
The Retreat was co-sponsored by the Victorian Taxi Association (on behalf of the Australian Transport Industry Association) in February 2003. The workshop achieved a number of significant outcomes in terms of products/processes that were identified as meeting the objective:

- registration integrity — aligning the ABN/GST registration requirements with taxi regulator authorisation processes;
- easier payments — introduction of a payment card with marketing to encourage regular deposits of GST (to assist with cash flow); and
- record keeping — introducing processes that would assist drivers to determine their GST liability and make provision for it.

### Ensuring effective execution

186 Execution of any specific compliance treatment strategy and the authority’s overall compliance programme must deliver procedural justice. That means it must be fair, impartial and consistent and that taxpayers’ individual circumstances are taken into account. The authority’s corporate values and policies can be instrumental in guiding the behaviour of individual officers at the time of strategy implementation.

187 To maintain the public’s trust and confidence and to pursue effective programme results, the revenue authority must ensure that its people have the knowledge, skills and support needed to work effectively. Any specific treatment strategy may require specialised training and learning. In combination with a skilled staff, an authority needs appropriate systems and procedures in place to support staff in applying the chosen strategy.
# 7 EVALUATING THE OUTCOMES

## KEY POINTS

| | Success criteria and measurement indicators should be considered when choosing treatment strategies. |
| | Qualitative measures add useful support to quantitative ones. |
| | Treatment objectives must look beyond immediate outputs (e.g. audit results) to changing behaviour over time. |
| | Isolating the effect of any specific intervention from that of other factors is problematic. |
| | At a programme level, no single measure is sufficient, but seeing the trend of different indicators is instructive. |
| | Process evaluation should also be considered: was the strategy implemented effectively? |

## KEY PRODUCTS

| | Evaluation methodology to assess the impact and identify what has been learnt. |
| | Organisational governance reports detailing efforts and progress made against the compliance programme. |
| | Reports of residual risk following compliance strategy intervention. |

### Planning for meaningful evaluation

188 The need for a compliance strategy is normally based on observations and indicators that suggest that specific compliance behaviour warrants attention. For an evaluation to be worthwhile, compliance strategies (whether of an enforcement, legislative, litigation or service nature) must have clearly defined objectives that are measurable. Without these, determining whether strategies impact on taxpayer behaviour will largely be guesswork open to interpretation and subjective debate.

189 It is important that evaluation criteria be determined at the time the treatment strategy is being chosen or developed. Consideration of how a change in taxpayer behaviour is to be measured can often clarify the behaviour to be targeted. It may also help to design a treatment strategy and its application so that the data necessary for measurement is available in the required form. This is simply a good research method. Careful evaluation planning may also:

- support the basis on which resources are deployed to the programme;
- encourage multiple sources of data;
- improve the accuracy of corporate reporting; and
- help determine whether alternative strategies should be considered.
Developing an evaluation framework

If an administration is to improve the effectiveness of its compliance programme, it needs to be able to state the compliance benefits that have been achieved through the application of its compliance strategies. Revenue authorities that fail to measure the effectiveness of their compliance strategies run the risk of continuing to sub-optimise their strategy selection.

An evaluation framework provides the proper foundation for the continuous improvement of compliance strategies. A sample framework is outlined below. Under this framework, those planning to apply a specific treatment strategy should address the following questions:

- **target.** What risk is being addressed?
- **objectives.** What is the treatment strategy intended to achieve?
- **methodology.** What are the measurement methodologies used (including timeframes and external factors that could affect the measures and how they may be interpreted?)
- **measures.** What compliance indicators were used in identifying the problem? What changes are expected to be seen in these indicators as a result of the strategy?
- **data.** What data will be collected and how will it be collected to support the evaluation?

**Target:** *What behaviour are we treating?*

There are pre-defined obligations imposed by revenue authorities that indicate compliance and form the basis of a typical evaluation approach. These can be broadly classified into the following areas:

- registration;
- filing (lodging tax forms on time);
- reporting (complete and accurate information);
- payment of liability.

The analysis of these obligations, pre and post compliance intervention, provides for a basis for evaluating the direct influence of the intervention on the compliance behaviour of the target group.

**Objectives:** *What are we intending to achieve?*

The objectives of an authority’s compliance treatment programme will encompass some or all of the following impacts.

**Direct impacts.** These are the immediate impacts on the target population in relation to the specific risk identified.

**Related impacts.** These are the impacts beyond the immediate risk being addressed by the compliance strategy.
This means, for example, that a revenue authority must be vigilant in monitoring all of an individual taxpayer’s compliance obligations. Achieving compliance in one area such as registration does not mean there has been a positive influence in behaviour towards filing, reporting and payment. Without this monitoring — and appropriate follow-up action — we run the risk of reinforcing negative compliance behaviour and attitudes.

Similarly, it is important to monitor whether compliance strategies have a negative influence on taxpayer behaviour in areas not addressed by the strategy. For example, a compliance focus on a specific type of claimable deduction may result in taxpayers incorrectly inflating other types of deductions or understating income in order to compensate for the increased scrutiny on the specific deduction type.

**Impacts over time.** The evaluation should not be limited to the direct impact or outputs of the compliance strategy, such as the amount of tax raised from audits on selected taxpayers, but extended to measuring its ongoing impacts on taxpayer behaviour. For example, did the compliance strategy result not only in a correct return of income on one occasion, but in a sustainable *motivation* to report correctly in the future and the *capability* to do so — through improved record keeping? Or, to take another example, did the strategy result not only in small businesses paying their Value Added Tax liabilities on time, but in an *intention* not to treat the revenue authority as the creditor of last resort and the *capability* to do this — through better management of cash flow?

Figure 7.1 shows evaluation at three levels and measurement at different points of time.

**Figure 7.1 Measuring impacts of compliance treatment**

![Diagram showing three levels of measurement: Level 1 Population, Level 2 Group, Level 3 Individual, with arrows indicating changes over time by looking at a point in time.]

Impacts beyond the immediate target group. In most cases the short-term and potentially long-term impacts of specific interventions for specific risks on the behaviour of specific taxpayers can be measured with some confidence. But while compelling, this is hardly sufficient. Did the intervention influence the behaviour of the wider sub-group of which the selected taxpayers are a part? And what of compliance in the broader population and the community as a whole?

To provide a balanced evaluation, an authority needs to look at impacts beyond the immediate target group. While there will inevitably be a progressive decrease in the validity of measures associated with broader impacts, if the trends of all indicators are the same, confidence in the effectiveness of the programme is increased.

Figure 7.2 provides an example of a multi-level approach for monitoring compliance within the ‘shadow’ or ‘cash’ economy. It compares the performance of certain groups of clients with the performance of larger industry groups through to the full population. It represents the ‘ripple’ effect of compliance interventions.
Methodology: What broad approaches will we take?

204 It has been suggested\(^\text{15}\) that there is no single approach to measure the effectiveness of strategies influencing behaviour. There are numerous approaches used to measure compliance levels including:

- audit based studies, including the use of control groups and random audit sampling;
- statistical techniques such as trend or time series analysis; and
- qualitative techniques such as surveys, interviews and observation.

205 To ensure greater confidence when drawing conclusions, none of these measures should be used in isolation for measuring impacts on compliance. By combining different approaches and applying them to different taxpayer groups, it should be possible to establish a reasonable and comprehensive view of compliance. For example, qualitative studies such as case studies based on interview data are of significant value in helping develop a broad picture of taxpayer behaviour. This is particularly important when reliable objective scientific measurements are not available.

Measures: What kinds of indicators can be used?

206 To enable a revenue authority to monitor its performance against its overall compliance plan (see Introduction, Figure A), the authority needs to establish a consistent and comprehensive picture of compliance at any given time. This guidance note recommends application of a Compliance Measurement Framework (CMF) similar to the framework in Canada to provide a systematic approach to monitoring and measuring compliance. A CMF enables decision makers to:

- understand compliance trends and how they relate to current programmes and initiatives;
- help identify areas where compliance treatment strategies need to be modified or adjusted; and

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- be aware of emerging trends in non-compliance that will need close attention in the future. Figure 7.3 below provides some examples of indicators that are used in some jurisdictions to monitor overall compliance levels.

**Figure 7.3 Examples of indicators of compliance used in some OECD jurisdictions**

<table>
<thead>
<tr>
<th>Type of Risk</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Registration</strong></td>
<td>The number of individuals filing income tax returns in comparison to statistics on the population of individuals more than fifteen years old.</td>
</tr>
<tr>
<td></td>
<td>Trend in the number of registered taxpayers (by specified entity type) compared to estimates of total population.</td>
</tr>
<tr>
<td><strong>Filing</strong></td>
<td>Trend in the percentage of returns filed on time by tax type.</td>
</tr>
<tr>
<td></td>
<td>Trend in the percentage of returns filed on time by entity type.</td>
</tr>
<tr>
<td><strong>Correct Reporting</strong></td>
<td>Net VAT/GST revenues tracked against changes in consumer expenditures and levels of imports.</td>
</tr>
<tr>
<td></td>
<td>Net VAT/GST collections/estimates of VAT/GST base (derived from national accounts data).</td>
</tr>
<tr>
<td></td>
<td>Trend in extent of unreported income/aggregate income paid (e.g. as measured by random audit programme or macro measures)</td>
</tr>
<tr>
<td></td>
<td>Trends in effective tax rates by entity type, e.g. comparing corporate income tax revenues assessed to corporate profits.</td>
</tr>
<tr>
<td><strong>Payment</strong></td>
<td>Trend in the percentage of tax paid on time by revenue type.</td>
</tr>
<tr>
<td></td>
<td>Trend in the percentage of tax paid on time by entity type.</td>
</tr>
<tr>
<td></td>
<td>Trend in the value of year-end debt inventory (gross debt and collectable debt) as a proportion of net annual revenue collections.</td>
</tr>
</tbody>
</table>

A major component of a CMF are compliance indicators that track compliance trends using a set of proxy measures derived from a variety of internal and external data sources. The indicators are also used to identify compliance risks and issues for further study and assess compliance impacts of programme strategies and initiatives. They are developed for specific client segments. Improvements in the indicators would serve to indicate improvements in compliance levels at the relative level of measurement. By the same token, decreases in the indicators would potentially signal a decrease in relative compliance levels. Based on the sources of data, compliance indicators may be loosely grouped into four broad categories:

- **macro indicators** (e.g. the average effective taxation rates compared to changes in GDP) illustrate a relationship between an aspect of compliance and an external statistic, benchmark or similar point of reference that can be used for tracking macro trends. These indicators provide a general assurance of the effectiveness of the compliance approach.

- **non-compliance indicators**, (e.g. the ratio of business expenses relative to business income) derived from administrative data and from statistical calculations or estimates based on random samples, provide statistically valid generalisations about a specific taxpayer population.
• **public opinion indicators** (e.g. community perceptions of professionalism and fairness on the part of the administrator) draw information from client surveys and other public opinion research. These indicators help understand contributing influences to compliance and provide an insight on the behavioural aspects of compliance and the public viewpoints concerning compliance strategies.

• **programme impact indicators** (e.g. the consequential and on-going effects of a compliance intervention such as an audit on a given client) assess the impact of specific programmes or initiatives on their identified client population. These indicators explore cause and effect relationships and identify factors for improving programme effectiveness. They are usually topical and targeted, assessing the impact on a segment of the population against the objective of a programme, strategy or initiative. This group of indicators are produced through special studies that will vary from year to year according to the research agenda.

**Data: What are the measurements based upon?**

To improve the evaluation of strategies, the data on which conclusions are drawn needs to be improved. Data are derived from many sources, including programme operational data, tax return entries and external data. Data should be subject to quality standards and tested and filtered prior to analysis.

**Carrying out the evaluation**

As has been suggested earlier, no strategy should be implemented without a clear process by which the outcomes can be evaluated and reported. Measurement considerations must, therefore, be an integral part of the development of a compliance strategy.

In particular, the capture of pre and post intervention data is a priority in evaluating compliance campaigns whose objective is to change the tax compliance attitudes of a specific segment of the community.

**Example**

The Swedish Tax Agency undertook extensive surveys to assess the attitudes of people in the community towards tax issues. The surveys revealed that young people had a more positive attitude towards tax evasion than the total population. One item in the survey was: ‘I think it is okay to evade tax if I have the opportunity’. 12% of the age group 18-24 agreed compared to 7% of the total population.

It was decided to run a campaign with the objective of influencing attitudes of young people towards less acceptance of tax evasion. The campaign was designed to run for three years. It started in 2002 with TV-advertising (a short film about how the society would look like if we didn’t pay tax), distributed information in schools about how the taxes are spent and the Director General sent a letter to the target group with some information about taxes. A web site was developed with for general tax information. During the second year the campaign continued with additional TV-advertising showing the connection between taxes and benefits like healthcare, libraries, infrastructure etc. The municipalities also put up small posters...
(stickers) with the message ‘Paid for by you’ on park benches, waste bins, schools and similar objects.

The results so far show that the campaign has been working. The latest surveys show that the attitudes of young people have changed. Attitudes are now comparable to those of the total population with only 7% in the age group 18-24 now agreeing with the item mentioned above.

The use of letters designed to influence the compliance behaviour of a specific group is a common practice among revenue authorities. But what sort of message is most effective in eliciting the desired response? In the UK, a carefully planned experiment provided some answers.

**Example**

In the United Kingdom, self-assessing self-employed businesses with a turnover under £15K are not required to provide analysis of expenditure in their Income Tax returns. Routine monitoring and statistical analysis of the returns for businesses in this category for both 1999 and 2000 indicated that many people appeared to be suppressing turnover so that they would fall below the £15K threshold — thus only need to submit a simplified account.

As audits tend not to be cost-effective for this group, the UK Inland Revenue decided to conduct a letter campaign. This provided the opportunity to test which, if any, messages would influence people in this group to increase declared turnover over the threshold. To allow proper statistical analysis of results, an experiment was designed with five groups each receiving a different treatment and one group no treatment to act as a control.

Thus each of five groups was sent one of the following letters:

1. ‘We can provide you with advice and support’
2. ‘Paying the right tax increases public spending on hospitals, schools etc.’
3. A warning: ‘We are increasing enquiries — your return may be chosen’
4. As in letter 4 — but adding that ‘we charge financial penalties’
5. ‘Your 2001 Return has already been selected for audit’.

As indicated, a further group received no letter and acted as a control for evaluation purposes.

The content of the letters and design of the trial was arrived at in consultation with an academic consultant, who also assisted in its evaluation.

Letters of type 3, 4 and 5 produced significant increases in self-reported turnover and net profit on the next return, by comparison with the group who did not receive any letter. To check the accuracy of the self-reporting by recipients of letters 3 and 4, audits were carried out on 10% of their next returns. The initial assessment showed that both letters were far more effective in achieving improved compliance than an enquiry unsupported by any previous warning. The next return of all letter 5 recipients was audited. The self-reported profits of this group, with the addition of
yield from the audit, should provide the most accurate measure of actual turnover.

The project successfully achieved its aim of testing which messages were most effective in improving the compliance of this risk group. Although letter 5 resulted in higher self-reported income, the most cost-effective effective intervention (with a cost/yield ratio of 1:3) was letter 4, because the improved accuracy of self-reporting by this group was achieved without the costs of carrying out an audit in every case.

**Recognising the difficulties of evaluating compliance**

212 Evaluation issues associated with measuring compliance for both the individual taxpayer and group or population level need to be taken into account when assessing the extent to which taxpayer compliance may have changed over time as a result of a compliance strategy.

213 There are many factors that combine to influence taxpayer behaviour that extend beyond the control of tax administration. These include social and economic conditions including:

- national and global economic factors;
- physical environment factors e.g. droughts and floods; and
- legislative factors and social, demographic and attitudinal factors.

214 These factors invite particular caution when measuring the ‘tax gap’ for both the individual taxpayer and corresponding population. A better approach is to develop proportionate or percentage measures rather than additional revenue raised from the intervention or treatment. These factors have less impact on measuring the effectiveness of narrowly focused compliance initiatives than in the case of broadly based ones.

215 The use of random audit based methods provides for an unbiased selection process to measure compliance levels and subsequent changes. However, care should be taken to:

- minimise the opportunity cost of productive audit work forgone to perform audits on randomly selected cases without a known productivity outcome;
- ensure there is no excessive burden on the taxpayer population; and
- ensure audits are conducted uniformly otherwise the validity of results cannot be substantiated.

216 An issue arises when considering the implications of technical compliance and its basis for determination. To declare an individual or business compliant, we must establish the ‘correct amount of tax’ that is due. Defining the correct amount of tax may be difficult given the ambiguity in the tax system and the variability of interpretation of the legislation on the part of taxpayers, tax practitioners, auditors and/or a judicial body.

217 Rather than being paralysed by these problems, revenue authorities should acknowledge that there is no one method that will unequivocally measure perfectly the impact of strategies on taxpayer behaviour. To get most meaning and value from analysis, indicators of compliance must be interpreted systematically and in
conjunction with one another. This allows for reasonable judgements to be made on whether a particular compliance strategy has influenced behaviour.
CONCLUSION

Encouraging voluntary compliance

218 As the inscription on the Internal Revenue Service’s Headquarters in Washington D.C. reminds us ‘taxes are what we pay for a civilised society’\(^{16}\). To the extent that people, for whatever reason, fail to meet their obligations under the law, the community is denied the revenue that could be funding improvements in security, health, welfare, education and other government programmes.

219 This guidance note has suggested that, in order to manage and improve compliance with tax and other relevant laws, revenue authorities need to adopt an administrative approach that encourages voluntary compliance within a co-operative and participative regulatory environment. Such an approach recognises that almost all jurisdictions rely, at least to some extent, on self-assessment, given that a system based on reviewing every event or transaction that may have taxation implications would be too intrusive, time-consuming and costly. It also recognises that modern revenue administration is founded on managing risk — responding quickly to circumstances and leveraging the impact of interventions.

220 Evidence has been presented earlier that taxpayers are more likely to increase voluntary compliance when they believe that the revenue authority acts in a way that is fair and reasonable. Regulatory response that is consistent with a framework such as the compliance pyramid reinforces this belief because taxpayers tend to regard tough enforcement action as more procedurally fair when persuasion has been tried first. Further, while taxpayers’ value being trusted themselves, they want to know that the authority carries a big stick to deal with others who cannot be trusted. In this way, responsive regulation builds community confidence and belief in the legitimacy of the tax system.

Following a consistent process

221 There is a strong message that the major issues being faced with regards to tax compliance are common across all jurisdictions. Any variation appears to be in terms of degree and priorities within an individual jurisdiction. However, despite these variations, an effective approach to managing and improving tax compliance is to follow a structured risk management process that involves:

- continuous monitoring of both the operating context of the authority and taxpayer activity;
- identifying, assessing and prioritising risks to the revenue, the taxation system as a whole and the reputation of the authority in the community;

\(^{16}\) Oliver Wendell Holmes
• understanding the factors underlying taxpayer behaviour that drive any
non-compliance;
• addressing the non-compliant behaviour; and
• evaluating the success of any intervention.

Some key advice relevant to this process, emphasised in this guidance note and, in
some cases, deriving from its associated catalogues, includes the following points.

Identifying and assessing risk

• risk can be identified using either top-down techniques such as
macro-economic analysis or by bottom-up processes such as case-based
risk assessment systems;
• appropriate client segmentation is fundamental to achieving a thorough
identification of risks;
• risk identification processes that offer linkages to understanding the
drivers of compliance behaviour provide the most effective leverage of
intelligence;
• authorities need to develop appropriate criteria for objectively
evaluating the relative size of compliance risks in the context of their
organisational business priorities;
• assessment and prioritisation needs to be firmly based upon objective
evidence.

Understanding compliance behaviour

• understanding compliance behaviour is more than guesswork: several
factors are now supported by robust empirical research;
• both economic and non-economic explanations of compliance
behaviour have predictive force;
• the reason taxpayers may not comply appears to depend on a number of
the following factors: age, education level, moral compass, gender,
industry, personality, circumstances, the perceived cost of compliance
and assessment of the risk involved;
• investigations into the impact of deterrents, such as threats of
prosecution or prosecutions, suggest that they may have a time limited
effect on compliance behaviour of taxpayers. However, studies have
shown that those who are compliant appear to want those who are not
compliant to be punished;
• giving taxpayers incentives may have a positive effect on compliance
behaviour (i.e. taxpayers becoming more compliant), though this needs
further exploration.

Choosing and applying treatment strategies

• compliance programmes need to provide a graduated response to
compliance behaviour — making it easy for those who want to comply
and applying credible enforcement to those who do not;
• treatment needs to address the underlying drivers of compliance
behaviour;
• the most effective strategies are likely to be multi-faceted and systemic;
• the first step is often to ensure that taxpayers understand their taxation obligations and find it easy to comply;
• acting at all times with integrity and in a manner perceived to be fair and reasonable will encourage voluntary compliance;
• enhanced capacity to influence taxpayer compliance behaviour often comes through strategic alliances and partnerships with other agencies, industry bodies and tax advisers;
• strategies need to be applied in a way that demonstrates effective and efficient use of resources;
• sustainable improvement in compliance can only be achieved by influencing and changing social and personal norms.

Evaluating the outcomes

• success criteria and measurement indicators should be considered when choosing treatment strategies;
• treatment objectives must look beyond immediate outputs (e.g. audit results) to changing behaviour over time;
• at a programme level, no single measure is sufficient, but seeing the trend of different indicators is instructive;
• qualitative measures add useful support to quantitative ones;
• isolating the effect of any specific intervention from that of other factors remains problematic.
GUIDANCE

1 Revenue authorities are encouraged to follow the compliance risk management processes described within this guidance note. More details on the practical application of approaches recommended in this note can be found in the accompanying set of papers described at the beginning of this note.

2 Revenue authorities are encouraged to utilise the research papers and compliance strategies contained within the catalogues of Compliance Research Projects and Compliance Strategies.