



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT



FORUM ON TAX ADMINISTRATION

Information Note:

Tax Compliance and Tax Accounting Systems

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CENTRE FOR TAX POLICY AND ADMINISTRATION

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ABOUT THIS DOCUMENT

Purpose

This information note describes how a number of OECD guidance notes dealing with aspects of electronic or computerised business and accounting system standards and audit assurance can be used as an aid to achieving voluntary compliance, including as part of an enhanced or cooperative relationship between revenue bodies and taxpayers.

Background to the Forum on Tax Administration

The Forum on Tax Administration (FTA) was created by the Committee on Fiscal Affairs (CFA) in July 2002. Since then the FTA has grown to become a unique forum on tax administration for the heads of revenue bodies and their teams from OECD and selected non-OECD countries.

In 2009 participating countries developed the *FTA vision* setting out that... *The FTA vision is to create a forum through which tax administrators can identify, discuss and influence relevant global trends and develop new ideas to enhance tax administration around the world.*

This vision is underpinned by the FTA's key aim which is to...*improve taxpayer services and tax compliance – by helping revenue bodies increase the efficiency, effectiveness and fairness of tax administration and reduce the costs of compliance.*

To help carry out this mandate, the FTA's work is directly supported by specialist Sub-groups—including the Tax e-Audit Group whose work is directed at developing internationally agreed software standards designed to facilitate:

- a reduction of compliance costs for businesses;
- a reduction of administrative costs for revenue bodies;
- the enhancement of the outcomes of audits of businesses carried out by revenue bodies; and
- the provision of a platform to make it easier for revenue bodies to co-operate in areas such as joint audits.

Membership of the Tax e-Audit Group includes representatives from FTA member countries, software developers, and the accountancy and audit professions.

Caveats

National revenue bodies face a varied environment within which they administer their taxation system and jurisdictions differ in respect of their policy and legislative environment and their administrative practice and culture. Similarly, 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

Enquiries concerning any matters raised in this guidance note should be directed to elizabeth.goli@oecd.org.

SUMMARY

1. Due to regulatory requirements and the demands of shareholders, modern businesses need to have in place an Internal Control Framework (ICF). These frameworks enable businesses to ensure that their operating, financial and compliance objectives are met and provide for the proper management of risk.
2. This note examines internal control frameworks for tax which can form part of a business' ICF. The use of an internal control framework for tax will ensure that the business has an ongoing and up-to-date view of its tax position and can provide the revenue body with reliable tax information. The use by the business of an internal control framework for tax will demonstrate a willingness to deal transparently with the revenue body who should reciprocate by providing increased and timely tax certainty.
3. It also discusses the concepts of voluntary tax compliance and co-operative relationships between taxpayers and revenue bodies which are based on commercial awareness, impartiality, proportionality, openness and responsiveness by revenue bodies and disclosure and transparency by taxpayers in their dealings with revenue bodies.
4. The note describes OECD FTA Guidance Notes on business and accounting software specifications and how their adoption by revenue bodies and business can be an important element of internal control frameworks for tax and can form part of a cooperative or enhanced relationship between the business and the revenue body.

TAX COMPLIANCE AND TAX ACCOUNTING SYSTEMS

1. Background

5. This note discusses internal control frameworks for tax and how the adoption of the OECD FTA Guidance Notes on business and accounting software specifications can be an important element of such frameworks.
6. Due to regulatory requirements and the demands of shareholders, modern businesses need to have in place Internal Control Frameworks. These frameworks enable businesses to ensure that their operating, financial and compliance objectives are met¹ and provide for the proper management of risk.
7. Businesses that seek to be compliant in relation to tax will have in place a tax control framework for the management of their tax affairs as part of their internal control framework. The use of an internal control framework for tax will ensure that the business has an ongoing and up-to-date view of its tax position and can provide the revenue body with reliable tax information. The use by the business of an internal control framework for tax will demonstrate a willingness to deal transparently with the revenue body who should reciprocate by providing increased and timely tax certainty.

2. Compliance Management by Revenue Bodies

8. The OECD Committee on Fiscal Affairs has released a number of papers related to taxpayer compliance and tax risk management.
9. The Forum on Tax Administration report *Monitoring Taxpayer's Compliance*² stated that in an ideal world, all citizens and businesses would satisfy their obligations under the tax law to register where specifically required, and to voluntarily declare and pay on time their tax liabilities, all calculated fully and accurately in accordance with the law. This statement encapsulates four basic tax compliance obligations of citizens and businesses that generally speaking must be administered by all revenue bodies in accordance with their respective tax laws:
 - To register for tax purposes;
 - To file tax returns on time (i.e. by the date stipulated in the law) or at all;
 - To correctly report tax liabilities (including as withholding agents); and
 - To pay taxes on time (i.e. by the date stipulated in the law).
10. Compliance by taxpayers with these basic obligations can also be viewed in terms of whether such compliance is achieved voluntarily (i.e. *voluntary compliance*) or corrected by verification/enforcement actions carried out by the revenue body (i.e. *enforced compliance*). In a tax

¹ Committee of Sponsoring Organisations of the Treadway Commission (COSO) (2009) *Guidance on Monitoring Internal Control Systems* page 1 www.coso.org.

² OECD (2008) www.oecd.org/dataoecd/51/13/40947920.pdf

administration context, this distinction is highly relevant as ‘enforced compliance’ has a cost, and very often a significant one.

11. This information note describes how FTA Guidance Notes on business and accounting software specifications; standard audit files for both Tax and Payroll; and audit test procedures may be used to correctly report tax liabilities and improve voluntary compliance. In line with their overriding goal and mission, all revenue bodies should be aiming to improve the overall level of ‘voluntary’ compliance and, by definition, rely less on ‘enforced’ compliance.

3. Compliance Risk Management

12. In the past revenue bodies have addressed compliance risks only in terms of enforcement programmes with a cyclical approach. Taxpayers tended to be treated with the same single action strategy broad-brush approach, and enforcement programmes were based solely on verification and enforcement actions. Many revenue bodies have now recognized that such an approach is neither efficient nor effective and have adopted compliance risk management.

13. The guidance note ‘*Compliance Risk Management: Managing and Improving Tax Compliance*’³ prepared by the FTA and released in October 2004 described the concept of compliance risk management as an essential management tool for revenue bodies.

14. Compliance risk management is based on 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 — could be crafted and implemented. Key elements of that paper were a model (BISEP model) for identifying factors that influence taxpayer behaviour and their attitudes to compliance.⁴

15. The value of applying the model is that it contributes to gaining a deeper understanding of taxpayers’ behaviour and lays the groundwork for the development of targeted strategies that will encourage taxpayers to voluntarily comply rather than resist complying. The model and the spectrum of taxpayer attitudes to compliance are reproduced in figure one.

Figure 1: Factors influencing taxpayer behaviour and the spectrum of taxpayer attitudes to compliance



16. On the left side are the factors identified under the BISEP model are determinants of taxpayers’ attitudes to compliance. On the right side, the diagram (known as the Compliance Pyramid) depicts

³ OECD (2004) www.oecd.org/dataoecd/44/19/33818656.pdf

⁴ See Part 4 pages 36-44.

the continuum of taxpayer attitudes towards compliance, ranging from a ‘willingness to do the right thing’ (i.e. voluntarily comply) to ‘having decided not to comply’ (i.e. resist complying), as well as the sorts of support and intervention appropriate for each attitude.

17. Compliance risk management has become an essential tool for revenue bodies, assisting with both the identification and treatment of risks.

4. Encouraging Voluntary Compliance - the enhanced relationship, disclosure and transparency

18. Many revenue bodies have adopted both a business model that recognises the different factors that influence taxpayers’ compliance and different strategies to achieve improved voluntary compliance and a number of revenue bodies have declared the pursuit of voluntary compliance as their main mission.

19. In 2008 the FTA released the ‘*Study into the Role of Tax Intermediaries*’⁵ which identified that there is an opportunity to establish a more co-operative relationship between taxpayers and revenue bodies and which facilitates high levels of voluntary compliance. This relationship, called ‘the enhanced relationship’, requires commercial awareness, impartiality, proportionality, openness and responsiveness by revenue bodies and disclosure and transparency by taxpayers in their dealings with revenue bodies.

20. In the context of this relationship, the disclosure expected by revenue bodies from taxpayers includes the information that they are statutorily obliged to provide as well as any information necessary for the revenue body to undertake a fully informed risk assessment. This will include any transaction or position that can reasonably be considered to carry a material degree of tax risk or unpredictability. Transparency is the ongoing framework within which individual acts of disclosure take place.⁶

21. This means that taxpayers and, where appropriate, tax intermediaries will:

- volunteer information about tax return positions where they see potential for a significant difference of interpretation between them and the revenue body; and
- provide comprehensive responses so that the revenue body can understand the significance of issues, deploy the appropriate level of resources and reach the right tax conclusions.

22. An enhanced relationship offers benefits for revenue bodies as well as taxpayers. Benefits for revenue bodies include that they are better informed about the tax affairs of taxpayers and are able to undertake more effective risk assessment and more appropriate resource allocation, thereby reducing administration costs.

23. The benefits for taxpayers are increased and timely tax certainty, which taxpayers and their advisers have indicated are very important in managing risks on transactions.⁷ Taxpayers who behave transparently can expect greater certainty and an earlier resolution of tax issues with less extensive audits and lower compliance costs.

⁵ OECD (2008) *Study into the Role of Tax Intermediaries* OECD Paris

⁶ See page 41.

⁷ See page 41.

5. Risk Management by Taxpayers using an Internal Control Framework

24. Due to regulatory requirements and the demands of shareholders, modern businesses need to have in place an Internal Control Framework (ICF). These frameworks enable businesses to ensure that their operating, financial and compliance objectives are met and provide for the proper management of risk. Figure 2 depicts the elements of an ICF.

Figure 2: Internal Control Framework⁸



25. **Risk Assessment** — Each organization is faced with external and internal risks that may affect the goals of the organization. Risk assessments identify *relevant* risks to the objectives and determine how the organization can manage the risks.
26. **Control Environment** — This component focuses on the risk management culture within organizations. Relevant questions include: are people throughout the organization aware of the importance of risk management and do they understand the risk profile of the organization? Do management and the board of directors set the tone at the top? Is risk awareness and mitigation embedded in the values of the organization, the integrity and competence of staff? Is risk management part of management's philosophy and operating style and the way management assigns authority and responsibility?
27. **Control Activities** — These refer to the internal control system of the organization, including policies and procedures that define approval processes, authorization levels, security of assets and the segregation of duties, etc.
28. **Information and Communication** — This component refers to an organization's information and communication systems, including the production of operational and financial reports.
29. **Monitoring** — This component is often confused with the "control activities" component. While control activities define an organization's internal control system, the monitoring component focuses on the monitoring of these systems, such as direct supervision and evaluation.
30. The effectiveness of an ICF starts with the moral and ethical values of the management of an organization and the way management ensures the implementation of these values in the day to day

⁸ Guidance on Monitoring Internal Control Systems page 1 www.coso.org Copyright 2009 by the Committee of Sponsoring Organisations of the Treadway Commission. All rights reserved. Reprinted with permission.

operation. The moral and ethical values of the management are sometimes referred to as “soft controls”. The incorporation of these values in the procedures is then referred to as “hard controls”. This note deals with hard controls as applied in electronic business and accounting systems.

31. Where an ICF is in place, the taxpayer will undertake a ‘self-risk assessment’ of all its control and monitor functions and will be in a position to provide a statement, known as an ‘in control statement,’ in relation to those functions. With an ‘in control statement’, a management board affirms that it is in control of the processes taking place in its business.
32. Monitoring of the hard controls should be implemented to help ensure that the internal control continues to function effectively. Monitoring in businesses can refer to internal (specific) and external (annual accounts or tax) monitoring.

6. Tax Control Framework

33. If a taxpayer is ‘in control’ they should be in a position to detect, document and report any relevant tax risks to the revenue body, provided that specific tax requirements are incorporated into the ICF. These specific tax requirements are sometimes described as a ‘Tax Control Framework’ (TCF), which focuses on the internal control of tax processes.
34. The taxpayer should provide the revenue body with both a description of the main tax risks related to the company and the design and effectiveness of the internal risk management and control systems for the main tax risks during the relevant financial year.
35. If the taxpayer is in a position to detect and report any meaningful risk to the revenue body, the role of the revenue body can change to assessing the monitoring system of the taxpayer itself, rather than intrusive auditing. Additionally, in a number of countries there are corporate governance codes and laws which emphasise internal control, requiring businesses to continuously monitor their risks.⁹

7. Meaningful Risks: Materiality

36. Meaningful risks should be monitored by management and in case of misstatements or debatable issues these should be reported to the revenue body in a timely manner so that these risks can be addressed in a proactive, rather than reactive, manner. The concept of materiality is used in practice by the auditing profession to explain meaningful risks.
37. The concept of materiality is often discussed in financial reporting frameworks in the context of the preparation and presentation of financial statements. These frameworks generally explain that:
 - Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;
 - Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and
 - Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The

⁹ For example, the United States’ Sarbanes-Oxley Act of 2002 imposes requirements for the establishment of internal controls by public companies.

possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.¹⁰

38. Materiality will vary across countries and types of tax. Revenue bodies need to consider the level of transparency about the risks that they would consider as material and therefore meaningful. This could include discussions between the taxpayer and the revenue body over what risks are material.

8. Using the OECD FTA Guidance Notes on business and accounting software specifications as an aid to developing an enhanced relationship

39. Rapid developments in information and communication technology have had a great influence on the way of doing business, particularly in relation to business and accounting systems. Developments include integrated accounting systems, Enterprise Resource Planning (ERP) systems, automated internal audit measures and E-invoicing.

40. The OECD Forum on Tax Administration has produced a number of Guidance notes that deal with various important aspects of the audit of business and accounting systems. The products described in these guidance notes can be used by business taxpayers to underpin their voluntary compliance, and to facilitate their participation in an enhanced relationship as the products provide adequate internal tax controls and the testing of those controls to ensure the integrity of tax processing and declarations and which support taxpayers and software developers.

41. The implementation of the products as described in the guidance notes, which leverage the use of technology, should therefore enable taxpayers to reduce their compliance costs by reducing the need for the revenue body to conduct intrusive audits. Similarly by adopting the standards contained in the guidance notes revenue bodies will be able to demonstrate transparency in their dealings with taxpayers and will reduce their costs of administration.

42. The guidance notes are summarised below.

Guidance Note - Guidance and Specifications for Tax Compliance of Business and Accounting Software (GASBAS) (2009 publication).¹¹

43. The GASBAS guidance note describes in general terms the standards that should be applied in the development of tax accounting software and the key controls that are expected from a tax perspective. It sets out the high-level design principles covering the processes found in a typical computerized business accounting system, including the integration of internal and tax protection controls; procedures to ensure the reliability of electronic records; and the facility to export data for further analysis. It also demonstrates how tax audit processes can be carried out with greater reliability and in such a way that costs to both revenue authorities and businesses can be minimized, and provides guidance on how the principles may be implemented in practice.

44. This note also sets out a specification for controls, functions and audit reports for use in the development of tax accounting software. This includes the facility for both self-auditing of data and its download for external audit testing including use of the OECD Standard Audit File-Tax.

45. The GASBAS guidance note is relevant to the following components of the internal control framework: risk assessment; control activities; and information and communication.

¹⁰ International Federation of Accountants, ISA 320, www.ifac.org.

¹¹ OECD (2010) www.oecd.org/dataoecd/42/33/45045404.pdf

Tax Administration Guidance – Record Keeping.¹²

46. This guidance encourages appropriate standards for record keeping by businesses offering services or products via the Internet. It is equally applicable to record keeping for transaction-based taxes (GST/VAT) and direct taxes that make use of aggregated transaction information. It is aimed specifically at record keeping requirements for e-commerce, although its principles apply equally to all computerised record keeping.
47. This guidance is relevant to the information and communication component of the internal control framework.

Guidance Note – Guidance on Test Procedures for Tax Audit Assurance¹³

48. This guidance note contains a detailed inventory of compliance and substantive tests performed by tax auditors, which could also be performed by businesses to check the operation of their internal controls. It describes the tests that revenue bodies would expect in the control activities and monitoring component of the internal control framework.

Guidance Note – Guidance for the Standard Audit File-Tax, version 2.0.¹⁴ (SAF-T)

49. This guidance note describes a standard audit file for tax purposes that also includes inventory data elements. SAF-T can be used for both internal and external test programmes, and can be linked to the inventory in the Guidance on Test Procedures for Tax Audit Assurance guidance note.
50. The SAF-T is an important element in the control activities component of the internal control framework.

Guidance Note – Guidance for the Standard Audit File-Payroll, version 1.0.¹⁵ (SAF-P)

51. This guidance note describes a standard audit file for payroll purposes. Similar to the SAF-T, the SAF-P is an important element in the control activities component of the internal control framework.

9. Conclusion

52. The use of an internal control framework for tax will ensure that a taxpayer has an ongoing and up-to-date view of its tax position and can provide the revenue body with reliable tax information. It will also demonstrate a willingness to deal transparently with revenue bodies who should reciprocate by providing increased and timely tax certainty.
53. As taxpayers are increasingly using electronic business and accounting systems to enable compliance with their tax obligations, products that facilitate e-auditing are also assuming increasing importance. A comprehensive knowledge of the operation of electronic business and accounting systems is critical if a revenue body is to rely on the outputs of the systems to accurately reflect the tax position of the taxpayer. Auditing by electronic data processing (EDP) auditors will be critical in this regard.

¹² OECD (2005) www.oecd.org/dataoecd/29/25/31663114.pdf

¹³ OECD (2010) www.oecd.org/dataoecd/42/34/45045414.pdf

¹⁴ OECD (2010) www.oecd.org/dataoecd/42/35/45045602.pdf

¹⁵ OECD (2010) www.oecd.org/dataoecd/42/36/45045611.pdf

54. Where electronic business and accounting systems with good internal controls are in place the revenue body's activity can move from intrusive auditing to the monitoring of the taxpayer's internal controls, with a resultant reduction in administrative and compliance costs.
55. The FTA guidance notes referred to in section 8 of this information note which deal with aspects of e-auditing and which provide guidelines and specifications for accounting software support will be an important element of an adequate internal control framework for tax.
56. The adoption of the standards contained in the guidance notes will facilitate more cooperative relationships between revenue bodies and taxpayers through the provision of transparency and assurance that taxpayers have adequate control processes in place. Revenue bodies will benefit from receiving data in a standardised electronic format and for those taxpayers whose records adhere to the standards, the revenue body can focus on checking the checks. Taxpayers, whose electronic records are based on the standards, can expect a reduction in their compliance costs as time consuming tax audits by the revenue body become unnecessary.