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## **FORUM ON TAX ADMINISTRATION: SME COMPLIANCE SUB-GROUP**

### **Information note**

**Reducing opportunities for tax non-compliance  
in the underground economy**

**January 2012**

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## ABOUT THIS DOCUMENT

### **Purpose**

This information note has been prepared to assist revenue bodies in advancing their thinking and practices concerning the identification and treatment of risks posed by the underground economy and electronic payment systems and to promote discussion and knowledge sharing on these important tax administration issues.

### **Background to the Forum on Tax Administration**

Since its establishment in July 2002, the Forum on Tax Administration (FTA), a subsidiary body of the OECD's Committee on Fiscal Affairs (CFA), has operated with the broadly stated mandate ..... *to develop effective responses to current administrative issues in a collaborative way, and engage in exploratory dialogue on the strategic issues that may emerge in the medium to long term.*

To carry out this mandate, the FTA's work is directly supported by two specialist Sub-groups—Small/Medium Enterprise (SME) Compliance and Taxpayer Services—that each carry out a program of work agreed by member countries. The SME Compliance Sub-group exists to:

- Periodically monitor and report on trends in compliance approaches, strategies and activities;
- Consider and compare members' compliance objectives, strategies to achieve those objectives and the underlying behavioural compliance models and assumptions being used;
- Consider and compare members' compliance structures, systems and management, and staff skills and training; and
- Develop and maintain papers describing good country practices as well as develop discussion papers on emerging trends and innovative approaches.

### **Caveats**

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 and information 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 information note should be directed to Richard Highfield (International Cooperation and Tax Administration Division) at e-mail ([richard.highfield@oecd.org](mailto:richard.highfield@oecd.org))

## SUMMARY

Although difficult to quantify with any degree of accuracy, revenue bodies generally acknowledge that non-compliance associated with their respective underground economy is a significant area of tax risk and tax revenue leakage. Furthermore, dealing effectively with such non-compliance presents many challenges, given a range of factors:

- Economic transactions comprising the underground economy can be difficult to detect, given the relatively large number of participants involved, the informality of the economic activities concerned, and the deliberate steps taken to conceal transactions;
- Participants rarely maintain adequate books and records of their economic activities, making it a difficult and time-consuming task for revenue officials to quantify unreported income; and
- For many participants the amounts of tax involved are relatively small; however, the given the large numbers involved, the aggregate tax revenue at stake is sizeable.

The complexities of dealing with such non-compliance emphasise the importance of revenue bodies exchanging details of their approaches and experiences, successful or otherwise, in dealing with these issues.

A related consideration concerns the growth in e-commerce, facilitated by an explosion in the use of the Internet and related electronic payment systems (EPS) e.g. prepaid credit and debit cards, Internet payment services and mobile payment services. This has resulted in a situation where businesses and individuals now have far greater opportunities for concealing income from underground economic activities in both domestic and offshore locations. On a positive note, the use of EPS also creates electronic records that could prove to be a significant source of intelligence for revenue bodies on unreported business proceeds.

Building on the Forum's previous work on compliance risk management, this note explores the approaches and experiences of member revenue bodies in addressing non-compliance associated with participation in the underground economy, including the use of EPS to both conceal and detect unreported income. The key findings and recommendations are as follows:

- A number of revenue bodies reported the existence of a comprehensive 'overarching' set of strategies to address the many tax compliance issues presented by those who participate in underground economic activities and examples of these are highlighted in the report to guide revenue bodies wishing to enhance their own approaches.
- There were a number of 'core' elements common to all of the overarching strategies described by the revenue bodies concerned:
  - There are arrangements in place for 'whole of revenue body' co-ordination;
  - Comprehensive research efforts are undertaken;
  - Enhanced risk detection processes are in place;
  - A multi-faceted set of risk treatments is undertaken;
  - Steps are taken to leverage improved compliance through key intermediaries;
  - There is effective co-operation across Government;
  - Wide use is made of the media; and
  - Efforts are made to evaluate the impacts of individual risk treatments and/or the overall strategy.
- Survey responses also revealed that many revenue bodies do not have a comprehensive overarching strategy for addressing their respective underground economies, suggesting that this area of non-compliance may not be receiving adequate attention.

- A very large range of risk detection and risk treatment approaches were reported by revenue bodies in their responses or were brought to notice from additional research. The more significant approaches (in terms of innovation and/or potential impact) were:
  - Comprehensive industry benchmarking, coupled with leveraging via tax professionals, media engagement and automated targeting of large numbers of taxpayers (Australia).
  - Industry-based withholding/third party reporting regimes (Ireland and Canada).
  - Increased controls over cash transactions (Netherlands, Spain, and Sweden).
  - Increased record-keeping controls for employees in high-risk industry sectors (e.g. restaurants and hairdressing) (Sweden's staff ledgers).
  - Initiatives aimed at reducing the use of cash transactions (Norway and Turkey).
  - The use of monetary incentives to encourage proper record-keeping and deter unrecorded cash payments (Canada's and Norway's home renovation tax credit, Korea's lottery and incentive for obtaining receipts).
  - Increased revenue body use of suspicious transactions reports collected by a separate government agency (Australia and France).
  - Educating new/potential taxpayers (Austria's schools initiative, Canada's trade school initiative).
- Drawing on the work of the Financial Action Task Force (FATF), there appears to have been a significant rise in the number of transactions and the volume of funds moved through new EPS, and this would seem likely to continue and therefore justify being kept under review by the FTA; the work of a small number of revenue bodies reveals that the availability of EPS is facilitating tax evasion practices, including by enabling ready access to undisclosed funds/assets held in offshore accounts;
- The work of a small number of revenue bodies focusing on selected eBay sellers and users of PayPal and relying on aggregated electronic transaction data is revealing indications of fair amounts of related tax non-compliance, including practices involving the use of offshore bank accounts;
- Several potential areas of further international collaboration were identified by some revenue bodies – e.g. payroll compliance (illicit and foreign workers, cash paid wages and sham contracting) and Internet businesses; and
- Many revenue bodies do not as yet appear to have assessed whether users of EPS, including eBay sellers or PayPal users (or equivalent intermediaries), represent areas of tax non-compliance risk requiring attention.

### ***Recommendations***

- Revenue bodies are encouraged to review their strategies for addressing tax non-compliance arising from their respective underground economies in light of the information and practical experiences set out in this note.
- Revenue bodies that presently do not have an explicit overarching strategy, as described in this note, for addressing their respective underground economies may wish to assess the merits of having such a strategy, having regard to their own compliance risk contexts.
- Revenue bodies are strongly encouraged to be vigilant for evidence of tax non-compliance facilitated by the use of EPS and, where appropriate, to take advantage of electronic records created by EPS to identify unreported business income that may have been earned by those participating in the underground economy.

## I. BACKGROUND

1. Reducing the revenue losses arising from non-compliance with tax laws is a critical objective of all revenue bodies. Nowhere is this more important than in the small/medium enterprise (SME) sector<sup>1</sup> of the taxpaying population, which a number of countries have shown to be the least compliant of all taxpayer segments.<sup>2</sup>
2. A major component of non-compliance in the SME sector arises from economic activities that go unreported for tax (including social contributions) and sometimes other regulatory purposes (e.g. health and safety, social security, and licensing). As described more fully in Chapter II, these unreported activities take many guises and exist across a diverse array of economic participants and together constitute part of what the OECD describes as a country's 'non-observed economy'. There is a diverse range of terminology used, even by national revenue bodies, to describe this phenomenon—for example, the terms 'black', 'cash', 'hidden', 'informal', 'shadow', and 'underground' economy are used variously to describe unreported economic activities. And to further complicate matters, some revenue bodies (and others) attach different interpretations to the meaning of these terms. More is said on this in Chapter II.
3. For the purpose of this note, the term 'underground economy' is used to describe unreported economic activities and revenue bodies' approaches to addressing related non-compliance, given its familiarity with revenue bodies (while use of the term 'non-observed' is confined largely to statistical agencies in the context of their work to produce accurate aggregates of economic activities for National Accounts purposes).
4. Dealing effectively with the underground economy presents many challenges for revenue bodies:
  - The "hidden" and dispersed nature of the economic activities concerned invariably make them difficult to detect;
  - In any country, the number of participants is relatively large, for many involving quite small amounts of tax; identifying the most revenue-productive targets presents difficulties for revenue bodies;
  - Many participants have poor books and records and in some cases may not even be registered with the revenue body;
  - Even where some unreported transactions of a participant are detected, ascertaining the full extent of their unreported income for a fiscal period may necessitate exhaustive and often time-consuming inquiries by the revenue body;
  - Even where unreported income is assessed to the participant concerned, there may be difficulties in actually collecting the amounts of tax, interest and any penalties that are due;
  - Detecting and dealing with such non-compliance provides no guarantee that it will not be repeated into the future; and
  - Compliant taxpayers who feel that the underground economy is not being properly addressed and that, as a result, they bear an unfair share of the tax burden may respond by becoming less compliant.

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<sup>1</sup> For the purposes of this note, the SME sector includes self-employed individuals/entrepreneurs.

<sup>2</sup> Some national revenue bodies (e.g. Denmark, Sweden, and United States) carry out compliance measurement programs across their taxpayer segments. Published reports on the findings of these programs provide evidence of the pervasiveness of non-compliance of the SME sector. For example, Denmark reported that its study for fiscal year 2006 revealed that over 80% of the estimated income tax gap was attributable to small businesses and self-employed taxpayers; for Sweden, almost 60 percent of the estimated tax gap for 2006 (SEK 133 billion) resulted from the non-compliance of micro-businesses and SMEs.

### **The study**

5. At its May 2010 meeting, the Forum’s SME Compliance Sub-group discussed potential future work streams for 2011. There was considerable interest among delegates in carrying out a study of revenue bodies’ successful strategies for reducing opportunities for what were described as informal/cash/underground economic activities. At the same time, it was also noted that some of the more “sophisticated” participants in these activities were using electronic payment systems (EPS) of financial intermediaries to conceal, and at the same time provide a ready means of access to, unreported income in off-shore locations; delegates were particularly interested in what revenue bodies were doing to address these particular risks, including the possible use of such systems to help detect unreported income. For ease of reference, this topic is addressed in a separate chapter—Chapter 5 refers.
6. Arising from discussions at the Forum’s Bureau meeting in June 2010, it was decided to conduct a study of revenue bodies’ strategies for reducing opportunities for what were loosely described as “informal activities” that would also incorporate an examination of the use of electronic payment systems and actions being taken by revenue bodies to address these risks. The Commissioner, Canada Revenue Agency, agreed to sponsor the project and provide resources to assist with undertaking the study.
7. Following the development of terms of reference, eleven countries agreed to participate in a task group to provide guidance and input to this work: Australia, Canada, Denmark, France, Ireland, Mexico, New Zealand, Sweden, South Africa, United Kingdom and the United States, with support as deemed necessary from the OECD Secretariat. This was followed by:
  - A detailed survey of countries participating in the SME Compliance Sub-group to gather information concerning their over-arching strategies, individual risk treatments, and case study examples of the strategies being deployed; and
  - The conduct of an extensive literature search by project staff.
8. Twenty six countries responded to the survey and the contributions by Australia, Austria, Belgium, Brazil, Canada, Chile, Denmark, Estonia, Finland, France, Germany, Hungary, Ireland, Japan, Mexico, Netherlands, New Zealand, Norway, Poland, Singapore, Slovenia, Spain, Sweden, Turkey, United Kingdom and United States are gratefully acknowledged.
9. This note describes the key findings from the study, including a large number of case study examples. A summary document (unpublished) containing details of the study’s terms of reference, survey instrument and individual country survey responses has been prepared and made available to delegates to the Forum’s SME Compliance Sub-group.

### **Structure of this note**

10. The rest of this note is structured as follows:
  - Chapter II: Introduction
  - Chapter III: Revenue bodies’ overarching strategies for addressing the underground economy—discusses aspects of revenue bodies’ overall approaches.
  - Chapter IV: Risk detection and treatment strategies for dealing with the underground economy—discusses, and demonstrates by providing practical examples, ways to enhance the detection and treatment of risks posed by unreported economic activities.
  - Chapter V: Electronic Payment Systems (EPS)—discusses the risks and challenges that such systems pose and how some revenue bodies are responding, including through use of EPSs, to detect related unreported economic activities.
  - Chapter VI: Key findings and recommendations.

## **II. INTRODUCTION**

11. This chapter provides context for the study. To this end, it:
  - Clarifies the area of focus for the study by exploring the various terminology used to describe unreported economic activities;
  - Briefly discusses aspects of efforts to estimate the size of unreported economic activities; and
  - Describes prior work of the Forum on compliance risk management and its relevance in dealing with non-compliance related to the underground economy.
12. As observed in Chapter I, a large variety of terms are used to describe unreported economic activities (e.g. the ‘black’, ‘cash’, ‘hidden’, ‘informal’, ‘parallel’ ‘shadow’, and ‘underground’ economy). And to further complicate matters, some revenue bodies (and others) attach different interpretations to the meaning of these terms. For example, using revenue bodies’ survey data for this study the following interpretations were apparent:
  - Most revenue bodies include some or all illegal activities in their umbrella terminology while others (e.g. Canada and Sweden) exclude them. (NB: In most OECD countries it is the practice to administer the tax implications of illegal activities under a separate programme with specialist/dedicated staff located within the revenue body.)
  - In the case of the UK HMRC, the term ‘hidden economy’ is used to denote “ghosts” (i.e. defined as people operating entirely outside the tax system) and “moonlighters” (i.e. those known in one income producing capacity but with another unknown source) but excludes taxpayers with a known source of income that is under-reported for tax purposes (e.g. businesses that are registered for tax purposes and file returns but who skim a portion of proceeds “off the top” from what they report for tax purposes; most other revenue bodies apply a broader interpretation, including the latter component. Elsewhere, the term ‘ghosts’ is used by some revenue bodies to mean fictitious employees—a ploy used by some business operators to conceal their own income).
  - Other definitions reported in survey responses included:
    - Any taxable income that is not declared (Ireland);
    - Low visibility transactions where it is difficult to reconstruct the transactions unless the taxpayer keeps proper records (Singapore);
    - Both monetary and non-monetary transactions that are intentionally not declared or accurately reported, including barter or cash, not filing, under reporting, inflating expenses, income from illegal activities and deliberate fraud (New Zealand); and
    - Income from both legal and illegal activities that is not subject to information reporting or withholding (United States).
13. In addition, other terminology is used in varying ways to describe types of behaviour generally associated with unreported economic activities (e.g. ‘moonlighting’, ‘skimming’, and ‘black’ or ‘illicit’ work).
14. All of this terminology, along with some obvious differences in interpretation, have the potential to cause confusion and misunderstanding in conducting dialogue and other information exchanges between revenue bodies. However, a source of standardisation and clarification of some of the terminology can be found in the work of national statistical agencies and relevant coordinating international bodies.

### The non-observed economy

15. With their mandate to produce accurate national accounts and estimates of gross domestic product (GDP), the OECD and national statistical agencies have adopted the term ‘the non-observed economy’ to refer to unreported economic transactions in an aggregate economic sense. The term is defined as consisting of four components (Box 1 refers):
- 1) Unreported income arising from **legal** activities;
  - 2) unreported income arising from **illegal** activities;
  - 3) Production of goods for own use; and
  - 4) A “statistical underground” reflecting shortcomings in statistical techniques and information sources.

#### Box 1. What is the non-observed economy?

The term “Non-Observed Economy” (NOE) refers to those economic activities which should be included in the GDP but which, for one reason or another, are not covered in the statistical surveys or administrative records from which the national accounts are constructed. What are these reasons?

**First**, of course, because these activities are carried out in a clandestine fashion to lower the costs of labour by avoiding the payment of taxes or social charges, to avoid the costs associated with legislation on safe working conditions or protection of consumers’ rights. This is usually what most people have in mind when they speak of the “underground” or “hidden” economy. Sometimes the transactions are only partly concealed and may be reported to the tax authorities or to the statistical office at lower than true values so as to reduce rather than entirely eliminate taxes. In other cases, there will be no record of the transaction at all and in such cases the payment will usually be made in cash.

Most clandestine transactions involve the production or exchange of goods and services that are perfectly legal in themselves but, obviously, those which involve illegal goods and services - narcotics and prostitution for example – will also be carried out in secrecy. In addition to the “legal” underground, certain kinds of illegal activities are therefore the **second** component of the NOE.

A **third** component is the production of goods for own use. This is usually perfectly legal and there is no reason for producers to conceal their activities. It may be omitted from the national accounts only because there are no observable transactions between sellers and purchasers since they are one and the same. In OECD countries, construction and maintenance of dwellings is probably the most important example of production for own use. In transition and developing countries growing one’s own food is another important activity. Following the collapse of Communism in the early 1990s, small scale crop production became an essential survival strategy in most transition countries and may have accounted for up to half of total agricultural output in some countries.

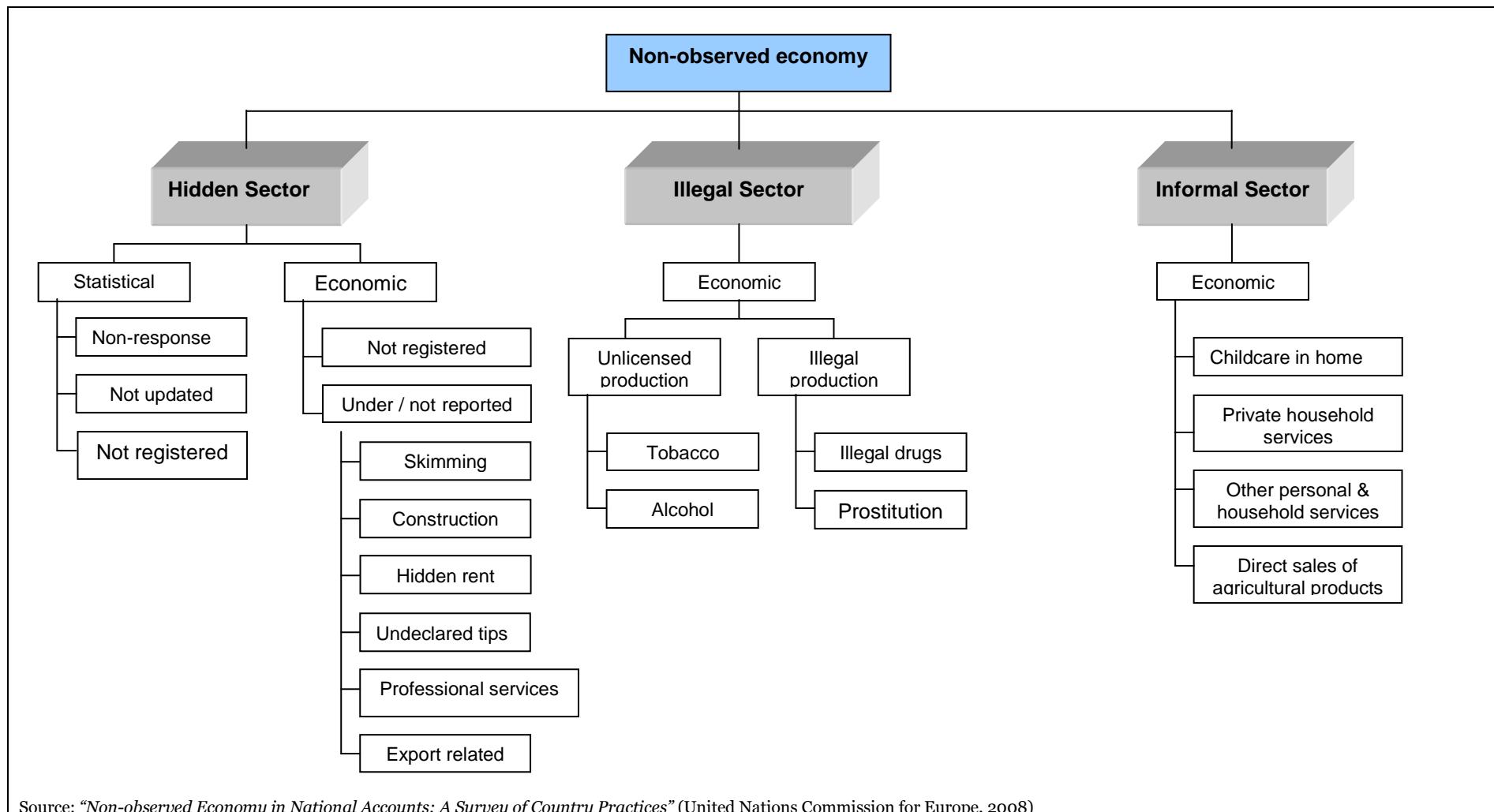
The **fourth** component of the NOE is sometimes termed the “statistical underground”. The statistical surveys and the administrative records that provide the basic data for the national accounts are incomplete. Sometimes this is by design; it may simply be impractical to cover every producer in a survey so a cut-off point is used to exclude the smallest enterprises. In other cases, the problem arises from poor statistical practices. The business register used for the survey is out of date or incomplete; the questionnaires are not returned or come back with missing answers; informal activities such as street trading may not be covered by any survey; inappropriate methods are used to correct for non-response.

Source: OECD’s Statistics Brief: Measuring the Non-Observed Economy (November 2002).

16. For revenue bodies, components 1) and 2) are the main areas of interest. However, for this study only component 1) is being addressed. This definition along with the analytical framework set out in Figure 1 and developed by Statistics Canada gives some additional insights as to elements of each component.<sup>3</sup>

<sup>3</sup> This diagram was reported as being used by Statistics Canada (SC) in the publication “*Non-observed Economy in National Accounts: A Survey of Country Practices (United Nations Commission for Europe, 2008)*”. An accompanying explanation states that it follows the Italian statistical agency’s (i.e. ISTAT) analytical framework for measuring the underground economy, in that the various underground activities are classified by underground economy (UE) sector and sub-sector, as depicted in Figure 1. SC aims to develop measures for all components with the exception of hidden production due to statistical reasons.

**Figure 1. Analytical framework for understanding and measuring the non-observed economy**



Source: "Non-observed Economy in National Accounts: A Survey of Country Practices" (United Nations Commission for Europe, 2008)

17. From the definitions and explanation provided in the previous paragraphs, it will be evident that for national accounts purposes, unreported economic activities comprising the NOE can arise from:
  - 1) Omissions in reporting by participants arising from deliberate and careless actions or simply out of ignorance;
  - 2) Overclaimed deductions that reduce the value of economic activities (in a net sense) reported in tax returns; and
  - 3) Unreported transactions made in non-cash (e.g. barter) form.
18. Given that all of these actions may have a tax consequence, there would seem no reason from a revenue administration viewpoint why they should not constitute part of revenue bodies' definition of the underground economy.

### ***Who are the participants?***

19. From the information provided in Figure 1 and survey responses in general, it can be seen that in addition to illegal sector activities there is a large and diverse number of participants involved in a broad range of industries and activities:
  - For larger businesses, deliberately concealed income streams generally accompanied by fabricated books and records.
  - Cash sales of small retailers "skimmed off the top" of actual business proceeds.
  - Professional and other services provided to households for payment in "cash only" (e.g. gardening and house repairs).
  - Use of "ghost" employees to conceal income of proprietors.
  - Cash sales of small agricultural producers.
  - Unreported rental income of real property owners.
  - Informal employment income (typically paid in cash for work performed on a casual basis) and often from the unreported earnings of the employers concerned).
  - Work carried out by individuals for cash outside of their main occupation/employment (e.g. teachers giving night classes or private tuition).
  - The unreported tip income of employees.
  - Casual earnings derived from the provision of personal services (e.g. child-minding, household chores).
  - Payroll compliance risks (illicit workers, cash paid wages and sham contracting/mischaracterisation of employment income as self-employment).
20. Given the numbers of participants and the diversity of non-compliance practices evident there can be little doubt that implementing an effective strategy to reduce the overall incidence of this noncompliance is a challenging undertaking for all revenue bodies and one that is likely to require a sustained effort over a fair period of time. More is said on this in later chapters.

## **Estimating the size of the non-observed economy**

### ***The work of national statistical bodies***

21. National statistical agencies are generally charged with ensuring the good quality of national accounts and exhaustive estimates of Gross Domestic Product (GDP). As such, and because they rely to a fair degree on information contained in tax returns on income of SME's/self-employed taxpayers to derive their estimates, they are required to make additional efforts to take account of missing economic activities. To assist statistical agencies and ensure consistency in the compilation of national accounts, the OECD released in 2002 its

- “*Handbook for Measurement of the Non-observed Economy*”, which is now applied internationally as the standard in this area.
22. In 2005-06, the United Nations Economic Commission for Europe (UNECE) Secretariat carried out a study of national practices in estimating non-observed economic (NOE) activities in national accounts. It published the findings of its study, which included 43 countries, in 2008 and also provided a summary indicating the extent of adjustments made by various countries to allow for NOE activities—refer Annex 1. From the data provided in Annex 1 it will be seen that:
- For OECD countries where data were reported, the extent of the adjustments for NOE activities was typically well under 10% of GDP, although there were some exceptions (e.g. Hungary—11.9%; Italy—14.8% to 16.7%; Mexico—12.1%; Spain—11.2%).
  - The extent of adjustment made for the new EU economies in Central Eastern Europe was typically in the range of 10-20% of GDP.
  - Very large adjustments (i.e. 25-30% of GDP) were made by most Commonwealth of Independent States (CIS) countries, an outcome not surprising given they administer relatively new and immature tax systems and the challenges associated with establishing a positive “taxpaying culture”.
23. Assuming that adjustments of this magnitude remain broadly applicable in 2011, it seems reasonable to conclude that unreported economic activities are a major challenge for most countries and, of course, their respective revenue bodies with their mandate to improve compliance with tax laws.
24. In June 2011, Statistics Canada released the findings of its most recent work to update its estimates of Canada’s underground economy, covering the period 1992 to 2008.<sup>4</sup> The key findings of this research, which exclude illegal production activities reflected in Figure 1, were:
- The underground economy grew less quickly than the total economy in Canada from 1992 to 2008. In 2008, the upper bound estimate of the underground economy (UE) in Canada was CAD 36 billion. This was an increase of 90% from 1992, the initial year for the period under study. During the same period, nominal gross domestic product (GDP) grew by 128%.
  - The upper bound estimate of underground activity was equivalent to 2.2% of GDP in 2008, down from 2.7% in 1992. Some, but not all, underground economic activity is already included in the published GDP estimate.
  - The main reason for the slower growth of UE compared to the total economy is that industries traditionally considered to be involved in underground activity are a declining portion of the overall economy and those sectors less impacted by UE are growing more quickly.
  - Personal spending on underground goods and services in 2008 was an estimated CAD 24 billion at an upper limit, equivalent to 2.7% of the total published household expenditure on goods and services.
  - Underground activities related to investment in residential and non-residential structures, a component of business gross fixed capital formation accounted for CAD 10 billion in 2008 at an upper bound.
  - Unreported income may be found in any industry, but UE activity is particularly prevalent in retail trade and construction. These sectors accounted for over half of the total UE upper bound estimate.

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<sup>4</sup> See “*Estimating the Underground Economy in Canada, 1992- 2008*”, (Income and Expenditure Accounts Division, Statistics Canada), June 2011.

### **Other research into the size of the non-observed economy**

25. Over recent decades it has become fashionable for academics and others to attempt to make estimates of the size of country NOEs. For this purpose macro-model methods—described in the OECD’s handbook as ‘monetary methods’, ‘global indicator methods’, or the ‘latent variable method’—have been most frequently used to derive an estimate of unobserved activities.<sup>5</sup> **However, it should be noted that the OECD (and other international organisations) reject these methods as being useful in obtaining exhaustive estimates of GDP or in estimating underground production and have observed that when applied they produce for most countries spectacularly high estimates of NOE activities which have no sound scientific base but which, nevertheless, attract much attention from the media and other parties.**<sup>6</sup> This has been shown to be the case in some developed countries (e.g. Australia and Canada) where relatively high estimates of their respective NOE were produced by various academics,<sup>7</sup> only to be subsequently shown as being highly implausible by the national statistical agencies of the countries concerned.<sup>8</sup>
26. In early 2006, following publication (and resultant media articles) of further estimates of countries’ NOEs derived from using these macro-model methods, the international organisations involved in producing guidance on the preparation of national accounts – the European Commission (Eurostat), the International Monetary Fund, the World Bank, the United Nations, and the Organisation of Economic Co-operation and Development – published an official repudiation of the utility of macro-methods for deriving estimates of the GDP and NOEs.<sup>9</sup>
27. Finally, on this particular aspect it is noteworthy that a recent paper from Germany summarises the findings of work to investigate the size of the ‘shadow economy’ in over 30 mostly OECD countries applying what are described as ‘panel-data techniques’.<sup>10</sup> The authors note in their findings that their estimates of the size of the shadow economy in individual countries are substantially lower than other alternate estimates (although with a generally good degree of correlation) and are, in fact, more in line with the micro-evidence such as that produced by statistical bodies.

### **Prior guidance on compliance risk management**

28. The Forum has published an extensive array of practical guidance and knowledge of revenue body practices concerning the management of tax compliance risks in recent years.

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<sup>5</sup> See ‘Measuring the Non-observed Economy: A Handbook’ (a joint publication of the OECD, IMF, ILO and CIS Statistical Committee (2002).

<sup>6</sup> Refer “Measuring the non-observed economy”, Statistics Brief (OECD, November 2002).

<sup>7</sup> For example, Fredrik Schneider, and David Giles and Lindsay Tedds, (Canadian Tax Foundation, Toronto, Canadian Tax Paper No 106, 2002).

<sup>8</sup> In 2004, largely in response to the reported findings of some academics’ research that suggested that Australia’s underground economy could be equivalent to up to 15% of official GDP, the Australian Bureau of Statistics (ABS) completed a study explaining its methods for compiling national accounts and examining the implications of missed underground transactions on the quality of national accounts. After an extensive study, it concluded that the official estimates of the level of GDP are highly unlikely to be understated by more than about 2%. (See for instance “The Underground Economy and Australia’s GDP”, National Accounts Branch, ABS, March 2004). For Canada, after careful scrutiny of their statistical sources, Statistics Canada (SC) estimated that in 1992 the upper limit to the underground economy was 2.7% whereas Schneider and Enste quote macro-model estimates of between 10% and 13.5% for the same period. (See Gyllyane Gervais: “The Size of the Underground Economy in Canada”, Statistics Canada, 1994). SC’s recently published estimates of UE activity establish that Canada’s UE is likely to be in the range of 2-3% of GDP, significantly less than estimates based on the use of macro-model methods.

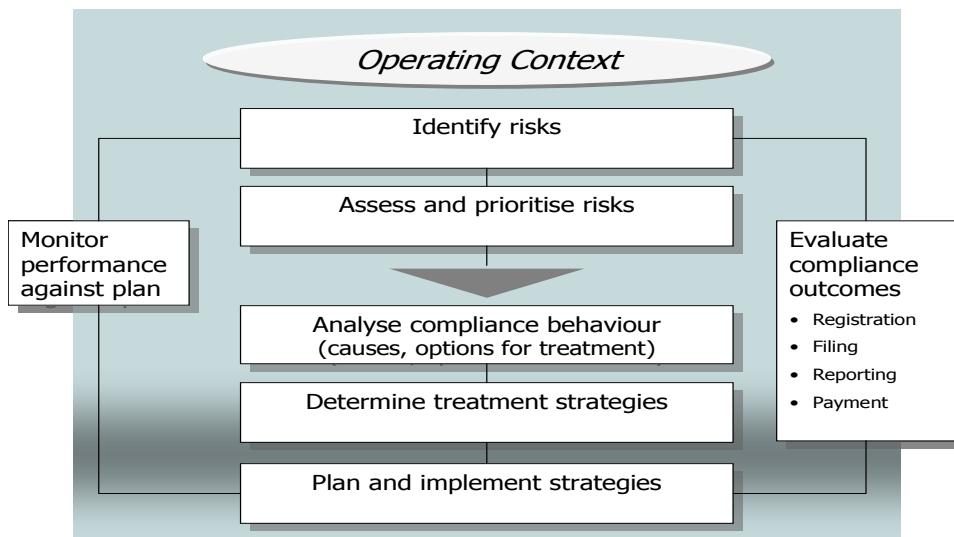
<sup>9</sup> See Annex 2 and [www.oecd.org/dataoecd/0/42/36333066.pdf](http://www.oecd.org/dataoecd/0/42/36333066.pdf).

<sup>10</sup> See Discussion Paper 1122 “The Shadow Economy in OECD Countries: Panel-Data Evidence”, Konstantin Kholodin and Ulrich Thieben, German Institute for Economic Research, May 2011.

### **The compliance risk management process**

29. The guidance note “*Compliance Risk Management: Managing and Improving Tax Compliance*” published in October 2004 describes and seeks to promote the concept of compliance risk management as an essential management tool for revenue bodies and give a description of practical approaches that could be adopted by revenue bodies.<sup>11</sup> The model of compliance risk management recommended, which draws on leading revenue body experience, is depicted in Figure 2.

**Figure 2. The Compliance Risk Management Process**



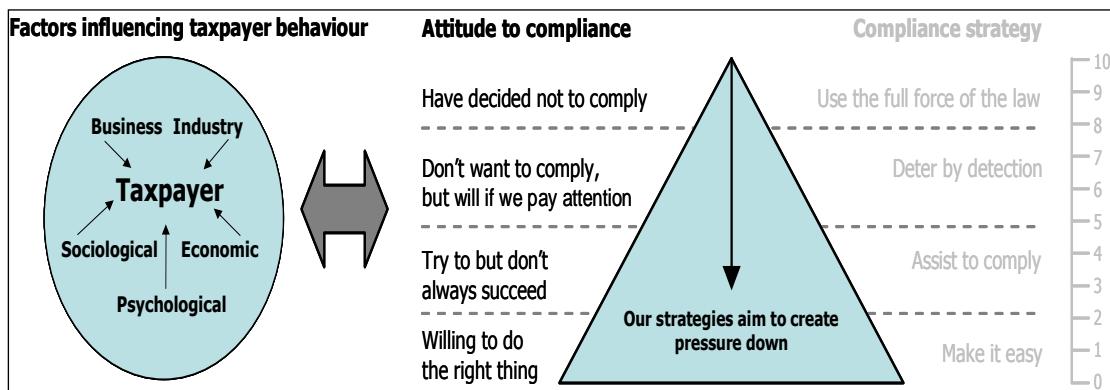
30. Using the model across each of the major taxes administered as part of their normal management cycle, revenue bodies attempt to answer the following key questions:
- What are the major compliance risks to be addressed?
  - Which groups/segments of taxpayers do they apply to?
  - What are the underlying behaviours and their drivers?
  - How should these risks be addressed, taking account of the foregoing considerations, to achieve the best possible outcome?
  - What measures can be used to gauge whether the overall set of treatment strategies is achieving the intended outcomes?
  - Which treatment strategies are having the intended result, which ones are not?
31. As will be evident, the model is essentially a ‘top-down’ strategic process designed to deliver gains in the form of sustained compliance improvement for individual revenue bodies and, in turn, additional revenues for the government and taxpaying community, or simply improved cost-effectiveness (i.e. a similar level of compliance but at lower cost).
- Understanding and influencing taxpayer behaviour***
32. Research supporting the ideas contained in the 2004 guidance note described two broad approaches to understanding and approaching the problem of non-compliance, the first based on self interest and economic rationality and the second drawing on a wider range of explanations for human behaviour derived from behavioural and regulatory sciences,

<sup>11</sup> See [www.oecd.org/dataoecd/44/19/33818656.pdf](http://www.oecd.org/dataoecd/44/19/33818656.pdf)

psychology, anthropology and other fields.<sup>12</sup> It considered that these approaches are by no means complementary, but rather complement each other as when taken together they allow for a nuanced analysis of compliance risks and the opportunities for intervention.

33. In combination with the research of Australian academic Dr Valerie Braithwaite around the sets of values, beliefs and attitudes of individual taxpayers (persons or businesses), the 2004 note offered a BISEP model for thinking about the combination of these factors and the attitudes of individuals in the way they may relate to a revenue body and the tax system it administers. This model (Figure 3) allows users to categorise the factors in a consistent manner and form to aid understanding, and is also sufficiently robust to stand up to applied and practical application in a tax administration environment.

**Figure 3. The BISEP model and spectrum of taxpayer attitudes to compliance**



34. It was highlighted that an individual taxpayer is capable of adopting any of the attitudes described at different times and may also adopt all of the attitudes simultaneously in relation to different issues. It noted that these 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 guidance note suggested that the value of this model is in the contribution it makes in developing a deeper understanding of taxpayer behaviour and being able to lay 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.
35. Further guidance and insights were set out in an additional note published in October 2010. In describing the findings of recent behavioural studies and revenue body research and their relevance in a tax compliance context, the note "*Understanding and Influencing Taxpayers' Compliance Behaviour*"<sup>13</sup> drew attention to a range of factors influencing taxpayer behaviour—see summary in Box 2. It concluded by noting that while there is no simple answer as to how best to influence taxpayer behaviour, the findings suggest that revenue bodies adopt a compliance strategy which combines both a deterrence approach and a normative approach. The deterrence approach should be used to create and support social norms – to signal that society does not approve of non-compliant behaviour. In the long run, high levels of compliance are achieved preferably by establishing and reinforcing norms in favour of compliance. Not only are norms considered by both researchers and revenue bodies to be the most effective way to influence behaviour, they are also the least costly.

<sup>12</sup> Simon James, John Hasseldine, Peggy White, and Marika Toumi (2001) "Developing a Tax Compliance Strategy for Revenue Services", pp. 158-164 in "Bulletin from International Bureau of Fiscal Documentation", April 2001.

<sup>13</sup> See [www.oecd.org/dataoecd/58/38/46274793.pdf](http://www.oecd.org/dataoecd/58/38/46274793.pdf)

## Box 2. Factors influencing taxpayer behaviour

**Deterrence:** Deterrence resulting from audits, the risk of detection and/or severity of punishment is often the first response that comes to mind when the general public is asked about how a revenue body promotes compliance; however, studies demonstrate conflicting evidence as to whether deterrence strategies have the desired behavioural influence on compliant and non-compliant taxpayers—some revenue bodies have reported that deterrence activities (large audit adjustments and monetary penalties) have actually emboldened taxpayers to behave more non-compliant in subsequent years. For the habitual non-complier, a deterrence strategy involving recurring audit activity may be required.

The success of deterrence strategies is also linked to a taxpayer's norms. Of particular interest is the finding that deterrence is more effective where strong social norms exist. Therefore, revenue bodies could consider the use of non-monetary penalties that attach a “social cost” response to non-compliance behaviour.

Research findings suggest that communication plays a critical role in how a deterrence strategy is perceived by taxpayers. It is not sufficient to simply deliver a message that non-compliant taxpayers are being detected; the public must also be reassured (truthfully) that most taxpayers are honest, as this promotes a strong social norm to remain compliant. Otherwise, deterrence communication can give the impression that non-compliance is the norm, thus running the risk of promoting further non-compliance.

**Norms:** Norms, both personal and social, are considered to be the most important drivers of compliance. However, influencing norms is not an activity in which most revenue bodies have a great deal of experience. Instead, revenue bodies have tended to focus on short-term, output-driven indicators of performance. They have historically been reluctant to engage in longer-term strategies designed to regularly assess (using outcome measures) and permanently influence taxpayer behaviour. Most revenue bodies now recognise the need for a longer-term approach based on outcomes (compliance levels). Aside from attempting to influence norms, revenue bodies should consider incorporating normative messages in their dealings with taxpayers. For instance, messaging that others have acted in a certain manner (i.e. taxpayers have changed their behaviour or have complied) can influence those that have yet to do so.

It is also important for revenue bodies to be alert to, and promptly address, public misconceptions or inaccuracies that may impact social norms (hence taxpayer behaviour). For example, if a media story suggests that taxpayers are being dealt with unfairly by the administration, or that tax evasion is more widespread than in reality, a response to the effect that this is a rare case, or is not true based on factual evidence, should contribute to public trust.

**Opportunities:** Revenue bodies have traditionally sought to limit the opportunities for non-compliance and have expended much less effort on making it easier for taxpayers to comply. For example, third party reporting, withholding regimes, and regular legislative amendments have been used and are seen as effective in minimising non-compliant behaviour. However, revenue bodies have tended to overlook the “lazy non-complier”—the taxpayer who would have complied if only it had been easier. Further research could also be undertaken to better understand why taxpayers unintentionally non-comply, such as by making errors in completing forms. Suggestions for making it easier to comply and/or reducing unintentional non-compliance include the use of plain language in communications and simplifying forms and tax laws.

**Fairness:** Research suggests that fairness, as exhibited by the revenue body or government, can play a role in taxpayer behaviour. Three types of fairness are discussed in the note. *Distributive fairness* is the perception that the government acts as a good custodian and wise spender of tax revenues. *Procedural fairness* is the perception that the revenue body adheres to procedures that are fair in dealing with taxpayers. *Retributive fairness* is the perception that the revenue body is fair in the application of punishment when the rules are broken. Studies show that a lack of perceived fairness is linked to a taxpayer’s inclination (or justification) to not comply.

**Economic factors:** The work undertaken indicates that there has been, in general, a lack of research to link economic factors to taxpayer compliance behaviour. The general conclusion is that factors that promote economic growth also tend to promote tax compliance.

**Interactions:** Not to be overlooked from the research is the need to better understand how the various drivers of compliance behaviour interact with each other. In particular, a revenue body must be cautious when using controlling and supportive approaches to influence behaviour. For example, if a revenue body’s approach is perceived as very controlling, it can cause taxpayers to feel distrusted. Research implies that when taxpayers feel distrusted, they may adopt the same attitude towards the revenue body, and this may reduce compliance. A revenue body should send a clear signal to the general public that non-compliant behaviour is seen by society as wrong. By suggesting that society (and not just the revenue body) view this behaviour as wrong existing personal norms are reinforced.

Source: OECD: “*Understanding and Influencing Taxpayers’ Compliance Behaviour*”, November 2010.

### **Monitoring taxpayers' compliance**

36. A key element of the recommended approach to compliance risk management is a compliance monitoring framework, which is intended to provide revenue bodies with a range of 'top-down' compliance measures and indicators to monitor and evaluate the impacts of its compliance activities at the aggregate level. These can be complemented by various 'bottom-up' measures and indicators derived in the course of evaluating the impact of specific risk treatments in targeted risk areas. The 2004 note gave only limited guidance as to the nature of specific measures and indicators that could be used at all levels. Further guidance was elaborated in a subsequent note published in June 2008- see "*Monitoring Taxpayers' Compliance: A Practical Guide Based on Revenue Body Experience*".<sup>14</sup>

### **Evaluating compliance risk treatments**

37. Finally, the note "*Evaluating the effectiveness of compliance risk treatment strategies*"<sup>15</sup> published in November 2010 set outs a practical methodology for conducting outcome evaluations of compliance risk treatment strategies in priority areas, drawing on innovative work carried out by the Australian Taxation Office. This guidance note gives emphasis to the identification and development of practical measures and indicators that, set at the commencement of risk treatment action, can be used to gauge progress and assess the merits of risk treatment strategies in terms of improved taxpayer compliance and confidence in a revenue body's administration. To illustrate these aspects, the note includes a large number of case study examples, including one specifically dealing with the underground economy, from a cross-section of revenue bodies, describing specific measures and indicators used to evaluate the impacts of specific risk treatments and, for most, the impacts observed. The note acknowledges that for some strategies there are limitations as to degree of precision or confidence that can be attached to any conclusions of their impacts and effectiveness.

### **Implications for administration of the underground economy**

38. The 2004 guidance note, and as elaborated further in subsequent notes, emphasised a range of critical factors to be considered in relation to each element of the overall risk management model. Those more relevant to this study are set out hereunder:

#### **Identifying risks**

- Risk can be identified using top-down techniques such as macro-economic analysis and/or by bottom-up processes such as case-based risk assessment systems.
- A more complete understanding of risk will occur through taking a multi-level approach (e.g. strategic and operational) to risk identification and assessment.
- Risk identification processes that offer linkages to understanding the drivers of compliance behaviour offer the most effective leverage of intelligence.

#### **Assessing and prioritising risk**

- Revenue bodies need a mechanism for systematically assessing the relative size of compliance risks in the context of organisational business priorities.
- Assessment and prioritisation should be based on objective evidence.
- A balanced approach to risk prioritisation may see some risks being addressed that do not represent the highest revenue exposure (for example, the reporting of tips and gratuities by hospitality industry staff, which for many may be their first job, because of the influence that this may have on their future tax compliance.)

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<sup>14</sup> See [www.oecd.org/dataoecd/51/13/40947920.pdf](http://www.oecd.org/dataoecd/51/13/40947920.pdf)

<sup>15</sup> See [www.oecd.org/dataoecd/59/3/46274278.pdf](http://www.oecd.org/dataoecd/59/3/46274278.pdf)

### ***Analysing compliance behaviour***

- 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.

### ***Determining 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 deter those who do not, while reassuring those who do.
- Treatments must address the underlying drivers of compliance behaviour.
- The most effective strategies are likely to be multi-faceted and systemic, applying a long term perspective and gradually evolving over time with the accumulation of experience and in response to changes in environment and/or risk picture.

### ***Evaluating outcomes***

- 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.
39. All of these considerations provide a framework for understanding and learning from the approaches of surveyed revenue bodies in relation to their approaches for dealing with the underground economy, as described in the following chapters. Readers seeking more information on aspects of the risk management model referenced in this note are directed to prior published materials on compliance risk management identified above.

### **III. OVERARCHING STRATEGIES FOR ADDRESSING THE UNDERGROUND ECONOMY**

40. In line with the Forum's prior work on compliance risk management, the survey of members sought to identify the features, both common and unique, of any overarching strategy put in place to address compliance risks associated with underground economic activities. In using the term 'overarching' the intention of the survey's questions was to elicit details about revenue bodies' strategies that covered in a reasonably comprehensive manner all/most aspects of the risk management approach recommended by the Forum's prior work. For survey purposes, specific information was sought concerning:
- 1) The definition of the underground economy (or equivalent terminology) used by the revenue body, and whether it included legitimate and/or criminal economic activities;
  - 2) Industry sectors where a high level of underground economy activity had been observed;
  - 3) Research undertaken to help understand the compliance behaviour of taxpayers who participate in the underground economy;
  - 4) Strategies used for addressing the compliance risks of the underground economy;
  - 5) Indicators and measures used to monitor/evaluate the overarching strategy's impact;
  - 6) The involvement of other Government agencies in the development and implementation of the overarching strategy; and
  - 7) Any issues that would benefit from collaboration between countries.

#### **Existence of an overarching strategy**

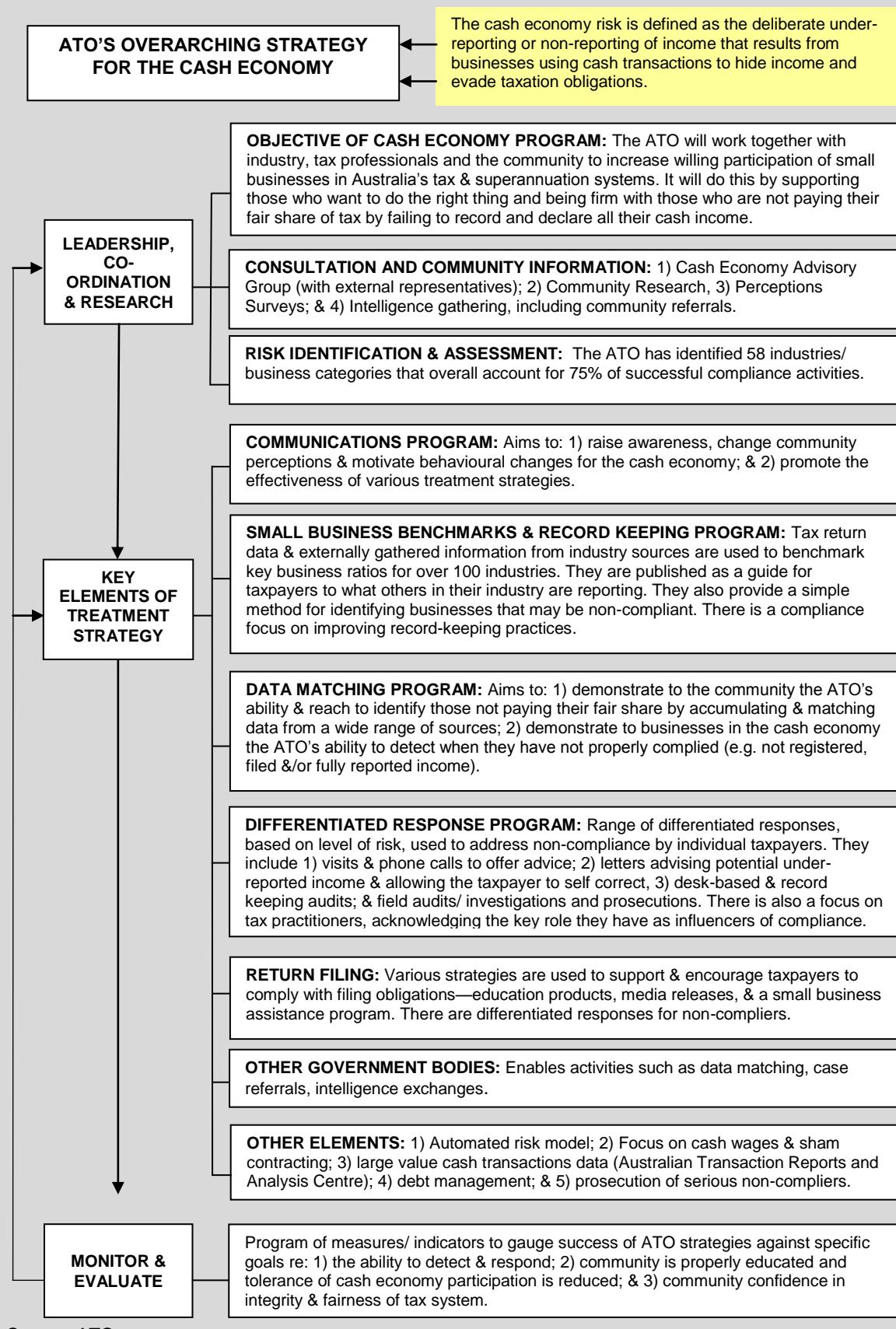
41. Survey responses from no more than half of surveyed revenue bodies provided information on the overarching strategies being used to identify, assess and treat compliance risks and, to a lesser extent, to monitor and evaluate the impacts being achieved. Generally speaking, however, many of the overarching strategies described in survey responses were fairly narrow in their scope and did not encompass the full range of activities envisaged by the risk management approach recommended in the Forum's prior work.
42. The fact that a fair number of revenue bodies reported that they do not have an overarching strategy at all for dealing with the 'underground economy' (or whatever descriptor is used) needs to be interpreted with care. As noted in Chapter II, there are differences across revenue bodies in the interpretation of the term 'underground economy', with some adopting a fairly narrow view while others give it a considerably broader scope. As a result, some revenue bodies falling into the former category framed their survey responses against a narrower set of compliance risks that was not deemed to justify a unique overarching strategy. On the other hand, other revenue bodies reported that the underground economy was a part of their overall compliance programme or strategy.

#### **Examples of overarching strategies and their core elements**

43. A number of revenue bodies described the features of their overarching strategy, and Figures 4 to 7 depict a number of country examples, highlighting their key elements and related activities. The more common 'core' elements and related activities of these strategies are:
  - 1) Management arrangements are in place across the revenue body for effective 'whole of revenue body' leadership, co-ordination and evaluation of the strategy, recognising the cross-programme nature of the activities being carried out to improve overall compliance;

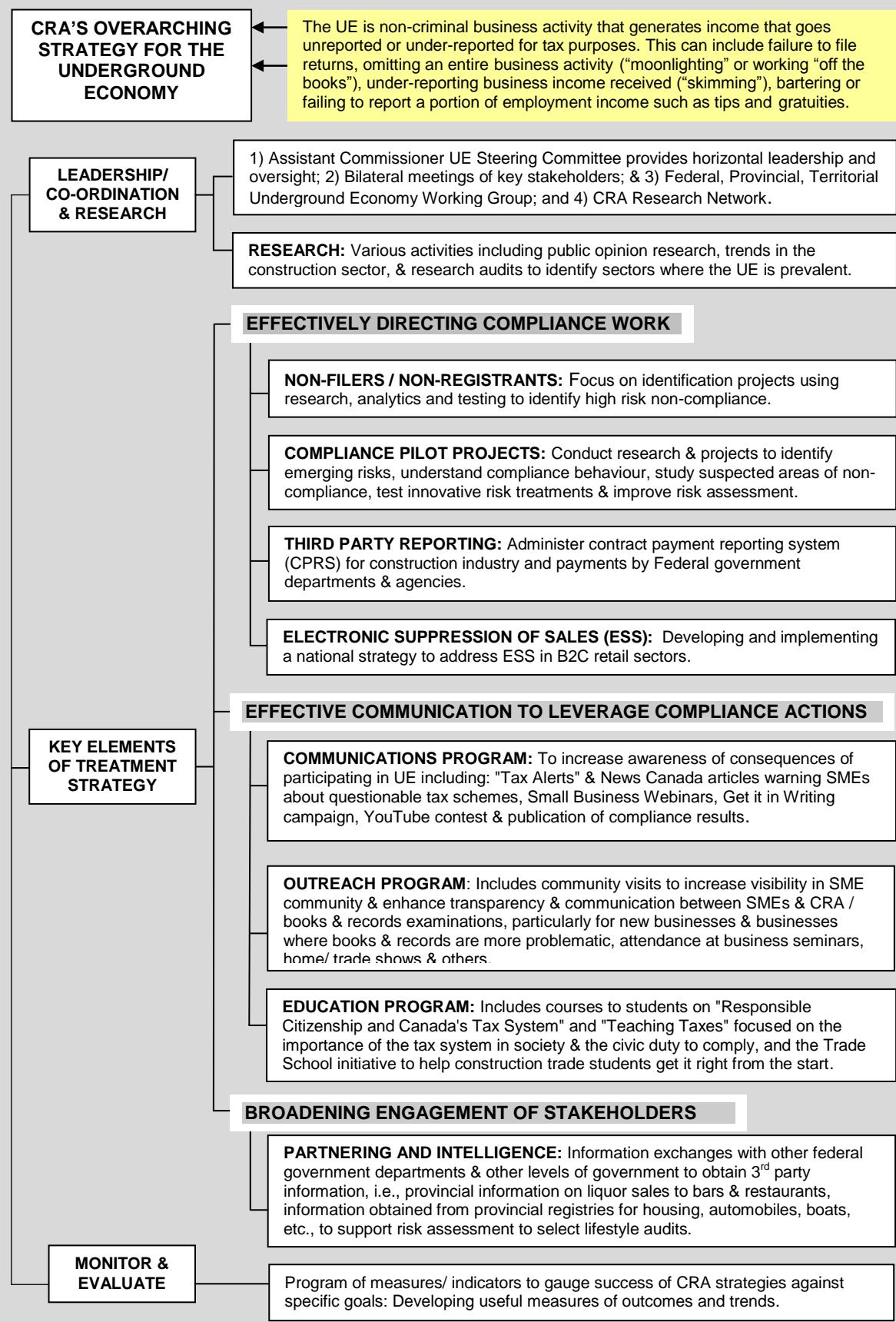
- 2) Comprehensive research efforts are undertaken (e.g. to assist risk detection and assessment, to test treatments, and to monitor external perceptions and attitudes);
- 3) Enhanced risk detection processes are being used, including the use of third party information sources and sophisticated risk profiling techniques;
- 4) A broad set of treatment strategies is deployed, typically including education, outreach and communication-based initiatives, specially legislated tools to assist in deterring and detecting non-compliance, traditional enforcement programmes and specialist programmes for serious tax evasion, including that from illegal activities;
- 5) An important element of some treatments is the effort made to leverage improved compliance via intermediaries such as tax professionals, industry representatives, and primary business contractors;
- 6) Effective relationships and mechanisms for exchange of information exist with relevant other Government agencies, in particular for information gathering and co-ordinating programme efforts;
- 7) Wide use of the media to communicate aspects of the strategy and the positive results being achieved; and
- 8) Further attention and development is required by most revenue bodies, to evaluate the impacts of their individual treatments and/or overall strategy.

**Figure 4. Australia—Overarching strategy for the cash economy**



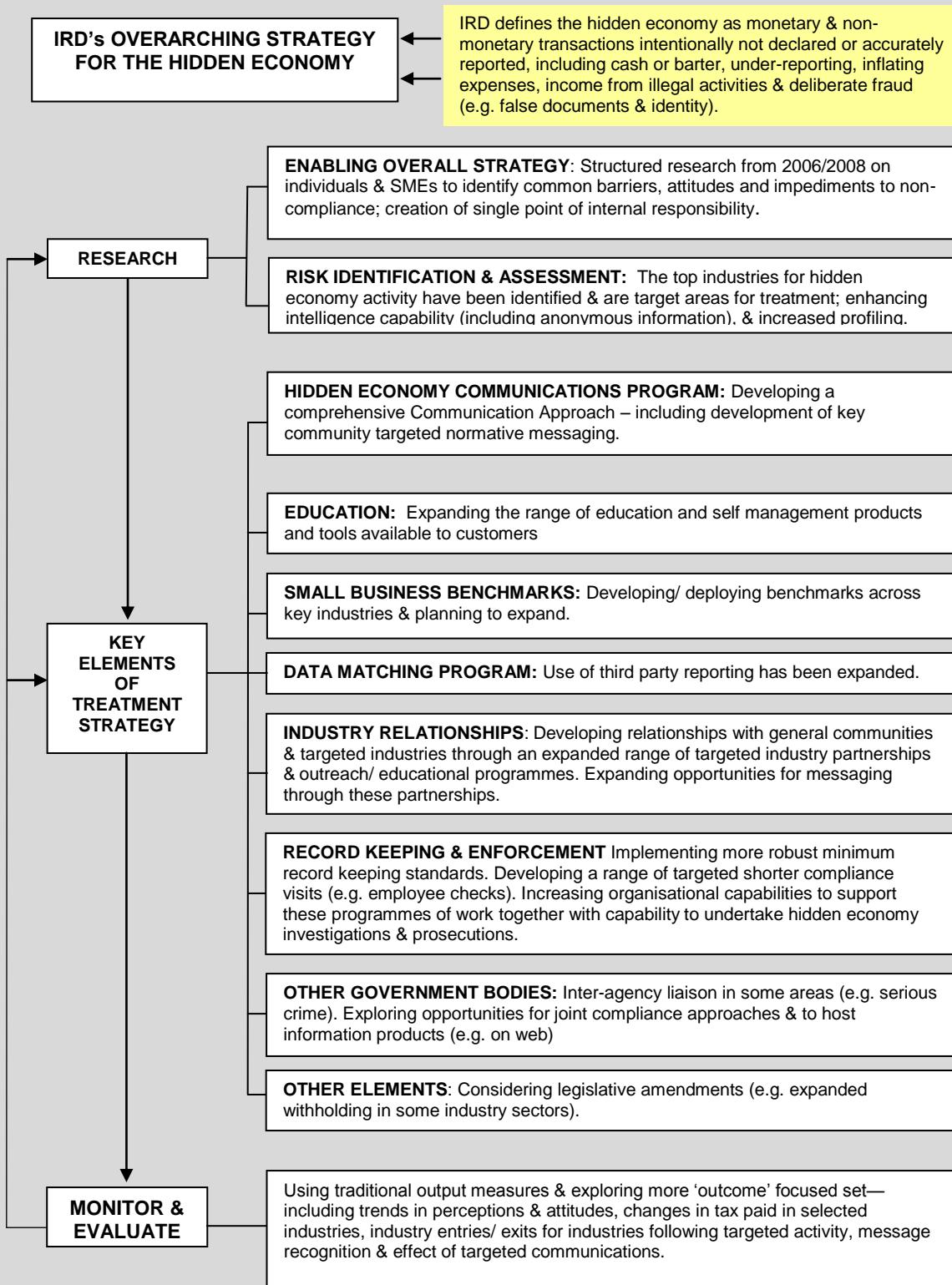
Source: ATO survey response

**Figure 5. Canada—Overarching strategy for the underground economy**



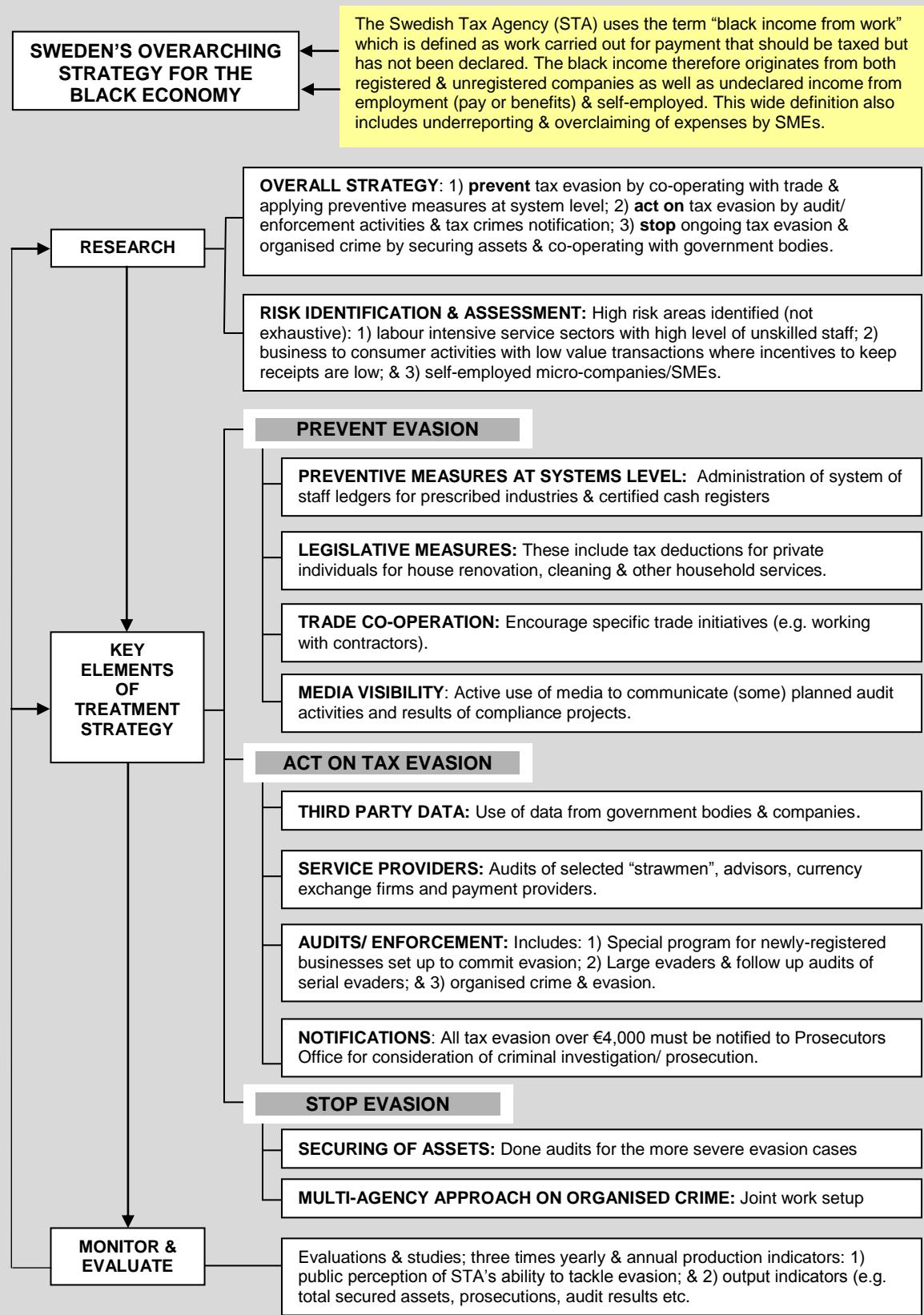
Source: Canada Revenue Agency survey response and other official documents

**Figure 6. New Zealand—Overarching strategy for the hidden economy**



Source: New Zealand Inland Revenue survey response

**Figure 7. Sweden—Overarching strategy for “black income from work”**



Source: Swedish Tax Agency survey response

## Defining the area of risk

44. While there were many variations in the terminology and definitions used, most revenue bodies generally include all unreported economic activities in their risk definition. With few exceptions, this definition broadly includes illegal activities. However, for operational purposes, just about all revenue bodies have a separate enforcement programme/area and cadre of specialist staff dealing with illegal and criminal tax evasion case work (the methods for dealing with this work are beyond the scope of this note).

### **Industry sectors or taxpayer groups of most concern**

45. Given differences in defining the underground economy and the varying views of activities captured, as well as the fact that participating countries use a variety of terminology and references in describing industry sectors/taxpayer groups, the degree of heterogeneity used to explain the make-up of the underground economy is not surprising. Around 44 industry sectors, sub-sectors and taxpayer groups were identified as having high levels of underground economy activity in response to the question regarding areas of primary focus—Table 2 refers.

**Table 1. Industry sectors commonly reported by revenue bodies**

<b>Industry sector</b>	<b>Bodies reporting (%)</b>	<b>Nature of activities included in this sector</b>
Personal Services (B2C transactions)	22.1	House cleaning, hairdressing, beauty, dry cleaning, catering, pest control, computer maintenance, security, health, pet care, matchmaking, etc.
Hospitality	16.4	Restaurants, cafés, pubs, takeaways, hotels
Retail	15.6	Store based, flea/public markets, etc.
Construction	15.6	Building, home renovations, home repairs
Car sales & service	5.7	
Transport	3.3	
Taxi	3.3	
Agriculture, Fishing, Aquaculture	2.4	
Other	15.6	Tourism, real estate (incl. rental), recycling, internet based, freelancers, professionals, entertainers, etc.

46. As acknowledged earlier in this note, an additional perspective for one country (i.e. Canada) on the industry sectors where unreported economic activities were most prevalent was identified in the work of Statistics Canada (SC) to estimate the size of Canada's underground economy (UE) and its trend over time (1992 to 2008). In its June 2011 report, SC noted that:

- In 2008, the three most significant sectors in terms of UE activity were **construction** (30%), **retail trade** (16%) and **accommodation and food services** (12%). These three sectors together accounted for nearly 60% of total value added of UE activities.
- In 2008, UE activities in the **construction** industry accounted for CAD 10.6 billion, at an upper bound. This was all attributed to skimming (underreporting of income) or not reporting income at all by those working in both residential and non-residential construction industries.
- In 2008, UE in **retail trade** accounted for CAD 5.7 billion, at an upper bound. Just over half of this was attributable to skimming by retail outlets. The sales of illegal wine and spirits as well as illegal tobacco accounted for the remaining balance.
- UE activities **in accommodation and food services**, accounted for CAD 4.1 billion in 2008, at an upper bound.

## Research to help understand taxpayer behaviour

47. Understanding the size, scope, the make-up of participants, the underlying drivers of behaviour and the factors that influence behaviour is critical to developing an effective overall approach to the underground economy. Based on responses provided, research and other initiatives geared to acquiring knowledge of the underground economy appears to be an area where further investment and international collaboration may be warranted.
- Just over one-third of revenue bodies indicated they had not done any research in support of their overall approach although a few countries indicated they have some research planned.
  - Around one-third of revenue bodies indicated they undertake limited research primarily geared to estimating the relative size, overall or in relation to certain sectors, or to assessing risk.
  - Only one-quarter of the respondents reported multi-faceted research that had been undertaken to support the development of their underground economy strategy.
48. A few examples of more multi-faceted research or behavioural based research are presented hereunder to illustrate the range of research and knowledge gathering initiatives to support overarching underground economy strategies.

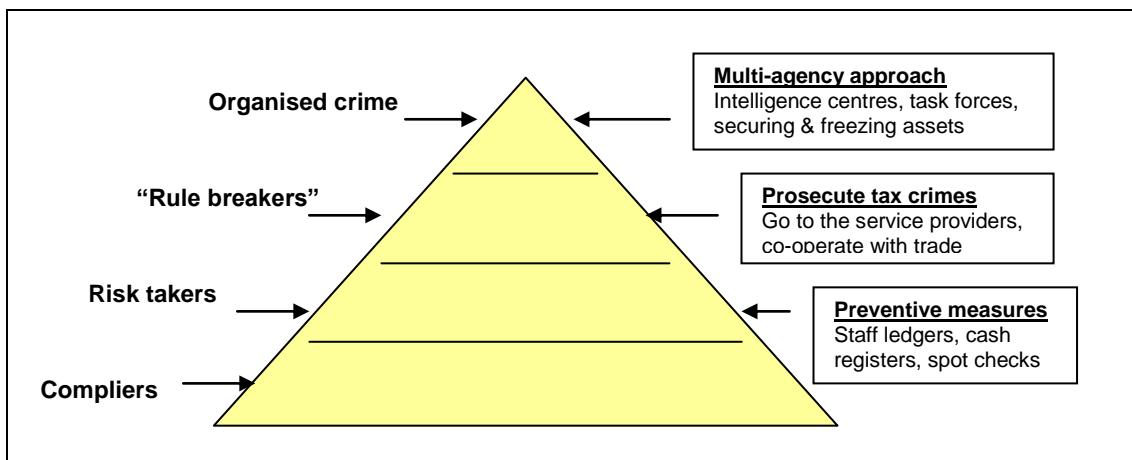
Nature of research (country)	Description
Broad range of activities (Australia)	<p><b>The Cash Economy Task Force:</b> The Task Force (comprising representatives from the ATO, industry, community groups and the Australian National University) was established in 1996 to examine the cash economy in Australia with a view to gaining a better understanding as to the composition of the cash economy, the likely compliance issues associated with the cash economy risk and what additional steps the ATO could take to address tax evasion in the cash economy. The Task Force produced three reports which identified a range of structural drivers for cash economy behaviour and outlined how these drivers could be addressed.</p> <p><b>The Cash Economy Advisory Group:</b> The Cash Economy Advisory Group is an annual forum comprised of a broad range of stakeholders, including tax professionals, persons with international expertise, consumer representatives and industry body representatives. The forum aims to generate ideas and provide guidance to the ATO Cash Economy stream, actively participate in the co-design of strategies to manage compliance risks, provide industry/sector specific insight regarding compliance and provide intelligence about cash economy behaviour in the small business community.</p> <p><b>Cash Economy Community Research:</b> This research (conducted by an external consultant) focused on exploring and understanding attitudes towards three specific issues relating to the cash economy – community norms and personal behaviour, the cash economy ‘transaction’ and attitudes towards cash economy behaviours in the community.</p> <p><b>Business Perceptions Surveys (BPS):</b> Conducted annually, the BPS explores the views of Micro and Small to Medium Enterprise (SME) business operators on the ATO’s performance, deliberate non-compliance, key business issues such as compliance effort, business activity statement experience and record keeping and their attitude towards the cash economy.</p> <p><b>Community Perceptions Surveys (CPS):</b> Conducted annually, the CPS monitors community perceptions about the ATO’s administration of the tax system, and some specific issues including the cash economy. Collecting and analysing intelligence from the ATO’s compliance activities contributes to a better understanding of the demographics of the cash economy risk population and the reasons why taxpayers may be operating outside the benchmarks for their industry segment.</p>

Nature of research (country)	Description
Research to understand the drivers of behaviour (UK)	<p>HMRC conducted specific research in late 2010 into the drivers behind customer behaviours, linked to both hidden economy activity and non-cash payments. The research identified a range of ‘typologies’ that those operating within the hidden economy appear to fall into – from those who justify their non-compliance on the basis that they are involved in nothing more than a ‘well paid hobby’ to others who take a more ‘catch me if you can’ approach at the other extreme. The research also identified key drivers (individual, social, structural) behind customer behaviour and ‘tipping points’ - changes in life circumstances – which were seen to play a part in explaining entry into the hidden economy.</p>
Studies to estimate the size and nature of non-compliance (Denmark and Sweden)	<p>The Danish Tax and Customs Administration has carried out an ambitious compliance study on the basis of random audits of 22,000 returns for the tax year 2006. The results (as far as businesses are concerned) have been analysed in two comprehensive reports, which present detailed information about compliance failures among businesses, including a break-down of error types and tax gap across 16 business sectors.</p> <p>Among the findings are that errors are present in 42% of cases; that most errors can be classified as non-intentional; that there is a large volume of low-value errors; and that errors typically occur in combination. The analysis further shows that companies are less prone to error than the self-employed and that error occur most frequently in certain sectors, including hospitality, education, health care and construction. These insights have informed risk analysis and resource allocation as well as provided a firm basis for setting targets and evaluating outcomes. In addition they have prompted and guided successful efforts to design out error by way of revisiting legislation and administrative processes. Finally they have served as a platform for communication, dialogue and co-operation with stakeholders, including professional bodies representing affected business sectors.</p> <p>The full reports are available in English translation at the International Tax Dialogue website.</p>
	<p>A large study of the anatomy of black income was conducted by the Swedish Tax Agency in 2006—see Report “<b>2006:4B Purchasing and performing undeclared work in Sweden</b>”. The study included types of incentives, attitudes and the extension of black income in different sectors.</p> <p>A study of the size of the overall tax gap in Sweden was conducted in 2007/08; Report “<b>2008:1B The Tax Gap Map for Sweden</b>”. According to the report, about half of the tax gap (amounting to approximately EUR 6 billion) was due to “black” income. Other (smaller) studies related to black economy are carried out annually targeting different segments. These reports are made by the STA’s analysis units (central and regional) to support its annual planning. These reports target different topics such as VAT fraud, SMEs with low income, e-commerce and so on.</p>

### Comprehensive set of treatment strategies

49. As noted in Chapter II and depicted explicitly in Figure 3 (The BISEP model and attitudes to taxpayer behaviour), compliance programmes ideally should be designed to provide a graduated response to compliance behaviour, reassuring those who comply, making it easier for those who want to, and applying credible enforcement efforts to deter those who do not. Treatments need to address the underlying drivers of compliance behaviour. The most effective strategies, in an overall sense, are likely be multifaceted and systemic, applying a long term perspective and gradually evolving over time with the accumulation of experience and in response to changes in environment and/or risk picture. Reflecting this recommended approach, Sweden’s overarching strategy could be illustrated along the lines set out in Figure 8.

**Figure 8. Sweden's overarching compliance framework**



### Evaluating the success of the overarching strategy

50. Understanding the success/degree of impact of a revenue body's strategies for addressing any compliance risk is critical to both strategic and operational decision-making. However, achieving this in practice to a reasonable degree of confidence is easier said than done, and prior Forum work has highlighted this as a relatively immature aspect of revenue administration in many countries warranting greater attention by all levels of management. It was for this reason that the FTA, in November 2010, published the guidance note '*Evaluating the effectiveness of compliance risk treatment strategies*', as briefly outlined at paragraph 27 of Chapter II. For this study, the survey sought details of the measures and indicators being used by revenue bodies to gauge the degree of success of their overarching strategy for addressing the underground economy.
51. Generally speaking, survey responses revealed that many revenue bodies do not have an appropriate means for properly evaluating the impacts of their strategies and, as a result, cannot be certain that taxpayer behaviours are changing in a positive way. For example:
  - Over 40% of surveyed revenue bodies indicated they did not have success factors for their underground economy strategies or indicators for evaluating outcomes; however, of these bodies, 40% noted that success factors and indicators for evaluation are under development.
  - Over 40% of revenue bodies indicated they did have success factors but the indicators used for evaluation seemed to be largely based on 'output' measures; a few of these revenue bodies noted they were working on making the measures more robust.
  - Slightly over 15% of surveyed revenue bodies reported having success factors and indicators for evaluating outcomes, although generally there was little evidence of sophisticated methodologies being used in the evaluations.
52. As reported in the 2010 guidance note regarding evaluation, the Australian Taxation Office is recognized for having a well structured and systematic approach to measuring success and outcomes of its compliance strategies. An outline of their measurement approach for evaluating the impact of their cash economy strategy, as reported for this survey, is set out in Box 3 below.

### **Box 3. Australia—Measurement approach for ATO’s cash economy strategy**

A programme has been established to measure the success of the approach to the cash economy against the following goals:

- The ATO demonstrates its ability to detect and respond to those operating in the cash economy and not meeting their taxation obligations and any improvement in voluntary compliance levels amongst those participating in the cash economy are sustained.
- The community is educated appropriately and tolerance of cash economy participation is reduced.
- Community confidence in the integrity and fairness of the tax system is maintained.

In measuring the success of its approach to the cash economy, the ATO uses the following indicators:

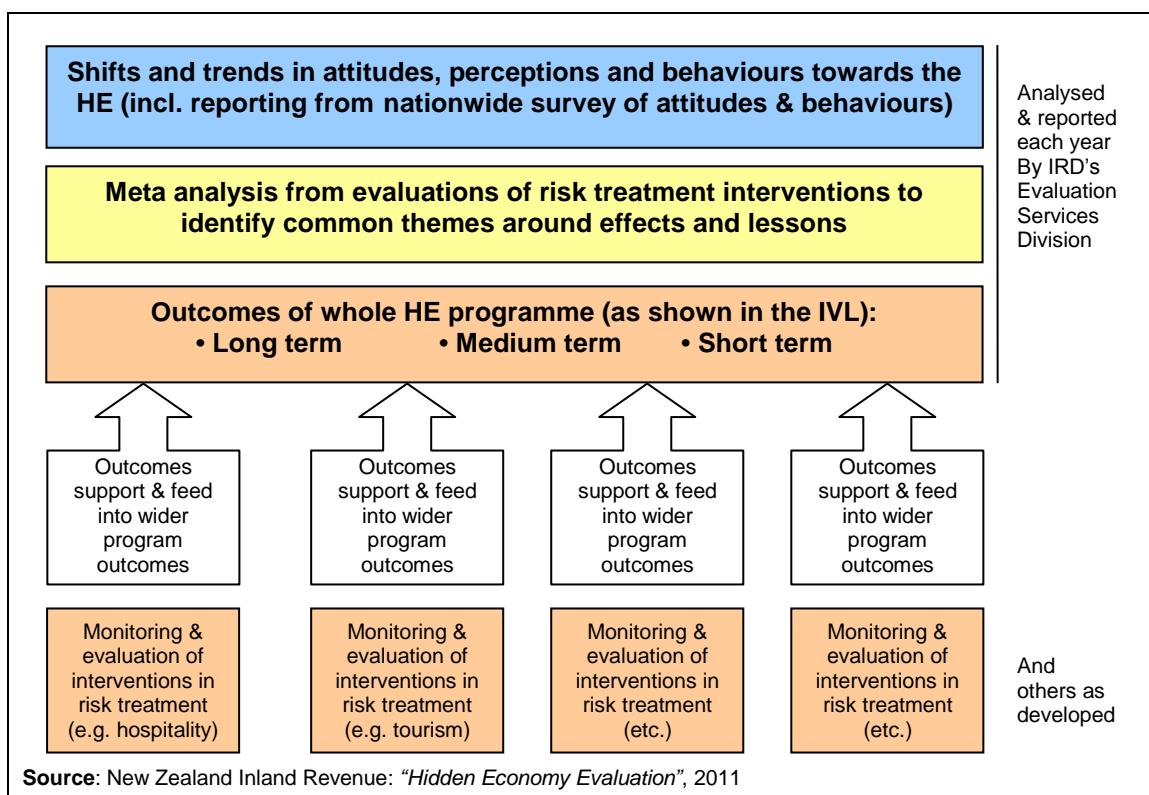
- Changes to relevant indicators of tax performance at individual taxpayer and industry levels;
- Changes to relevant indicators of tax performance for all benchmarked businesses moving into the reported benchmark ranges measured against the micro segment (businesses with an annual turnover of less than AUD 2 million);
- Changes in filing performance for activity statements lodged by cash economy participants;
- Changes in payment behaviour by cash economy participants;
- Number of allegations received through the Tax Evasion Referral Centre demonstrating levels of community engagement and intolerance;
- Number of website hits for cash economy related web pages indicating the level of awareness and usage of available information and tools;
- Responses to ATO surveys including community, business & tax practitioner perception surveys;
- Frequency and tone of media comment relating to the cash economy;
- Levels of industry engagement in the management of the cash economy;
- Trend in compliance levels in cash economy industries compared to external macro indicators and/or benchmarks; and
- Number of disclosures, self amendments and responses to letters.

53. New Zealand Inland Revenue (IR) has also recently invested a significant amount of time and energy to develop a strategy for evaluating its hidden economy (HE) programme. The programme’s approach to achieving its outcomes comprises what is described as a “theory of change”, compliance principles and intervention logic (IVL).<sup>16</sup>
54. The HE programme’s theory of change is that positively influencing attitudes and behaviours will lead to a sustained improvement in voluntary compliance. The programme is operationalising this theory through the IR Debt area’s Prevent, Assist, Recover and Enforce (PARE) compliance principles. These principles underlie the programme’s IVL, which IR’s Evaluation Services Division developed in consultation with core staff working with the HE programme. Examples of the links between PARE and the programme’s IVL are:
  - **P** – Prevent through increased IR presence in the community;
  - **A** – Assist by providing education to stop people from entering the HE unintentionally;
  - **R** – Recover by getting voluntary disclosures; and
  - **E** – Enforce through audit and prosecutions for HE activity.
55. The IVL is illustrated in Annex 4 while the evaluation framework diagram is presented in Figure 9 below.

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<sup>16</sup>An intervention logic is a model of how a programme is intended to achieve its specified outcomes.

**Figure 9. New Zealand—Evaluation framework diagram**



### Involving other government agencies

56. Government in general, and its agencies having non-tax regulatory responsibilities specifically, have a vested interest in addressing the underground economy. Accordingly, other government departments and agencies are willing to participate and can add-value in the development and implementation of an overarching strategy.
57. Survey responses provide evidence that member countries recognize the value of engaging other government departments and agencies. For example.....
  - *"As a result of the action plans of the Secretary of State for the battle against tax and social security fraud, better collaboration exists between the social security services and the tax auditors. A start has been made with exchange of information. The collaboration has been effective in the case of an audit programme in the transport sector. Information derived from the "Social" service has also been used in a target group of "cleaning companies". It happens that certain actions are organised together with the police, customs, social inspection in certain sectors such as construction and telephone shops" (Belgium)....."*
  - *"Historically, Government Agencies and Departments have had their own strategic approach to tackling risks associated with the cash economy, but over more recent years there has been more focussed activity on collaborative working in order to share intelligence and to enhance risk analysis. Operationally, HMRC's Hidden Economy Group now works more closely with other Agencies (including Benefits & Credits Agency, the Department for Work & Pensions and National Insurance Contributions Agency); as an example, we are currently working alongside our UK Border Agency (UKBA) colleagues undertaking 'real-time' activities (following agreement on protocols under which information gateways were opened up) targeting illegal workers and employers who engage them – often linked to cash economy activities and off-record sales/payments" (UK HMRC).*

58. Two thirds of the participating countries indicated other departments or agencies were either involved in strategy development or implementation or both. The most common areas of collaboration were exchange of information (including bulk data for matching), case referrals, co-ordination of enforcement efforts, and strategy development.
59. In a few countries, cross-agency action to address non-compliance is formalised in a plan that is approved by Government, given wide publicity and which serves as the basis for co-ordinated actions. The approach adopted by Spain is described briefly in Box 4.

**Box 4. Spain—Integral Plan of Prevention and Correction of Fraud**

This plan, approved by the Council of Ministers in 2010, is a collaborative effort between the State Agency of Tributary Administration (the national revenue body), the Inspection of Work and Social Security and the General Treasury of the Social Security. The plan aligns the three organisations to prevent and deal with non-compliance in the irregular economy and with respect to undeclared work. It aims to jointly address non-compliance issues through the promotion of voluntary compliance, the detection of risk of non-compliance and the enforcement of the law where fraud is uncovered. The plan is based on the use of three instruments: 1) sharing information between the three organisations; 2) designing and conducting joint activities; and 3) coordinating actions to collect taxes and social security.

***Issues that would benefit from collaboration between countries***

60. All member countries see value in exchanging ideas, best practices, lessons learned and information in respect of their shared interest in addressing the underground economy. Due to globalisation and increased opportunities to conduct business and financial transactions across national borders, they also see the need for greater international cooperation to properly monitor these transactions, including pursuing the development of common international strategies, sharing information and establishing international task forces.
61. Several specific potential areas of collaboration were identified. A few thematic areas concerning the SME/self-employed emerged for consideration:
  - International movement of goods including contraband and cash;
  - Use of cross border transactions to hide income (including the role of electronic payment systems in concealing income and the need to make such systems more transparent and traceable);
  - Internet-based businesses;
  - Electronic suppression of sales ; and
  - Payroll compliance (illicit and foreign workers, cash paid wages and sham contracting/mischaracterisation of employment income as self-employment).

## **IV. RISK DETECTION AND TREATMENT STRATEGIES FOR ADDRESSING THE UNDERGROUND ECONOMY**

62. In accordance with the study's terms of reference, this note was to include:
  - Information and guidance on the detection and treatment of risks posed by the underground economy;
  - An inventory of country examples/case studies, highlighting the risk detection methods and innovative risk treatment strategies being used or tested to address the underground economy; and
  - Information on how revenue bodies evaluate their strategies and determine relative success.
63. To achieve this, specific examples were requested from all surveyed revenue bodies regarding successful/innovative strategies being employed to detect and treat underground economy risks including the following information for each example provided: 1) nature of the strategy; 2) its objectives and targets; 3) a comprehensive description/key elements; 4) details of success factors/indicators/measures used to evaluate outcomes; 5) details of impacts and implications; and 6) lessons learned from deployment of the strategy. There was a good response to the survey request with 24 member countries completing the questionnaire providing around 60 examples of risk detection methods and risk treatment strategies.

### **Risk detection approaches**

64. The enhancements to risk detection approaches identified in the underground economy strategies submitted by surveyed revenue bodies can be broadly classified into four groups and were used to varying degrees:
  - ***Enhanced use of tax return data and third party information sources***—encompasses novel approaches to accessing and managing external data and third party information to improve the systematic capture and quantitative assessment of risk (e.g. incorporation of benchmarking, revenue proxies, etc.).
  - ***Intelligence gathering***—encompasses gathering qualitative risk information to detect risk (e.g. systematic capture of non-compliant behaviour), “on-the-ground” gathering of information to identify risk, etc.
  - ***Random audit programme risk profiling***—encompasses the conduct of audits on randomly-selected samples of a population/segment and using inferential statistics to draw conclusions about a population/segment.
  - ***Computer forensics***—encompasses examination of digital media in a forensically sound manner to detect the manipulation of electronic books and records (e.g. electronic suppression of sales).
65. Examples of approaches of each of the above groups are set out in the next part.

#### ***Enhanced use of tax return and third party information sources***

66. Some of the risks associated with the underground economy may escape traditional methods of assessing risk as the risk in question relates to activities that have not been declared or reported to revenue bodies. Consequently, non-traditional sources of external data and third party information may need to be accessed and managed both at the individual taxpayer and aggregate levels. Where the access and use of such information and business norms are strategically communicated, compliance can be leveraged in a cost effective manner as businesses are provided with stronger incentives to self-regulate. In addition, broader-based communication initiatives in respect of underground economy risks and strategies are enriched by including this type of messaging resulting in higher levels of reassurance within the general taxpayer population that compliance is being well managed.

The messaging also helps set a platform for dialogue and cooperation with stakeholders including other government agencies. Examples of strategies reported in survey responses are set out below.

<b>Detection strategy (country)</b>	<b>Description</b>
Benchmarking of tax return information by industry categories (income tax and VAT) (Australia)	<p>The ATO has used Income Tax and Goods and Service Tax (GST) information to benchmark the key business ratios—performance benchmarks such as cost of sales to sales, labour to sales, motor vehicle expense to sales, rent to sales—for more than 100 industries. Much of this information is obtained from regular business activity statements and annual income tax returns. It has also compiled sets of input benchmarks for different industries, in consultation with industry representative bodies.</p> <p>The development of benchmarks provides a simple and readily understandable method for businesses to compare and review their performance against similar businesses. Benchmarks also enable the ATO to identify businesses that are outside their industry benchmark and therefore potentially under reporting their sales and in some cases, have been used to raise assessments.</p> <p>Benchmarks are provided to tax professionals and given wide publicity and as a result, the benchmarking strategy increases the visibility and efficiency of the approach to addressing the cash economy risk by impacting large numbers of taxpayers.</p> <p>The benchmarking strategy is successfully detecting risk and influencing taxpayer compliance as demonstrated by the measurable increase in the number of businesses reporting within or below the cost of goods sold benchmark for their industry. At June 2011, benchmarks have been developed for approximately 600,000 businesses that potentially participate in the cash economy.</p> <p>In June 2011, the ATO reported that it had benchmarked key business ratios for 107 industries and had identified 46,000 businesses potentially under-reporting cash income. A significant number of these businesses were the clients of a relatively small number of tax agents. Those agents with high numbers of taxpayers outside the benchmarks will be contacted for explanations.</p> <p>A copy of the ATO's performance and input benchmarks for bricklaying services is reproduced in Annex 3.</p>
Flow measurement systems for excises (Brazil)	<p>A system was developed that measures liquid flow as well as electrical conductivity and temperature for beer and soft drink production lines. The data is transferred online to the Secretariat of Federal Revenue of Brazil. This information is then used to project estimates of revenue and risk is identified in respect of reporting anomalies.</p> <p>A study confirmed that voluntary compliance with respect to a specific tax has increased since the implementation of the system. There are also indications that growth in tax revenues was higher than the growth of the sector.</p>
Reports of electricity consumption (Spain)	<p>A legislative measure was passed whereby information is supplied to the revenue body by electric suppliers regarding electricity consumption by real estate premise. The information includes the name of the person responsible in accordance with the supply contract. Inconsistencies between energy consumption and reported economic activities are used to detect unreported or underreported activities.</p>
Monitoring the use of high value euro banknotes (Spain)	<p>A measure was implemented to obtain information about 500 euro-notes sent by Spain Central Bank to bank offices. Bank offices are then selected and enquiries made about the customers who asked for the high value notes. The results of these enquires are used to identify risky taxpayers for additional enquiry and possible audit. There is clear evidence of a decline in the use of €500 notes to conceal income as demonstrated by audit results following the introduction of the measure.</p>
Suspicious	<p>Legislation underpinning a system known as TRACFIN requires that certain</p>

<b>Detection strategy (country)</b>	<b>Description</b>
transaction reporting (France)	<p>entities must declare money or transactions that they know of, suspect or have good reasons to suspect that they result from tax evasion; in particular, in the event of "frequent cash withdrawals from a business account or frequent cash deposits on such an account that are not substantiated by the level or nature of the economic activity". These entities include payment institutions, lending institutions, insurance companies, money changers, persons involved in real property business, gaming or gambling operators, persons who habitually engage in the trade in, or organise the sale of, gems, precious materials, antiques and works of art, certified public accountants, lawyers, notaries, bailiffs, and court-appointed receivers and liquidators. In 2009, a reform was introduced to add 'tax frauds' within the scope of the obligation to report suspicious transactions to TRACFIN.</p> <p>In the past, the tax administration (Public Finances General Directorate (DGFiP) could not have access to the information managed by TRACFIN and it would have been an offence to establish any kind of relationship. From 2009 on, a new regulation allows the provision of information concerning tax frauds. This new area of responsibility led TRACFIN to set up a tax hub with staff from auditing and anti-tax fraud units from the DGFiP). Its mission is to improve upon the information received by means of various types of investigations.</p> <p>Among the resources at its disposal, TRACFIN can obtain information from the DGFiP in order to better understand the declarative situation of those persons under suspicion, and compare it with known financial circuits. The tax hub, which has an expertise in the area of tax fraud, can, if need be, provide declarants with information on commercial or financial transactions as well as technical support. After improving upon this information, TRACFIN may, on the basis of Article L.561.29-II of the French Monetary and Financial Code, send information to the tax authorities on facts brought to its attention leading to a suspicion of tax fraud or money-laundering. The tax authorities will then implement specific tax procedures for collecting evaded taxes.</p> <p>TRACFIN launched specific meetings to highlight the importance of reporting and this led to a very significant increase in the number of reports (17,310 in 2009 and 14,565 in 2008) especially submitted by banks and money exchange offices. Casinos and game operators doubled the number of reports (361/148) and accountants and auditors even tripled their contribution (77/24).</p> <p>The tax administration regards this information source as a highly valuable weapon for detecting/deterring tax evasion and is at the source of the new system established in 2009 making all efforts to improve the value of rough pieces of information received by TRACFIN through the tax hub. The directorate in charge of tax intelligence (DNEF) is taking care of the relationship between the two bodies.</p>

### ***Intelligence gathering***

67. Detecting risk in the underground economy in respect of taxpayers determined to hide their non-compliance often requires resorting to non-traditional methods of managing compliance and accumulating "on-the ground" intelligence in respect of individual taxpayers. Examples of strategies reported in survey responses are set out below.

<b>Detection strategy (country)</b>	<b>Description</b>
Photographed cash receipts (Slovenia)	<p>Tax inspectors performed research on reporting cash sales in the service sector (restaurants, hotels, etc.). A sample of 150 establishments in that sector was chosen for the research. Inspectors photographed invoices received for ordered services that were left on the premises. Subsequently they checked the recorded sales amounts on the cash register tape and books of accounts by comparing those amounts to the photographed invoices. Based on the comparison of 415 photographed invoices, it was established that 45% of the establishments deleted the whole invoice or changed individual items, on at least one of the</p>

<b>Detection strategy (country)</b>	<b>Description</b>
	<p>photographed invoices and stated income lower than was actually earned.</p>
Tax inspectorate -real time reviews (Austria)	<p>A significant amount of time passes from when a tax event occurs until a declaration is made and even further time passes until that event may be reviewed by the revenue body to verify compliance. This passage of time makes the detection of non-compliance challenging. Real time interventions whereby the recording of transactions is observed and information on tax related matters is procured in real-time were introduced to assist in the detection of risk. The reviews are targeted at sectors of high levels of suspected non-compliance and are carried out by multi-disciplinary teams. Insights gained from the real-time reviews are used to guide subsequent actions.</p> <p>The pilot phase of the real time reviews in 2010 was securing information for follow-up actions. These follow-up actions will assist in evaluating the effectiveness of the initiative to detect risk.</p>
Collection and analysis of qualitative information reported by the public (New Zealand)	<p>A new approach was recently introduced for staff to report information about non-compliance (using a tool called 'InfoRep') and for the public to report non-compliance (which we call anonymous information).</p> <p>InfoRep is the primary channel to capture staff information about non-compliance, which is analysed by the intelligence unit. It provides a single IR channel for information referral from all staff that facilitates the Intelligence Unit providing feedback to the organisation via a monthly 'Snapshot' report and analyst contact. As a result, more referrals on hidden economy issues will be generated and emerging threats will quickly be identified and analyzed if they are indicative of a bigger issue allowing us to better prioritize workloads.</p> <p>In respect of anonymous information from the public, we have introduced a range of new initiatives to improve referrals, analysis and response, including the introduction of a national free calling number, a website, more efficient collection and analysis processes, regular reporting and a dedicated panel to determine treatment responses.</p> <p>These enhancements will make it easier for the public to provide more quality referrals about non-compliance improve security for this information and improve our ability to analyse anonymous information in conjunction with information from other sources.</p> <p>The approach has only been recently introduced and consequently, no evaluation of its effectiveness is available at this time.</p>
High Risk Compliance Strategy Pilot Projects (Canada)	<p>The purpose of these pilot projects is to analyze the nature and extent of emerging high risk compliance issues in order to develop innovative approaches and corrective measures to address them. These projects provide great insight on sectors or industries where there is little or no knowledge and they also help identify ways to improve operations. They are essential in identifying problematic areas of non-compliance and in gathering intelligence. As a result of these projects, the CRA is better able to adapt its strategies and initiatives in an effort to have a greater impact on taxpayer behaviour and, ultimately, increase compliance.</p> <p>In general, the pilot projects are considered successful as the results and findings have been used to enhance operations, adapt strategies and improve the risk assessment system.</p>

### ***Random audit programme risk profiling***

68. Detecting the risk of the underground economy in respect of sectors or taxpayer groups suspected of high levels of non-compliance requires a systematic approach. An example of a strategy reported in survey responses is set out below.

<b>Detection strategy (country)</b>	<b>Description</b>
Using the Research Audit Programme to	The Canada Revenue Agency's Research Audit Programme selects a random sample of small and medium enterprises for audit to estimate a reliable

Detection strategy (country)	Description
detect compliance risks (Canada)	<p>compliance rate. Different segments of the SME population are selected each year. Detailed information regarding tax non-compliance is captured and analysed, such as details of the assessments, and the reasons for non-compliance.</p> <p>Files that might not normally be scrutinized by the tax authority are looked at as part of the random sample. This would include underground economy files where cash income is unreported but it has not been flagged by risk assessment systems, for whatever reason. In this case there is often no third party verification of the unreported income, necessitating the use of an indirect verification of income audit technique.</p> <p>The programme is a rich source of information that might otherwise be overlooked through current expert-based risk assessment systems. The establishment of a compliance rate for sub-segments of the population will become increasingly important to monitor the compliance of Canada's tax base into the future. The information gathered has the potential to be a valuable source of new tax compliance issues and information on tax non-compliance missed by the normal risk assessment process (particularly regarding normally cash transactions).</p> <p>Although the number of files examined is small compared to other random audit programmes that exist, the information gathered from the Research Audit Programme is considered a valuable source of intelligence regarding new compliance issues and risks that may have been missed by normal risk assessment processes.</p>

### **Computer forensics**

69. Methods used to facilitate non-compliance are becoming increasingly sophisticated making the detection of risk more and more challenging. An example of a strategy reported in survey responses is set out below.

Detection strategy (country)	Description
Retail pharmacy/chemist—electronic suppression of sales (Belgium)	<p>It was established that fraud was occurring in the retail pharmacy sector using business software to manipulate registered cash receipts. Two methods were being used in respect of the fraud: One involved reducing actual daily sales by a percentage and the other involved removing sales all together. An e-audit strategy was adopted to detect the electronic manipulation of sales. The review included an examination by information technology specialists of the:</p> <ul style="list-style-type: none"> <li>• Composition /structure of the automated system;</li> <li>• Information flow;</li> <li>• Number and content of the files;</li> <li>• Moment and periodicity of the manipulation; and</li> <li>• System records.</li> </ul> <p>The audit results following the examination by specialists have revealed significant amounts of unreported revenues and understated taxes.</p>

### **Risk treatment strategies**

70. As noted earlier, successful strategies to address the underground economy require a diverse set of risk treatments sets geared to influencing taxpayer behaviour in a variety of ways. Consequently, more than one risk treatment set is usually used in a strategy. That said, revenue body responses contained a variety of risk treatments that can be broadly classified as follows:

- **New incentives, sanctions or controls resulting from legislative enhancements:** Changes to existing tax or other laws or the introduction of new tax laws involving additional or varied sanctions, incentives, new control

mechanisms (e.g. withholding and/or third party reporting mechanisms, limits on cash transactions), improved administrative powers, etc.

- **Enforcement programmes:** Traditional interventions to validate the information reported by taxpayers (e.g. desk and office audits, and investigations) or to secure payment of taxes (i.e. collection processes, etc.)
- **Education-based programmes and initiatives:** Targeted education initiatives and programmes in which a revenue body proactively provides information in learning type situations or by way of broad-based messaging on tax obligations to the taxpayer population or their agents.
- **Co-operative arrangements:** Formal engagements and structured relationships with third parties (including industry representative groups, banks and other financial institutions, tax agents and other government agencies) to improve compliance.
- **Encouragement/incentive-based initiatives:** Activities aimed at promoting compliance in a focused manner (e.g. providing information on the interpretation and application of tax laws, the tax authority's policies and procedures, administrative practices, etc.) and preventing non-compliance (e.g., conducting books and records reviews, highlighting the importance of the employer trustee responsibilities and making appropriate provision for payment of taxes through instalments, etc.).
- **Use of media etc. to communicate important messages:** Advising of potential concerns regarding filed tax returns or declarations made in advance of any traditional intervention to impose legal requirements providing an opportunity to self-correct (e.g. amend filings/declarations, utilize voluntary disclosures, etc.)
- **Improved decision support:** Providing better access to, and quality of, information that allows taxpayers to make informed decisions, including on the interpretation and application of tax laws, the tax authority's policies and procedures, the risk and the consequences of the detection of non-compliance, etc.
- **Pre-obligation contact/warnings:** Proactive contact with taxpayers, taxpayer segments, or their tax representatives prior to their filing tax returns or declaring obligations where concerns exist regarding past compliance. The general intent is to deter future non-compliance by warning taxpayers that their affairs are being closely monitored.

71. Some examples of the more innovative/unusual risk treatment reported by revenue bodies as part of their underground economy strategies are set out hereunder.

#### **New incentives, sanctions or controls resulting from legislative enhancements**

72. Historically, legislative measures to address non-compliance in this area were largely geared to revenue bodies' ability to more effectively enforce compliance in one-on-one situations with taxpayers—for example, by increasing financial sanctions for non-compliance and improving administrative powers (e.g. access to taxpayers' records etc). In more recent times, revenue bodies (and their Governments) have been using legislative reform more strategically to achieve a larger impact on compliance. Drawing on survey responses, these reforms have taken the guise of new control mechanisms (with related sanctions for non-compliance), new incentives, or increased sanctions and their administration by the revenue body. Examples of strategies reported in survey responses are set out below.

<b>Treatment strategy (country)</b>	<b>Description</b>
Withholding: Relevant Contracts Tax (RCT) System (Ireland)	Relevant Contracts Tax (RCT) is a withholding tax that applies to payments from principal contractors to subcontractors in <b>the construction, meat processing and forestry industries</b> . Further to the introduction of the VAT Reverse Charge for these sectors in 2008, the paper-based RCT system

<b>Treatment strategy (country)</b>	<b>Description</b>
	<p>is being replaced by an electronic system where principal contractors will be obliged to engage with the revenue body online. The new electronic system has three RCT rates to 0%, 20% and 35%. The rate that is applied to a subcontractor will depend on the subcontractor's compliance record. All payments will have to be notified to Revenue in advance and a deduction authorisation will be issued in response. Therefore, all information will be with Revenue in real time rather than in over a year arrears as in the current system. The legislation to give effect to changes to the system is targeted to come into effect in 2012. Consequently, no evaluation of its effectiveness is yet available.</p>
New tax on cash transactions—Cash Deposits Tax (Mexico)	<p>This tax was introduced for the purpose of attacking the black economy and tax evasion through increased reporting requirements and joint liability for tax payment between banks and applicable account holders. The requirement is applicable to all individuals and corporations for deposits made in cash or foreign currency made in any type of bank account opened with the Mexican financial system, whenever these deposits exceed MXN 25,000 (approx. USD 2,300).</p> <p>Until December 2009, the CDT was a 2% flat rate tax applicable to all cash deposits made into a single bank account, either individually or cumulatively in excess of MXN 25,000 during one calendar month. In 2010, the tax rate was increased to 3%, the monthly threshold was reduced to MXN 15,000 and cash deposits made into own current credit accounts are also taxable. In addition to withholding and remitting this tax to Mexican tax authorities, Mexican banks provide information collected via the CDT monthly. This information includes, the taxpayer's identifier code (if it is registered), the total cash deposits made on the account, the tax withheld and/or tax pending to collect, as well as general information related to the account (name of the taxpayer, address, etc.). Thus the revenue body collects tax on an amount that may not be declared otherwise, and also gains information on individual deposits of cash for the purpose of risk assessment.</p> <p>To date, improved data integrity in the taxpayer registry, increased sources of information to locate non-compliance taxpayers and enhancement to the detection of risk has been attributed to the CDT. Determining its impact on compliance behaviour will require the passage of more time.</p>
Third party reporting (Canada)	<p>The Contract Payments Reporting System (CPRS) is a third party reporting system. There are two components. One relates to payments <b>made by government bodies to contractors providing services</b> and the second relates to the <b>construction industry</b> in respect of payments made to subcontractors. Slips recording details of the payments and the recipients are sent to the CRA. The information on the slips is entered into its risk assessment systems and matched to the information reported by recipients. This enables the detection of omission or understatement of income. It also elevates the perceived risk of detection and, in those cases where non-compliance is detected, makes meeting onus of proof requirements much easier in terms of applying penalties and other sanctions.</p> <p>The results of an independent review of the CPRS indicated that the results attributable to the system have exceeded expectations.</p>
New record keeping requirements—staff ledgers (Sweden)	<p>In 2005, the Swedish Government proposed new legislation stipulating that all businesses in the <b>restaurant and hairdressing industries</b> (sectors where a high level of non-compliance had been observed) would be obliged to keep a daily staff register/ledger. The ledger should, on a daily basis, include an entry for each employee working on that particular day. The Parliament approved the proposal in June 2006, and the legislation came into effect in January 2007.</p> <p>The law also allows the tax agency to conduct unannounced inspections at workplaces to determine if employers are registering their staff in the correct manner. If not, the employer may be charged a fine. The agency could also choose to go ahead with a full in-depth audit if needed. If the workplace does not have a staff register in order, a fine of SEK 10,000 (about EUR 900) can be imposed, along with an additional fine of SEK 2,000 (EUR 180) for each</p>

<b>Treatment strategy (country)</b>	<b>Description</b>
	<p>unregistered employee. The ledger has to include the name of the business, employees' names and birthdates and their working hours. Registration must take place when employees begin and end their shifts. The tax agency performed 31,000 inspections at workplaces in 2007, 18,000 in 2008 and 17,000 in 2009, covering around 80% of businesses.</p> <p>An in-depth evaluation of the staff ledgers initiative was carried out in 2009. The evaluation shows that staff ledgers have had a significant impact on salary reported in the restaurant industry and the effect has increased gradually during the first two years after the legislation came into effect. For the hairdressing industry, the evaluation indicated that staff ledgers had some impact on reported salary initially after the legislation came into effect but the impact declined over time.</p>
Altering the point of responsibility for tax collection—VAT reverse charge mechanism (Chile)	<p>To assist in the management of compliance of markets characterized by high levels of informality and elevated risks of non-compliance, different types of reverse charges are applied to certain products. The reverse charge can be a total or partial VAT retention. The reverse charge mechanism effectively shifts the VAT liability from a large number of unsophisticated taxpayers to a smaller number of more disciplined larger taxpayers. It is estimated VAT collection have increased between 30- 35% in respect of the shifting of liability.</p> <p>(Note: The VAT Reverse Charge is also used in many EU countries where the general EU legislation allows member states to introduce reverse charges for certain high risk sectors.)</p>
New record-keeping controls over cash transactions—the taxi industry (Netherlands)	<p>The Ministry of Infrastructure and Environment introduced legislation that makes the use of a certified board computer in <b>taxis</b> mandatory. The board computer tracks every taxi ride including distance and price. The specifications for this device are developed in collaboration with stakeholder organisations and the software developers.</p> <p>The goal of the legislation is to improve compliance behaviour and the social norm for the taxi industry. The legislation that makes use of the board computer mandatory after a two year introduction period will only be in place as of October 1, 2011. Consequently, no evaluation in respect of the progress being made in obtaining this goal is available at this time.</p>
New record-keeping controls over cash—certified cash registers (Sweden)	<p>All traders selling goods or services in return for cash (or credit card) payments must have a certified cash register (manufactures specifications are set by the tax agency). It is mandatory for the trader to give a receipt to the customer for all transactions and to register the cash register with the Tax Agency.</p> <p>The legislation allows the tax agency to conduct unannounced visits to traders regarding cash registers. The tax agency can also make "public" visits checking the cash register or make "hidden" visits to see if all transactions are put into the register (e.g. by making control purchases) as well as confirm that receipts are given. Failure to issue receipts or register cash registers can result in the trader being fined and possibly lead to a full scale field audit.</p> <p>A full evaluation of the impact of certifying cash registers is planned.</p>
Reducing the use of cash (Norway)	<p>Two proposals in a 2009 Norwegian public commission report on opportunities to reduce tax evasion focus on reducing the incidence of cash as a strategy to address the cash economy. One proposal involved making the right to certain deductions for house renovation expenses dependent on the form of payment: consumers were required to pay the entrepreneur via a bank (or a company offering electronic payment services) in order to claim the deductions. Another proposal involved introducing conditional chain responsibility linked to the form of payment: consumers paying for home renovation expenses above the threshold of NOK 10,000 (approximately EUR 1,250) in cash would be responsible for tax and VAT evasion by the entrepreneur.</p> <p>Both proposals seek to manage the compliance risks linked to cash payments by reducing the incidence of cash. By providing mutually reinforcing incentives for consumers to replace cash payments with traceable electronic transfers, Norwegian legislators hoped to affect the compliance behaviour of small</p>

<b>Treatment strategy (country)</b>	<b>Description</b>
	<p>businesses involved in home renovation. Another expected beneficial effect was increased awareness among the population of the link between the form of payment and the risk of tax evasion, which could contribute to altering payment preferences over time.</p> <p>Both proposals were subsequently enacted in legislation, entering into effect from January 2011. It is thus still too early to evaluate the impact.</p> <p>(Note: France also has for many years had a law that limits the value of cash payments to a prescribed threshold. In 2009, this threshold was set at EUR 3,000).</p>
New payment requirements and mechanisms (Turkey)	<p>Payments of amounts over 8,000 TRY and any rental payments over 500 TRY have to be made through the banking system or postal offices. Self-employed <b>doctors, dentists and veterinarians</b> have to use point of sale devices in their offices. For receipts to be accepted, they must be generated by these devices. In order to help eliminate the informal economy, enterprises employing over 10 employees have to pay their salaries including bonuses through banks.</p>
New licensing requirements—security industry (Ireland)	<p>The Public Security Authority introduced a licensing system for all those working in the <b>security industry</b>. A pre-requisite of obtaining a licence was a requirement for individuals and companies to have a Tax Clearance Certificate (TCC) from Revenue. A TCC will only be issued by Revenue when a taxpayer is on the Revenue record and has a satisfactory tax returns and payment compliance record. This strategy ensured that the majority of operators in the sector were obliged to bring and keep their tax affairs up to date.</p> <p>Revenue states with a high degree of certainty that the requirement to have a TCC combined with the licensing requirements and the compliance activities (Revenue and PSA) have improved compliance in the sector. Further indicators of success will be tested in planned evaluation activities.</p>
New incentives—home renovation tax credit (Canada)	<p>The Government of Canada introduced a temporary Home Renovation Tax Credit (HRTC) that reimbursed part of a domestic property owner's renovation costs. To be eligible for the HRTC, expenditures were required to be supported by documentation (e.g. agreements, invoices, receipts) including information that clearly identified the vendor/contractor, their business address and tax registration number where applicable. This created an immediate incentive for suppliers to operate in the formal economy to access this lucrative market. The audit trail that was established with the Canada Revenue Agency through home owners' HRTC claims encouraged suppliers to report all of their income. Moreover, it reinforced the importance and benefit of tax compliance to both suppliers and their customers.</p>
Reducing demand for hiring of informal sector participants—system of work vouchers (Belgium)	<p>The system of 'Local employment agencies' was the first attempt to transfer certain household services into the formal labour market in Belgium. Up to then, many of these services tended to be made available through undeclared work. Set up in 1994, the ALE/PWA system also aimed to reintegrate long-term unemployed people into the labour market. ALE/PWAs have been established in all Belgian municipalities. Through the ALE/PWA, long-term unemployed people can carry out neighbourhood services for private persons, local authorities, non-profit associations or schools for up to 45 hours a month. They keep their entire unemployment benefit and receive an income supplement of EUR 4.10 per hour worked; this is paid by means of ALE/PWA vouchers obtained by the service users.</p> <p>On January 1, 2004, the Belgian federal government launched a – still ongoing – system of service vouchers in a new attempt to boost job creation by promoting the demand for domestic services and proximity services, and to offer an alternative to the ALE/PWA scheme. Service vouchers allow private persons to hire the services of recognised companies for domestic help. ALE/PWAs still provide certain services such as gardening for private persons or activities that are usually performed by volunteers on behalf of associations or schools</p>

Treatment strategy (country)	Description
	The service voucher approach generated considerable interest among the Peer Review countries in the Mutual Learning Programme of the European Employment Strategy 2007. Although the approach has some shortcomings, some countries saw a major potential benefit in helping to bring some of those currently in the informal or undeclared economy into the regular labour market. <sup>17</sup>

### ***Enforcement programmes***

73. Enforcement remains the most commonly used risk treatment set. While universally used as a treatment for addressing the underground economy, it is being increasingly used by revenue bodies in some non-traditional ways to achieve broader/greater impact. Examples of these non-traditional/innovative ways include “the element of surprise”, sustained monitoring of detected offenders, and “naming and shaming”. Examples of strategies reported in survey responses are set out below.

Treatment strategy (country)	Description
Unannounced “Cold Calls” to Cash Businesses (Ireland)	<p>Behaviour in respect of trades under-declaring income and paying employees salaries free of tax can more successfully be detected through real time unannounced interventions or “cold calls” than retroactive reviews of books and records. Accordingly, a strategy was put in place involving unannounced visits to all cash businesses in a town, street, market or at an event (e.g. concerts, trade shows etc) to check on the controls and procedures in effect for handling cash transactions. The methodology employed in conducting an enquiry or investigation on cash business can include some or all of the following:</p> <ul style="list-style-type: none"> <li>• Surveillance (including covert) and use of intelligence;</li> <li>• Test purchases;</li> <li>• Examination of Cash Registers and Electronic Point of Sale systems;</li> <li>• Ensuring all equipment is connected as appropriate;</li> <li>• Examination of books and records;</li> <li>• Interviews with proprietors, managers and employees;</li> <li>• Ensuring all employees are on the books;</li> <li>• Stock Checks; and</li> <li>• Follow-up visits.</li> </ul> <p>Streetscape operations have proven to very successful –not only have compliance issues in the cash business been identified and addressed but the profile of Revenue has been raised in the towns concerned. The majority of business who had issues with their books and records has corrected the situation as confirmed by follow-up actions.</p>
Sustained and targeted monitoring of delinquent taxpayers-Managing Deliberate Defaulters Programme (United Kingdom)	<p>The Managing Deliberate Defaulters (MDD) programme has recently been launched. It seeks to manage those who have demonstrated deliberate non-compliant behaviour, proven once a compliance check or investigation is complete. It is aimed at improving compliance behaviour and removing the risk of recidivism with increased levels of closer scrutiny of their tax affairs and existing obligations for up to five years.</p> <p>Deliberate defaulters are identified based on demonstrated non-compliant behaviour. They are notified by letter that they are known evaders and are now under closer scrutiny. The HMRC will continue to check that returns are filed on time and that any tax that is due is paid on time. In addition, there will also be regular reviews of deliberate defaulters’ tax affairs to check that any errors or failings have been put right. There are a variety of ways HMRC monitor a deliberate defaulter’s tax affairs. These include:</p> <ul style="list-style-type: none"> <li>• Making announced or unannounced inspection visits to carry out pre-return checks of their books and records;</li> </ul>

<sup>17</sup> Taken from [www.eurofound.europa.eu/areas/labourmarket/tackling/cases/be004.htm](http://www.eurofound.europa.eu/areas/labourmarket/tackling/cases/be004.htm)

Treatment strategy (country)	Description
	<ul style="list-style-type: none"> <li>• Asking for certain records so that they can be checked;</li> <li>• Requiring that additional information or documents are sent in with the person's tax returns;</li> <li>• Conducting in-depth compliance checks into all or any part of the person's tax affairs;</li> <li>• Observing and recording the person's business activities and cross-checking details in their accounts. For example, test purchases or inspections of the records of one or more of their suppliers or customers could be made; and</li> <li>• For our VAT customers submission of quarterly or monthly VAT returns may be required and the same accounting periods for VAT and Income Tax or Corporation Tax may be imposed.</li> </ul>
Indirect measures of income—presumption of income on the basis of lifestyle (France)	<p>In the event of a marked discrepancy between a taxpayer's lifestyle and the income the taxpayer reports, under certain conditions, the authorities can substitute the income reported for higher income based on an estimate based on lifestyle that is determined by applying a tax scale provided by law.</p> <p>The law provides for two notional taxation mechanisms:</p> <ol style="list-style-type: none"> <li>1) A general system to address a situation where there is a clear discrepancy between the income reported and the person's net worth, available cash and the lifestyle characteristics of the members of the tax household. If the taxpayer does not provide evidence of the nature and origin of income, the income will be deemed to be of indeterminate origin, and the tax authorities will be entitled to tax such income without any form of categorisation; and</li> <li>2) A specific system in respect of criminal offences as part of the fight against unlawful activities.</li> </ol>
Name and shame strategies (Ireland and Korea)	Names of delinquent taxpayers are published or posted on the revenue body's Website. Sometimes the delinquent taxpayer's city of residence and the nature of the offence that led to the taxes owing are disclosed as well.

74. Greater impact is also being sought by increasing the perceived consequence of detection. There are a number of approaches to enhance the deterrence factor other than those traditionally used (e.g. financial penalties and fines) including non-monetary sanctions (e.g. name and shame, restricting government privileges, mandatory compliance courses and exposure to higher levels of scrutiny).<sup>18</sup>

#### ***Education-based programmes and initiatives***

75. Education can be used to encourage higher personal and social norms in respect of tax compliance that lead to enhanced compliance levels and lower acceptance of non-compliance in the underground economy. By demonstrating the social costs and risks associated with tax evasion, it is seen as more offensive, making the shame and guilt associated with tax evasion greater. This leads to two positive results, demand for goods and services sold through the underground economy are curbed, and the perceived consequence is heightened by associating a greater shame factor to the commission of tax offences. It is generally agreed that educational efforts should be made earlier rather than later for individuals (who may later become business owners).
76. Education-based risk treatments are also used directly to curb demand for goods and services sold in the underground economy by promoting consumer self-interest (i.e. customer protection against shoddy work, exposure to claims for personal injury, etc). Examples of strategies reported in survey responses are set out below.

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<sup>18</sup> See Brian Erard (1992): "The Influence of Tax Auditing on Reporting Behaviour". In Joel Slemrod (ed.): "Why People Pay Taxes", University of Michigan Press.

<b>Treatment strategy (country)</b>	<b>Description</b>
Encouraging responsible citizenship (Canada)	<p>The Responsible Citizenship and Canada's Tax System Learning Unit introduces youth to the concept of voluntary compliance with Canada's tax system. It provides basic information about the tax system and where tax dollars go. It also provides awareness of taxpayers' rights and responsibilities, and how a person can actively participate in Canadian society.</p> <p>The learning unit is targeted to junior and high school students to reach them before they start participating in the tax system. It provides an early start to acquiring information on responsible citizenship in a learning environment before these students start working and paying taxes.</p> <p>While the initiative has enjoyed success in getting participation from education institutions, its impact on compliance has not been measured as there is no mechanism to track the compliance behaviour of those who have taken the learning unit.</p>
Educating potential taxpayers –education at schools programme (Austria)	<p>Austria has developed an education at schools programme based on an expected outcome that compliance behaviour can be better established at school level when less external influences exist. Under this programme, schools across Austria will receive educational visits by tax officials focusing on providing core awareness of future responsibilities for tax and customs compliance.</p>
Promoting the risks and social impacts of the underground economy—YouTube contest (Canada)	<p>The CRA launched a video contest that invited Canadians to create a video about the risks and social impacts of participating in the underground economy. Communications products and activities were developed to promote the contest, encourage participation, and demonstrate the CRA's commitment to addressing the underground economy. Participants were asked to create a short video that focused on the risks and social impact of participating in the underground economy. These videos were posted on a CRA channel of YouTube, the popular video-sharing Web site. From the videos submitted, the best were selected by a group of subject matter and public affairs experts. Two winners, one for an English video and one for a French video, were selected in each of the internal and external contests. The winners are invited to Ottawa for a reception marking the launch of their videos on the CRA's YouTube channel and Web site.</p> <p>The feedback in respect of the contest has been positive but no evaluation of the impact on compliance has been made at this point.</p>
Educating potential/new taxpayers—trade school initiative (Canada)	<p>The Trade School Initiative is intended to reach students and apprentices in the trades. Particular attention is paid to students in the construction trades as this is typically a high-risk area of non-compliance. The aim of the initiative is to provide the students with tax information and explain the benefits of reporting their income and paying taxes in Canada. The intention is to reach students before they begin their careers in the trades and develop a pattern of non-compliant behaviour. Research determined that a typical in class learning unit would not fit into most trade programmes. So an alternative approach was adopted using a Web site designed specifically for trade students, along with a video to promote the Web site, an information card and a lunch and learn session. Testing to determine students' preferences resulted in the Web site not having the look and feel of a government Web site.</p> <p>A rigorous evaluation plan has developed in three phases. The first phase was a qualitative means to concept test the draft products. Results from the focus tests were used to make modifications. Phase two was a quantitative study that sought to examine the impact of materials on a subset of the intended population through quasi-experimental research design involving a questionnaire in a controlled setting. Results suggested exposure to the products may have shifted students' understanding and opinions regarding tax matters. The third phase will provide additional information to fine-tune the website and feedback on the quantitative measurement process for future evaluation studies of this type.</p>
Promoting consumer self-interest/curbing	<p>Atlantic UE Compliance Measurement Initiative –The focus was to implement a communications campaign aimed at consumers, the demand-side of the UE.</p>

Treatment strategy (country)	Description
demand for cash economy services (Canada)	<p>A broad communication campaign was designed that targeted a wide range of Atlantic homeowners. Various mediums, including radio, television, internet, posters, display systems and outreach materials, were utilized to communicate the key messages. The knowledge objectives included increasing awareness of the risks involved with paying under the table, the risks of the underground economy and the link between participating in the underground economy and the impact on government programmes and benefits. The project team pursued partnerships with external stakeholders in Atlantic Canada, such as homebuilders associations and retailers that could assist in identifying homeowners who are in a position to hire in the construction industry.</p> <p>An evaluation process to measure the impact of the communication strategies on attitudes/behaviours of homeowners in relation to the underground economy was put in place. The process involved conducting pre-campaign and post-campaign public opinion surveys in the targeted cities as well as in non-targeted control cities to measure and compare changes in attitudes/behaviours.</p>

### ***Using the media to communicate important messages***

77. Communication is also playing a key role in leveraging enforcement activities in terms of enhancing the perceived risk of detection. When taxpayers are made aware as to the sources of information available to a revenue body and how those sources are used to detect and treat non-compliance, they are likely to give further thought to participating in non-compliance given their perceptions of the risk of detection. Examples of strategies reported in survey responses are set out below.

Treatment strategy (country)	Description
Communicating revenue body strategies to encourage voluntary compliance—benchmarking communication strategy (Australia)	<p>Benchmarks and data matching enable the ATO to increase community awareness about its ability to detect underreported cash income by demonstrating that it has knowledge of what the “normal” level of income it could expect from a particular business, or that it has knowledge of their sources of income or expenditure. To make taxpayers aware of how it detects under reported cash income the ATO has written to a large number of businesses in industries that have a high risk of cash economy participation, have reported outside their industry benchmark or have reported unrealistically low business income. Where taxpayers are reporting outside their relevant benchmark, it has highlighted the level of income it would expect them to report if they were to report with-in the benchmark. The letter campaign has been supported by an extensive campaign of media releases and messages addressed to tax practitioners.</p> <p>Initial data shows that the benchmarking strategy is successfully influencing compliance as a small but measurable increase in the number of businesses reporting within or below the cost of goods sold benchmark ratio for their industry has occurred since the introduction of benchmarks in 2009.</p>
Community referrals program (Australia)	<p>The number and nature of community referrals received through the Community Referrals Program is reported. The program is actively promoted to the community as a valuable source of intelligence to assist in maintaining the integrity and fairness of the tax system.</p>
Overarching communications strategy (Australia)	<p>The Cash Economy Communications Strategy is designed to: 1) raise the awareness of cash economy behaviours in the community in order to change community perceptions and motivate a behavioural change; and 2) amplify the effectiveness of all other cash economy strategies. All cash economy communications are underpinned by four core themes:</p> <ul style="list-style-type: none"> <li>• <b>What is the cash economy?</b> Cash economy participation occurs when businesses deliberately use cash transactions to hide income and evade taxation obligations;</li> </ul>

	<ul style="list-style-type: none"> <li>• <b>Why is the cash economy a problem?</b> These behaviours within the cash economy undermine the fairness of our tax system; cost the community and unfairly impact on businesses doing the right thing;</li> <li>• <b>What we are doing about the cash economy?</b> We are expanding our ability to detect, deter and deal with dishonest taxpayers and are making it harder for dishonest taxpayers to get away with not reporting cash income – making it fairer for everyone; and</li> <li>• <b>What can the community do about the cash economy?</b> Businesses can ensure they record and report all cash transactions; the community can recognise and report cash economy activity; and registered tax agents can help their clients keep correct and accurate records of all cash transactions.</li> </ul> <p>The strategy has been successful in achieving extensive coverage of these messages in print/online publications, industry and tax practitioner publications, favourable commentary on the ATO's approach in the media, sustained hits on the benchmark website and positive community and business feedback. Community perception surveys also indicate that an enhancement in those who feel that the community is kept informed about the ATO's efforts, a strengthening of support for a level playing field and an increasing trend on intolerance for the use of cash to avoid payment of tax has occurred.</p>
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### ***Encouragement/incentive-based initiatives***

78. The use of 'encouragement/incentive-based' risk treatments were also reported by a number of revenue bodies and appear to be gaining popularity in combating the underground economy because of their potential to have a broad impact in a very cost effective and non-intrusive manner, particularly when compared to methods that enforce compliance. In addition, when compliance is encouraged as opposed to enforced, it makes many see the tax system and the tax administrator as more responsive to their needs and fairer to the majority.<sup>19</sup> Examples of strategies reported in survey responses are set out below.

<b>Treatment strategy (country)</b>	<b>Description</b>
Monetary incentives—lottery for cash receipts (Puerto Rico and Zambia)	A programme has been introduced where cash receipts with a government issued number can be submitted to a government sponsored lottery/raffle. The programme seeks to involve citizens as a quasi enforcement agent. In the case of Puerto Rico, the programme will give anyone with a receipt a chance to win USD 1,000 or a car, while forcing businesses to report and pay taxes.
Monetary incentives—lottery for cash receipts (South Korea)	Implemented in 2004, the Cash Receipts System encourages taxpayers to request receipts for transactions and enables them to register these online with the National Tax Agency. A tax credit (capped) is available to taxpayers proportional to the value of the receipts requested. Similar tax credit incentives are available to businesses registered and complying with the cash receipt system. This approach also saw changes to qualify for tax deductions, whereby previously deductions that could be claimed without a receipt are no longer accepted unless a cash receipt has been submitted.  Further, each receipt registered is entered into a unique Cash Receipt Lottery with prize rewards of up to USD 10,000 each month issued.
Encouraging good record-keeping (Japan)	With the Blue Return System, taxpayers who keep accounting books with certain accuracy can file tax returns with approval of District Director of Tax Offices in blue format. The Blue Return System requires taxpayers to keep books and records with a certain level of sophistication and detail including not only profit and loss accounts but also balance sheet accounts. By keeping track of the daily cash flows, the Blue Return System enables taxpayers to compare actual cash balances and to those recorded in the books and records. This enhances the tax compliance of cash economy businesses.

<sup>19</sup> See James Alm, Betty Jackson, and Michael McKee (1992) "Deterrence and Beyond: Towards a Kinder, Gentler IRS" in Joel Slemrod (ed.): "Why People Pay Taxes", University of Michigan Press, pp 311-329.

	<p>Those who are approved to file the Blue Returns can apply for various types of tax incentives. For example, they can apply the special deduction for Blue Returns (only for Individuals), treat the wages paid to family employees as qualified expense (only for Individuals), and carry over losses.</p> <p>The system is not evaluated at a national level, however, at the regional level tax offices that conduct examinations of the cash economy analyse and evaluate the system using a “Plan-Do-Check-Act” process.</p>
Reduced rates of withholding for compliant taxpayers—(Ireland)	<p>Relevant Contracts Tax (RCT) is a withholding tax that applies to payments from principal contractors to subcontractors in the construction, meat processing and forestry industries. Further to the introduction of the VAT Reverse Charge for these sectors in 2008, the paper-based RCT system is being replaced by an electronic system where principal contractors will be obliged to engage with the revenue body online. The new electronic system has three RCT rates to 0%, 20% and 35%. <b><i>The rate that is applied to a subcontractor will depend on the subcontractor's compliance record.</i></b> All payments will have to be notified to Revenue in advance and a deduction authorisation will be issued in response. Therefore, all information will be with Revenue in real time rather than in over a year arrears as in the current system.</p> <p>The legislation to change the system is targeted to come into effect in 2012.</p>

79. Other work being carried out by the Forum indicates that revenue bodies are becoming increasingly attracted to the idea that there are benefits to be gained from investing in a strategy that aims to prevent non-compliance arising in the first place. When someone is prevented from becoming non-compliant a lifetime of compliant behaviour requiring minimal intervention by the revenue body can be achieved. When prevention opportunities are missed, revenue bodies are faced with the difficult task of identifying the participant and trying to change a well established non-compliant behaviour. This approach to preventing non-compliance is described in the recent (December 2011) FTA information note *“Right from the Start: Strategies for Influencing the Compliance Environment for Small and Medium Enterprises”*.

### ***Early warning approaches***

80. Early warning risk treatments can leverage the impact of potential enforcement actions where there is a high degree of perceived risk of detection. This usually occurs when the participants in non-compliance believe the revenue body has knowledge in respect of the non-compliance and information available to identify with a reasonable degree of accuracy who is involved. An example of a strategy reported in survey responses is set out below.

<b>Treatment strategy (country)</b>	<b>Description</b>
Offshore Compliance Initiatives Programme (United States)	<p>The IRS proactively identifies U.S. taxpayers who are hiding untaxed income, often skimmed or diverted from business profits, in offshore bank accounts by development of focused compliance projects and initiatives that use John Doe summonses and promoter investigations. To date, initiatives have been developed involving offshore debit and credit cards, offshore nominee owned broker accounts, electronic payment systems, offshore merchant accounts and offshore private banking.</p> <p>The IRS recently announced a voluntary programme that will allow U.S. persons with undisclosed foreign accounts or entities an opportunity to retroactively disclose such accounts and entities. U.S. persons with foreign accounts are required to report the existence of the accounts annually on Form TD F 90-22.1. Other reporting requirements apply to interests owned by U.S. taxpayers in foreign entities. A failure to report the existence of a foreign account can result in stiff civil penalties and may constitute a criminal offence. The IRS publicized that it has greatly increased its enforcement efforts in this area and that it is actively pursuing investigations of other financial institutions that cater to U.S. taxpayers who are hiding accounts overseas.</p> <p>The new voluntary disclosure programme is similar to one that ended in 2009 and which brought in 15,000 voluntary disclosures.</p>

### **Working co-operatively with stakeholders**

81. Based on survey responses, there is growing evidence that revenue bodies are recognising the power of these indirect influences and increasingly taking advantage of opportunities that are available. The indirect influences follow two streams, cooperative arrangements involving a multitude of stakeholders that share a common goal of reducing non-compliance and other regulatory bodies that have a responsibility to address the underground economy and see merit in adopting a more government-wide approach, including engaging in research to better understand its drivers. Examples of strategies reported in survey responses are set out below.

<b>Treatment strategy (country)</b>	<b>Description</b>
Cooperation with contractors to reduce the use of illicit work (Sweden)	<p>A compliance programme of co-operation with contractors started in 2008. The initiative consists of a specific programme where the STA in cooperation with large contractors sets up letters of intent to discourage the use of illicit labour.</p> <p>The letter of intent includes commitments for both parties. The contractors form their tendering process along these lines and they are given a contact point at the STA. The STA provides public information about potential subcontractors informing of their past tax records in terms of payments etc. The letters of intent are not legally binding. The programme also includes co-operation with several trade sectors where the STA supports trade specific initiatives. Examples of such initiatives from the construction sectors are a “code of conduct” project for construction sector.</p> <p>The programme represents a relative low cost approach to managing compliance and seems particularly well suited for large infrastructure projects. Developing cooperation with contractors is considered more of a long-term approach and the STA has an on-going evaluation using qualitative methods.</p>
Cross-government Fair Play Initiative (Denmark)	<p>The more organized aspects of the underground economy are often associated with violations of legislation in other areas such as immigration, work place safety, unemployment benefits, food administration and environment. Therefore the Danish Tax and Customs administration has since 2004 co-operated closely with other authorities within a strategic and operational framework called Fair Play. Activities under the Fair Play umbrella are designed to increase deterrence and nurture tax morale through a combination of a traditional enforcement approach with communication, visibility in the field, press leverage and campaigns. The initiative is supported by changes in legislation aiming to reduce opportunity and enhance the reach and impact of enforcement activities by for instance allowing for increased access to premises or instant sanctions like seizures or administrative fines. More than 2,000 businesses in high risk areas receive visits or inspections by the Fair Play initiative each year.</p> <p>Impact evaluations reveal that the initiative has been successful in dramatically reducing illegal trade with parallel imported beer and soft drinks with no excise duties paid; in nurturing overall tax morale; and in raising the perceived risk related to participating in the cash economy.</p>

82. Tax intermediaries in particular have a large capacity to influence taxpayer behaviour. They are seen as knowledgeable and taxpayers trust them to assist in complying with their tax obligations and in dealing with tax authorities. Taxpayers also believe that they represent their best interests and accordingly, they are strongly inclined to respect their advice and follow their direction. An example of a strategy reported in survey responses is set out below.

<b>Treatment strategy (country)</b>	<b>Description</b>
Small Business Benchmarks & Record Keeping	Engagement with tax practitioners is an important element of ATO benchmarking and record keeping strategy. A key feature involves the way the ATO has gained the attention of tax practitioners through its letter campaign

Treatment strategy (country)	Description
Strategy (Australia)	<p>programme. Under this programme, it writes to taxpayers and their tax practitioner where it has identified a risk of potential under reporting of income. The extensive nature of the programme means that most tax practitioners have clients directly impacted by the letter campaign or are at least aware of it. The linking of benchmarking with poor record keeping is encouraging tax practitioners to focus on clients who are exhibiting poor record keeping practices or are inclined to report outside the benchmark.</p> <p>Tax practitioners are very aware of benchmarks and the ATO's approach to record keeping. As a result, tax practitioners are now actively engaged in incorporating benchmarks into their practices. In addition, the ATO is talking to software developers to identify opportunities to include benchmarks into their products.</p>

### ***Pre-obligation contact***

83. Pre-obligation contact can also leverage the impact of potential enforcement actions. This usually occurs when the participants in non-compliance believe the revenue body has knowledge in respect of the non-compliance and information available to identify it with a reasonable degree of accuracy. It differs slightly from early warnings in that enforcement action is effectively averted if a taxpayer proactively corrects their compliance behaviour by virtue of filing or declaring accurately in the future. Anticipating the response rate is also less critical than with early warnings as the perceived “threat” of enforcement and the need for follow-up action is not as great. Examples of strategies reported in survey responses are set out below.

Treatment strategy (country)	Description
Increasing compliance at festivals (Ireland)	<p>A component of the strategy involved arranging meetings with festival promoters in advance of major events. At these meetings, the promoters agreed to supply details of all casual staff, including security operatives, who would be working at the festival. This enabled Revenue to pro-actively ensure compliance of those working at the event in advance.</p>
Small business amnesty programme (South Africa)	<p>South African Revenue Service will offer a tax amnesty to small businesses including taxi operators, to give them a chance to become tax compliant without worrying about the large cost of previous tax, penalties and interest.</p>
Commissioner's guarantee to new businesses (Australia)	<p>To assist new businesses meet their taxation obligations the ATO offers to visit the business and provide education and/or assistance to comply. These visits are especially directed at taxpayers who are setting up a new small business, are making changes to an existing small business (e.g. taking on employees) or just need some business tax help.</p> <p>The intent is to provide practical, hands on assistance that is tailored to meet the needs of each small business visited.</p> <p>The term practical assistance refers to discussing the business operator's specific needs and circumstances and working with them to develop better record keeping practices; to ensure the correct lodgement of their activity statements and to ensure that they are meeting their tax obligations.</p> <p>The Commissioner's guarantee applies to these visits and as a result none of the information obtained by the ATO can be used for any other purpose, including compliance action. A copy of the Commissioner's Guarantee letter is provided to the client either at the visit or by posting a copy to the client prior to the visit. However, while the guarantee precludes information gathered during an assistance visit from being used to initiate an audit, it in no way excludes the taxpayer from being audited at some future time.</p>

### **A multi-faceted set of treatments for a targeted industry**

84. There appears to be a growing trend among several revenue bodies to incorporate a full range of risk treatment sets in their underground economy strategies to address the diversity of attitudes among the target group and to come at the compliance issues from a number of angles. Several of the strategies endeavour to create linkages between the various risk treatments sets to create more synergy within the strategy. An example of a strategy reported in survey responses is set out below.

<b>Treatment strategy (country)</b>	<b>Description</b>
Tackling the hospitality sector (New Zealand)	<p>The timing and activity types will generally follow the IR model designed to:</p> <ul style="list-style-type: none"> <li>• <b>Educate &amp; assist</b> – Reduce the incidence of non-compliance ;</li> <li>• <b>Detect and deter</b> – Limit the impact of conscious non-compliance; and</li> <li>• <b>Enforce</b> – Address significant noncompliant behaviour.</li> </ul> <p>The programme of activity includes:</p> <ul style="list-style-type: none"> <li>• Actively establishing ongoing relationships with key governing or representative industry bodies, other agencies and key ethnic communities;</li> <li>• Through the relationship approach, educating ourselves as to the pressure points within the industry and expand our knowledge of causal factors to the risks and considering areas where non-compliance can be designed out;</li> <li>• Increasing the collection and use of 3rd party data information;</li> <li>• Piloting the use of gross profit analysis/margins as a means of segmenting the industry customer population;</li> <li>• Design and deployment of a range of risk treatments focusing on opportunities to improve point of sale recording &amp; reporting practices, employers meeting registration/record keeping requirements of employees, deduction and payment of PAYE and, tax agent attitudes to accurate income reporting and filing.</li> <li>• Tailoring an information, education and assistance programme (and the most effective distribution channels for this) to increase tax awareness, and promote good tax morale and self management compliance practices, whilst also inviting higher-risk customers to voluntarily bring their tax affairs up to date;</li> <li>• Using collection and investigation treatment activities targeted toward highest risk customers;</li> <li>• Establishing a baseline compliance measurement /index or set of indicators for this sector;</li> <li>• Identifying ways in which we can measure and monitor the effectiveness of our initiatives; and</li> <li>• Improving the knowledge of staff working within this sector and tools and practices available for them to use.</li> </ul> <p>The area of success/outcome measurement is currently under development.</p>

## V. USE OF ELECTRONIC PAYMENT SYSTEMS TO CONCEAL AND DETECT UNREPORTED BUSINESS INCOME

85. In early discussions that led to the decision to embark on this study, a number of revenue bodies observed that some unreported economic activities could be associated in some way with the use of electronic payment systems (EPS). An obvious example was the practice of taxpayers diverting business proceeds to an offshore bank account that could be accessed by them from just about anywhere in the world through use of a debit/credit card transaction via the banking system. Electronic business platforms such as eBay, which have experienced enormous growth globally over recent years, were cited as likely examples where this might be the case. At the same time, it was acknowledged that the very use of EPS created electronic records that could prove to be a significant source of intelligence for revenue bodies on unreported business proceeds. It was accordingly decided to include this topic as a line of special inquiry for this study.
86. In undertaking research for this particular aspect of the study, it was also recognised that substantial work on the emergence of new payment methods as a tool of money launderers and those financing terrorist activities had already been conducted by an OECD-related government body—the Financial Action Task Force (FATF).<sup>20</sup> Given the often overlapping relationship between money laundering and tax evasion activities, some of the findings of FATF's work were seen as having relevance to this study. To assist readers, the chapter commences with a brief account of the key relevant findings from FATF's work.

### Related work concerning the use of electronic payment systems

87. There have been two substantive study reports published by the FATF over the last five years concerning the use of new payment methods:
  - “*New Payment Methods*” (October 2006);<sup>21</sup> and
  - “*Money Laundering Using New Payment Methods*” (October 2010).<sup>22</sup>
88. As described by the FATF, the first report – “*New Payment Methods*” – was an initial look at the potential money laundering (ML) and terrorist financing (TF) implications of payment innovations that gave customers the opportunity to carry out payments directly through technical devices such as personal computers, mobile phones or data storage cards. In many cases, these payments could be carried out without the customer needing an individual bank account. The report found that as these payment innovations were relatively new and therefore still evolving, there was little hard evidence of their wide use, or indeed even a comprehensive understanding of how the products themselves were structured. By and large, the report was intended to raise awareness of the potential of these products and concluded that the matter should be kept under review when there was greater clarity of the risks associated with these new payment methods.
89. The FATF's latest report – “*Money Laundering Using New Payment Methods*” – is the follow-up report on this topic and gives a contemporary view of these methods and the risks presented. While the report is focussed principally on observed and potential implications for money laundering and terrorist financing, many of the observations are relevant in a tax non-compliance context.

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<sup>20</sup>The Financial Action Task Force (FATF) is an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering and terrorist financing. Recommendations issued by the FATF define criminal justice and regulatory measures that should be implemented to counter this problem. These recommendations also include international co-operation and preventive measures to be taken by financial institutions and others such as casinos, real estate dealers, lawyers and accountants. The FATF Recommendations are recognised as the global anti-money laundering (AML) and counter-terrorist financing (CFT) standard.

<sup>21</sup> See [www.fatf-gafi.org/dataoecd/30/47/37627240.pdf?bcsl\\_scan\\_42A418D6AC94B6Bo=0&bcsl\\_scan\\_filename=37627240.pdf](http://www.fatf-gafi.org/dataoecd/30/47/37627240.pdf?bcsl_scan_42A418D6AC94B6Bo=0&bcsl_scan_filename=37627240.pdf)

<sup>22</sup> See [www.fatf-gafi.org/document/2/0.3746.en\\_32250379\\_32237202\\_46705794\\_1\\_1\\_1.1.00.html](http://www.fatf-gafi.org/document/2/0.3746.en_32250379_32237202_46705794_1_1_1.1.00.html)

90. The report includes descriptive material on the various new payment methods (NPMs) now being used, how they are used, and some (incomplete) volume usage information based on country surveys. The payment methods described are prepaid cards, Internet payment services, and mobile payment services. Some information from the report providing useful background for this study is set out for reference purposes in Annex 4.
91. In releasing the report, the FATF noted that since 2006 there has been a significant rise in the number of transactions and the volume of funds moving through NPMs. Consequently, the number of discovered cases where such payment systems were misused for money laundering and terrorist financing purposes has also increased. One might therefore suspect a similar trend in respect of tax non-compliance practices facilitated by the use of EPSSs.
92. Annex 4 also includes a risk matrix taken from pages 22 and 23 of the FATF's October 2010 report. At a glance, it outlines factors considered in assigning risk to new payment methods, comparing them to the risks associated with cash payments. For the most part, these risk factors would also be relevant to the risk of tax evasion (in particular the detection of tax evasion activity).
93. Responding to the recommendations made to date by the FATF, most jurisdictions have subjected electronic payment system service providers to anti-money laundering or combating the financing of terrorism obligations and regulations, or are in the process of doing so. These checks and balances should also benefit revenue bodies, assuming access to third party information becomes a more commonplace method to detect tax compliance concerns such as unreported income.

### **The nature of electronic payment systems**

94. The term "Electronic Payment Systems" (or FATF's terminology 'New payment methods') describes the many different kinds of electronic payment methods available, including online payment, the processing of transactions and their application within online merchant and e-commerce web sites. Electronic payment systems are a different form of the following three categories of payment possibilities:
  - Payment up front: money orders, prepaid cards;
  - Pay at the time of purchase: cash, checks, debit cards; and
  - Pay after purchase: credit cards, payday loans, lines of credit.
95. The FATF offers a typology of four electronic payment methods (i.e. Internet payment services, prepaid cards, electronic purse and mobile payments) to promote understanding and awareness of how they operate in practice. Internet payment services appear the most relevant to this study— refer Box 5 for a description.

### **Box 5. Description of Internet payment services**

The expression “Internet payment services” is generally used to address: 1) payment services that rely on a bank account and use the Internet as a means of moving funds to or from a bank account; and 2) payment services provided by non-bank institutions operating exclusively on the Internet and that are only indirectly associated with a bank account.

In the former case, Internet payment services refer to traditional payment methods where the Internet is only an innovative channel to exchange the information that is needed to move the funds from one account to another, which allows customers to access their bank accounts from home, 24 hours a day.

Where Internet payment services do not rely directly on a bank account, such as PayPal, individuals can transfer funds, shop online, or participate in online auctions, using a pre-funded account; however, the payment service provider may not be subject to the same AML/CFT measures that apply to banks. The service provider usually will not have a face-to-face relationship with its customers. Depending upon the accessibility of the Internet payment service, these activities can involve payments or funds transfers across national borders.

Some non-bank Internet payment services allow customers to hold accounts with the payment service provider, while others offer only to send or receive individual payments using the customer’s existing bank or credit card account. When non-bank Internet payment services offer customer accounts they may pool those customer funds in a single account at a bank. The account may be held in the name of the service provider. In that case, the bank holding the service provider’s account may have no direct relationship with the service provider’s individual customers.

While a limited number of similar products exist in certain countries, PayPal appears to be the most widely used non-bank, Internet-based NPM. PayPal primarily functions as a payments intermediary for individuals and organisations that wish to trade with each other or transfer funds via the Internet.

PayPal operates by allowing an individual to set up a pre-paid account in his name with PayPal that can be funded from a credit or debit card or a bank account via a credit transfer. Using those pre-paid funds, individuals can buy items or transfer funds to other PayPal account holders. The payment or transfer of funds occurs as a book-entry transaction between the PayPal accounts. When an individual wishes to access the funds in his PayPal account, he directs PayPal to credit his credit or debit card or bank account via a credit transfer or even a paper check.

Service providers will differ as to the methods of payment they will accept to initiate a funds transfer, and the methods of payment they will use to distribute funds to the recipient. Figure 4 above illustrates how an individual can use a bank-issued credit card or other traditional payment methods to fund an Internet-based transaction account and subsequently make purchases or transfer all or a portion of the prepaid value to another account holder via book-entry by the service provider. The recipient can then use those funds to conduct additional transactions or withdraw the money via a traditional retail payment method. Online money transfer services set their own terms as what form of payment they will accept from senders and what forms of payment they make available to receivers.

Source: “*New Payment Methods*” (FATF, October 2006).

## **Survey approach**

96. For the purposes of the study, the following questions were posed to revenue bodies:
  - Do you have evidence of electronic payment systems being used to conceal income by taxpayers and/or their agents?
  - As a result of electronic payment systems, has your country been able to develop successful strategies to access and use the data to detect concealed income?
  - What preventative measures are being contemplated to address the risks presented by electronic payment systems to detect concealed income?
97. While there was a good response to this aspect of the survey, no more than half of the 26 surveyed revenue bodies were able to provide substantive answers to assist with further analysis of the key issues raised.
98. Revenue bodies were also asked to provide, where available, specific examples/case studies of the use of electronic payment systems to conceal income, the specific details of strategies employed to access and use data in respect of electronic payment systems to detect concealed income and details of any preventative measures being contemplated to manage

the risks posed by electronic payment systems. There was a good response to this request of the survey with 22 examples provided of risk detection methods and risk treatment strategies.

### **Evidence of use of EPSSs in concealing income**

99. Drawing on the case studies provided, a number of observations and conclusions could be made on revenue bodies' experience with the use of EPSSs to conceal income:

- Likely due to the newness of these issues for many revenue bodies, the evidence of the use of electronic payment systems to conceal income from revenue bodies is to date fairly limited to non-representative samples that cannot be used to estimate non-compliance in this area on a national or sub-sector basis. This also appears to be the case in the money laundering environment, where a lot more investigative work has been conducted to date. Some revenue bodies have identified the potential risks associated with specific types of electronic payment systems and, in particular, a number of countries (e.g. Australia, Canada and Germany) reported the detection of arrangements involving eBay and PayPal services to conceal business proceeds.
- There was some evidence in the survey responses that electronic payment systems are used relatively frequently to conceal income. Various projects described in survey responses provide anecdotal support through descriptions of task forces and project teams who are able to match data from external sources on the same individual or business entity.
- The United States has identified some common schemes used to move taxable income offshore. Some of them involve the use of electronic payment system providers, debit cards, and credit cards.

100. Country examples evidencing the above observations are set out below.

<b>Non-compliance indicators</b>	<b>Description</b>
Following the money to and from offshore locations (Denmark)	<p>The Danish Tax and Customs Administration has since 2006 run a high-profiled project targeting Danish residents hiding income abroad or wrongfully claiming non-residence. Based on analysis of transaction data for domestic transactions involving credit cards issued abroad, more than 800 high risk cases have been identified, half of which have already been closed, leading to additional revenue and fines well in excess of EUR 50 million. The project has used media leverage to increase deterrence and reassure the community that no one is immune to justice. Among the convicted offenders are several persons of standing in the community, including an internationally recognized sports star.</p> <p>Building on the experience with the credit cards project, the Danish Tax and Customs Administration has designed another project around money transfers from Denmark to tax havens or likely intermediary jurisdictions. This project is expected to become an even bigger success than its predecessor. Political support has been vital in securing access to data on credit card transactions and money transfers respectively.</p>
Use of off-shore credit card data (Sweden)	<p>After obtaining third party information to investigate a selection of private individuals using credit cards issued by foreign banks (usually in tax havens), the STA found that the use of foreign cards was not related to laundering of money emanating from crime. Instead the money originated from unaccounted income.</p> <p>The most common source for tax avoidance is when a business partner directly transfers payments (wire transfer) to a bank account in an offshore bank that the taxpayer has requested when signing the "payment option" part of the agreement. These payments are hardly ever reported. It is not a new problem but the global trade and the Internet have made these transactions easy to perform and we have today a large and expanding number of small traders that are global from the start – micro multinationals – and the risk will therefore be much higher than in the past.</p>

Non-compliance indicators	Description
“Super Credit Card” (Sweden)	<p>It can commonly be used in different Swedish stores (chains). There is no limitation on deposits. All payments are made electronically and can be made anywhere in the world. One can order such a card in several stores (chains). The cards are anonymous. Sweden concluded that these cards cover most of an individual's everyday needs and the usage gives opportunity to payments regarding unaccounted remunerations. The difficulty with these cards is that payments are difficult to find among the huge number of card transactions. The problem increases since many of the cards are anonymous and only possible to use with verification through a PIN verified terminal. The difficulties do not decrease since the cards can be issued by a foreign company. The cards can be bought with a fixed amount or be loadable with unlimited amounts.</p>
Use of eBay data (Australia and Canada)	<p><b>Australia:</b> Data has been obtained identifying 31,000 eBay sellers with sales in excess of AUD 20,000. A review of a sample of the sellers shows that while many of the sales are in a private capacity there are a number of businesses making sales via eBay that are not being reported.</p> <p><b>Canada:</b> The CRA obtained authorisation from the Federal Court to serve Unnamed Persons Requirements on eBay's subsidiaries in Canada to obtain information on their Canadian “PowerSellers”, in order to determine whether they were meeting their tax obligations. Forty six test audits identified almost CAD 5 million in unreported income, representing over CAD 750,000 in taxes owing. A statistically valid sample of 400 audits is being done to determine the rate of non-compliance for this population, and to develop a profile to support risk assessment and compliance strategy development. The publicity from this project has resulted in over 170 voluntary disclosures.</p>
Use of PayPal data (Australia and Germany)	<p><b>Australia:</b> Data obtained by the ATO from PayPal identified that an Australian taxpayer had received payments of several million dollars over a two year period from the sale of electronic goods. The taxpayer was also the subject of an investigation of another government agency and both agencies worked together to coordinate investigations into the taxpayer's activities. The taxpayer used fake credit cards to acquire store cards which were then redeemed to purchase electronic goods. These goods were subsequently sold over the internet and the proceeds used to purchase properties and businesses in the names of family members. The taxpayer came to the attention of government agencies when an attempt was made to redeem loyalty points accrued on the store cards. The taxpayer was convicted of receiving stolen goods and a two year non-custodial sentence was imposed, in part because the taxpayer had no prior criminal history. A Proceeds of Crime confiscation order of over AUD 400,000 was also made against the taxpayer. Amended tax assessments of over AUD 4 million were issued.</p> <p><b>Germany:</b> The German survey response also reported that some state revenue bodies had detected situations where taxpayers who run a business through eBay abuse the online payment service system “PayPal” for these purposes. In the respective cases the online payments received on a “PayPal” account are transferred to foreign accounts directly and not to a domestic one. It emphasised the difficulty the considerable difficulties in detecting these transactions in a systematic way.</p>
Internet-based businesses (Canada)	<p>The Canada Revenue Agency investigated an Internet-based business that sold equipment and services enabling persons to decode encrypted satellite television programming signals without paying a subscription fee. The investigation revealed that the business was evading taxes and defrauding the lawful distributors of encrypted subscription programming signals in Canada and the United States. Online merchant accounts were used to process payments for the sale of the illegal products and services and proceeds were sent to offshore bank accounts. The owner of the business pleaded guilty to two counts of income tax evasion and to one count of fraud over CAD 5,000, one count of money laundering and one count of possession of proceeds of crime under the <i>Criminal Code</i>. The Judge sentenced the owner to three years in prison and a fine of CAD 223,849, equal to 100% of the total taxes sought to be evaded.</p>

Non-compliance indicators	Description
Offshore merchant accounts (United States)	E-commerce business owners create an International Business Corporation (IBC) in an offshore secrecy jurisdiction and use the IBC to establish a merchant account at a merchant acquiring bank in the same or another secrecy jurisdiction so as to receive deposits of income attributable to debit and credit card sales. The transaction processor under contract to the offshore bank then processes the online debit and credit card sales of the merchant and settles (i.e.; deposits) the daily net sales proceeds directly into the offshore merchant account. When the business owners want to withdraw funds from their offshore merchant account, they can be obtained through the use of debit cards or credit cards linked to the offshore accounts, or via wire transfers or checks drawn on the offshore bank account.
Transfers via peer to peer electronic payment systems (United States)	Domestic taxpayers or business owners create an International Business Corporation (IBC) in an offshore secrecy jurisdiction. The taxpayers next use the IBC to open a bank account with an offshore bank located either in the same or another secrecy jurisdiction. The owners then establish an account with a peer to peer electronic payment systems provider (e.g.; PayPal) and link or fund the account with a debit card or credit card linked to the offshore bank account. The taxpayers can now engage in online purchasing, selling or money transfers with the actual funding originating from, or going to, the offshore bank account. When the business owners want to withdraw funds from their offshore account, they can be obtained through the use of debit cards or credit cards linked to the offshore accounts, or via wire transfers or checks drawn on the offshore bank.

### Strategies to access and use EPS data to detect concealed income

101. An important component of the information gathered from revenue bodies was the identification of successful strategies to access and use data in respect of electronic payment systems to detect concealed income. In this regard, it was accepted that the determination of success may be subjective given the early stage most revenue bodies are at in terms of the evaluation of strategies and that the issues around electronic payment systems are seen as emerging. As such, while there are some limitations to this, it was considered counter-productive to establish a constraint in calling for examples. Accordingly, in the selection of examples, “success” of the strategy did not necessarily have to be supported by a formal evaluation process.

102. Drawing on the case studies provided, a number of observations and conclusions could be made on revenue bodies’ approaches to accessing and using data from EPS:

- Countries that had a comprehensive strategy in place to deal with potential tax non-compliance facilitated through electronic payment systems had a legislative framework in place that allowed the revenue body to obtain data from banks and Internet service providers on a regular basis. This data is being systematically compared with tax return information to identify areas of concern for workload development.
- The most successful strategies allowed the revenue body to clearly view transactional data from a third party source and to then compare this information to tax records.
- Legislative measures implemented by the United States are aimed at increasing the transparency of beneficial ownership of off-shore financial accounts and assets.
- Some countries demonstrated the use of a multi-faceted communications approach designed to leverage the data they obtained and optimize use of their standard voluntary disclosure policy in the population of interest.

For example, Canadian and Australian revenue bodies in possession of third party data (e.g. eBay) took steps to publicise this information widely through the media and press releases. Subsequently, or in the same release, the revenue body

emphasized the substantial penalties associated with concealed income, and usually allowed a period of time during which people could make a voluntary disclosure (thus avoiding the full penalties that could have been applied had they not come forward and were subsequently audited).

- A number of countries have a legislative framework in place to request bank and Internet service provider information upon request, given that the request meets certain conditions.
- Some revenue bodies reported that their auditors required specialized training in order to be able to discover, examine and interpret electronic payment systems data; others are negotiating tax information exchange agreements to obtain details of offshore accounts and assets.
- Some revenue bodies rely heavily on information provided proactively by other tax jurisdictions, while others rely on Internet research activities to proxy the amount of business conducted by any particular business or to identify entities who are not complying with their tax obligations.

103. Country examples evidencing the above observations are set out below.

<b>Strategy (country)</b>	<b>Description</b>
Strengthened reporting requirements (United States)	Strengthening transparency and accountability of electronic payment service providers in the United States. Beginning in 2011, certain acquiring banks and card transaction processors will be required to provide information returns to their U.S. merchant clients and the IRS identifying the merchant's annual gross payments processed through debit cards and credit cards (IRC 6050W). Beginning in 2012, backup withholding on reportable payments will also be required if the merchant fails to provide its US taxpayer identification number to the reporting entity (IRC 3406).
Banking transparency strategy (Australia)	During the first half of 2010 the ATO launched a data matching programme directed at Australian financial institutions; subsidiaries and branches of international financial institutions operating in Australia; credit/debit card providers and clearing houses. The programme is seeking to 1) obtain intelligence about Australian resident taxpayers that have an indirect/direct interest in bank accounts located in offshore jurisdictions and identify risks/trends of non-compliance; 2) identify Australian residents that may be completely outside the tax system, 3) work with the representatives of domestic and foreign banks present in Australia, as well as other financial institutions who facilitate offshore transactions and accounts to obtain a better understanding of the issues identified as risks and trends of non-compliance. Data obtained under the programme is currently being risk profiled with the view of identifying Australian taxpayers who may have undisclosed offshore activity/income.
Data obtained from eBay (Australia)	The ATO initiated action to obtain data identifying 31,000 eBay sellers with sales in excess of AUD 20,000 or more in the 2009 and/or 2010 financial years. It has identified potential issues with matched sellers who appear to have reported fewer sales on their activity statements or tax returns than the sales reported by eBay. Review and audit activity of these sellers shows that while many of the sales are in a private capacity there are a number of businesses making sales via eBay that are not being reported.  This data matching activity is also important in enabling the ATO to increase the visibility of their compliance activities and demonstrate that they are addressing an area that the community might regard as high risk. Compliance activity in relation to online sales is reinforced by a tailored communication strategy which has resulted in numerous media articles being published and eBay has contacted all sellers to tell them that they had provided data to the ATO. Voluntary disclosures were received as a result of this publicity.

<b>Strategy (country)</b>	<b>Description</b>
Sales data obtained from PayPal (Australia)	The ATO has undertaken work using PayPal sales data to assess the risk of income received from sales and exports being under-reported or not reported by sellers. The ATO obtained PayPal data via the issue of formal notices requesting account information including transaction, bank and credit card details. The data was limited to PayPal sellers who had made over AUD 50,000 in sales over three years. The ATO compared the PayPal sales data against matched taxpayer income tax returns and activity statements. Community information such as Internet web sites are being searched to confirm what business, if any, a PayPal seller may be engaged in.
Potential use of Tax Information Exchange Agreements (TIEAs) (New Zealand)	New Zealand Inland Revenue has been negotiating Tax Information Exchange Agreements (TIEAs) with offshore finance centres which will enable Inland Revenue to obtain even more details of offshore accounts and assets of New Zealanders; approximately 15 TIEAs have been finalised so far. At the same time, Inland Revenue had a public communications strategy in place to inform the public that they held a particular type of third party data (like PayPal accounts and/or bank data).
Use of export information (Hungary)	Using export/import data as a proxy for either supplies and/or sales for risk detection for electronic/online sales in Hungary: The National Tax and Customs Administration of Hungary uses information from parcel sending companies and the Hungarian Post to approximate or estimate actual sales of online companies compared to what they declare.

### **Preventative measures to address EPSs risks**

104. It was apparent from survey responses that, generally speaking, most revenue bodies are either in the early stages of developing preventative measures or have not yet given any thought to the matter. The most significant and/or commonly reported strategies were:

- The implementation of legislative measures to reveal the beneficial ownership of offshore financial accounts and assets (United States)
- Inclusion of EPS in revenue bodies ongoing risk identification/monitoring activities (e.g. Australia, Canada, France, Ireland, New Zealand, and United States).

105. Most countries are planning a multi-faceted approach to address tax compliance issues facilitated by electronic payment systems in an indirect way. Communications focus on advising taxpayers of their obligations, especially in reference to moving money offshore or repatriating funds from foreign sources without declaring this income to the tax authority. At the same time they advise citizens of third-party data they have obtained and information-sharing agreements they have negotiated with other tax jurisdictions and offshore finance centres.

### **General observations and emerging themes**

106. Most countries associate electronic payment systems with e-commerce activity on the Internet, and with the off-shoring and repatriation of funds. They recognize the need for specific legislation that allows them access to third party data to verify the information disclosed to the revenue body by the taxpayer or their representative.

107. However, it appears that most revenue bodies do not yet feel very confident in the area of electronic commerce and the use of new payment systems. While some work on identifying the risk inherent to these new payment technologies has been conducted by the FATF in the area of corruption, money laundering and terrorist financing, relatively little attention and/or interest has been paid to the possibilities surrounding unreported income and associated tax evasion activities.

108. Only one revenue body (Canada) reported that it is conducting research to establish a compliance rate in any particular sub-sector and none has been able, as yet, to determine

compliance trends or the impact of their strategies outside the counts and amounts associated with individuals and businesses that have been directly touched by their compliance activities. No such research activities were mentioned as part of future plans to address the potential non-compliance in this sector.

109. Some revenue bodies observed that the use of e-cash seems to be growing, and this is borne out by the work of the FATF, as referenced earlier in this chapter. It was pointed out that the evolution of these payment systems may be towards greater anonymity because more and more transactions are verified through PIN verified terminals.<sup>23</sup> In addition, only a few revenue bodies have embraced the use of electronic payment systems as an opportunity to push more business out of the underground economy and into the formal sector.
110. The growing use of electronic payment systems will likely increase their use to facilitate tax evasion. Accordingly, a number of revenue bodies have identified the need to monitor the situation, and have set up specialized task groups, often with specialized training, to perform this task. However, with the exception of seeking out information exchange agreements with other countries and some financial institutions, the work in this area to date has been fairly reactive. In this respect, there would seem a need for more proactive work to address this emerging risk and it should be kept under review.

### **Risks and challenges related to electronic payment systems**

111. Electronic payment systems increase opportunities to conduct transactions across national borders. Certainly, at least some of the legal and administrative barriers revenue bodies face in obtaining information on cross-border transactions are publicly known, and perhaps considered in the organisational structures of individuals and businesses. Although some individual countries are achieving success with domestic campaigns to identify cross border tax leakage facilitated by electronic payment systems, there is a need for increased international cooperation to find ways to address the barriers to increased exchange of information on electronic payment transactions.

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<sup>23</sup> See [www.internet-security.ca/internet-security-news-025/critical-security-flaw-discovered-in-chip-and-pin-credit-card-authorization-system.html](http://www.internet-security.ca/internet-security-news-025/critical-security-flaw-discovered-in-chip-and-pin-credit-card-authorization-system.html) (accessed March 17, 2011) for information on research and analysis performed by Steven Murdoch, Saar Drimer, Ross Anderson and Mike Bond of the University of Cambridge. The research describes a major flaw in a chip and PIN credit card system that was widely used. The problem has since been addressed, but raises a question about the security of technology involved and the ability of the firms to keep up to date with the efforts of professional hackers, for example.

## VI. KEY FINDINGS AND RECOMMENDATIONS

112. The preceding chapters have described the approaches of surveyed revenue bodies to addressing tax compliance issues in respect of the underground economy and EPS.
113. The key findings, conclusions and recommendations arising from the study are:
- Notwithstanding the many practical limitations involved, the work of national statistical agencies and others suggest that the aggregate value of unreported economic transactions comprising the underground economy is statistically significant in many OECD countries, providing indications of large tax revenue losses.
  - Relatively few revenue bodies reported the existence of a comprehensive/holistic ‘overarching’ set of strategies to address the many tax compliance issues presented by those who participate in underground economic activities.
  - A few revenue bodies outlined in their responses details of their overarching strategies that may guide revenue bodies wishing to enhance their approaches; the ‘core’ elements common to all of the overarching strategies described were as follows:
    - **Whole of revenue body co-ordination:** Management arrangements are in place across the revenue body for effective ‘whole of revenue body’ co-ordination and evaluation of the strategy, recognising the cross-programme nature of the activities being carried out to improve overall compliance;
    - **Comprehensive research efforts:** There is a comprehensive research effort undertaken (e.g. to assist risk detection and assessment, to test specific treatments, and to monitor external perceptions and attitudes);
    - **Enhanced risk detection:** Enhanced risk detection processes are being used, and greatly facilitated by a large variety of information from third party sources and the use of sophisticated risk profiling techniques;
    - **Multi-faceted set of treatments:** A fairly broad set of treatment strategies is deployed, typically including education, outreach and communication-based initiatives, specially legislated tools to enhance detection and deterrence efforts, traditional enforcement programmes and specialist programmes for serious tax evasion, including that related to illegal activities;
    - **Leveraging improved compliance through key intermediaries:** An important element of some treatments is the effort made to leverage improved compliance via intermediaries such as tax professionals, industry representatives, and primary business contractors;
    - **Effective co-operation across Government:** Effective relationships and mechanisms for exchange of information exist with relevant Government agencies, especially for information gathering and co-ordination purposes;
    - **Wide use of the media:** The media is used widely to communicate aspects of the strategy and the positive results being achieved; and
    - **Impact evaluation:** Efforts are being made, although further attention and development is required by most revenue bodies, to evaluate the impacts of revenue body’s individual treatments and/or overall strategy.
  - A large range of risk detection and risk treatment types were reported by revenue bodies in their responses or were brought to notice from additional research. The more significant (in terms of innovation and/or potential impact) were:

- Comprehensive industry benchmarking, coupled with leveraging via tax professionals, extensive media publicity and automated targeting of large numbers of taxpayers (Australia).
- Industry-based withholding/third party reporting regimes (Ireland).
- Increased controls over cash transactions (Netherlands, Spain, and Sweden).
- Increased record-keeping controls for employees in high-risk industry sectors (e.g. restaurants and hairdressing) (Sweden's staff ledgers).
- Initiatives aimed at reducing the use of cash transactions (Norway and Turkey).
- The use of monetary incentives to encourage proper record-keeping/deter unrecorded cash payments (Canada's and Norway's home renovation tax credit, Korea's lottery and incentive for obtaining receipts).
- Increased revenue body use of suspicious transactions reports collected by a separate government agency (Australia and France).
- Educating new/potential taxpayers (Austria's schools initiative, Canada's trade school initiative).
- Drawing on the FATF's work, there has been a significant increase in the number of transactions and volume of funds moving through electronic payment systems (EPS) and this would seem likely to continue and therefore justify being kept under review by the FTA;
- The work of a small number of revenue bodies reveals that the availability of these systems is facilitating tax evasion practices, including by providing ready access to undisclosed funds/assets held in offshore accounts;
- The work of a small number of revenue bodies focusing on selected eBay sellers and users of PayPal and relying on aggregated electronic transaction data is revealing indications of related tax non-compliance, including practices involving the use of offshore bank accounts; and
- Many revenue bodies do not as yet appear to have assessed whether users of EPS, including eBay sellers or PayPal users (or equivalent intermediaries), represent areas of tax non-compliance risk requiring attention.

### ***Recommendations***

- Revenue bodies are encouraged to review their strategies for addressing tax non-compliance arising from their respective underground economies in light of the information and practical experiences set out in this note.
- Revenue bodies that presently do not have an explicit overarching strategy, as described in this note, for addressing their respective underground economies, may wish to assess the merits of having such a strategy, having regard to their own compliance risk contexts.
- Revenue bodies are strongly encouraged to be vigilant for evidence of tax non-compliance facilitated by the use of EPS and, where appropriate, to take advantage of electronic records created by EPS to identify unreported business income that may have been earned by participating in the underground economy.

### Annex 1. Adjustments for NOE activities /1

Countries	Year	Size %	N1	N2	N3	N4	N5	N6	N7
<b>New EU members</b>									
Bulgaria	2001	10.2	•	•	•	•	•	•	•
Czech Re	2000	4.6(E), 6.6(I), 9.3 (O)	•	•	•	•	•	•	•
Estonia	2002	9.6	•	•				•	•
Hungary	2000	11.9	•	•	•			•	•
Latvia	2000	13.6 (O), 8.28 (E)	•	•				•	•
Lithuania	2002	18.9	•	•				•	•
Poland	2002	15.7(O), 7.8 (E)	•	•	•			•	•
Romania	2002	17.7	•	•				•	
<b>OECD-EU members</b>									
Austria	2001	7.9	•		•	•	•	•	•
Belgium	2002	3.0~4.0	•		•			•	•
Finland		N.avail	•		•			•	
Germany		N.avail	-	-	-	-	-	-	-
Ireland	1998	4.0			•	•		•	•
Italy	2003	14.8 (L), 16.7 (U)	•		•	•	•	•	•
Netherlands	1995	1.0						•	•
Spain	2000	11.2	•			•		•	•
Sweden	2000	1.3		•				•	•
UK		N.avail	•		•		•	•	•
<b>OECD Non- EU members</b>									
Australia	2001	1.3			•			•	•
Canada		N.avail	•	•	•			•	•
Mexico	2003	12.1	-	•	•	-	-	-	-
Norway	1995	2.4 (O), 1.0 (E)			•	•	•	•	•
United States	1997	0.8						•	
<b>EU candidate countries</b>									
Croatia	2002	10.1	•	•	•	•	•	•	•
Macedonia	2003	16.3	•		•			•	
Turkey	2004	1.66	•		•			•	
<b>CIS</b>									
Armenia	2003	28.9	•		•			•	
Azerbaijan	2003	20.7	•		•	•	•	•	
Belarus	2003	10.7	•		•				
Georgia	2004	28.3	•		•			•	
Kazakhstan	2003	21.6	•	•	•			•	
Kyrgyzstan	2003	17.0	•		•			•	
Moldova	2001	31.6	•		•			•	
Russia	2003	24.3	•		•	•	•	•	•
Tajikistan	N.avail	25.0	•		•	•	•		
Turkmenistan	2005	18.1	•	•	•			•	•
Ukraine	2003	17.2	•	•	•	•	•	•	•
Uzbekistan	N.avail	29.0~30.0	•		•		•		
<b>Other</b>									
Albania	2003	30.8	•					•	
Brazil	2003	12.79	-	-	-	-	-	-	-
Mongolia	N.avail	13.0 or 30.0	•		•				
Montenegro	2002	8.8	•		•		•	•	
Serbia	2003	14.56	•	•	•	•	•	•	

Source: Non-Observed Economies in National Accounts: Survey of Country Practices, United Nations (2008)

**Notes:**

O - according to output approach, E - according to expenditure approach, I - according to income approach, L - Lower bound estimate, U - Upper bound estimate

“-” – it is not possible to establish which types of the NOE are covered based on the country's contribution to the survey.

/1. For some countries, the classification into different types of non-exhaustiveness has been made by the UNECE Secretariat and should be treated as indicative. For more information, the reader should refer to the country description in this publication.

/2. Mongolia: two estimates: 13% and 30% were produced based on two different studies.

#### **Box 6. Eurostat's tabular approach: types of non-exhaustiveness**

##### **Not registered**

###### **N1 - Producer deliberately not registering - underground**

Producer deliberately does not register to avoid tax and social security obligations. Most often this refers to small producers with turnovers that exceed threshold levels above which they should register.

Producers that do not register because they are engaged in illegal activities fall under type N2. **Type N1 does not include all underground activities, some of which are associated with type N6.**

###### **N2 - Producers deliberately not registering - illegal**

Producer deliberately does not register as a legal entity or as an entrepreneur because it is involved in illegal activities. Type N2 excludes illegal activities by registered legal entities or entrepreneurs that report (or misreport) their activities under legal activity codes.

###### **N3 - Producers not required to register**

Producer is not required to register because it has no market output. Typically these are non-market household producers that engage in production of goods for own consumption, for own fixed capital formation, and construction of and repairs to dwellings. Or, producer has some market output but it is below the level at which the producer is obliged to register as an entrepreneur.

##### **Not surveyed**

###### **N4 - Legal persons not surveyed**

Legal persons not surveyed due to several reasons such as: the business register is out of date or updating

procedures are inadequate; the classification data (activity, size or geographic codes) are incorrect; the legal person is excluded from the survey frame because its size is below a certain threshold etc. This leads to (systematic) exclusion of the legal person from surveys when in principle they should be included.

###### **N5 - Registered entrepreneurs not surveyed**

Registered entrepreneurs may not be surveyed due to a variety of reasons: the statistical office does not conduct a survey of registered entrepreneurs; the registered entrepreneur is not in the list of registered entrepreneurs available to the statistical office, or if available, is systematically excluded from it; the registered entrepreneur is not in the survey frame because the classification data (activity code, size code, geographic code) are incorrect.

##### **Misreporting**

###### **N6 - Producers deliberately misreporting**

Gross output is under-reported and/or intermediate consumption is overstated, in order to evade income tax, value added tax (VAT), other taxes, or social security contributions. Misreporting often involves maintenance of two sets of books, payments of envelope salaries which are recorded as intermediate consumption; payments in cash without receipts, and VAT fraud.

##### **Other**

###### **N7 - Other statistical deficiencies**

Type N7 is subdivided into N7a - data that are incomplete, not collected or not directly collectable, and N7b - data that are incorrectly handled, processed or compiled by statisticians. The following areas should be investigated: handling of non-response; production for own final use by market producers; tips; wages and salaries in kind; and secondary activities.

**Annex 2. Estimates of the unrecorded economy and national accounts:  
“Declaration of the ISWGNA”, January 2006**

The degree to which official national accounts estimates cover the economy differs among countries. Statistical authorities of some countries make explicit and comprehensive estimates of activities not recorded from the usual data sources—be it because these are illegal, underground, or simply outside scope. In other countries, statistical authorities do not provide such estimates, a situation that sometimes prompts unofficial estimates. These unofficial estimates may have a sound statistical underpinning, but many are based on bold assumptions and few actual data. The Inter-secretariat Working Group on National Accounts (ISWGNA) feels it is necessary to alert users to the limited value of these unofficial estimates in terms of reliability and accuracy.

Unofficial estimates are often based on macro-economic models. For instance, they may assume a fixed relation between the size of the economy and money in circulation. Such methods may yield grossly exaggerated results, attracting the attention of politicians and newspapers and thereby gaining wide publicity. The OECD-ILO-IMF-CIS manual on measuring the non-observed economy rejects such “macro-model” methods because these methods suffer from serious problems that cast doubt on their utility for any purpose in which accuracy is important. In particular, they are completely unsuitable for use in compiling the national accounts.

(Declaration signed by the members of the ISWGNA: Commission of the European Community (Eurostat); International Monetary Fund; Organisation for Economic Co-operation and Development; United Nations; and the World Bank).

### **Annex 3. Australia—Example of published ATO benchmark**

#### **Bricklaying services**

##### ***Industry overview***

Businesses in this industry lay, cut and repair bricks and prepare sites for the construction of buildings and other structures.

These benchmarks do not apply to block-layers, pavers or builders.

#### **Performance benchmarks**

These performance benchmarks are developed using information reported on income tax returns and activity statements for the 2008-09 year. Performance benchmarks are updated annually.

These benchmarks show a number of different financial ratios of business income to business expenses, to help businesses compare their performance against similar businesses in an industry.

The key benchmark ratio for this industry is labour to turnover. This ratio is likely to be the most accurate predictor of business turnover. For businesses that do not report labour or only report a small amount, total expenses to turnover

Businesses operating outside the key benchmark may be contacted by us.

During an audit, if a business does not have records to support their reported income and expenses, we may use benchmarks and other information available to assess the profits of the business.

For information about calculating benchmarks, refer to detailed information on small business benchmarks on the ATO website.

<b>Key benchmark ratio</b>	<b>Annual turnover range</b>		
	<b>Low:</b> AUD 50,000-150,000	<b>Medium:</b> AUD 150,000-350,000	<b>High:</b> Over AUD 350,000
Labour/turnover	20% - 35%	30% - 45%	35% - 49%
Average labour	27%	38%	42%
Total expenses/turnover	37% - 58%	59% - 73%	76% - 88%
Average total expenses	47%	66%	82%

**Notes:** Labour – salary and wage payments, including contractor payments but excluding payments to associated parties, amounts exclude GST.

Benchmarks are published as a range representing the ratios reported by businesses grouped either side of the average. Publishing benchmarks as a range allows for variations across financial years, regions and business models.

The following benchmarks are made available as a guide for businesses to review their performance and business practices against other similar businesses.

The following expenses are not reported by every business, so one or more of these benchmarks may not apply to an individual business.

<b>Key benchmark ratio</b>	<b>Annual turnover range</b>		
	<b>Low:</b> AUD 50,000-150,000	<b>Medium:</b> AUD 150,000-350,000	<b>High:</b> Over AUD 350,000
Labour/turnover	7% - 16%	9% - 20%	15% - 30%
Average labour	7% - 10%	4% - 6%	2% - 4%

## **Definitions**

**Cost of sales:** Cost of anything produced, manufactured, acquired or purchased for either: manufacture; sale or exchange in deriving the gross proceeds; and earnings of the business. For the purposes of calculating the benchmark, cost of sales excludes labour.

**Labour:** Salary or wage payments, including contractor payments (amounts exclude GST). Labour does not include payments to associated parties - for example, labour provided by a business owner or business partner.

**Total expenses:** Total expenses reported on the income tax return less payments to associated parties (amounts exclude GST).

**Turnover:** Total revenue received from providing goods or services each year, excluding GST.

## **Input benchmarks**

These input benchmarks have been developed in consultation with the: National Federation of Bricklayers and Masonry Employers Association; Tasmanian Master Bricklayers Association; Masonry Contractors Association of NSW/ACT; and Master Bricklayers and Segmental Paviors Association of Queensland.

They represent the industry norm and apply to bricklayers who work directly with household customers and are responsible for purchasing their own materials.

These benchmarks are current as at October 2010 and supersede previous published benchmarks.

### ***Input benchmark guide***

The table below sets out input benchmarks for bricklayers.

You can use these benchmarks to compare and check your business performance to the bricklaying industry average.

<b>Benchmark guide</b>		
Coverage rate - number of standard single bricks (230L x 110W x 76H) required per square metre		50
Coverage rate - tonnes of sand to make mortar to lay 1,000 bricks		1
Coverage rate - number of 20kg cement bags to make mortar to lay 1,000 bricks		8
Cost of materials - sand, cement and lime as a percentage of labour price charged to customer		10 - 15
Number of bricks for average job (for example, extension, garden walls or granny flat)		2,000
Days to complete average job (including one day for excavation)	Tradesperson only	5
	One tradesperson plus labourer	4
	Two tradespeople plus labourer	3
Price charged (AUD) per 1,000 bricks - labour only*		840 - 1,260

\* Add a further 10% to 15% to the labour charge if sand, cement and lime are supplied.

**Notes:** 1) All dollar amounts are GST-inclusive; 2) Prices charged may vary between states and regions; 3) In Tasmania, deduct 100-200 bricks laid per day depending on size of job for manual washing of bricks if applicable; and 4) Calculations based on a standard brick 230mm long x 110mm wide x 76mm high.

### ***Input benchmark – sales turnover***

You can use these benchmarks to estimate your income, compare your income against the bricklaying industry average, and/or check that your records accurately reflect your income.

<b>Income guide</b>	<b>Tradesperson only</b>	<b>Tradesperson plus labourer</b>	<b>Two tradespeople plus labourer (gang of three)</b>
Tonnes of sand purchased or used per year	80 - 120	120 - 160	160 - 240
Bags of cement purchased or used per year (20kg bags)	640 - 960	960 - 1,280	1,280 - 1,920
Bricks laid per day	350 - 600	600 - 800	800 - 1,200
Bricks laid per year	70,000 - 120,000	120,000 - 160,000	160,000 - 240,000
Price charged (AUD) per 1,000 bricks - labour only*	840 - 1,260	840 - 1,260	840 - 1,260
Sales turnover range (AUD) - labour only*	58,800 - 151,200	100,800 - 201,600	134,400 - 302,400
Average labour charge (AUD) per day per person	294 - 756	252 - 504	224 - 504
Jobs completed per year	40	50	67
Days to complete average job	5	4	3
Days worked per year	200	200	200

\* Add a further 10% to 15% to the labour charge if sand, cement and lime are supplied.

**Notes:** 1) All dollar amounts are GST-inclusive; 2) Prices charged may vary between states and regions; 3) The number of bricks laid per day may vary due to job conditions, different application and finish and whether the job is new or renovation work; 4) Calculations based on a standard brick 230mm long x 110mm wide x 76mm high; 5) Add brick charges if supplying bricks; and 6) In Tasmania, bricks laid and sales per year may be less due to local process of manual brick washing and quantities of sand and cement required per year will need to be adjusted accordingly.

## Input benchmark examples

### **Example 1**

Ben runs a bricklaying business with one full-time labourer. They work on household jobs only.

Ben normally charges AUD 1,100 for 1,000 bricks laid which includes AUD 100 per 1,000 bricks for sand, cement and lime. Together with his labourer they lay 800 bricks per day. Ben's records show that he has used 150 tonnes of sand and 1,200 bags of cement during the year. Using the benchmarks he estimates that they have laid approximately 150,000 bricks with income of about AUD 165,000, including AUD 15,000 for materials.

Checking his business records, Ben finds he has recorded income of AUD 136,000 for the year. Ben reviews his quote books and finds that he has not recorded some of his cash work. Ben contacts a bookkeeper for advice on record keeping.

### **Example 2**

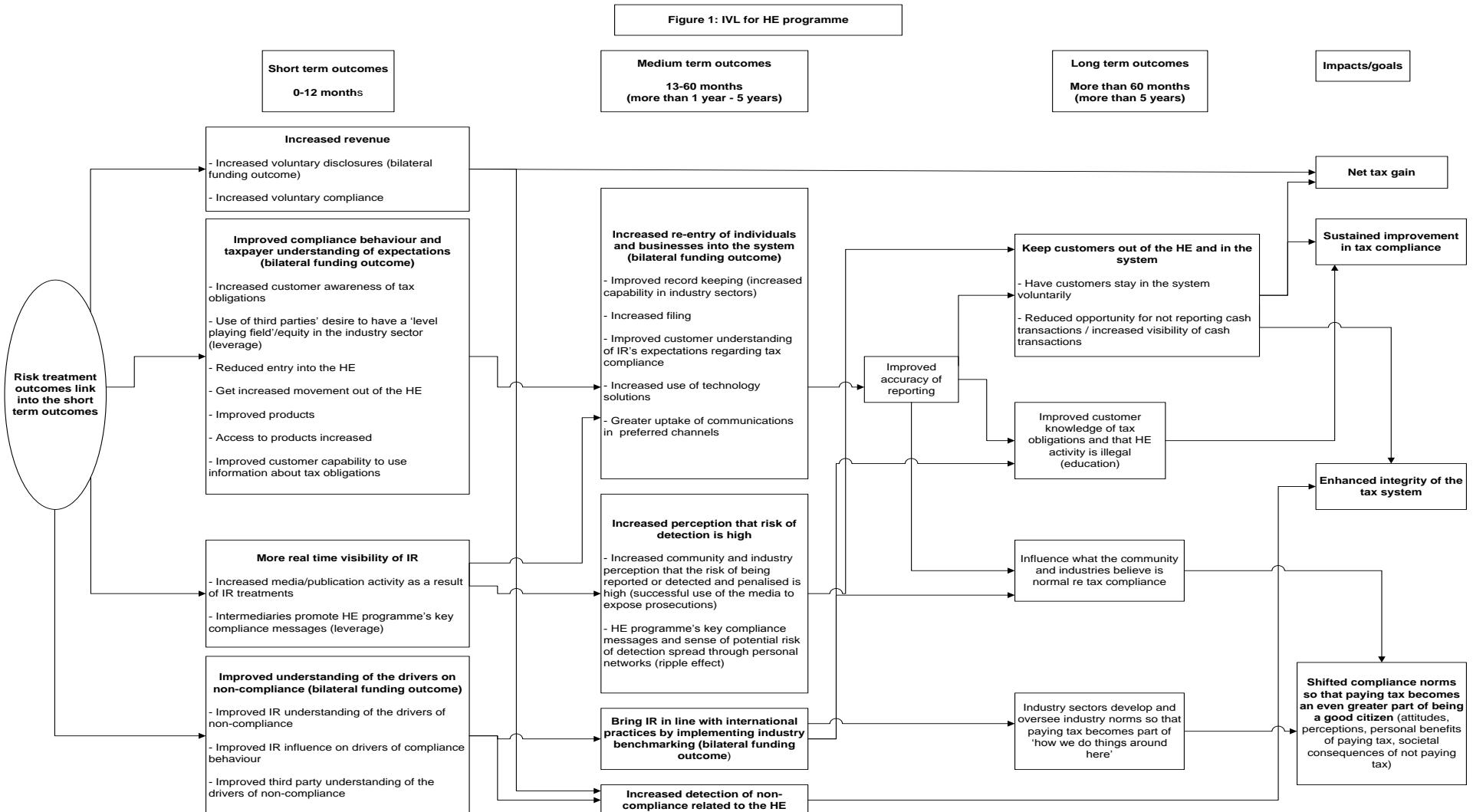
Harold and Sandy run a bricklaying partnership with a regular labourer (gang of three). They specialise in the domestic renovation and extension market. Harold and Sandy quote for work on the basis they can lay 1000 bricks per day for which they charge AUD 900 plus AUD 100 for materials.

Checking their supplier purchase records for the year Harold and Sandy find they have purchased 200 tonnes of sand, which for their business equates to approximately 200,000 bricks laid and sales of AUD 200,000 (including materials).

Harold and Sandy have recorded sales of AUD 175,000 and decide to check their work diaries for cash work they have not recorded because they were busy.

Source: Material reproduced (with minor adaption) from the website of the Australian Tax Office.

## Annex 4. New Zealand–Intervention logic for hidden economy evaluation programme



## **Annex 5. Reference material on new payment methods from the FATF report “Money Laundering Using New Payment Methods”**

### **Box 7. Recent developments related to Internet payment services**

Internet payment services (IPS) can be provided by financial institutions and firms outside the financial services sector. They can rely on a bank account or operate independently from a bank account. Internet payment methods fall into one of three categories:

- **Online banking**, where credit institutions offer online access to traditional banking services based on an account held at the credit institution in the customer's name. Online banking is outside the scope of this document.
- **Prepaid Internet payment products**, where firms who may not be credit institutions allow customers to send or receive funds through a virtual, prepaid account, accessed via the Internet;
- **Digital currencies**, where customers typically purchase units of digital currencies or precious metals which can either be exchanged between account holders of the same service or exchanged against real currencies and withdrawn.

The market for prepaid Internet payment products has diversified and grown steadily since 2006 in parts of the world, possibly as a result of increased Internet usage and acceptance of Internet payments by online merchants. They are also increasingly being used to support person-to-person (P2P) transfers.

Recent years have seen the emergence of electronic currencies linked to **virtual worlds**, where users convert real currencies into virtual currencies in order to complete purchases within the virtual world environment. Within that same environment, P2P transfers are often conducted among users (*i.e.*, users sending virtual currencies to fellow users). These virtual currencies are not confined to a particular online game, as they can be traded in the real world and be converted into real currencies.

**Cash vouchers** have gained popularity in some markets. These vouchers can be bought anonymously at retailers, petrol stations etc. and are usually sold in units ranging from as low as EUR 10 up to GBP 500 (approx. EUR 750). Cash vouchers are originally designed for person-to-business (P2B) payments on the Internet, but can also be used for P2P transactions where they are accepted as a funding method by other NPM service providers (*e.g.* prepaid card issuers or digital currency exchangers), or where they can be used for online gambling.

**Internet payment services are increasingly interconnected with different new and traditional payment services.** Funds can now be moved to or from a variety of payment methods, ranging from cash, money remittance businesses (*e.g.* Western Union), NPMs, bank wire transfers, and credit cards. Furthermore, some IPS providers have started to issue prepaid cards to their customers, thus granting them access to **cash withdrawal through the worldwide ATM networks**.

As indicated previously, 15 of the jurisdictions responding to the questionnaire indicated that IPS providers were operating in their respective jurisdiction. Statistics regarding the number of such providers and active client accounts were not consistently provided. However for countries providing such statistics, the estimated number of providers varied between one and 23. As for the estimated number of active IPS accounts, it varied between 45,000 and over 80 million accounts.

### **Box 8. Recent developments related to mobile payment services**

For the purposes of assessing risks and vulnerabilities it is essential to differentiate between “mobile payments” based on individual bank accounts or securities accounts for each customer (and recipient) held at a financial institution that is subject to adequate AML/CFT regulation and supervision, and those services offered separately from such accounts. In this respect, it may be helpful to use the four categories of mobile payment systems described by the World Bank:

- **Mobile financial information services:** Users may view personal account data and general financial information, but there is no capability for any financial transaction and therefore may be considered low risk.
- **Mobile bank and securities account services:** Users may transact, in a similar fashion to internet banking. The service will be tied into individual bank or security accounts and is therefore (like internet banking) not considered a NPM in the strict sense of this report. Mobile bank and securities account services are likely to be regulated and supervised.
- **Mobile payment services:** Allows non-bank and non-securities account holders to make payments with mobile phones. However, payment service providers may be non-traditional financial institutions with widely varying controls and supervision measures.
- **Mobile money services:** Subscribers are able to store actual value on their mobile phone. They may use phone credits or airtime as tender for payment. Such systems offer versatility but may often fall out of regulation and prudential supervision altogether.

The scope of this report covers the last two categories only. However, some of the issues discussed in this report may apply for mobile bank and securities account services as well (e.g., the issue of outsourcing business activities or using agents; or simplified due diligence measures; or non-face-to-face account opening).

Advances in mobile phone technology since the 2006 report should reasonably have been expected to facilitate a marked increase in the use of mobile payments systems. The expected proliferation of such systems was regarded as symptomatic of the trend for migration from paper to electronic payments common to all payment systems innovations. Despite a predicted marked increase in the use and spread of mobile payments, only a few providers have managed to run a successful and profitable business model in the long term so far.

### **Common risks of NPMs**

The 2006 report identified a number of characteristics shared by most NPMs. These include the absence of credit risk, speed of transactions and (often) non-face to face nature of the business relationship:

- **Absence of credit risk:** Funds for use with NPMs are generally prepaid. This absence of credit risk means that service providers may have fewer incentives to obtain full and accurate information about the customer and the nature of the business relationship.
- **Speed of transactions:** NPM transactions can be carried out and funds withdrawn or converted much quicker than through more traditional channels. This can complicate monitoring and potentially frustrate efforts to freeze the funds.
- **Non-face to face business relationship:** Many (but not all) NPM providers’ business model relies on non-face to face business relationships and transactions, which FATF Recommendation 8 identifies as presenting “specific”<sup>36</sup> ML/TF risks due to increased impersonation fraud risk and the chance that customers may not be who they say they are.

### **The Risk Matrix**

The 2006 FATF report developed a risk matrix which featured several risk factors to assess the risks associated with individual NPM products. This matrix has been updated as follows:

- “Identification” has been renamed “CDD” and now encompasses identification, verification and monitoring.
- “Record keeping” has been added as an additional risk factor.

- “Value limits” and “usage limits” have been broken down into more detail; and
- “Segmentation of services” has been integrated into the risk matrix. Segmentation of services had already been identified as a challenge for regulators and law enforcement in the 2006 report, but had not been included in the risk matrix then.

Some of the risks (such as anonymity, methods of funding, value limits etc.) are the direct result of product design, while others result from the providers’ CDD measures (such as verification and monitoring procedures). The risk factors listed in the following matrix should not be looked at in isolation but as a whole; a “high risk” rating in one risk factor does not necessarily mean an overall rating of “high risk” for the product. It is important to look at the whole picture not only including all risk factors, but also all risk mitigants implemented in order to effectively assess the risk associated with a particular NPM product.

**Table 2. Risk matrix for payment methods**

Payment methods risk factors				
Factor	Criteria	Cash	New Payment Methods (High Risk)	New Payment Methods (Low Risk)
Customer Due Diligence	Identification	Anonymous	Anonymous	Customers are identified
	Verification	Anonymous	Customer's identity (where obtained) is not verified on the basis of reliable, independent source documents, data or information.*	Customer's identity is verified on the basis of reliable, independent source documents, data or information
	Monitoring	none	none	Ongoing Monitoring of business relationships
Record Keeping		none	Electronic transaction records are generated, but not retained or not made accessible to LEA upon request	Electronic transaction records** are retained and made accessible to LEA upon request
Value Limits	Max. amount stored on account / accounts per person	no limit	no limit	Amount limit
	Max. amount per transaction (incl. loading / withdrawal transactions)	no limit	no limit	Amount limit
	Max. transaction frequency	no limit	no limit	Transaction limit
Methods of Funding		n.a.	Anonymous funding sources (e.g., cash, money orders, anonymous NPMs); also multiple sources of funds, e.g., third parties	Funding through accounts held at a regulated financial or credit institution, or other identified sources which are subject to adequate AML/CTF obligations and oversight
Geographical Limits		Some currencies are accepted more widely than others; currencies can be converted through intermediaries	Transfer of funds or withdrawal across national borders	Transfer of funds or withdrawal only domestically
Usage Limits	Negotiability (merchant acceptance)	Generally accepted	High number of accepting merchants / POS (e.g., through usage of VISA or MasterCard standard)	Few accepting merchants / POS
	Utility	P2B, B2B, P2P, no online usage possible	P2B, B2B, P2P, online usage possible	P2B, B2B, online usage possible, but no P2P
	Withdrawals	n.a.	Anonymous and unlimited withdrawal (e.g., cash through ATMs)	Limited withdrawal options (e.g., onto referenced accounts only); limited withdrawal amounts and frequency (e.g., less than a certain fixed sum per calendar year)
Segmentation of Services	Interaction of service providers	n.a.	Several independent service providers carrying out individual steps of the transaction without effective oversight and coordination	Whole transaction carried out by one service provider
	Outsourcing	n.a.	Several singular steps are outsourced; outsourcing into other jurisdictions without appropriate safeguards; lack of oversight and clear lines of responsibility	All processes completed in-house to a high standard

NPM = New Payment Methods, LEA = Law Enforcement Agency, AML = Anti Money Laundering, CTF = Combating Terrorist Financing, POS = Point of Sale, P = person, B = business

\* Some jurisdictions that have no national identity card scheme, or other appropriate alternative forms of identification.

\*\* "Examples of the necessary components of transaction records include: customer's (and beneficiary's) name, address (or other identifying information normally recorded by the intermediary), the nature and date of the transaction, the type and amount of currency involved, and the type and identifying number of any account involved in the transaction."