Forum on Tax Administration

# FORUM ON TAX ADMINISTRATION

## Measures of Tax Compliance Outcomes - A Practical Guide

### Scoping document

**September 2013**

OECD

**FTA PROJECT:**
**Measures of Tax Compliance Outcomes - A Practical Guide**

***Background: current common practice in measuring performance of tax authorities***

Most revenue bodies use measures of 'intervention yield'[1] to track their performance and to account for the use of resources on compliance activity to external stakeholders, for example in their annual reports. Intervention yield measures the additional tax revenues that are assessed and collected as a result of a downstream compliance activity. By 'downstream' we primarily have in mind an audit or similar intervention that is made by a revenue body to correct a tax return after it has been filed by a taxpayer.

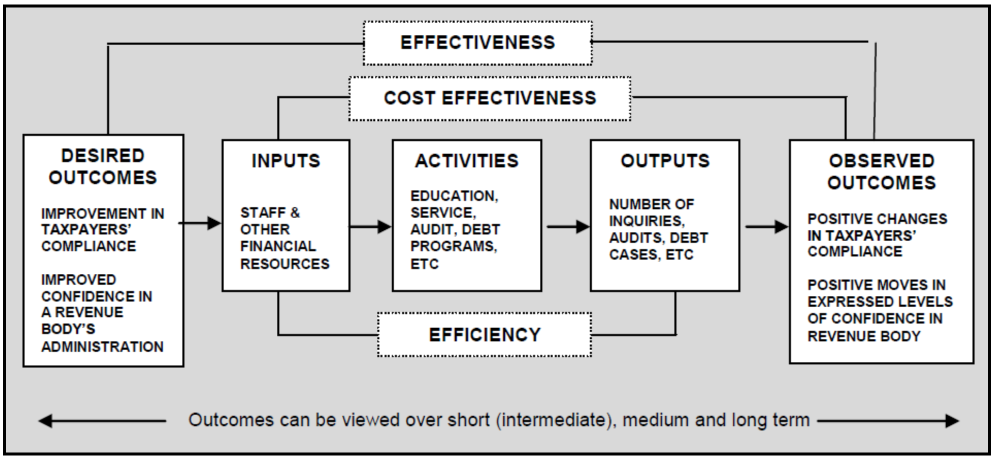
Intervention yield has a number of strengths as a measure. Most obviously, its quantification is relatively straightforward. If an audit determines that the true tax liability is £x rather than the £y on the return submitted by the taxpayer, then the intervention yield is £(x-y). Management information systems used by tax authorities record this information so it is easy to verify. Because these measures have been in place for a long time, they are generally well understood. The rate of return on these activities is relatively easy to calculate (the cost of undertaking audit activity compared to the revenues raised, or the cost:yield ratio). It is also easy to compare performance over time.

The scope of intervention yield can also be extended beyond direct yield (the additional liabilities assessed in an audit) by complementing with measures of the 'indirect effects' of compliance activity. For example, the UK introduced new high level measures in 2011 to better assess the full impact of compliance activities in ensuring the correct tax liabilities are paid. These new measures include the impact of future behavioural change and a deterrent effect. Together these record the expected increase in future years' revenues from those who have been found to be non-compliant in the past; and those deterred from deliberately being non-compliant from specific compliance initiatives. This is obviously not something that can be directly observed and needs to be inferred on the basis of wider evidence.

***The limitations of current practice***

Measures of intervention yield only capture the benefits of actions taken to counter non-compliance that has already happened. Increasingly revenue bodies are looking to invest more effort in preventative measures designed to ensure much higher levels of voluntary compliance. This involves much more activity "upstream", i.e. before a tax return has been filed, or in some cases even before a business has commenced activity. This reflects a greater strategic focus on the delivery of improved compliance outcomes and overall effectiveness, in line with the tax compliance programme logic described in the FTA's 2010 report "Evaluating the Effectiveness of Compliance Risk Treatment Strategies"[2], and represented by the diagram below:

[1] The exact terminology and definition varies across revenue bodies. Similar terms include: Tax Yield, Active Compliance Liabilities Raised, Fiscal Impact, Audit Discrepancies and Additional Tax Assessed.
[2] www.oecd.org/ctp/administration/evaluatingtheeffectivenessofcompliancerisktreatmentstrategies.htm




Measures of intervention yield clearly fall within the category of output measures and, as such, serve as good indicators of the results and efficiency of this type of compliance activity. What they cannot fully measure is how successful the overall compliance strategy is at delivering higher levels of voluntary compliance, whether through deterrence, or by reducing the opportunities for non-compliance. Compliance strategies that place more emphasis on 'upstream' activities (such as taxpayer education, working with taxpayers to re-engineer their processes and those of the tax system to build in compliance and advanced rulings on complex tax issues) should, over time, reduce intervention yield by reducing the incidence of error that does not arise from a deliberate decision on the part of the taxpayer to evade taxes. Perversely, by reference to traditional output measures, this success could appear to degrade performance.

Intervention yield is an imperfect measure of the overall success of a compliance strategy. In some countries this realisation has given rise to an increased focus on the measurement of the "tax gap". In principle this does provide a holistic measure of how successfully a revenue body is reducing the amount of tax that is underpaid for whatever reason. Tax gap measures remain controversial and tend to operate at the macro level and be backward looking. There is a need for other measures that focus on outcomes but that are also relevant to the operational management of compliance activities.

***Recent FTA Studies***

In 2013 the FTA published two studies that were both focused on improving compliance through upstream activity and that addressed the issue of measurement. The report "Together for Better Outcomes"[3] recommended that revenue bodies should:

*Assess how E&I approaches fit with their current performance evaluation framework and consider opportunities for strengthening the outcome focus: Narrow output measures are relatively easy to work with, but may channel attention and resources away from innovative approaches. Documenting outcomes and attributing them to revenue body activities (and their individual components) on the other hand represents a number of challenges. Therefore more pragmatic approaches are often required. Revenue bodies may find inspiration in previous work of the FTA.*

The report "Co-operative Compliance: A Framework"[4] devotes a whole chapter to a discussion of the evaluation of co-operative compliance programmes. It suggests that this problem could be addressed by measuring the proportion of the tax base that can be shown to be "under control" and so assured as accurate, as a result of the operation of these programmes. It is suggested that such a

[3] http://www.oecd.org/ctp/administration/together-for-better-outcomes.htm
[4] http://www.oecd.org/ctp/administration/co-operative-compliance.htm

measure is meaningful at an operational level and a "leading" indicator that should be validated in time by tax gap measures in countries where these are seen as useful.

***The Current Project***

In the light of this analysis and the results of its recent work, the FTA has decided to undertake a specific study of outcome measures with a view to providing its members with practical guidance on how to develop a suite of measures that will help to assess the overall effectiveness of their compliance strategies. This project will focus on upstream activities for large business and SMEs, and to a lesser extent for personal taxpayers. This work will be led and sponsored by the United Kingdom. This study will have the following objectives:

- Developing a framework for measuring the outcomes of compliance strategies, building on the results of the FTA's recent work. The framework should ensure that benefits are properly quantified, while at the same time minimising the risks of double counting and the use of flawed assumptions;

- The framework will recognise the need to adapt the measures used to the different taxpayer segments, while exploring the general application of the principle that outcome measures will include a focus on the extent to which the tax base has been assured as correct as a result of the overall compliance strategy applied;

- Capturing case studies of how upstream activities can be quantified and taken into account in overall performance management. This could cover a wide range of examples such as co-operative compliance for large business, SME education campaigns and benchmarking (business ratios), working through third-parties to improve compliance or tackle the hidden economy, innovations in tax processes through digitalisation; and

- Exploring what techniques and approaches are available to evaluate whether the expected benefits have been achieved.

- Exploring revenue bodies' experience of implementing outcome measures of tax compliance, such as the development of business and reporting processes.

The UK will be seeking views and contributions from other Forum members and inviting them to express an interest in being involved in the project. It will create a core task team of countries with which to progress the work. Following an initial review of current developments, the UK will host a conference of interested experts to help develop the proposed framework. In developing the framework the project will also draw on:

- Relevant and current academics in the field;

- The newly established Advanced Analytics Network;

- The Large Business Network;

- The Taxpayer Service and SME Compliance Sub-groups;

- Reports and projects by other international groups, such as EC Fiscalis Risk Management Platform Group.

***Outline timetable***

| Timing | Action |
|---|---|
| June-July 2013 | Prepare terms of reference and outline timetable |
| July 2013 | Terms of reference to FTA Bureau for approval by written procedure |
| September 2013 | Countries invited to express an interest in being involved in the project and task group formed. |
| September 2013–January 2014 | Research into current developments in revenue bodies and in relevant academic work. Outline structure of report developed. |
| January 2014 | UK hosts conference of interested experts |
| February – March 2014 | Meeting of core task team of countries |
| March – June 2014 | Report drafted and agreed with task group |
| July 2014 | Report finalised and submitted for formal approval |