

**Inter-American Center of Tax Administrations – CIAT**

**44<sup>th</sup> CIAT GENERAL ASSEMBLY**



**“THE ROLE OF THE TAX ADMINISTRATIONS IN THE GLOBAL CRISIS”**

**Topic 2**

**DEVELOPMENTS IN VAT COMPLIANCE MANAGEMENT IN SELECTED COUNTRIES**

**O.E.C.D**

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## **ABOUT THIS DOCUMENT**

### **Purpose**

This information note has been prepared to assist member revenue bodies achieve improved compliance with their VAT systems by sharing knowledge of recent developments in selected countries.

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

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

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

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

To help carry out its mandate, the FTA's work is directly supported by two specialist Sub-groups—Compliance and Taxpayer Services—that each carry out a program of work agreed by member countries, and a number of more focused task groups.

The Compliance Sub-group's mandate, in broad terms, is to provide a forum for members to:

- periodically monitor and report on trends in compliance approaches, strategies and activities;
- consider and compare member compliance objectives, the strategies to achieve those objectives and the underlying behavioural compliance models and assumptions being used;
- consider and compare member 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.

Since its inception, the Sub-group has focused its work on issues associated with improving the tax compliance of SME taxpayers. The Sub-group meets annually to review and discuss developments, to provide oversight and direction of its work program, and to provide a forum where members can exchange experiences and approaches for improving taxpayers' compliance.

## **Caveat**

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

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

## **Inquiries and further information**

Inquiries concerning any matters raised in this information note should be directed to Richard Highfield (CTPA Tax Administration and Consumption Taxes Division) at e-mail (Richard.highfield@oecd.org).

## **Developments in VAT Compliance Management in Selected Countries**

### **Summary**

VAT is now a widespread and significant means of raising revenue, being used by 29 of the 30 OECD member countries. In 2006, it accounted for 18.8 percent on average of all tax revenues across OECD members, compared to 11.9 percent in 1965. In terms of percentage of GDP in 2006, it was roughly double that for the revenue collected from corporate profit taxes. Given population trends across OECD countries, projections of a declining work force and an ageing population, and the negative revenue impacts (especially in relation to corporate tax receipts) of the current global economic and financial crisis, Governments are likely to become even more dependent on consumption taxes. It follows, therefore, that any substantial leakage from the VAT revenue base will have a serious impact on Governments and their ability to balance budgets. Furthermore, perceptions of serious compliance issues with the VAT can only be expected to have a negative "knock-on" effect with taxpayers' compliance for other taxes.

This is the third report prepared by the Forum on this topic. Earlier reports produced in 2004 and 2005 both reflected concerns at indications of serious revenue losses across many countries, particularly among EU member countries, arising from criminal fraud and general non-compliance, and weaknesses in aspects of administration. On a positive note, the reports highlighted promising work being undertaken by the UK

indirect revenue body (now part of Her Majesty's Revenue and Customs Department), based on efforts to establish a systematic risk management approach to both estimating the overall extent of these losses and their key components and developing and implementing strategies to counter their growth. It also referenced a variety of other measures introduced across different countries to counter the abuses being experienced. In making recommendations for further work, it emphasised the need to develop techniques for measuring losses, and strategies for countering them in ways which would not fundamentally undermine the taxes. It was agreed that the matter would be kept under review and a follow up report produced after around two years.

This report reviews developments in a small sample of volunteer countries (i.e. Australia, Austria, Canada, Ireland and the United Kingdom), particularly in relation to their overall risk management approach, as a primer for consideration of whether further work should be done by the Forum. It deliberately does not address members' activities to address fraud associated with EU intra-community transactions, as this matter is the focus of special efforts by the European Commission's Tax Directorate-General Taxation and Customs Union.

Although confined to a relatively few member countries, the survey has revealed a useful array of developments that build on the Forum's earlier work on VAT abuses and compliance risk management in general. The key observations and conclusions are as follows:

- Compared to the situation observed in 2004, there are clear indications of a maturing in the strategic approach to compliance risk management (e.g. increased attention to the development and use of top-down measures covering the major risk types, significantly increased use of better IT tools to detect compliance risks and assess their potential magnitude, more systemic risk treatment approaches).
- Survey responses indicated an improved or consistent pattern of VAT compliance for the countries concerned:
  - In the case of the UK, compliance trend and other data support a conclusion of substantially improved compliance over patterns of serious non-compliance observed in the early 2000's, of the order of around a 20 percent reduction in the estimated tax gap, and lend support to the value of its 'strategic approach' described in the Forum's previous reports;
  - In the case of Canada, indications of improved compliance were evident from its range of strategic outcome measures; and
  - For other surveyed countries, responses indicated that their VAT systems had generally performed in line with revenue projections and/or other indicators, suggesting a broadly consistent pattern of compliance.

- Notwithstanding the observations of improved or consistent compliance and the measures implemented all revenue bodies continue to rank their VAT as a “high risk” area for their administration.
- The use of random audits for risk profiling and overall compliance monitoring purposes figures in the compliance management approach of three of the five surveyed revenue bodies.
- Revenue bodies are increasingly moving to detect and treat risks on a ‘whole of client’ basis, as opposed to a ‘tax by tax’ approach. Among other things, this is evident in the way IT systems are being designed and the way in which work processes (e.g. audit/ verification) are being conducted.
- Given a number of ‘hard to treat’ compliance risk issues, there has been a fair resort to legislative responses over recent years; numerous efforts to simplify the laws thereby making it easier to comply and easing the burden on taxpayers were also noticeable.
- Revenue bodies have evolved more systematic and specialised risk-based processes for validating the integrity of VAT registrations; three of the five surveyed bodies reported they have a systematic process using internal and/ or external data sources to identify businesses that should be, but are not, registered for the VAT.
- Considerable attention is being given to strengthening case-based risk profiling systems but these require close monitoring and fairly regular updating to take account of changing patterns of compliance behaviours.
- Deficiencies in the performance management information systems of a number of revenue bodies were apparent—there was a dearth of information concerning VAT refund claims and their processing, information on ‘VAT specific’ verification checks and their results and the value unpaid VAT debt could not be reported in two countries.

## **Recommendation**

- Revenue bodies, especially in those countries where there are indications of serious non-compliance, are encouraged to examine closely the findings of this study in order to identify opportunities to strengthen their administration of VAT compliance (and other taxes).
- Revenue bodies are encouraged to put in place, if not already the practice, a comprehensive set of performance/output and outcome measures to enable them to monitor key risk areas (e.g. VAT refund claims processing and VAT verification activities) and to gauge the impacts of their targeted risk treatments.

## **Developments in VAT Compliance Management in Selected Countries Background**

1. This is the third Forum report on the topic of VAT compliance management.

### **The 2004 report**

2. Following a request from the former Tax Administration Advisory Board in January 2003 for work on the increasing compliance problems arising with VATs, a survey of all member countries was carried out through the summer of 2003. A report on this work (see DAFPE/CFA(2004)13/CONF/REV2) summarised some preliminary findings and made proposals for further work, given a number of concerns.
3. The survey, which received a high rate of response from members reflecting their concerns in this area, provided indications of significant VAT revenue losses in terms of criminal fraud, general non-compliance and tax avoidance activity in many OECD countries. Analysis of the survey results suggested that losses in those countries were probably running in the order of at least 15% (and possibly much higher) of the potential tax base although, with a few notable exceptions, many OECD countries did not appear to have undertaken work to estimate aggregate losses or the key components of non-compliance. The report briefly noted potentially promising work carried out by the former UK Customs and Excise Department, as part of a systematic risk management approach to both estimating the overall extent of these losses and their key components and developing strategies to counter their growth. It also referenced a variety of other measures implemented across different countries to counter the abuses being experienced. In making recommendations for further work, it emphasised the need to develop techniques for measuring losses, and strategies for countering them in ways which would not fundamentally undermine the taxes.

### **The 2005 report**

4. The follow-up report finalised in May 2005 (see CTP/CFA(2005)8REV) updated member country information and provided further details on approaches taken by member countries to reduce the incidence and impact of VAT abuses. These approaches were considered at the strategic, legislative and administrative levels.
5. The report described in some detail the strategic approach adopted by the UK revenue body, noted the significant improvement in compliance reported by the UK authorities, and provided further information on its VAT gap measurement methodology. The report also elaborated a number of practices identified by countries as assisting in reducing losses and went on to note that whatever approaches and practices were adopted some measurement of their impact should be a key component for application.

6. In order to assist member countries, the report made two recommendations. First, it encouraged revenue bodies, especially those with a significant VAT revenue leakage problem, to strengthen their VAT compliance improvement activities, drawing on the experiences and approaches of member countries. Second, that the matter be kept under review and a further report produced after around 2 years.

### **Other relevant reports**

7. Since 2003, the FTA has produced a number of reports directly relevant to this topic.
  - The guidance note 'Managing and Improving Taxpayers Compliance' published in October 2004 described a strategic and systematic approach for managing and improving taxpayers' compliance. The purpose of this guidance note was to provide a framework for the application of modern compliance risk management principles to the management of tax compliance risks. It identified and discussed the general principles found in both the identification and treatment of compliance risks within a wide variety of taxation jurisdictions and provided information about the way in which treatment strategies influence the behaviour of small businesses in relation to their taxation obligations.
  - The guidance note 'Monitoring Taxpayers' Compliance: A Practical Guide Based on Revenue Body Experience' published in June 2008 encouraged revenue bodies in member countries to improve their understanding of taxpayers' compliance and the effectiveness of their compliance improvement programs by developing a compliance monitoring framework (where one was not already in place). It suggested that such a framework should embody a range of measures and indicators for each of the major risk types for the major taxes administered by the revenue body, drawing on the ideas, approaches and practical examples provided in the note and other measures and indicators deemed useful by them. It also encouraged revenue bodies to document and publish their approaches (and where applicable, any related qualifications and limitations concerning the approaches adopted) and the results of their monitoring efforts in this area to promote greater dialogue, understanding and exchanges of experience among national revenue bodies.
8. Other bodies have also been active over the last three years in drawing attention to the significant difficulties in achieving effective administration of the VAT, for example:

- An EC communication in May 2006 <sup>1</sup> called on members to develop a co-ordinated strategy to improve the fight against fiscal fraud and identified a number of areas for exploration, including improved risk management. In 2007, the EC Directorate-General of Taxation commissioned a study to provide estimates of VAT revenue leakage across all member countries. In December 2008, the EC outlined the elements of a co-ordinated strategy to improve the fight against VAT fraud in the EU, focussing largely on intra-community transactions. <sup>2</sup>
- In response to its concerns for VAT collection effectiveness, the Contact Committee of the Supreme Audit Institutions of the EU in December 2007 resolved that member states should be encouraged to produce top-down and bottom up estimates of aggregate VAT losses to check reliability and to allow international comparisons.
- The IMF's Fiscal Affairs Department has released a number of special reports. <sup>3</sup>

## This report

9. At the April 2008 meeting of the Forum's Compliance Subgroup, the Secretariat presented a proposal to delegates for work in the area of VAT compliance management. The Secretariat's proposal envisaged a study to gather information on key developments in VAT compliance management at the strategic and operational level. Special focus would be given to VAT refund controls, in particular to the use of advanced computerised risk profiling techniques, given their critical role in the detection of potentially fraudulent VAT refund claims. It accordingly proposed that to assist with the study a survey be conducted of a representative sample of countries that would be designed to gather information on aspects of VAT compliance risk management, drawing on the Sub-group's risk management model. The Secretariat noted that the intention to restrict the countries initially surveyed was made to minimise the amount of work entailed with the study, particularly for EU member countries, and to help expedite the work's overall completion. However, all countries would have an opportunity to contribute to a draft report prepared following the initial survey. Steps would be taken also to avoid overlap with the EC's work in this area and its particular focus on 'carousel/missing trader' fraud and the associated need to improve the monitoring of intra-community transactions. Delegates gave in-principle agreement to the work and 6 countries (i.e. Australia, Austria, Canada, France, Ireland, and the United Kingdom

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<sup>1</sup> See 'Communication from the Commission....to improve the fight against fiscal fraud' (COM(2006)254 final

<sup>2</sup> See 'Communication from the Commission....On a Co-ordinated strategy....' (COM(2008)807 final

<sup>3</sup> For example, see 'VAT Fraud and Evasion: What Do We Know, and What Can Be Done?' IMF Working Paper WP/07/31, February 2007 and 'VAT Refunds: A Review of Country Experience', IMF Working Paper WP05/218, November 2005.



agreed to be involved in the initial survey phase. (France subsequently withdrew from this phase).

10. This report focuses on the findings of the initial survey, with emphasis given to identifying positive developments in the area of strategic and operational risk management. It is not, nor is it intended to be, an evaluation of the performance of the participating revenue bodies.

## **II. VAT and Compliance Risk Management**

### **Introduction**

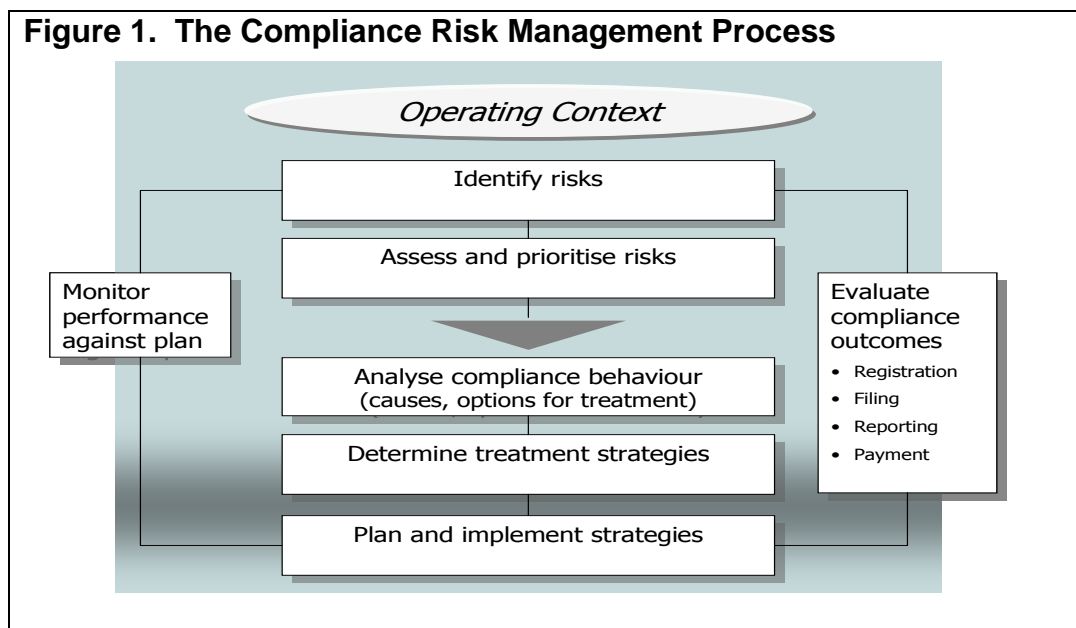
11. As noted in prior reports, VAT is now a widespread and significant means of raising revenue, being used by 29 of the 30 OECD member countries. In 2006, VAT accounted for 18.8 percent on average of all tax revenues across OECD members, compared to 11.9 percent in 1965 and, in terms of percentage of GDP, was double that for revenue collected from corporate profit taxes (OECD (2008), Revenue Statistics 1965-2008, OECD, Paris, p81). Given population trends across OECD countries, projections of a declining work force and an ageing population, and the negative revenue impacts (especially in relation to corporate tax receipts) of the current global economic and financial crisis, governments are likely to become even more dependent on consumption taxes into the future. It follows, therefore, that any substantial leakage from the VAT revenue base will have a serious impact on governments and their ability to balance budgets. Furthermore, perceptions of serious compliance issues with a tax such as the VAT can only be expected to have a negative “knock-on” effect with taxpayers’ compliance in relation to other taxes.
12. The Forum’s last report on this topic—see ‘VAT Abuse: 2004 Report’ released by the CFA in May 2005 (hereafter referred to as ‘the 2004 report’)—provided indications of significant VAT revenue losses in terms of criminal fraud, general non-compliance and tax avoidance activity in many OECD countries. In response to these many and significant challenges, it encouraged revenue bodies to strengthen their VAT compliance improvement activities and provided details of the approaches taken by some countries to counter VAT abuses. These approaches were considered at the strategic, legislative and operational levels and the report drew particular attention to the strategic approach adopted by UK revenue authorities which had been successful in achieving improved compliance.
13. Drawing on the survey responses of volunteer revenue bodies, this note identifies further developments at the strategic, legislative and operational level in order to 1) assist member countries further develop their own approaches; and 2) guide members on any further examination on aspects of the topic that may be useful to members.

## Compliance risk management

14. The Forum's guidance note 'Compliance Risk Management: Managing and Improving Tax Compliance' published in 2004 described, and sought to promote, the concept of compliance risk management as an essential management tool for revenue bodies and gave a description of practical approaches that could be adopted by revenue bodies. The model of compliance risk management recommended, which draws on leading revenue body experience in this field, is depicted in Figure 1. Application of the model by revenue bodies across each of the major taxes administered as part of the normal management cycle is intended to answer the following critical questions:

- What are the major compliance risks to be addressed?
- Which groups/ segments of taxpayers do they apply to?
- How should these risks be treated 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?

15. 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.



16. 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.

### **Implications for administration of the VAT**

17. The 2004 guidance noted emphasised a range of critical points in relation to each element of the overall risk management model. Those more relevant to this report are set out hereunder:

#### Identifying risks

- Risk can be identified using either top-down techniques such as macro-economic analysis or by bottom-up processes such as case-based risk assessment systems.
- 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 prioritizing risk

- Revenue bodies need a mechanism for objectively assessing the relative size of compliance risks in the context of organisational business priorities.
- Assessment and prioritisation needs to be firmly based upon objective evidence.
- A balanced approach to risk prioritisation may see some risks being addressed that may not represent today's highest revenue exposure. 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 those who don't.
- Treatment needs to address the underlying drivers of compliance behaviour.
- The most effective strategies are likely to be multi-faceted and systemic.

## Evaluating the 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.

18. All of these points provide a framework for understanding and learning from the approaches of surveyed revenue bodies in relation to their administration of VAT, as described in the following sections. Readers seeking more information on aspects of the risk management model referenced in this note are directed to earlier FTA published materials on compliance risk management identified at paragraphs 14 and 17.

## European Commission Study on the Incidence of VAT Fraud

19. At the time of completing this note, the European Commission's (EC) Directorate General Taxation and Customs Union was finalising a report on research it had commissioned in 2007 to provide estimates (and associated trends) of the incidence of overall VAT revenue leakage—the VAT tax gap—for all (then) 25 EU member countries (which includes 18 OECD member countries and two others currently subject to OECD accession processes). The purpose of this research, which is part of a wider study into fraud that also includes corporate income taxation and excise duties, is to quantify and analyse the extent of tax fraud, thereby allowing an assessment of tax fraud and tax activities and their impact on the fiscal revenues of member states.<sup>4</sup>

20. While the detailed findings of this work are yet to be published, EC officials have indicated that, based on the preliminary findings of this work, the estimated VAT gaps for the 25 countries included in the study vary widely in their magnitude and

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<sup>4</sup> See 'Specifications attached to tender... *'A Study to Quantify the Extent of Tax Fraud in the EU (25) Member States in the Field of VAT, Excise Duties and Corporate Income Taxation'* (January 2007).

for some countries the results are both disturbing and confronting (ranging up to around 30% of the estimated theoretical tax base).

21. While acknowledging the limitations of the top down VAT gap estimation methodology (ies), these findings point to the likelihood that, faced with serious levels of non-compliance, many countries may need to mount major efforts to revamp their overall risk management approaches.

### **III. Developments in VAT Compliance Management**

22. This section draws on the information provided by participating revenue bodies. It outlines developments with; 1) their overall strategic approach; 2) compliance-related features of their VAT legislative framework; and 3) their VAT administration operations. It commences with some basic information on the VAT systems in place, providing context for their circumstances and associated administrative implications.

#### **The surveyed countries- background information on their VAT systems**

23. It is important to bear in mind that policy design features of VAT systems can have important implications for their administrability. For example, a VAT with a multiple rate structure and numerous exemptions is likely to facilitate non-compliance and will be more difficult for taxpayers to comply with and for the revenue body to administer than, say, a VAT with a single rate structure and few or no exemptions. Similarly, a VAT with a relatively low registration threshold is likely to have relatively greater workloads than one where the threshold is set at a realistic level.
24. Tables 1 and 2 provide background information on the VAT systems of participating countries. They reveal some important differences to be kept in mind when appraising the developments described in this note:
  - Standard rates of tax vary significantly across the surveyed countries (i.e. from 5 to 21 percent), as does the relative amount of revenue produced (expressed in terms of tax/GDP (%)), reflecting differences in the degree of reliance on the VAT as a source of revenue.
  - There are large differences (i.e. by a factor of four) in the value of the VAT registration threshold—from the equivalent of around €18,000 to €72,000, measured at current exchange rates—which is likely to have significant implications for revenue body workloads, particularly the number of VAT returns where a refund is involved.
  - There is significant divergence in the overall proportion of VAT refunds that must be refunded to taxpayers, resulting from a range of factors (e.g. the

incidence of zero-rated exported goods and services and reduced rates) that impact to varying degrees across countries.

- As EU members Austria, Ireland and UK are impacted by the absence of border controls between EU member states, which is known to facilitate increased VAT fraud. Neither Australia nor Canada is impacted by an absence of border controls.

**Table 1. Background information on VAT system**

Country	Standard rate of VAT (%)	Reduced VAT rates (%)	VAT registration threshold	Businesses registered (millions)	EU members
Australia	10	0	\$A75,000	2.6	x
Austria	20	10, 12	€30,000	0.6	✓
Canada	5	0	\$C30,000	3.0	x
Ireland	21	0, 4.8, 13.5	€70,000 (G)/€35,000 (S)	0.29	✓
UK	17.5 /1	0, 5	£67,000	1.92	✓

Source: OECD Consumption Tax Trends 2008 and survey responses.  
/1. Temporarily reduced to 15 percent for 2009.

**Table 2 VAT revenue, refunds and revenue ratios (by fiscal years)**

Country	VAT revenue /GDP (%) /1			VAT VAT (%)	refunds/ revenue	VAT revenue ratio (%) /1,/2	
	2004	2005	2006	2006	2007	2003	2005
Australia	4.0	4.0	3.9	49	51	0.56	0.57
Austria	7.9	7.9	7.9	n.avail.		0.59	0.60
Canada	3.4	3.4	3.1	80	81	0.51	0.52
Ireland	7.4	7.7	7.9	25	25	0.62	0.68
UK	6.9	6.8	6.7	42	42	0.50	0.49
OECD	6.7	6.9	6.8	n.avail		0.57	0.58

/1. Sourced from OECD Revenue Statistics and Consumption Tax Trends.

/2. The VAT revenue ratio measures the gap between the revenues that would arise from a pure VAT system (where all consumption is taxed at the standard rate) and the amount of tax actually collected. It is therefore impacted by both policy design features and the tax that not uncollected as a result of taxpayers' non-compliance.

## Overall strategic approach

### Risk identification and assessment

25. The Forum's 2004 guidance note described the importance of revenue bodies having 'top down' and 'bottom-up' processes as part of an effective set of risk management arrangements. It emphasised that a more complete understanding of risk will occur if revenue bodies take a multi-level approach to risk identification and assessment.
26. A number of revenue body responses to this aspect of the survey were informative.
- As identified earlier in this note, the UK measures the totality of VAT risk through the use of its top-down VAT gap measurement methodology. However, it readily acknowledges that this top-down measure does not give information about specific types of non-compliance or the groups or segments of taxpayers responsible. As a result, it is looking to develop new approaches to provide this finer level detail, such as the recent introduction of a random audit program for smaller businesses to gather finer compliance detail, a survey approach for case workers of large businesses, and the use of data matching and network analysis technology to provide estimates of levels of serious attacks on the VAT system.

The UK emphasised that its approach to compliance risks is based on their materiality, and that its prime compliance objective is to reduce the VAT gap. As such, its identification of strategic risks is always in respect of their impact on the VAT gap. It utilises a number of tools and systems to monitor receipts and identify trends at an early stage and to ensure that an appropriate compliance response is actioned quickly. In order to build on this, it has recently set up specialist Futures Assessment and Tax and Duty Alerts teams to increase its awareness of potential risks/threats at the earliest possible stage.

The Futures Assessment team will provide HMRC with the foresight to successfully shape its future. The team will be responsible for assessing the plausible implications of potential future compliance risks, threats and opportunities for HMRC and likely future compliance developments which are at the margins of current thinking and planning. Techniques such as horizon scanning, environmental scanning, scenario planning, predictive analysis, divergent analysis and hypothesising will be used. Generating realistic future scenarios will allow for better informed decision making and more successful compliance strategies to be developed. The Futures Assessment Team will generally operate across the medium-long term, which can often (though not exclusively) be seen as the 3-10 year period.

The Tax and Duty Alert Team will be responsible for a number of HMRC analytical tools containing a range of HMRC data that can be used to identify indicators of emerging compliance risk and also to monitor factors such as trends and changes to trading patterns. The team will use tax and technical expertise to identify and evaluate emerging compliance risks, threats and issues and their impact as they occur and present decision makers with their findings. This will be done by providing Tax Alerts (summarising emerging compliance risks) and Tax and Duty Briefings (a more detailed product providing further information or answers following the delivery of a Tax Alert).

In order to improve its identification of compliance risks, HMRC is also looking to take a more holistic view of the risk of the taxpayer. To this effect, it is making increasing use of data/information from direct taxes and third party information sources to help inform its view of the risks posed by VAT taxpayers.

- Australia reported that it utilises a structured corporate-wide process for gathering information on actual and potential compliance risks that is described in Box 1. One outcome of this process is a prioritised list of key compliance risks.

**Box 1. Australia—Strategic Approach for Identifying Compliance Risks**

The ATO has a robust risk management framework to identify GST compliance risks.

Information is gathered as observations that are processed through the intelligence processes, assessed as risks and managed. The four-stage process used for Intelligence entails: 1) Direction and Coordination; 2) Collection; 3) Analysis and Production; and 4) Dissemination. This then feeds into the risk management processes: 1) Risk Identification and Assessment; 2) Treatment; and 3) Evaluation.

The information collection and subsequent intelligence processes stem from the identification of Key Intelligence Needs. Significant planning is undertaken to determine the sources of the information that's needed and how it is to be analysed. The information gathered is then analysed to determine any salient issues requiring further exploration. If these issues represent a threat to the GST system they are escalated through the decision making committees to register as a Matter of Concern (MOC) and stored centrally. The MOC is then further analysed to identify if a risk exists, the size of the risks, any relevant drivers and the methods being adopted to avoid GST. Generally a proposed risk mitigation strategy is developed if the risk represents a significant threat. Once the risk has been identified and assessed it is tabled at the decision making forum for endorsement and prioritisation. This committee critically analyses the information being tabled, ensuring:



- there is sufficient evidence to support decision making,
- all GST product areas have been included and provided input into the future direction and methods to manage the risk.

Endorsed risks are recorded on the GST Risk Register. Risks are reviewed at least annually to reaffirm the risk rating and the treatment strategy. This includes any additional or altered strategies and any changes in the risk that might increase or decrease the size of the threat.

The ATO publishes an annual compliance program which details its focus risk areas (and for some, intended treatment strategies) for the coming fiscal period. Table 3 hereunder describes the specific GST compliance risks it has identified and publicised for attention in 2008-9.<sup>5</sup> Performance against each of these risk areas is evaluated as part of an annual 'health of the system assessment' process.

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<sup>5</sup> Some specific examples of compliance risks may be peculiar to an individual country because of unique policy design features.

**Table 3 Australia— GST/ VAT Compliance Risks**

<b>Taxpayer segment</b>	<b>Major compliance risks highlighted in compliance program</b>
Large business (turnover over \$250mn)	<ul style="list-style-type: none"> <li>● GST risk management by businesses' internal business systems.</li> <li>● A range of specific risks with real property transactions.</li> <li>● Financial services and related GST issues.</li> <li>● Ensuring correct GST treatment of international transactions.</li> </ul>
Small / medium businesses (turnover of \$2mn-250mn)	<ul style="list-style-type: none"> <li>● Refund integrity</li> <li>● Property transactions</li> <li>● Financial supplies</li> </ul>
Micro-businesses (turnover under \$2mn)	<ul style="list-style-type: none"> <li>● Filing returns</li> <li>● Collecting tax debts</li> <li>● Refund integrity</li> <li>● Property transactions</li> </ul>
Government bodies	<ul style="list-style-type: none"> <li>● Treatment of grants</li> <li>● Property transactions</li> <li>● Machinery of government changes (with GST implications)</li> </ul>
Non-profit organisations	<ul style="list-style-type: none"> <li>● Misclassifying supplies as GST-free</li> <li>● Misclassifying grants as GST-free</li> </ul>

Source: 2008-09 Compliance Program (ATO)

- Canada reported that it uses a risk management approach that focuses on improving its ability to identify high-risk registrants through enhancements to the registration, risk assessment and enforcement processes, legislative and policy changes, broadening the engagement of stakeholders, and increasing research. Its tailored strategies to identify risk through methodologies include:
  - 1) Automated risk-based profiling;
  - 2) Expert and knowledge-based systems to apply criteria that identify potential non-compliance situations and estimate possible revenue at risk;
  - 3) Data mining through the use of automated processes of exploration and analysis of large quantities of data in order to reveal patterns and trends; and
  - 4) A cross-program compliance profile to integrate the CRA's view of any taxpayer's compliance history enabling it to respond to behavioural characteristics through more tailored compliance strategies.

- Australia, Canada, Ireland and the UK all reported their reliance on automated case-based risk identification systems (see paragraphs xx for more detail).

27. As part of the survey process, all revenue bodies were asked for their assessment of the risk to revenue presented for a range of specific risk areas that are detailed in Table 4.

**Table 4 Compliance risk areas identified as “high (H) or medium (M)” risk**

Risk area	Australia	Austria	Canada	Ireland	UK
Failure to register	H/M	H	H		H/M
Failure to file returns on time	H	M	M	H/M	H/M
Failure to correctly report:					
— avoidance schemes	H	H	H	H/M	H/M
— evasion schemes	H	H	H	H/M	H/M
— practices to inflate refunds	H	M	H	H/M	H/M
— specific industry issues	H	M	M	H/M	H/M
— cross-border transactions	H /2	M	H	H/M	H/M
— reporting non-compliance	H/M	M	H	H/M	H/M
Failure to pay tax on time	H/M	H	H	H/M	H/M

/1. The ATO noted that while collection of GST on imported goods is the responsibility of Australian Customs it has a number of cross-border transaction risks which deal indirectly with aspects of this question. The mitigation strategies for these risks may result in legislative changes to close loopholes and/or clarify taxpayer understanding which will have a flow on effect to this point. ATO risks are also broader than just importation and deal with connectivity with Australia.

28. Generally speaking, their responses reflect a common degree of “high to medium” concern for the various categories of risk that must be managed to achieve acceptable levels of taxpayers’ compliance. In other words, despite the measures that have been implemented and observations of satisfactory or improved performance—see further comments at paragraph 29—each surveyed revenue body continues to assess its VAT as a high priority area for ongoing administration.

### **Risk treatments**

29. The 2004 guidance note emphasised the importance of a graduated/ selective response strategy to compliance behaviour, acknowledging that taxpayers are not homogenous in the postures they take in relation to meeting their compliance obligations. It also stressed the importance of treating the underlying drivers of

compliance—rather than the symptoms— and noted that the most effective strategies are likely to be multi-faceted and systemic. This matter is also the subject of further work recently finalised by the Forum’s Sub-group that is contained in a publication released in March 2009—‘Managing and Improving Compliance: Recent Developments in Compliance Risk Treatments’. The key findings of this work, which focused on the development and use of innovative risk treatments and includes over 90 individual examples of specific risk treatments, are set out briefly in Box 2.

**Box 2. Key findings of recent work on innovative risk treatments**

The key findings from an analysis of over 90 examples of innovative risk treatments identified by around 20 revenue bodies were as follows:

- ✓ The range of new risk treatments employed by revenue bodies has expanded considerably over the period since the initial research for the 2004 guidance note.
- ✓ Taken as whole, the examples reflect that many revenue bodies are demonstrating increased sophistication in shaping and managing compliance programs in a more strategic way through developing multi-faceted treatment strategies that often have influence over several risk domains. It is also evident that in developing these risk treatment strategies, a more balanced suite of interventions is being applied across each of the ‘educate, assist, deter and enforce’ dimensions of the Compliance Model.
- ✓ Many of the new forms of treatment strategies commonly incorporate a proactive education & communication component that aims to prevent or deter non-compliance.
- ✓ Many treatment strategies also reflect a focus on effecting changes in behaviour across broader (although targeted) population groups through greater use of co-operative relationships with 3rd parties, including tax practitioners, industry representatives and wider inter-agency collaboration.
- ✓ There is also increased use of external information and data matching to identify aggregated risks and more specifically define target populations in order to develop greater behavioural understanding and consider broader treatment options.

- ✓ Another general observation is that is quite common for revenue bodies to be persistent in seeking compliance—single interventions being replaced with a number of different and sequential interventions until an actual change in compliance is detected.
- ✗ The approach to measurement and evaluation appears much less advanced, in part attributable to failing to gather too little critical information during treatment implementation.

30. The survey's responses reflected a number of developments in line with the directions suggested (and identified in other recent Forum work):

- The UK HMRC reported that its move to campaign/ projects introduces a program of national activities to address significant problem areas and/or achieve specific outcomes, such as including closing the tax gap and behavioural changes. It also provides a vehicle to allow HMRC to adopt a multi-disciplinary approach to tackling non-compliance ranging from education through to investigation and prosecution. HMRC campaigns will have a limited lifespan and be focused in three areas: 1) combating or preventing unwanted behaviours; 2) supporting and implementing policy changes; and 3) dealing with issues which have the potential to lead to non-compliance. The ongoing work against multi-cell fraud considering analysis of high risk sectors, audit of transaction chains, inspection of goods at storage facilities and legislative measures such as joint and several liability is one example of such activities.
- The UK also reported that during 2007-08 it developed and rolled out a new integrated approach to tackling fraud and evasion, including:
  - A central Evasion Referral Team to provide an escalation point for cases of suspected evasion or fraud;
  - Cross-tax Evasion teams, which bring together staff with direct and indirect tax expertise to work cases jointly with the aim of identifying and tackling evasion across all taxes and duties;
  - A new approach to the application of VAT civil penalties, which has been introduced to discourage evasion and ensure that non-compliant activity is heavily penalised once identified;
  - Testing a range of tools and actions designed to identify the proceeds of crime and maximize the value that can be recovered through the criminal and civil systems;

- A new professional standards strategy, adapted from existing models in police forces and other government departments, to combat threats and vulnerabilities; and
  - Legislative changes to target goods commonly used in MTIC fraud.
- Ireland reported that some years ago it took the strategic decision to develop integrated IT systems that now incorporate all the major business taxes, including VAT, together with PAYE employees in our Integrated Taxation Services (ITS) system. This enables it to take an integrated cross-tax head approach to managing the tax affairs of customers. Therefore, while it undertakes tax head specific projects and programmes to address tax head issues, it has focussed its main efforts to implementing integrated approaches to compliance.
  - Australia's approach to the treatment of risks is pursued within the context of its overall compliance risk management approach which is described in Box 3.

**Box 3. The ATO's compliance processes**

**Making it as easy and inexpensive as possible:** On the assumption that the vast majority of people want to comply with their obligations, the ATO's starting point is to make compliance as easy & inexpensive as possible. There are three main aspects to this.

First, the ATO consults and collaborates with individuals and their advisers to co-design the administrative processes that affect them. An empathetic, user-based approach ensures administrative solutions are designed around what works for the community. Second, it aims to provide individuals and their advisers with the information they need to understand their rights and responsibilities. Information products are tailored to the needs of different taxpayer segments and industries. People are encouraged to come to the ATO for personalised advice. Third, it aims to provide convenient and inexpensive ways for people to undertake transactions, such as reporting information, and making and receiving payments. The ATO also works with other agencies to develop whole-of-government solutions that minimise red tape and compliance costs - such as sharing of information to pre-fill forms and returns, standard business reporting and multi-agency online accounts.

**Verifying and enforcing compliance:** While ATO compliance verification activities vary according to taxpayer segments, they generally involve:

- Building risk profiles - identifying risk characteristics among taxpaying groups (such as transaction patterns) by analysing information collected in returns and from third parties (such as

financial institutions, government agencies and auditors of self-managed superannuation funds).

- Data matching and applying risk profiles to taxpaying groups - identifying inconsistencies, unreported transactions and other risks by automatically checking returns against their past behaviour and third-party data;
- Reviewing specific individuals/businesses where it identifies inconsistencies or other risks;
- Auditing individuals and businesses where reviews confirm the risk and taking other action where necessary. Tax returns (including activity statements and other reports) are the foundation for verifying compliance, which is why we put so much emphasis on the need for people to lodge returns in full and on time. The returns also contain information required by others, such as the Australian Bureau of Statistics.

When risks are identified, the ATO's contact with people depends on the nature and complexity of the risk. But it typically starts with letters and phone calls seeking more information or clarification, and extends to field visits and audits where required. Risk profiling is as much about identifying individuals or businesses that represent little or no risk to the tax and superannuation systems, as it is about identifying non-compliance.

Source: 2008-09 Compliance program

As an alternative to traditional risk treatment approaches the ATO has developed a new product known as an 'annual compliance agreement' that mirrors a similar approach being pursued for income tax (and also by the Dutch tax Administration where it is goes by the term 'horizontal supervision' and its associated covenants). The ATO's agreements, implemented over the last 18 or so months, businesses can choose to undergo a low-intensity due diligence review of their tax compliance and governance arrangements, systems and controls for managing tax risk. Businesses need to demonstrate good standards of self-scrutiny, governance, risk management and continuous disclosure. Regular meetings and reviews support the relationship. Subject to satisfying the conditions of the agreement, businesses are largely freed of traditional compliance checks. A fuller description of these agreements and the underlying process is set out in Annex 2. While still in its infancy, this initiative appears to have considerable merit.

- The EC's recently published short term action plan for fighting VAT fraud— see 'Communication from the Commission....On a Co-ordinated strategy....' (COM(2008)807 final) can be viewed as reflecting an integrated set treatment strategies to prevent and deal with fraud on intra-community transactions. The proposed treatments envisaged by the plan are set out in Box 4.

**Box 4. Proposed short term action plan to fight VAT fraud**

- 1) Common minimum standards for the registration & deregistration of taxable persons;
- 2) Confirmation of traders' names and addresses electronically for VAT status purposes;
- 3) Simplifying, harmonising and modernising the current rules on invoicing;
- 4) Common understanding of VAT chargeability on intra-community transactions;
- 5) Reducing timeframes for exchange of information on intra-community transactions;
- 6) Harmonised rules for the exemption of VAT on importation;
- 7) A range of specific activities to enhance administrative co-operation between states;
- 8) Increased automated access to information;
- 9) Strengthening of the EUROFISC network;
- 10) Measures aimed at enhancing capacity to collect taxes (e.g. joint & several liability); &
- 11) Uniform instruments for the cross border collection of taxes.

Taken as a whole, this latest plan represents an integrated set of possible measures that can be expected to assist in the fight against fraud. However, the ability of individual member states to effectively execute such a plan will depend very much on the maturity of their strategic approach to overall compliance risk management.

**Monitoring and evaluation**

31. Compared to the situation observed in 2004/05, it is apparent that increased efforts are being made to improve the monitoring of trends in taxpayers' compliance using a variety of measures/ indicators across the main compliance risk types. This is evident from the data in Table 5 which displays the individual measures reported by surveyed bodies and other information in survey responses.



**Table 5 Main measures & indicators used to monitor health of VAT system**

Risk category and measure/ indicators	Countries using the measure/ indicator				
	Australia	Austria	Canada	Ireland	UK
<b>Failure to register:</b> Actual / potential registrants	✓		✓		
<b>Failure to file returns on time:</b> % of VAT returns filed on time	✓	✓(2010)	✓	✓	✓
<b>Failure to correctly report:</b> Trend in VAT gap (macro approach)	✓ (2009)				✓
Trend of VAT gap (random audits)				✓	✓
Trend of growth in VAT receipts to retail sales/ consumption etc	✓		✓		
Trend in VAT/ GDP%	✓				
Trend in yielding audits		✓		✓	
<b>Failure to pay tax on time:</b> % of VAT paid on time	✓		✓	✓	
Trend in total debt	✓	✓		✓	
Total end-debt/annual receipts (%)				✓	

32. A number of the more significant observations from the survey are as follows:

- **Use of tax gap measures (based on macro-economic analysis):** The Australian revenue body has decided to explore the value of the VAT gap estimation methodology, along the lines of the methodology developed and used by UK HMRC and elaborated in previous Forum documents. (A more recent description of this methodology and its findings is set out in Annex 1.) In addition, Austrian authorities advised they had undertaken a similar analysis to validate external research findings.  
More broadly, as noted at paragraph 19 et seq. the EC's Directorate of Taxation and Customs has commissioned its own EU-wide study of the VAT gap using various top-down macro methods. The Swedish Tax Agency in a fairly recent report <sup>6</sup> indicated that an estimate of the aggregate VAT tax gap,

<sup>6</sup> See 'Tax Gap Map', Swedish Tax Agency.

applying the macro-economic approach, had been made as part of an overall tax gap estimation exercise for its tax system.

- **Compliance testing using random audit approaches:** Canada and Ireland reported the use of formal random audits to test compliance for VAT and other taxes, while the UK has recently introduced a similar VAT-focused activity. The Danish revenue body is also known to be finalising the results of its own initial random testing program (including coverage of VAT) largely carried out in 2008.
- **New measures not previously identified:** Ireland reported its intention to use additional new measures and to carry out a number of studies to gauge the compliance impact of its programs;
  - Trend of yielding and non-yielding audits from random audit program.
  - Measured behaviour of tranches of taxpayers: The Revenue is undertaking a study to establish if using the scores of its risk model (REAP) can be used to accurately track movements in compliance behaviour for selected tranches of the case base e.g. audits closed in 2008 can have their scores tracked both pre-intervention and for a number of years on a post- intervention basis—this could be subdivided into cases that had no adjustments and those that had adjustments greater than a specified figure.
  - Re-audit program: This measure is now under consideration. The view is that by re-auditing a proportion of cases that were audited some 2/3 years ago the Revenue will be able to get a measure of the success or otherwise of the original intervention. By tracking the risk score of possible re-audit cases during the interim period the Revenue will be able to monitor them electronically and to select suitable cases for re-audit

The UK HMRC also reported a number of other additional “new” measures that it is developing/ using to supplement its knowledge of the impacts of compliance interventions:

- **Future revenue benefit:** Future Revenue Benefit (FRB) is the estimated monetary amount that will accrue to the department or the business as a result of HMRC’s intervention. It is applicable to any and all regimes and is calculated to cover a twelve-month period from the date of the intervention that gives rise to the benefit. It is trader specific (i.e. it relates to the preventive effect of a direct intervention). It should be borne in mind that FRB, even when following strict application of the criteria, is subjective—it relies on a trader having and declaring that

same liability in the future as estimated, which will not always be the case.

- **Sticking tax (intervention additional liability):** Sticking tax is assessed additional liability and reduced prepayment claims that will not be recovered by businesses through the VAT system. This covers most adjustments to: 1) net payment returns; 2) net repayment returns (paid and prepayment); 3) central assessments; and 4) voluntary disclosures. It also covers the entirety of any voluntary disclosure which can be attributed to imminent assurance activity and which will not be recovered by businesses through the VAT system. The majority of our results are expressed in terms of direct impact i.e. additional yield or loss prevented because demonstrating the preventive and deterrent impact of our activities is highly complex and uncertain in most cases. Central Compliance and Knowledge, Analysis and Intelligence (KAI), together with the relevant supporting Directorates and the Treasury, continue to work on agreeing robust methodologies to help us achieve this.
- **Evaluation of specific risk treatments:** Australia reported the development of a formal methodology to assist “risk owners” evaluate the impacts of specific compliance interventions. The methodology, a copy of which is publicly available on the ATO’s website, is currently being applied to test the effectiveness of interventions in a range of areas, including the cash economy. An extract from an ATO report describing its approach and findings, presented against the background of the four phase methodology, is provided at Annex 3.
- Australia, Austria and Ireland all indicated that the system has performed generally as expected, reflecting in their view, a consistent pattern of compliance. In the case of Ireland, this was supported by a range of trend measures provided in their survey response and published in their annual report (see Table 6).

**Table 6 Ireland—VAT Strategic outcome measures (by fiscal years)**

Measure	Year				
	2004	2005	2006	2007	2008
Returns submitted timely:					
- Large businesses	89	92	93	91	89
- Medium-sized businesses	83	88	88	87	86
Average % revenue received in due month	85	84	88	88	90
VAT debt as % of gross revenue	2.8	2.1	1.5	1.1	1.3

- Canada reported that the system had operated as expected, reflecting some improvement in patterns of compliance. It noted that its strategic compliance outcome measures (registration, filing, reporting, and remittance)—see Table 7 below with trend measures that are published in its annual report— along with overall positive performance against its expected results supported its assessment that it has positively promoted compliance.

**Table 7 Canada—VAT strategic outcome measures (by fiscal years)**

Indicator	Target %	Year					2008
		2004	2005	2006	2007		
Businesses are registered	90	86.6	88.8	89.5	93.0	n.avail	
Businesses file returns on time	90	92	92.6	91.8	91.4	n.avail	
Growth in net revenue with retail sales & personal expenditures	Tracks favourably	Yes	Yes	Yes	Yes	Yes	
Businesses that collect GST	N/A	2.6 mn, \$44bn	2.7 mn, \$47bn	2.8 mn, \$52bn	3 mn, \$50bn	n.avail /1	

Source: 2008 CRA Annual report  
/1. Standard rate of VAT reduced from 7 to 6%.

- The UK observed that its VAT system, in terms of overall revenue collected, has generally performed as expected over the last 2 years reflecting, in its view, some improvement in overall compliance patterns. This observation is supported by the findings of HMRC’s VAT gap research activities that suggest a positive trend of improved taxpayer compliance over the last 3 years (see Table 2 of Annex 1).

### VAT legislation framework

33. Under this topic, revenue bodies were asked to identify any important legislative reforms recently introduced and/or any unusual or unique features of their VAT system that had been adopted to primarily to improve /more effectively control taxpayers’ compliance. They identified a large number of developments that may be of interest:

- Ireland reported that a significant change was introduced in September 2008 in relation to the operation of VAT in the construction industry. This change is referred to as the VAT Reverse Charge. The change applies specifically to principal contractors and sub-contractors in the construction industry. As a result of the change, principal contractors are now legally obliged to charge themselves VAT on supplies from subcontractors (i.e. instead of the previous position (which applies in relation to most other transactions) where the sub-contractor is liable to charge VAT on his/her invoices). The purpose of the amendment was to place the liability for accounting for VAT in the construction industry on a relatively small number of principal contractors as distinct from a relatively large group of sub-contractors.

Ireland also reported a number of other recently-introduced measures: 1) various penalties (for failure to register and keep proper records etc.) have been increased; 2) the VAT registration threshold has been increased; and 3) a number of burden reduction measures have also been made, including increased threshold for use of cash accounting basis and reduced filing and payment frequency for small businesses.
- UK noted that as a key part of a wider strategy designed to combat Missing Trader Intra-Community (MTIC) fraud, on 1 June 2007 the UK implemented changes to the normal VAT accounting rules for supplies of certain specified goods, namely mobile telephones and computer chips. Under this change of accounting provision, known as the reverse charge procedure, the purchaser of the goods, rather than the seller, is liable to account for the VAT on the sale. The supplier does not charge VAT, but has to specify on the invoice that the reverse charge applies. Provided that the purchaser has correctly accounted for the VAT under the reverse charge procedure, he will retain the right to input tax recovery, subject to the normal rules. Broadly, the reverse charge only applies to sales within the UK where the specified goods are purchased by a VAT registered business for business purposes. Sales to non-business customers are unaffected by the change, and normal VAT rules continue to apply.

Further information on the reverse charge and the associated reverse charge sales list procedure are contained in Revenue & Customs Brief 24/07: VAT – Proposed reverse charge accounting for businesses trading in mobile telephones and computer chips: announcement of targeted implementation and details of how the rules will operate in practice; and exposure of draft legislation for comment.

The UK also reported a revamping and updating of its penalty regime relating to inaccuracies in documents, effective 1 April 2008, and applying to the main taxes administered. A more recent act (Finance Act 2008) provides a new penalty regime for belated registration and contains new provisions relating to inspection and information powers, record-keeping requirements and debt collection powers.
- Canada reported that a legislative measure was implemented in 2007 to restrict the payment of refunds to clients until they have filed outstanding returns

required under VAT and other programs (income tax, payroll, and excise). This measure was expected to motivate clients to be more compliant with filing all required returns. The 'compliance refund hold' provision requires that the payment of all refunds and rebates be withheld until all outstanding returns under all tax programs have been filed. Also introduced was a late-filing penalty between 1-4% that is assessed depending on the lateness of the return and the removal of collection restrictions to permit the automated application of refunds/rebates to tax debts as soon as they become available rather than waiting the former 90 day period. The calculation of interest was also changed to permit an increase in interest charged: the sum of the 90 day average federal Treasury bill rate plus 4 percentage points. A 2% rate differential between interest charge and paid was also introduced.

- Australia reported recent changes to its legislative framework, including: 1) simplified accounting methods for some retailers and small enterprises with a turnover up to \$2million to reduce their costs of compliance; 2) an increase in the GST registration threshold to \$75,000 ; and 3) amendments to associate, margin scheme and grouping provisions. It also noted that a broader review of the legal framework for the administration of the GST was underway, under the auspices of the Board of Taxation.
- Austria reported the introduction of a reverse charge mechanism for specific business to business transactions, monthly reporting obligations for intra-community transactions and a specific invoice requirement for transactions with private persons.

34. A summary of the penalty framework generally applying for VAT offences in the surveyed revenue bodies is set out in Annex 5. As noted above, in a few cases steps have been taken to strengthen the penalty framework.

## **VAT administration operations**

Overall organisation of key VAT administration functions

35. Revenue bodies were asked to identify any special organisational arrangements that were in place or being proposed to facilitate VAT administration for selected functions. Information reflecting their setups is set out in Table 8. Perhaps the most important feature to highlight here is the tendency to use integrated compliance teams covering both income tax and VAT.

**Table 8. Organisation features of certain VAT functions**

<b>Country</b>	<b>Registration</b>	<b>Refunds processing</b>	<b>Audit/ assurance</b>
Australia	Regional registration teams working across taxes	Regionalised workforce dealing with all activity statement processing /1	Dedicated workforce for GST audits. Some work (e.g. cash economy) cuts across taxes
Austria	Integrated VAT & income tax teams at regional/ district level	Integrated VAT & income tax teams at regional/ district level	Integrated VAT & income tax teams at regional/ district level
Canada	Regional registration teams working across taxes	Dedicated prepayment teams at regional level	Integrated VAT & income tax teams at regional/ district level
Ireland	Dedicated regional teams working across taxes	Dedicated prepayment teams at regional level	Integrated VAT & income tax teams at regional/ district level
UK	Two dedicated VAT registration teams	VAT Central Unit	Two separate arms: 1) Large Business Service; and 2) dedicated VAT teams for other taxpayers /2

/1. An activity statement is an integrated 'across taxes' return filed periodically by business in respect of all of the taxes they are responsible for.

/2. HMRC reported that it is moving towards joined up/ cross tax discipline teams with the intention of doing some integrated verification work.

## Registration

36. The Forum's 2004 report on VAT compliance emphasised the importance of revenue bodies having sound VAT taxpayer registration procedures, noting that registration is the first point in time a revenue body has an opportunity to make an initial risk assessment of the registrant. Furthermore, it noted that fraudulent registrations very often are an integral element of contrived schemes to defraud the VAT system (e.g. carousel and refund frauds).

37. Revenue bodies' survey responses revealed examples of different and innovative approaches for ensuring the integrity of the registration process that may be of interest in countries where the registration process is subject to high levels of abuse. The key points are as follows:

- All revenue bodies generally employ a range of “proof of identity” checks as part of their normal registration procedure. Canada, Ireland and UK implement these with actions to identify whether the applicant has previous history with them and, assess their if so, to assess their previous compliance (Refer to highlighted text for example). A detailed summary of comments extracted from survey responses is set out in Annex 4.

“The tools (systems, data components) that are used by High-Risk Analysis Teams are constantly being refined. CRA is also in the process of implementing a cross-program compliance profile that will assist in the integrity of VAT registration and in the identification of compliance risks by providing a history of compliance actions and risk assessments of clients and their associated entities.”

- The UK described a formal structured three stage registration process where applications are screened and, subject to meeting objective risk criteria, may be referred to 1) special risk referral teams; and 2) specialist intelligence teams. It reported that around 5% of applications get referred to 1) and 1% to 2). It also noted that in situations where there is insufficient evidence to refuse an application but there are still concerns about a trader, it can impose conditions on the registration such as requiring a financial guarantee or shortening the first VAT filing/ payment period to enable it to make an early assessment of the taxpayer’s compliance.
- A number of revenue bodies also reported that they administer a systematic program for contacting all/some new registrants shortly after registration. Austria reported that it aims to visit all new registrants shortly after business commencement. The UK reported that it aims to contact all registrants, either by letter or phone, to offer advice and support. In 2007/08 some 250,000 businesses were contacted by letters which enclosed brochures and help sheets. In 2008/09, this contact has been refined, whereby help sheets focussed specifically on certain trader groups have been sent, with invitations to businesses to attend presentations and workshops. Ireland reported that a “new business” contact letter is sent to new registrants where they have not filed an expected return. There is a further “new business” contact letter sent following repeated non-compliance. Thereafter, the matter is referred to a caseworker to establish if the business is trading and, if so, to inform the taxpayer of their obligations.
- Australia, Canada and Ireland all reported the use of systematic programs to detect potential VAT registrants using 1) income tax-related information on their internal databases; 2) information from third parties (e.g. corporation regulatory bodies); and 3) sectoral projects. In the case of Canada, a relatively recent initiative is the establishment of an enhanced registration process involving the use of specialist teams that is described in Box 5 (and was also referenced in the Forum’s work on innovative risk treatments published in April 2009).



### **Box 5. Canada: GST Enhanced Registration Review (GERR)**

**Background:** Fighting GST/HST fraud is one of the Agency's top priorities. The GERR program recognises the need to assess the probability that a legitimate business entity exists, and to stop the issuance of overstated or fraudulent GST/HST refunds.

Verifying the existence and contact particulars of new registrants at the time of registration is an effective tool in the fight against GST/HST refund fraud. The accuracy of account information is paramount for client contact and compliance actions. The GERR program was developed as a proactive approach to aid in reducing cases of fraudulent registrations by verifying the existence and contact particulars of all new GST/HST registrants, and then matching them against client profiles deemed to pose a risk to Crown Revenue through fraudulent refund claims. High-risk registrations are forwarded to Compliance Programs Branch for a more in depth review.

**Description of initiative and objectives:** The GERR program is integrated into the Business Number (registration) system. All new GST/HST registrants are transferred by the Business Number system to one of two GERR review teams. The GERR teams in Winnipeg, Manitoba and ST. John's Newfoundland and Labrador are responsible for this review. The objective is to streamline the risk screening of newly registered GST/HST registrants thereby reducing the screening process for Compliance Programs branch. This allows the reallocation of resources formerly used to perform this activity to other compliance actions.

**Registration validation strategy:** The validation strategy has 4 elements:

- Element 1: Verifying the integrity of Business Number tombstone information provided by the GST/HST registrants at time of registration such as the business name, addresses (physical and mailing), business activity, and contact information. Verifying spelling of names and addresses.
- Element 2: Capturing missing information from new GST/HST registrants through client contact & other Agency tools, respecting the Privacy Act & client confidentiality in order to improve database integrity and to educate clients about the information they are required to provide when registering a GST/HST account.
- Element 3: Identifying GST/HST registrants that meet the risk selection criteria and refer the accounts to Compliance

Programs Branch for further review.

- Element 4: Aid in identifying new trends in potential risk criteria.

For the 2006/2007 fiscal year the GERR program reviewed 236,484 recently registered GST/HST accounts for data integrity and referred 35,010 to Compliance Programs Branch for an in-depth review for potential fraud.

**Impacts of strategy:** The CRA has identified the following positive impacts:

- Capturing missing information from new GST/HST registrants through client contact and other Agency tools has improved the business number system data integrity for compliance purposes.
- Having accurate information in the business number system gives clients confidence when obtaining Business Numbers or program accounts.
- Identifying client accounts that meet the risk selection criteria and referring the accounts to Compliance Programs Branch has enabled them to reallocate resources away from screening towards more intense compliance workloads.
- Providing the early identification and referral of issues such as duplicate business numbers and individual non-filers to the attention of the appropriate sections.
- Earlier detection of fraud issues by Compliance Programs Branch.

Source: 'Managing and Improving Compliance Recent Developments in Compliance Risk Treatments', Forum on Tax Administration (April 2009)

38. While not included in the survey, the Singapore's revenue body (IRAS) is known to have introduced what appears to be a highly valuable strategy that is described in detail in the Forum's work on innovative risk treatments published in April 2009. The key elements of this strategy are as follows:

- **Program for newly registered GST traders:** This program has four elements: 1) GST Assistance Scheme - accounting software grants; 2) collaboration with accounting software providers; 3) compulsory GST education for voluntary registrants (annual turnover < S\$1m); and 4) risk assessment of all new trade.

Under the GST Assistance scheme, each voluntary registrant can get a grant of up to S\$5,000 to pay for accounting software and related costs (e.g. software

training). IRAS regards relying on accounting software for GST tracking and reporting as far more reliable than manual methods and it has an on-going arrangement where three well-established software vendors<sup>7</sup> present at its GST classes to showcase their accounting software. This is seen as a win-win arrangement as it provides the vendors with opportunities to access the new registrant market and helps IRAS heighten traders' awareness on the benefits of using such accounting software in the course of their businesses.

At the point of registration, all new applicants for GST registration are required to complete a questionnaire attached to the application form that helps IRAS assess their inherent risks. A high or low inherent risk rating is assigned to each trader, thereby providing the basis for formulating appropriate compliance responses.

- **Program for existing GST traders:** This program has two basic elements: 1) different reviews and audit treatment based on risk profiles; and 2) compulsory GST education for taxpayers with errors in GST returns. Compulsory education is targeted at all GST registered traders who have made mistakes in their GST returns and have been compounded for the mistakes. IRAS highlights the mistakes to the management of the business and requires them to attend a compulsory GST class within the next 6 months. Such classes are aimed at re-training these traders and equipping them with sufficient GST knowledge to ensure that GST returns are correctly filed and mistakes are not repeated.

39. Finally, it is perhaps worth highlighting that four of the five surveyed countries—Canada being the exception—have adjusted upwards the value of their respective VAT registration threshold over the last five years. While this has, no doubt, been done as part of an administrative burden reduction policy response it also has the additional benefit of reducing the workload of revenue bodies and reducing the numbers of low-value registrants that must otherwise be registered and monitored. The relatively low value of Canada's GST registration threshold, compared to other surveyed countries, largely explains its abnormally high number of registrants, having regard to size of economy factors—see relevant data in Table 1.

Refund controls (incl. risk profiling)

40. The Forum's 2004 report noted that in any VAT invoice-based credit system there will always be genuine refund claims made by business. This is particularly so where the business makes supplies at a reduced or zero rate of tax, whilst incurring deductible input tax on stock and assets. Exporters are perhaps the best examples of businesses that can legitimately claim refunds as their input tax will invariably exceed output tax. Against this background, it noted that abuse of this mechanism has always been present in VAT but it is only in recent years that many countries across the OECD have been subjected to sustained attacks through false claims for refund. This has led a number of countries to put in place

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<sup>7</sup> APAC, MYOB & Quickbooks.

stricter screening of refund claims, although this often has to be balanced with a requirement to effect refunds within a number of days from receipt of a VAT return. Payments delayed beyond these time limits generally attract interest on the amount of the refund claimed. An additional issue in this area for some countries is the sheer number of refund claims to be examined, making it a quite complicated task at times to isolate potentially abusive from legitimate claims.

41. The survey sought to understand the nature of the processes in place for detecting and dealing with those refund claims perceived to be ‘at risk’. However, it is helpful to first understand the circumstances (e.g. volume and overall incidence of claims, number of claims examined) under which each of the participating revenue bodies operates that affect the way in which these arrangements may be designed and how they are conducted.
42. Information provided concerning VAT refund claims is set out in Table 9. Generally speaking, there was insufficient data from across all countries to make any meaningful comparisons, a concern in its own right given the criticality of the VAT refund process.

**Table 9 VAT refund data (by fiscal years)**  
(All monetary amounts in local currency)

Country	Refund claims received (millions)		Refund claims examined (millions)		Value claims examined (\$bn)		of Refund claims adjusted	
	2007	2008	2007	2008	2007	2008	2007	2008
Australia	2.16	2.21	0.079	0.083	13.5	11.4	7,452	8,371
Canada	2.68	n.avail	1.053	n.avail	n.avail.	/1	n.avail.	
Ireland	0.284	0.275	0.054	0.052	3.7	3.3		

/1. Australia- Value of adjustments was \$498 million in 2007; Canada- value of adjustments was \$2.0 billion.  
/2. Ireland- the proportion of claims verified was 19%, while the relative value of claims examined was 80%.

43. Against this background, the key observations from the survey data are as follows:
- Australia, Canada, Ireland and UK all administer a computer-based risk profiling system, incorporating a broad range of risk criteria—see Table 10—to identify potentially ‘at risk’ refund claims that are examined on an exception basis. Austria reported a limitation in its risk profiling capability in relation to businesses with a turnover under €100,000. There was a lack of data within

survey responses to identify the relative success of these risk rating processes to determine their effectiveness in identifying productive cases.

**Table 10 Nature of risk scoring criteria used in risk profiling systems**

Nature of criteria	Australia	Austria	Canada	Ireland	UK
Size of refund	✓	✓	✓	✓	✓
Previous compliance history	✓	✓	✓	✓	✓
Business size	✓	✓	✓	✓	x
Refund history/ pattern	✓	x	✓	✓	✓
Length of time registered	✓	✓	✓	x	✓
Nature of business	✓	✓	✓	✓	✓
Existence of other tax debts	✓	✓	✓	✓	x
Status indicator- no/low risk	✓	✓	✓	✓	✓
Other useful criteria	✓/1		✓/1		

/1. The ATO also reported the presence of 'fraud' characteristics as a scoring criterion while the CRA noted that.... 'depending on the industry, regional discrepancies are also used to assess potentially 'at risk' cases'.

- These risk profiling systems vary in their scope and sophistication but the information in Box 6 describing the UK approach may be helpful to readers.

**Box 6: UK HMRC: Risk Profiling Development & Management Approach**

HMRC only has an automated system for the risk based profiling of all VAT repayment returns upon receipt. It takes the view that the risk from an inaccurate VAT return forms only part of the risk for that taxpayer and believes that the best way to profile the risk of the taxpayer is to consider all of the information it has about the taxpayer, rather than just the VAT return data. As such, it profiles the risk of the taxpayer by looking at the overall risk based on information provided at registration, information from previous audits/interventions, other information held on central systems as well as information from VAT returns to profile the taxpayers.

The process is known as Central Risk Analysis and is effectively a form of risk assessing taxpayers similar to the way that financial institutions assess the credit worthiness of applicants for loans, mortgages, etc. The process is carried out by specialist Analysts in KAI. On an annual basis, they will build a model by looking at the results from HMRC's compliance activity and use specialist software to identify which factors or variables (from all of the data listed in the paragraph above) feature most frequently in the instances where HMRC is: a) most likely to get some yield; and b) most likely to get significant yield. Once these factors are identified, they are given a score and applied to the entire VAT population. Based on the score applied, each taxpayer is allocated to an appropriate Risk Group (i.e. high, medium, or low). This information is made available to Compliance staff and informs the prioritisation of their activity. The taxpayers are regularly re-scored based on latest VAT return information. During the annual re-build, analysts spend considerable time researching the value of adding new data items, e.g. by considering data from other taxes or new derivations of existing data.

- Concerning its approach, Australia reported the operation of special governance arrangements for its automated risk based system known as the Risk Rating Engine (RRE) ..... “The RRE is managed by a team of GST Refund Integrity Risk & Strategy business analysts under the leadership of the RRE Business Rules Owner and Refund Integrity Risk Owner. A Credit Refund Integrity Steering Committee consisting of high level ATO executives has formal responsibility providing governance and leadership for the management of credit and refund risk and the associated integrity controls for all refunds across the Tax Office. Systems build/updates to the RRE are undertaken by a GST Projects & Systems area.”
- Generally speaking, surveyed revenue bodies reported that their risk profiling systems use computer-based credibility/ validity checks to assess refund claims against a set of variable parameters. Claims which fail the tests are referred for

further examination, either on a pre- or post-payment basis. The UK reported the operation of a central VAT Credibility Operations Unit to examine prepayment queries. Where these cannot be resolved, they are referred to a local office for examination. On the other hand, Ireland reported that it used a more decentralised setup (as does Australia) where all claims that fail the checking tests (i.e. a maximum individual repayment amount, an annual net repayment amount or a special status indicator such as ‘cancelled registration or liquidation/receivership’) are referred electronically to a case worker in a local revenue district office for verification. Austria reported that all refund claims over €7,500 are examined manually.

- Where claims are to be checked on a pre-payment basis, the time limits in place in all surveyed bodies impose a degree of urgency to the process. Australia, Austria, Ireland and the UK identified a range of information sources that are accessed to help verify the validity of the claim, including: 1) checks of internal systems for notes or justification of the claim following previous inquiries or in light of taxpayers’ compliance audit history; 2) examining the claim in light of the taxpayers’ business parameters; 3) requesting by phone copies of information from taxpayers; and 4) inspections of records on taxpayers’ premises—given time constraints these are in-frequent for pre-payment situations.

## **Audits/verification**

44. The 2004 report commented on the relevance of the audit function to achieving improvements in taxpayers’ compliance. Among other things, it noted indications of wide disparity in the extent of resources devoted across member countries to audit activities. Related to this, it emphasised that for any revenue body wishing to expand its resource base an open approach to measuring aggregate losses, combined with a comprehensive strategy for addressing all major forms of losses and giving rise to meaningful targets, might be a more successful mechanism for convincing Governments of its resource proposals.

45. The survey sought a limited amount of quantitative and qualitative information on audit/verification operations to shed light on any actual or envisaged developments that may be of interest to members. The key points are as follows:

- As evident from the information in Table 8, most revenue bodies have implemented, or are planning for, the use of **integrated audit/verification teams** that work across taxes (taking a ‘whole of taxpayer’ perspective), potentially improving the visibility and effectiveness of their overall verification activities. Based on the survey responses, a drawback to this approach seems to be an inability, which appears avoidable, to provide disaggregated information on VAT audit outputs.

- None of the survey revenue bodies uses or commits to some form of coverage/visibility objective for the VAT and, for the most part, are largely risk driven. However, both Canada and Ireland reported that their verification activities include a formalised random element to test compliance levels.

Canada noted that its Core Audit program (CAP) is designed to test overall compliance with VAT laws using statistical sampling methodologies. Detailed information concerning non-compliance is captured and analyzed for use in estimating compliance rates within the populations sampled and in gaining valuable insight into non-compliance. This information also enables comparison to compliance rates among segments of the population and track compliance trends over time. The information derived from this program permits validation and refinement of risk assessment models and to measure the success of audit strategies. Audit selection for VAT registrants focuses on businesses with annual sales <\$20M, with further population stratification using other variables such as the North American Industry Classification Structure. All CAP Audits are commenced as full scope. The audit approach taken will depend on the internal control system and the quality of the books and records. Further indirect or investigative approaches may also be taken.

In Ireland's case, the random program element consists of a national sample of around 400 taxpayers, encompasses all the major taxes and is executed by the same regional teams carrying out normal audits.

The UK reported that it was considering a plan to implement a random program to produce compliance-related information to supplement its top-down VAT gap measure. If the program goes ahead, the sample would be of the order of 1,000-2,000 taxpayers. However, it will not be large enough to produce annual results for most sectors.

- Data on completed audits (and other verification checks) are set out in Tables 11 and 12. Unfortunately, the data for Austria and Ireland include income tax-related checks and, therefore, are not comparable with the other countries' information. There are some other observations concerning the other countries:
  - Canada's lower rate of GST (i.e. 7 (to 2006), 6 (2007) and 5 (2008) clearly impacts on the aggregate value of audit adjustments made in practice in comparison with both Australia and UK.
  - The audit staff resource data for Australia, Canada and Ireland indicate that relative to their aggregate size, significant revenue body resources are being devoted to VAT compliance programs.
  - Australia, Ireland and the UK reported a substantially greater number of interventions (suggesting a larger array of different compliance interventions) than Canada which needs to be explored more deeply (NB: The results of this inquiry will be reflected in the final report.)



- The verification-related data available for Australia and UK reflect administrative efforts to achieve a high degree of visibility/ presence among the registered VAT population, with between 15-20% of taxpayers, on average, being touched by the various forms of interventions carried out in both 2007 and 2008; consistent with this, the value of adjustments made to reported liabilities appears relatively significant at between 4 to 5 percent of annual net revenue collections.

**Table 11 Audit/verification related information (latest two fiscal years)**  
(All monetary amounts in local currency)

Country	Audits and other checks (no.)		Adjustments (no.)		Value of adjustments (millions)		Staff resources (FTEs)	
	2007	2008	2007	2008	2007	2008	2007	2008
Australia	230,355 /1	392,847 /1	n.avail.		1,43 6	1,70 4	2,42 3	2,13 9
Austria/2	75,337 (16,486)	75,347- (15,175)	n.avail.		2,10 7 (292)	2,06 9 (252)	n.avail	
Canada/ 3	63,306	66,626	40,456	37,47 1	763	614	2,16 7	2,14 9
Ireland/4	14,308 & 237, 626 assurance e checks	13,414 & 345,452 assurance e checks	60% approx .	n.avail .	688	570	2,106 (staff work across taxes)	/5
UK	373,748	397,785	73,967	67,65 6	3,57 8	3,54 1	n.avail	

/1. Data includes assurance checks.

/2. Most of the data for this tabulation were sourced from the official publication Annual Report 2007. Audit data relate to all taxes, while bracketed numbers represent special VAT audits.

/3. Number of audits includes prepayment audits of credit returns which account for approximately 2/3 of total; the numbers and values relate strictly to VAT, no income tax results are included.

/4. Data relates to all taxes as no tax-head specific information is available.

/5. Data obtained from Forum's Comparative Information Series (2008).

**Table 12 Audit/verification data—Australia & United Kingdom (by fiscal years)**  
(all monetary amounts in local currency)

Indicators	Australia		United Kingdom	
	2007	2008	2007	2008
Registrants (millions)	2.589	2.599	1.868	1.929
Net VAT revenue (billions)	38.1	42.4	73.2	77.2
Assurance/ verification checks (no.)	230,35	392,84	373,74	397,78
Value of adjustments (billions)	5	7	8	5
Checking coverage (%)	1,436	1,704	3,578	3,541
Value adjustments/ net VAT revenue (%)	8.9	15.1	20	20.6
	3.8	4.0	4.9	4.6

#### Unpaid VAT debts

46. The survey also sought limited information on the level of unpaid VAT, another area of non-compliance. Three of the surveyed countries were able to provide information, as set out in Table 13.

**Table 13 Unpaid VAT (by fiscal years)**  
(All monetary amounts in local currency)

Countries	2007		2008	
	Unpaid VAT at year end (millions)	% of annual net VAT revenue	Unpaid VAT at year end (millions)	% of annual net VAT revenue
Australia	2,543	6.4	2,661	6.1
Canada	5,320	-	5,876	-
Ireland	242	1.8	196	1.4

#### Other administrative developments and initiatives

47. As part of the survey, revenue bodies were asked to identify important administrative reforms implemented over the last 2-3 years or which were being considered/ developed for implementation to enhance the management of taxpayers' compliance. Survey responses revealed a rich array of measures implemented and proposed that may be of interest to members. These are set out in Table 14.

**Table 14: Recent and expected future developments**

<b>Country</b>	<b>Measures implemented</b>	<b>Measures under development</b>	<b>under</b>
Australia	Annual publication of ATO Compliance Program that articulates key compliance risks by market segment System of Taxpayer Alerts to publicise emerging schemes etc under review GST annual compliance agreements New GST operating model in July 2006	A review of the overall legal framework for GST administration is underway	
Austria	Revision of VAT returns to provide more information for risk assessment	Unannounced audits	
Canada	Newly-dedicated resources to high risk analysis teams	Initiative to increase regional engagement in compliance strategy development	
Ireland	Development of risk analysis system (REAP), with focus of “whole of client” risk assessment and treatment	Phased introduction of mandatory e-filing & e-payments will release resources for compliance	
UK	Introduction of campaign/project intervention strategies (see text) New integrated approach to tackling fraud and evasion (see text) Implementation of recommendations from review of how HMRC works with its largest taxpayers (see text)	Ongoing refinement of overall risk management approaches Consultation on options for new late filing and payment penalties and interest on late payments Treasury tax simplification reviews for VAT include: 1) partial exemption and capital goods scheme; 2) VAT return frequency; 3) VAT retail scheme; and 4) EU-wide complexities.	

48. As noted in Table 8, Australia reported the development and introduction of a new GST operating (i.e. organisational) model from 2006. A review to assess the operations of the GST business line, five years after implementation, was undertaken in early 2006. The review contained a range of challenges and recommendations. One of the recommendations was the introduction of a new operating model.

49. This model was adopted on 1 July 2006 and was intended to: 1) improve the business line's corporate alignment; 2) provide a national approach to strategy development and risk prioritisation to ensure alignment of resources to areas of highest risk; 3) implement a delivery mechanism that allowed for clear and direct accountability for productivity improvements. The operating model implemented consists of:

- Risk and Strategy Stream (includes Interpretative Advice and Assistance);
- Active Compliance Stream (includes LAC & SME/Micro);
- Cash Economy Stream;
- People, Planning and Performance Stream; and
- Government Relations Stream.

50. One of the key drivers behind the new GST operating model was to ensure alignment of resources to areas of highest risk. This led to the implementation of risk and strategy segments responsible for the management of compliance risk and escalation processes across GST. While this organisational approach differs from the more 'integrated/ across taxes' approach seen in other surveyed bodies the ATO reported that 'integration/ co-ordination' is achieved through the adoption of co-operative approaches to compliance work. The case study described in Annex 3 concerning the treatment of risks posed by cash economy participants is one such example of this co-operative approach to addressing significant compliance risks.

#### **IV. Key Observations, Findings and Recommendations Arising from the Survey of Selected Countries**

51. Although confined to a relatively few member countries, the survey has revealed a useful array of developments that build on the Forum's earlier work on VAT abuses and compliance risk management in general.

##### **Key observations and findings**

52. The key observations and conclusions are as follows:

- Compared to the situation observed in 2004, there are clear indications of a maturing in the strategic approach to compliance risk management (e.g. increased attention to the development and use of top-down measures covering the major risk types, significantly increased use of better IT tools to detect compliance risks and assess their potential magnitude, more systemic risk treatment approaches).
- Survey responses indicated an improved or consistent pattern of VAT compliance for the countries concerned:

- In the case of the UK, compliance trend and other data support a conclusion of substantially improved compliance over patterns of serious non-compliance observed in the early 2000's, of the order of around a 20 percent reduction in the estimated tax gap, and lend support to the value of its 'strategic approach' described in the Forum's previous reports;
  - In the case of Canada, indications of improved compliance were evident from its range of strategic outcome measures; and
  - For other surveyed countries, responses indicated that their VAT systems had generally performed in line with revenue projections and/or other indicators, suggesting a broadly consistent pattern of compliance.
- Notwithstanding the observations of improved or consistent compliance and the measures implemented all revenue bodies continue to rank their VAT as a "high risk" area for their administration.
  - The use of random audits for risk profiling and overall compliance monitoring purposes figures in the compliance management approach of three of the five surveyed revenue bodies.
  - Revenue bodies are increasingly moving to detect and treat risks on a 'whole of client' basis, as opposed to a 'tax by tax' approach. Among other things, this is evident in the way IT systems are being designed and the way in which work processes (e.g. audit/ verification) are being conducted.
  - Given a number of 'hard to treat' compliance risk issues, there has been a fair resort to legislative responses over recent years; numerous efforts to simplify the laws thereby making it easier to comply and easing the burden on taxpayers were also noticeable.
  - Revenue bodies have evolved more systematic and specialised risk-based processes for validating the integrity of VAT registrations; three of the five surveyed bodies reported they have a systematic process using internal and/ or external data sources to identify businesses that that should but are not registered for the VAT.
  - Considerable attention is being given to strengthening case-based risk profiling systems but these require close monitoring and fairly regular updating to take account of changing patterns of compliance behaviours.
  - Deficiencies in the performance management information systems of a number of revenue bodies were apparent—there was a dearth of information concerning VAT refund claims and their processing, information on 'VAT specific' verification checks and their results and the value unpaid VAT debt could not be reported in two countries.

- This survey deliberately did not address the issue of VAT fraud arising with intra-community transactions within the EU, which is being addressed by the EC's own short term action plan (as described briefly in Box 4). However, it seems reasonable to conclude that a prerequisite to realisation of that plan by member countries, especially in a time of tough economic and financial conditions, is an effective system of compliance risk management drawing on the approaches and experiences of surveyed and countries, as reflected in this note.

## **Recommendations**

- Revenue bodies, especially in those countries where there are indications of serious non-compliance, are encouraged to examine closely the findings of this study in order to identify opportunities to strengthen their administration of VAT compliance (and other taxes).
- Revenue bodies are encouraged to put in place, if not already the practice, a comprehensive set of performance/output and outcome measures to enable them to monitor key risk areas (e.g. VAT refund claims processing and VAT verification activities) and to gauge the impacts of their targeted risk treatments.

## Annex 1

### HMRC's VAT Tax Gap Methodology

#### Estimating VAT Losses<sup>1</sup>

This estimate of losses from the VAT system excludes losses through illicit activity in spirits and tobacco goods, as these are covered by the HMRC's published excise duty gaps.)

#### Methodology

- 1) The methodology for calculating the VAT gap was first published in November 2002<sup>8</sup>.

#### Principle

- 2) The total level of VAT losses can be estimated using a top-down approach by comparing the net theoretical tax liabilities with actual VAT receipts. The difference between these amounts is known as the VAT gap.

$$\text{VAT gap} = \text{Net Theoretical Tax Liabilities} - \text{Actual VAT Receipts}$$

- 3) The approach employs a gap analysis (as at 2.1 above), which involves:
  - assessing the total amount of expenditure in the economy that is theoretically liable for VAT;
  - estimating the tax liability on that expenditure based on commodity breakdowns of the expenditure data;
  - estimating the value of tax on the VAT-able expenditure, to derive the gross VTTL;
  - subtracting any legitimate refunds (deductions), occurring through schemes and reliefs, to arrive at the net VTTL;
  - subtracting actual VAT receipts from the net VTTL; and
  - assuming that the residual element, the gap, is the total VAT loss due to any cause.

#### General Calculation Methodology

- 4) VTTL is the theoretical amount of VAT that would be collected in the absence of any losses. It is calculated by multiplying appropriate categories of expenditure liable to VAT in the economy by their VAT rate and allowing for other relevant rules determining tax liability.

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<sup>8</sup> 'Measuring Indirect Tax Losses' HM Customs and Excise, November 2002.

- 5) The expenditure series used in the calculation are mainly constituents of National Accounts macroeconomic aggregates. All National Accounts data used to construct VTTL estimates are consistent with the latest Office for National Statistics (ONS) Blue Book.
- 6) A number of streams of expenditure contribute to the tax base, with most VAT deriving from consumers' expenditure. The main expenditure categories that comprehensively cover VAT liabilities are:
  - household spending and non-profit institutions serving households' final consumption expenditure;
  - central government current and capital expenditure;
  - exempt sector intermediate consumption and other input tax blocks; and
  - housing expenditures - certain household and corporate capital expenditure which incurs non-refundable VAT.

### **Input Tax Adjustments**

- 7) Net VAT liability is the difference between VAT due on taxable supplies made by registrable traders ('output tax'), and that recoverable by traders on supplies made to them ('input tax').
- 8) VAT liability for the relevant categories can be estimated directly from National Accounts data, with one exception - the exempt sector. Businesses making outputs that are exempt from VAT are generally not permitted to reclaim the VAT on inputs associated with their exempt outputs. In order to make an adjustment for this irrecoverable input tax, a separate HMRC survey is used to ascertain the proportion of purchases on which VAT cannot be reclaimed.
- 9) A further adjustment is made for expenditure by businesses legitimately not registered for VAT and, as such, the VAT is not recoverable as input tax. This adjustment uses a combination of ONS data and HMRC information on the distribution of business turnover below the VAT threshold to estimate relevant expenditure.
- 10) Finally, third party data sources are used in conjunction with National Accounts data to inform estimates of business expenditure on cars and entertainment, on which VAT is due.
- 11) Because the calculation of non-recoverable input tax is complex, the level of uncertainty around input tax adjustments is larger than for the other elements.

### **Deductions**

- 12) The sum of the VAT liability arising from each of the expenditure categories listed in paragraph 6 gives an estimate of the gross VTTL in each year. However there are a



number of legitimate reasons why part of this theoretical VAT is not actually collected. These can be grouped into two broad categories:

- VAT refunds; and
- Expenditure at traders legitimately not registered for VAT.

13) VAT refunds are made primarily to government departments, NHS Trusts and regional health authorities for specified contracted out services acquired for non-business purposes. A number of other categories of expenditure cannot be separately identified in the overall VTTL calculation, for which VAT can be refunded. The value of these refunds is taken directly from audited HMRC accounts data.

14) Traders who trade below the VAT threshold can legitimately exclude VAT on their sales. Expenditure on the output of these businesses will have been picked up in the theoretical liability. To adjust for this an estimate of relevant expenditure is made using a combination of ONS data and HMRC information on the distribution of business turnover below the VAT threshold.

### **Methodology Changes**

15) The detailed calculations used to construct the estimated VTTL are continuously reviewed to identify improvements to the methodology.

16) The proportion of household expenditure on ex-business cars in second-hand car sales is now taken directly from data used to estimate the amount of input tax blocked on expenditure on cars by businesses, which is derived from ONS National Accounts data. This replaces an adjustment previously taken from the Own Resources Account, prepared by HMRC for the European Commission. This change ensures consistency in the data being used throughout the VTTL calculations.

17) The VTTL is now adjusted to reflect refunds of VAT made to the Isle of Man, under their agreement with the UK authorities to simplify tax collection procedures for businesses.

### **Summary of VTTL**

18) Estimates of the contribution to the VTTL of each relevant expenditure component are given in Table 1. Note that the household element excludes expenditure on purchases of illicit alcohol and tobacco. The revenue losses associated with such purchases are considered in the excise illicit market share estimates and to measure them here would constitute double counting.

**Table 1: Expenditure components of VTTL (£bn)**

<b>Category</b>	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>	<b>2005-06</b>	<b>2006-07</b>	<b>2007-08</b>
Household	56.6	59.4	62.4	64.5	66.9	69.9
Exempt	12.7	12.7	12.8	13.8	14.5	15.4
Government	7.8	8.5	9.2	10.1	10.9	11.4
Housing	3.6	3.8	4.0	4.1	4.3	4.7
Gross VTTL	80.7	84.3	88.4	92.5	96.6	101.4
Deductions	5.5	6.0	6.5	7.1	7.6	8.8
Net VTTL	75.2	78.3	81.9	85.4	89.0	92.6

<sup>1</sup> Household component also includes estimates of expenditure by non-profit institutions serving households; estimates exclude expenditure on smuggled alcohol and tobacco.

### Measure of Tax Collected

19) Figures for actual receipts of VAT are taken from HMRC's published Consolidated Fund figures. The receipts are adjusted, to reflect timing effects within each financial year, before being used in the model.

### Results

20) Table 2 shows the VTTL, net VAT receipts and estimated revenue losses for the years 2002-03 to 2006-07. Due to substantial revisions to National Accounts data, which underlies the VTTL, these figures are different in level to those published at PBR 2006.

**Table 2: VTTL, VAT receipts and revenue losses**

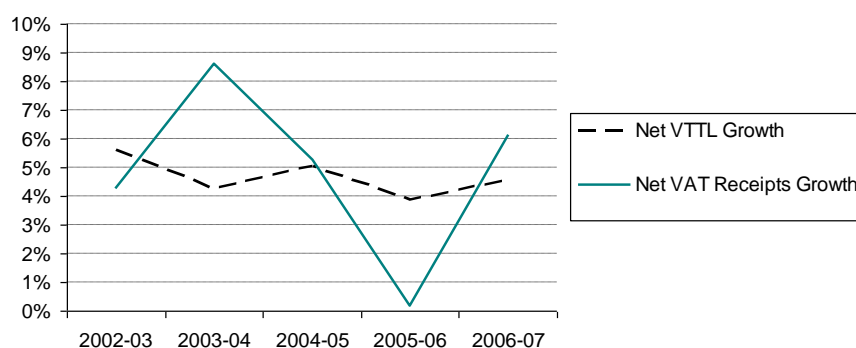
<b>Measure</b>	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>	<b>2005-06</b>	<b>2006-07</b>	<b>2007-08</b>
Net VTTL (£bn)	75.2	78.3	81.9	85.4	89.0	92.6
Net VAT receipts (£bn) /1	63.6	69.1	72.7	72.9	77.3	81.0
Revenue loss (£bn)	11.5	9.2	9.2	12.6	11.7	11.6
<b>VAT gap</b> %	15.4	11.7	11.2	14.7	13.2	12.5

/1. Net VAT receipts are expressed net of payments and re-payments.

/2. A proportion of the VTTL estimate for the final year is based on a forecast.

- 21) The results show a fall in the percentage VAT gap between 2002-03 and 2004-05, but then a rise in 2005-06 with a subsequent fall in 2006-07. Overall the level of the VAT gap is lower in 2006-07 than 2002-03.
- 22) The movement in the VAT gap from one year to the next is determined by the growth in VTTL and the growth in receipts. Growth in VTTL is determined mainly by growth in the total value of transactions liable to VAT and, to a lesser extent, any changes that are made to the tax regime. Figure 1 shows that in 2006-07 receipts grew at a higher rate compared with net VTTL growth and so the VAT gap estimate shows a decrease.

**Figure 1: Percentage growth rates of net VTTL and net VAT receipts**



### Error margins

- 23) The VTTL model and the top-down VAT Gap derived from it are broad measures, subject to a degree of uncertainty. They are based on an analysis of survey and other data, and include a number of assumptions and adjustments which add both random and systematic variation to the estimates. For the final two years' estimates, there is also an element of forecasting in some of the spending data, which introduces further random variation.
- 24) It is not possible to produce a precise confidence interval for the VAT revenue loss estimates. The VTTL estimate is constructed largely from ONS National Accounts data which are derived, in the main, from sample surveys and are thus subject to both sampling and non-sampling errors. The ONS does not publish error margins for the relevant input series and so it is not possible to construct a precise estimate of the impact of these errors on the VTTL. However, a broad analysis of potential errors has shown that the margin of error could be up to  $\pm 4$  percentage points.
- 25) It is important to note that this error margin relates to the point estimates of the VAT gap. Part of the error is likely to result from systematic errors in the source data, which do not contribute to error bounds for year-on-year changes in the VAT gap. Therefore it is likely that the error margins on the year-on-year changes observed in the VAT gap will be smaller than  $\pm 4$  percentage points.

## **Annex 2**

### **Australia. GST Annual Compliance Arrangements (ACA)**

#### **GST ACA Program overview**

The primary purpose of a GST Annual Compliance Arrangement (GST ACA) is to improve the compliance relationship between the Australian Taxation Office (Tax Office) and a large corporate through a collaborative forward looking approach.

Traditional audit or verification methods examine historical tax information on a typically substantive basis. The GST ACA operates to move the compliance relationship to a more current and real time approach applying a broader concept of compliance assurance rather than only examining specific areas for compliance. The focus is on improving the relationship between the Tax Office and a large business to facilitate transparency and open dialogue between the parties. The parties agree to operate in an environment of open and full disclosure in relation to matters that are considered to materially impact tax compliance. The parties then seek to mitigate risks or resolve issues in real time.

The GST ACA relationship provides benefits that include:

- increased certainty through a real time compliance relationship delivering timely clarification, understanding and resolution of risks and issues;
- a more timely and participative approach to seeking taxation advice and rulings to clarify and resolve issues; including access to senior staff and decision makers;
- a move away from high resource, long term Tax Office compliance activities;
- improved communication pathways established to raise material tax risks and issues through senior contact and escalation points;
- establishing and maintaining Tax Office assurance of compliant tax outcomes providing access to concessionary approaches including agreed behavioural assessment for administrative penalties in the event of tax shortfalls and a reduced rate of General Interest Charge (provided there is no evidence of recklessness or fraud); and
- Opportunity to explore administrative solutions to compliance difficulties including increased thresholds to amend errors and mistake in previous returns in a current tax period.

## GST ACA Entry Processes

Generally a GST ACA relationship is established and maintained in accordance with two foundation principles:

- the relationship is predicated on the taxpayer having a good **'culture of compliance'** focused on effectively optimising voluntary compliance at the corporate level that cascades effectively to tax compliance, and
- That the Tax Office can obtain **'reasonable assurance'** of the demonstrable existence and application of the good 'culture of compliance' through a review of appropriate frameworks, processes, evidence and information.

The ATO defines 'reasonable assurance' as an opinion, expressed in relation to the taxpayer's operating environment, systems, frameworks and approaches that establish the culture of compliance, based on the accumulation of sufficient appropriate evidence that corporate governance, risk management, information systems and compliance frameworks are designed and operate to achieve optimal voluntary compliance at the whole of entity level and specifically in relation to taxation risk management and the development of taxation outcomes and returns.

Evidence of a good corporate culture of compliance is obtained through Tax Office review of taxpayer corporate governance, risk management, information systems and compliance frameworks under a **Governance Assurance Review** that examines evidence of how these are applied, implemented and incorporated into the operational environment. This is at a high level and examines the existence of an appropriate overarching focus on optimising voluntary compliance.

The establishment of a GST ACA includes bringing the Tax Office view of GST compliance to a current position through a **GST Compliance Assurance Review** so that going forward the focus can be on risks and issues as they arise. This sets up the basis of the forward looking joint process to consider and resolve matters in a real time compliance environment.

The Tax Office effectively signs off on the achievement of GST compliance to the extent that full and true disclosure of material risks and issues has been provided including any risks or issues addressed under entry or assurance maintenance processes. This approach continues throughout the operational term of the GST ACA. The GST level review consolidates the Tax Office view of the GST compliance relationship to the point of GST ACA entry

## **Top 50 Alternative**

In May 2008, the Commissioner launched the income tax Annual Compliance Arrangement advising that this would be available to Australia's top 50 corporate entities. The GST ACA approach for the top 50 provides the option to adopt a differentiated GST ACA entry model and provide a similar experience to that applied in the income tax ACA entry process.

Under this approach, before agreeing to sign a GST ACA, the Commissioner requests a letter from the CEO or CFO confirming that the business has complied with the tax governance guidelines as outlined in the Tax Office 2006 Large business and tax compliance booklet.

The GST ACA is signed early in the process with initial compliance and governance assurance reviews conducted under the terms of the GST ACA. The review processes are essential to establishing the assurance based relationship and the environment in which the Commissioner agrees to provide concessionary approaches supporting and encouraging optimised voluntary compliance.

## **Ongoing Maintenance of a GST ACA**

The GST ACA terms include an annual review process whereby we meet with the taxpayer to consider annual assurance maintenance processes, whether the relationship objectives are being met and how well it has been managed as a basis on which to then formally agree to continue with the GST ACA relationship for the next 12 month cycle.

## **GST ACA Market**

We are currently focused on promoting the GST ACA to the large business market. It is available to both the Australian corporate and government sectors.

The ATO is also exploring a GST ACA program for taxpayers in the Small and Medium Enterprises market with a turnover range from \$A100-250 million and anticipate further differentiated compliance arrangement approaches for taxpayers below the \$A100 million threshold.

## **How many GST Compliance Arrangements are in place?**

The GST ACA is based on the Forward Compliance Arrangements (FCA) established by the Tax Office GST business line in 2006.

The Tax Office has partnered with 3 large businesses and 1 large State Government Department to enter FCA's, the ANZ Bank was the first starting with GST and then adding Fringe Benefits Tax, BP Australia followed with GST and Excise, the State Government Department signed up for GST and a large manufacturer was the first with an income tax FCA.

The GST ACA was launched in 2008 and the first arrangement was signed with Integral Energy, effective from 1 November 2008. The ATO is currently working with three top 100 companies with 2 GST ACA's due for signing in the first half of this year and the third in the second half. We have undertaken a large client visit program to introduce the GST ACA to suitable companies. A number of those visited are interested in the product.

### **GST ACA Overview**

An overview of the process is available via the Tax Office internet site at:

<http://www.ato.gov.au/content/downloads/lcm00168324gstaca.pdf>

### **Annex 3**

## **ATO: Cash Economy Project Evaluation with Specific Reference to Impacts on VAT/ GST Revenue and Compliance**

This case study outlines the ATO's risk treatment strategy for its cash economy project presented against the background of its formal four phase risk treatment evaluation methodology:

### **Phase 1: Articulation of the compliance risks involved**

#### 1) What is the compliance risk to be addressed?

The ATO adopts a compliance approach that changes behaviour, ensures that voluntary compliance is sustained, and which is recognised by the community as a credible response to non-compliance. For this project, the key risks were identified as:

- Continued community acceptance of participation in the cash economy encourages non-compliant behaviour;
- The community may perceive the ATO as unable to detect and respond to non-compliance in the cash economy;
- Visible non-compliance will erode the integrity of the tax system.

#### 2) Who's involved? What are the behaviours and drivers associated with the risk?

The primary form of non-compliance is failure to declare cash income. Registered participants may also fail to file returns or file on time, fail to accurately report transactions and may not pay on time. Often cash economy participants are poor record-keepers. They may also be non-compliant with other regulatory obligations.

This behaviour often results from a desire to minimise tax obligations coupled with a perception that there is only a small chance that non-compliance will be detected. Behaviour may be driven by low margins and the need to remain competitive. It is often evident in transactions between businesses and consumers, as consumers seek price discounts. In some instances business operators do not fully understand their tax obligations and may perceive the system to be too difficult or costly to comply with. They are often more focused on the operating side of their business.

Consumers may demand discounts for cash payments and make no connection with tax compliance considerations as they have no obligations in this situation. They may perceive little risk for themselves other than having no evidence of payment if the goods or services are not of an expected standard. Many people are also prepared to pay cash for priority access to tradespersons in periods of high demand.

Behaviour is often driven by the perception that everyone benefits from the cash economy and by a failure to recognise the broader impacts in terms of the Government's ability to provide a proper level of services to the Australian community.



The community is often reluctant to report cash economy participants and may accept such participation to a point. However, the community does not accept blatant non-compliance or conspicuously-wealthy lifestyles funded by undeclared cash. Nor does it accept under-reporting of income in order to receive social security benefits or avoid child support payments.

## **Phase 2: Definition of the outcomes sought and the strategies to achieve them**

The outcomes identified as being sought from this initiative were as follows:

- The ATO demonstrates its ability to detect and respond to the cash economy;
- Voluntary compliance by participating taxpayers is sustained;
- Appropriate community education reduces tolerance of participation in the cash economy;
- The community maintains its confidence in the integrity and fairness of the tax system.

An integrated package of strategies was developed, including the following elements:

- **Enforcement:** Identifying those who present a higher level of risk, by making increased use of the ATO's ability to cross-match third party and other data to identify likely non-compliance. A differentiated approach that escalated depending on the taxpayer's attitude to non-compliance was adopted and the strategies deployed ranged from letter campaigns suggesting voluntary disclosure, reviews, desk-based and comprehensive audits, administrative penalties and prosecution referrals.
- **Influence and leverage:** Entailed initiating less costly and leveraged activities that over time should encourage greater voluntary disclosure from participants large in number but relatively low in terms of revenue.
- **Communication:** Use of a variety of channels to educate and inform the community on: 1) the ATO's ability to detect and respond to non-compliance; 2) the assistance it provides; 3) its collaboration with representatives of high risk industries and the tax profession (e.g. using joint press releases); 4) inherent risks posed to consumers by cash jobs; and 5) the cost to the community of non-compliance.
- **Education:** Entailed a range of educational activities including letters, calculators, industry benchmarks, seminars and advisory visits, used either individually or as part of the ATO's Small Business Assistance Program.
- **Engagement:** Engaged of key stakeholders, including tax profession and industry representatives by working collaboratively to improve the ATO's understanding of the cash economy, developing industry benchmarks and related

assistance products, and co-designing appropriate responses and building on going working relationships.

### **Phase 3: Design of indicators (to gauge effectiveness of the risk treatment strategy)**

1) What indicators will we use?

A broad range of indicators were identified to gauge the effectiveness of the risk treatment strategy:

- 1) changes to indicators of tax performance at the individual and industry level;
- 2) changes to rates of filing performance for business activity statements;
- 3) payment of outstanding liabilities by participants in the cash economy;
- 4) trend in the number of reports received on the tax evasion hotline;
- 5) responses to various perceptions surveys involving key stakeholders;
- 6) frequency and tone of media comment relating to the cash economy;
- 7) levels of industry “engagement” in the management of the cash economy;  
and
- 8) levels of compliance by cash economy participants with other obligations (e.g. welfare).

### **Phase 4: Determining the extent of improved effectiveness achieved**

1) Have we been effective in achieving our desired outcomes? How do we know?

Focused attention to assessing the impacts of the strategy revealed indications of increased voluntary compliance, demonstrated through reporting of cash transactions, return filing and payment obligations by those operating in the cash economy. Specifically:

- **Return filing:** Success is evident from an increase in the number of activity statements overall and filed on time. On time filing of quarterly activity statements increased by 12% after the ATO data matched information from shopping centre operators.
- **Correct reporting:** Success is evident from increases from increases in the trend, relative to other industries, of amounts reported by those in the targeted industries. Observations of the restaurant and café industries and the building industry (sub-trades) showed:

- Increased GST (VAT) reported for businesses audited in 2006-7. While the year's average for quarterly GST liabilities for all industries increased by 9.5% and 9.7% in the June and September quarters respectively, taxpayers subject to intervention recorded up to a 60% increase in average net GST (VAT) in the June quarter.
- Average net GST (VAT) in the June 2007 quarter increased by 25% by taxpayers found to be compliant as a result of the ATO's interventions, suggesting that its audit activities had some indirect effect by increased the GST reported, even by taxpayers found to be compliant.
- **Community tolerance:** Community reports concerning alleged cash economy activity to the ATO's tax evasion hotline increased by 74.2% in 2007-08, over the number in 2005-06, reflecting declining community tolerance of cash economy activity.
- **Community confidence and engagement:** Evidence of increasing confidence and engagement from community sectors (e.g. positive coverage of ATO's activities in professional media, improved business perceptions survey results, and increased collaboration with trade associations).

#### 8) Where to from here?

Building on these outcomes and the experience gained, activities for 2008-09 will see development of the help and education activities that provide opportunities for self-correction and voluntary disclosure. However, the importance of maintaining a visible audit presence will remain and the emphasis on improved risk detection will be aided by further expansion of data matching capabilities, with some attention given to identifying situations of conspicuous consumption that are not matched by taxpayers' reported incomes.

Measuring the key elements of our response over the longer term will give us a better indication of whether changes in compliance behaviour have been sustained. Intelligence from the ongoing evaluation will help shape our strategies. For example, we expect to see an increase in the number of reports of tax evasion to our hotline as community gains confidence in how we use this information, our systems will monitor and record the volume and nature of accesses to specific website products, and there will be an expansion of data matching, providing us with better risk detection tools, especially in relation to taxpayers whose lifestyle appears out of step with their reported incomes.

**Source:** ATO survey response and related inquiries.

## Annex 4

### Comparative summary of country responses in key areas of administration

#### 1) VAT registration

Country	Nature of checks conducted to validate integrity of registration application, (including whether they entail: 1) proof of identity–type checks; 2) a requirement for an established bank account located in your country; 3) checking with related income tax records; 4) actual visits to business premises; and 5) any other special activities or requirements on applicants.)
Australia	<p>The Australian tax system allows for an entity in business to apply for an Australian Business Number. The legislation also allows for some entity types to register regardless of whether they are in business e.g. Corporations Law Companies. Registration for Goods Services Tax (GST) is a tax role linked to an Australian Business Number and is either voluntary under a specific threshold or compulsory over that threshold (or if the business is legislatively required to register regardless of threshold). Registering for the GST entitles an entity to claim input tax credits for GST paid to suppliers of goods and services.</p> <p><b>Proof of identity - Types of checks:</b> Entities eligible to register for either an Australian Business Number or Goods and Services Tax are sole traders, companies, partnerships, trusts, superannuation funds and government. There are a range of eligibility and identity requirements. The entity must satisfy legislative, business/enterprise tests as well as underlying identity validation.</p> <p><b>Business eligibility checks:</b> To be entitled or eligible for an ABN, the entity must meet one of the following criteria:</p> <p>Criteria 1: The entity can answer ‘yes’ to the following statements:</p> <ul style="list-style-type: none"> <li>• Its activity is carried out in the: form of a business; nature of trade, or the form of a regular or continuous grant of a lease, licence or interest in property.</li> <li>• Its activity is carried out in Australia or it makes supplies that are connected with Australia.</li> <li>• Its activity is not a private recreational pursuit or hobby.</li> <li>• There is a reasonable expectation of a profit being made (only for partnerships where all or most of the partners are individuals).</li> </ul> <p>Criteria 2: An entity is also entitled to register, regardless of satisfying the enterprise test if the entity is:</p> <ul style="list-style-type: none"> <li>• a company incorporated under the Corporations Act in Australia</li> </ul>

- a charitable institution or trustee of a charitable fund in Australia
- a deductible gift recipient in Australia, or
- a religious institution in Australia.

An entity that does not meet criteria 1 or 2 is not entitled to an ABN.

**GST registration:** Whilst there is an option for an entity not to register for GST, an entity must register if it is carrying on an enterprise and either: 1) has an annual turnover of \$75,000 or more (\$150,000 or more for non-profit organisations) or 2) is required to register because of a special rule. An example would be if you provide taxi travel as part of your business, regardless of your annual turnover. Taxi travel means transporting passengers by taxi or limousine for fares.

**Proof of identity checks:** Proof of identity is evidence provided to the ATO of the applicant's existence and identity. For individual or sole traders, we collect proof of the identity of the individual making the application (e.g. birth certificate). This verifies the identity through third party validation.

For all other entity types (e.g. companies, partnerships, trusts, superannuation funds and government), we collect information and link the business registration to at least one individual that sits behind the business entity. This will be at least one individual, or other listed persons, responsible for the business entity. A range of other information is collected that verifies the business entities structure (e.g. Australian Private Company), its trading name and various addresses as well as the authorised contact person.

**Is there a requirement for an established bank account located in your country:** There is no legal requirement to provide a financial institution account number for an entity. However, the structure of ATO administrative systems is such that refunds from the ATO will only be paid directly to a recognised financial account located within Australia.

**Checking with related income tax records:** There is no cross referencing of other tax records at the registration stage of the process.

**Actual visits to business premises:** There are no initial visits to business premises at the time of registration. However, the entity may make a request for a workplace visit by the ATO. These visits are designed to assist the new entity to comply with taxation and superannuation obligation. The service is provided free of charge

	<p>and can be provided at any location in Australia.</p> <p>The meeting generally discusses specific tax information which include:</p> <ul style="list-style-type: none"> <li>• registering for an Australian business number (ABN)</li> <li>• understanding and registering for the goods and services tax (GST)</li> <li>• understanding employer obligations (pay as you go withholding, superannuation guarantee, and fringe benefits tax)</li> <li>• understanding superannuation obligations</li> <li>• understanding activity statement and record keeping requirements and make use of electronic products such as e-record</li> <li>• understanding the range of other taxes and obligations that might apply to your business, and</li> <li>• filing activity statements online via the Business Portal (includes set up &amp; registration).</li> </ul>
Austria	<p>Visitation at the place of business after start of business, proof of identity (passports) and use of forms for capturing detailed information.</p>
Canada	<p>CRA validates the integrity of VAT registration applications through several means:</p> <ol style="list-style-type: none"> <li>1) <b>proof of identity</b> - Incorporation documents are required for corporate VAT registration, while social insurance numbers of individual (proprietorship) registrants are required and then validated through our income tax system. For partnerships, agreement documentation as well as the social insurance numbers of the partnership members are requested, however not legally required.</li> <li>2) There is <b>no requirement to have a bank account</b> in Canada.</li> <li>3) Other – Income <b>tax records are cross-referenced with VAT data</b> to validate common data fields. Limited visits to business premises are conducted. Further analysis is conducted through Enhanced Registration Review whereby client identification information is validated. Referrals from this review are then analysed further through different programs such as Audit Registration Review and then, if necessary to High-Risk Analysis Teams.</li> <li>4) <b>Actual visits to business premises</b> are conducted through the course of audit as necessary.</li> </ol>

Ireland	<p>We have resources dedicated specifically to Registration. VAT Registration is treated with particular care. Specifically we check:</p> <ul style="list-style-type: none"> <li>▪ The registration number being used by the applicant</li> <li>▪ In the case of an individual or partnership the registration numbers and the Common Registration System (CRS) for any records of relationship with other cases.</li> <li>▪ The PAYE record for any directorship(s)</li> <li>▪ In the case of companies the registration number of each director</li> <li>▪ The CRS record of each of these for any “Relationship” records</li> <li>▪ That the appropriate person signs the registration form.</li> <li>▪ The address of the business. We consider if it appears appropriate for the type of trade or service being carried on. We establish that the business is in fact being carried on at that address.</li> <li>▪ The description of the main business activity. If the nature of business is not clear from the form, the applicant or agent will be contacted for a precise description of the business activity.</li> <li>▪ The tax history of the sole trader, directors, and partners as applicable.</li> <li>▪ We maximise the use of local &amp; official knowledge to determine that a genuine trade has commenced (or is about to commence).</li> <li>▪ Where there is a doubt about the bona fides of the application or a suspicion that the application may be bogus or where there is no clear indication that the individual /company has or is about to commence a taxable activity, the case will be selected for a pre-registration visit prior to the granting of the VAT Registration.</li> <li>▪ In certain circumstances it may be necessary to ask an applicant to provide security, in the form of a bond or guarantee from a bank or other financial institution.</li> <li>▪ All applications for registration are approved at Manager level.</li> </ul>
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<p>United Kingdom</p>	<p>Regardless of the manner of applying for registration, HMRC carries out a number of risk-based checks at the point of registration. The purpose of these checks is to allow us to identify genuine taxpayers and register them as quickly as possible. We do this by:-</p> <ul style="list-style-type: none"> <li>• verifying the validity of the application;</li> <li>• verifying the validity of the applicant;</li> <li>• identifying whether the applicant has a previous history with HMRC; and</li> <li>• if they have a history, to assess their previous compliance.</li> </ul> <p>Re 2) requirement for an established bank account located in your country: applicants are asked to provide details of a UK bank or building society (BS) account. This must be in the name of the business for which the application is made.</p> <p>Re 4) actual visits to business premises: in selected cases –. The purpose of such visits is to check that the premises and activities seen are consistent with, and suitable for the carrying on of, the details provided by the applicant.</p> <p>Re 5) any other special activities or requirements on applicants: see description below.</p> <p>There are potentially three levels of checking of applications, determined by the risk HMRC considers they represent. The initial, semi-automated risk assessment process applies to all applications.</p> <p>The VAT registration process is as depicted below</p> <p>Trader application (paper or online)  ↓  Registration Unit Initial data capture, matching and risk assessment  Stage 1  ↓↑  Special Risk Referral Team  Stage 2  ↓↑  Specialist Intelligence Team  Stage 3</p> <p>During the initial Stage 1 checking, the Registration Units may contact applicants to ask for further information before continuing to process the application. Around 95% of applications require no further risk assessment and the processing is completed. The rest are referred for Stage 2 checking. Only around 1% of all</p>
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applications are referred to the Specialist Intelligence Team.

All applications are finalised through the Registration Unit, so after stage 3, an application may be returned directly to the Registration Units. If there is insufficient evidence to refuse an application but HMRC still has concerns about a trader, it can impose conditions on the registration, such as requiring a financial guarantee or shortening the first VAT period to enable the Department to make an early assessment of compliance.

**Annex 5**  
**Penalty framework for VAT Offences**

**1) Failure to pay VAT on Time**

Country	Sanction normally applied	
	First offenders	Repeat offenders
Australia	General interest charge	General interest charge
Austria	Interest charge	
Canada	Interest charge	Interest charge
Ireland	Statutory interest of 0.0273% per day	Statutory interest of 0.0273% per day, plus increased chance of being audited
UK	First default—issue of surcharge liability notice with warning of a surcharge of 2% of tax outstanding	Subsequent defaults—5%, 10%, and 15% of tax outstanding

**2) Failure to correctly report liabilities - careless actions**

Country	Sanction normally applied	
	First offenders	Repeat offenders
Australia	Actions deemed 'careless'—25% of shortfall. Actions deemed grossly careless (reckless)—50%.	Generally 20% uplift if entity had prior imposition of same penalty
Austria	<b>??? specify typical amount</b>	On third offence, additional 50%
Canada	Nil (except where gross negligence occurs)	Nil (except where gross negligence occurs)
Ireland	Statutory interest plus 40% of shortfall	Statutory interest plus substantially increased penalties
UK	Mis-declaration penalty (subject to objective tests) of 15%	Repeated mis-declaration penalty (subject to objective tests) of 15%

### 3) Failure to correctly report liabilities - deliberate actions

Country	Sanction normally applied	
	First offenders	Repeat offenders
Australia	75% of shortfall	Generally 20% uplift if entity had prior imposition of same penalty
Austria	2% additional amount	4% additional amount
Canada	Greater of \$250 or 25% of shortfall	Same as for first offenders
Ireland	Statutory interest plus up to 100% penalty	Statutory interest plus up to 100% penalty
UK	Either mis-declaration or civil evasion penalty of up to 100%	Either mis-declaration or civil evasion penalty of up to 100%

### 4) Failure to correctly report liabilities - fraudulent schemes

Country	Sanction normally applied	
	First offenders	Repeat offenders
Australia	50% of shortfall amount. 25% if taxpayer had a reasonably arguable position in case of avoidance scheme)	Generally 20% uplift if entity had prior imposition of same penalty
Austria	Penalty up to 2 times tax (imprisonment also possible with prosecution)	Penalty up to 2 times tax (imprisonment also possible with prosecution)
Canada	Penalty ranges from 50-200%	Same as for first offenders
Ireland	Statutory interest plus up to 100% penalty and likelihood of prosecution	Statutory interest plus up to 100% penalty and likelihood of prosecution
UK	Civil evasion penalty of up to 100%	Civil evasion penalty of up to 100%