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TAX Tribune

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31 Technical Articles

Editorial Column

IOTA Membership on 1 January 2013

In Focus...
IOTA Technical Activities Programme 2012

Dear Readers,

Mr. Miklós KOK
Executive Secretary of IOTA

It is my great pleasure to introduce our 29th issue of the Tax Tribune, the annual magazine of the Intra-European Organisation of Tax Administrations (IOTA), which is a reflection of our complex 2012 Work Programme.

The events of IOTA in 2012 attracted well over 800 participants from 46 member tax administrations. Just like in 2011, IOTA co-organised an important workshop on "VAT Fraud Schemes Involving Non-EU Countries" with DG TAXUD of the European Commission (EC) under the umbrella of Fiscalis programme. Several IOTA technical events have been attended and supported by speakers from the Organisation for Economic Co-operation and Development (OECD). The 2012 Work Programme covered a wide variety of topics which addressed the most important and urgent problems modern tax administrations are facing. In our magazine, we would like to echo this diversity by including articles from the widest field of technical taxation issues possible.

The 31 articles are organised under five main headings: Tax Fraud, Information Technology in Support of Tax Administrations, Mutual Assistance, Tax Compliance and Human Resources Management. We are very pleased that it is not only the topics that cover a wide range of tax administration work, but the geographical distribution of sources of articles is also diverse.

In this issue, you can read articles which are based on presentations delivered at different IOTA workshops as well as at the technical session of the 16th General Assembly of IOTA held in July 2012 in Oslo, Norway, of which the main theme was "Good Governance: The Way Forward for Tax Administration; Moving From Reactive To Proactive Approaches". At a time of considerable resource constraints, efficiency and innovation of a tax administration is becoming more and more important. So that it will not only be the participants to the event who can share their views on this actual topic, we have collected a number of related articles for your reference in this issue of our magazine.

Also, some tax professionals felt it important as a direct consequence of their participation to an IOTA technical event to share their thoughts with the readers based on their first hand impressions and experiences.

Similarly to previous years, some articles have been written by participants of IOTA Area Group members, of which three were running throughout the year of 2012. Besides, the participants to case study workshops present numerous articles on solutions and tools applied by their tax administrations in the field of identifying taxpayers involved in cross-border activities, auditing individuals and legal entities in the use of e-money and tackling VAT losses amongst large businesses. Finally, our 13 workshops organised in 2012 with a vast variety of taxation issues are food for thoughts for authors of a number of articles on new technologies applied by tax administrations, combatting VAT fraud, mutual assistance, managing integration and business processes, and data warehousing techniques.

As this is the first time for me as Executive Secretary of IOTA to also act as Editor-in-Chief of the Tax Tribune, I would like to express my sincere thanks to all authors of articles and to you all for your active interest in IOTA and in its technical events.

Finally, I am confident that you, Dear Reader, will find something of interest in this edition of the Tax Tribune, which will encourage you and your colleagues to even more actively participate in future IOTA technical events and generally in the life of IOTA.

Fraud

This issue features nine articles in relation to fraud from 2012. IOTA organised several Workshops, Case Study Workshops and Area Group Meetings with various fraud themes and most of the articles are based on the presentations of the participants from these meetings.

From the Finnish Grexel consultancy company Marko Lehtovaara and Markus Klimscheffskij explain how energy certificate markets work in Euroope. The complex energy certificate trading systems need to be understood which is crucial to controlling the VAT linked to it.

In this section François Trechot's article introduces the reader to a special market, the electronic telecommunication services and VOIP services in France, which saw dramatic changes after the carbon credit fraud cases. The actions taken by France to combat this threat are explained in detail.

Franck Benoit explains in his article which strategies are the most suitable to tackle tax fraud on the Internet. Not only the technical aspects are discussed, but the specialised tools required.

Fiscal Monitoring in Italy is explained by Valerio Rondoni and Gennaro Aulenta which is important to tackle tax fraud and capital outflow. The Italian case is supported by a description of the legislation issues and examples from the work of the tax administration.

How the income yardstick can be used as an indirect method for estimating tax liabilities of individuals in Italy is explained by Maria Luisa Guermani.

The Latvian Edgars Hercenbergs gives an in-depth analysis of a VAT fraud case. The article not only analyses the case, but gives an insight into the terminology used and a comparison of the different approaches available for tackling VAT fraud along with suggested solutions.

The new measures to prevent and combat tax fraud in Spain are explained in the article by Alfredo Arranz Sainz and Marcos Alvarez Suso. The changes are new, as the new act came into power on the 31st of October 2012 but will already be of interest to other countries.

You can read about the VAT risk selection processes in Spain described by Juan Ponz who examines the risk scoring and dynamic analysis.

Norwegian fictitious invoicing and tackling the issues are documented by Bjørn Weider Moen.

Guri E. Stange Lystad, Reino Nielsen, Alma Olofsdottir in their article explain the involvement of payment platforms in VAT fraud cases from the Nordic perspective. They also explain the history of alternative banking and how payment platforms facilitate VAT fraud.

Energy Certificates in Europe – What Tax Authorities Need to Know about the Markets

FINLAND

Marko LEHTOVAARA
CEO
Grexel Systems Oy

Hermannin Rantatie 8, 00580 Helsinki, Finland
Tel +358 9 4241 3160
E-mail: marko.lehtovaara@grexel.com

Mr. LEHTOVAARA holds a Technical Licentiate of Science degree from the Helsinki University of Technology. He is CEO of Grexel Ltd. and has 10 year experience in tradable energy certificates.

Markus KLIMSCHEFFSKIJ
Renewable Energy Expert
Grexel Systems Oy

Hermannin Rantatie 8, 00580 Helsinki, Finland
Tel +358 9 4241 3160
E-mail: markus.klimscheffskij@grexel.com

Mr. KLIMSCHEFFSKIJ holds a Technical M.Sc. degree from the Aalto University of Technology. He is working as Renewable Energy Expert in Grexel. He is specialized in reliable electricity disclosure.

By Marko LEHTOVAARA and Markus KLIMSCHEFFSKIJ

Finland

Introduction

You do not have to be an electrical engineer to understand that electricity flows to our houses and businesses from a mix of sources: from all power stations that are connected to our power system. Hence, you can be sure that your electricity is physically just as green, grey or red as the next person's, and there is no way to choose its energy origin.

Enter energy certificates.

Energy certification is the property of developed electricity markets in which electricity producers are issued electronic certificates for units (typically MWh) of electricity output. Energy certificates contain the relevant information (energy source, plant details etc…) of the underlying electricity production, but can be traded separately from the physical electricity to which they relate. These certificates are used to prove that sold or consumed energy is of a certain origin and thus they empower consumers to have a say in how their electricity is produced. In most countries, certificates are only issued for electricity production from renewable energy sources, but recent trends have favoured full certification schemes, enabling issuance for also fossil and nuclear energy.

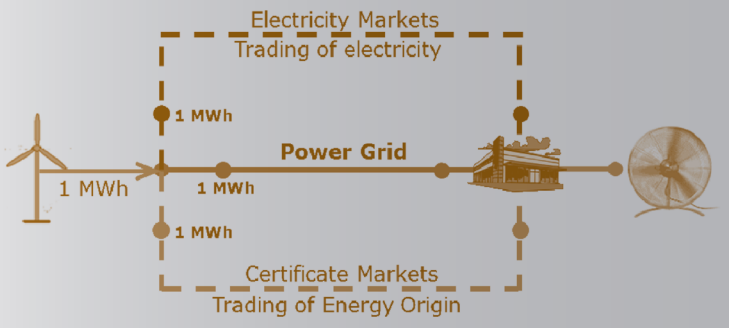


Figure 1 Energy Certification – The energy origin of 1 MWh of electricity is unbundled from the financial trading of electricity at the point of production. The energy origin can be reattached to any sold MWh of electricity at the point of consumption.

Certificates are used by electricity suppliers and large consumers for either electricity tracking, or quota compliance. Guarantees of origin are an example of an EU-wide tracking certificate scheme, whereas "el-certificates" are quota certificates used in the common Swedish-Norwegian support system for renewable energy. The monetary value of European EECS GO trading in 2011 is estimated at 200 million euro, whereas trading of elcertificates for the 2011 quota was approximately one billion euro. This is due to the quota obligation of elcertificates creating significantly higher prices. Typically energy certificates are considered as commodities or immaterial rights. Certificates are traded internationally and they are subject to VAT in most legislative domains. In practice transfers are made in electronic registries over the Internet using a standard web browser in a similar manner as making payments in Internet banks.This article elaborates the basics of the energy certification process and markets, focusing on the European-wide guarantee-of-origin system. Finally, the current state of market supervision from tax authorities' point of view is assessed.

Separation of Tracking and Quota Certificates

Tracking certificates, such as guarantees of origin according to directive 2009/28/EC, are used by electricity suppliers and large electricity consumers to claim the origin of sold or consumed energy. Electricity suppliers can use the cancellation information when disclosing the energy origin of electricity sold to final consumers, whereas large consumers typically use it to "green" their energy mix for e.g. labelling, adding value to secondary products, reaching environmental standards, carbon accounting etc. Energy origin, tracked through certificates, is removed from the energy origin of electricity disclosed to consumers who have purchased "general electricity" without a specified origin. This process is called the residual mix calculation and it is crucial for the reliability of the tracking system.

Quota certificates have a "purchase obligation", which is imposed on the relevant parties such as electricity suppliers and large electricity consumers (as percentage of sold or consumed electricity). Not complying with the quota leads to a financial penalty, which sets the price of quota certificates in most cases significantly higher than the price of tracking certificates that rely on voluntary demand. Quota certificates are, in most quota systems, (e.g. elcertificates) completely separated from disclosure. This means that an electricity supplier who cancels a quota certificate can only use the cancellation for complying with the quota but not for making claims of the energy origin of the electricity. Consequently, both types of certificates can be issued for the same MWh of production.

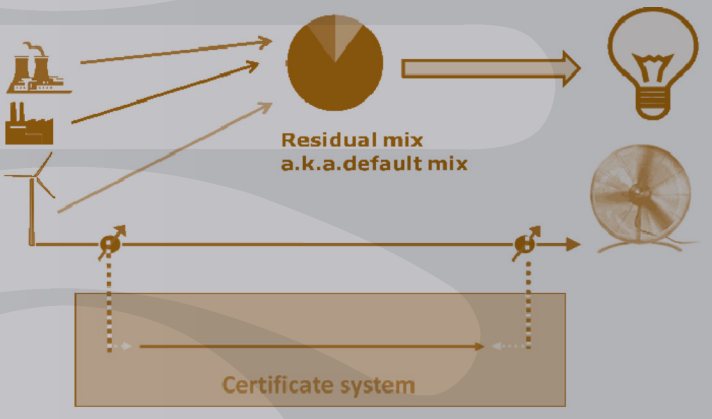


Figure 2 – Residual mix balances the explicit tracking of electricity by making the energy origin of the remaining electricity consumption "darker".

Energy Certification Process

The responsible party for the energy certification process is the mandated national competent body, which is often the Transmission System Operator (TSO) or Energy Market Regulator of the country. Certificates are issued, traded and cancelled in accounts residing in central registries, of which normally one exists per country. Registries are operated and monitored by the competent bodies, or independent registry operators. Market participants are required to open an account in the central registry in order to register production devices, own certificates and perform transactions. Owning and trading certificates is generally not restricted.

In some countries it is reserved for companies acting in the electricity wholesale market, but in most countries anybody, including private persons, can open an account. When a legal or natural person wishes to open an account, they must enter into an agreement called Standard Terms and Conditions in that country.
Certificates are issued against meter readings of the registered and verified production devices into the accounts of the owners of the plant. After the certificates are issued, account holders can execute transactions on certificates. Typically the first transaction is a transfer, in which the ownership of the certificate is transferred to another account holder in the same or different country. An account holder can also transfer certificates between their own accounts and sub-accounts. One account holder can have multiple accounts and sub-accounts as well as users with different rights. The same account holder can have accounts in several countries.
The final user of the certificate cancels it for one of the purposes previously described, depending on the type of certificate (tracking or quota). The account holder who cancels the certificate is typically an electricity retailer or a large consumer, but it can also be a trader, broker or an energy producer making the cancellation for the benefit of the final user.

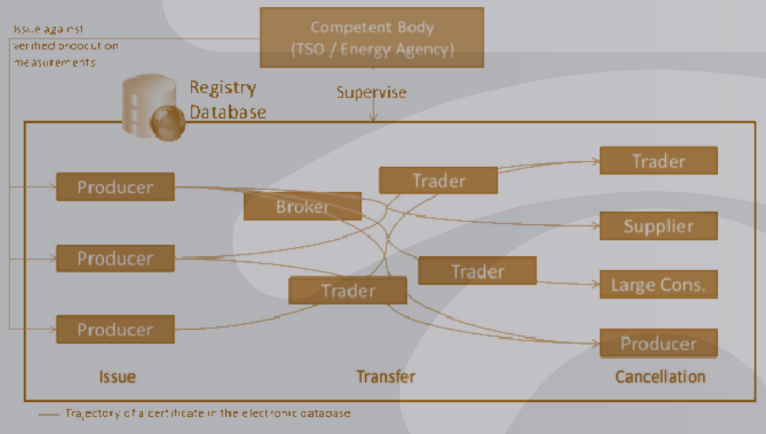


Figure 3 Energy Certification Process – Transfers of certificates are executed in or between accounts in national registries under the supervision of the competent body

Energy Certificate Markets

European EECS-GO Market

All EU members are required to implement a guarantee of origin system based on electronic certificates and accept GOs from other EU members. However, the implementation of Directive 2009/28/EC does not alone lead to a harmonized and technically compatible system within the EU, which hinders international commerce.The harmonization is currently ensured through EECS (the European Energy Certificate System), governed by an independent non-profit organization, Association of Issuing Bodies (AIB). Once a certificate is issued according to EECS by an issuing body (typically the competent body) being a member in the AIB, it can be transferred to any other EECS account in any other country. In practice the national registries are connected together by the central Hub operated by the AIB.
At the turn of 2012, the total historic volume of issued EECS certificates attained 1 billion, starting from 1.5 million in 2001. During 2011 a record volume of 250 million EECS certificates were cancelled and the total volume of transfers was approximately 300 million (100M domestic and 200M international). The issuing volume (180 million) fell behind cancellations, which meant that certificates issued for the 2010 production, and also older, were cancelled. Under directive 2009/28/EC, Art.15(3), guarantees of origin must be cancelled within 12 months from the production of the underlying energy or they become expired. However, not all countries have yet implemented this.

The trading volumes above are publicly available from the registries and aggregated by the AIB, but they only capture the spot market transactions. The volume traded as of bilateral forward contracts is approximately 4 times bigger than the spot volume. The average price in 2011 per certificate was estimated at 40 euro cent. Multilateral trading or central counterparties do not exist yet in the market, although attempts have been made to create exchanges by large traders (STX Services) and for example the European Energy Exchange (EEX) has formally announced its intent to establish

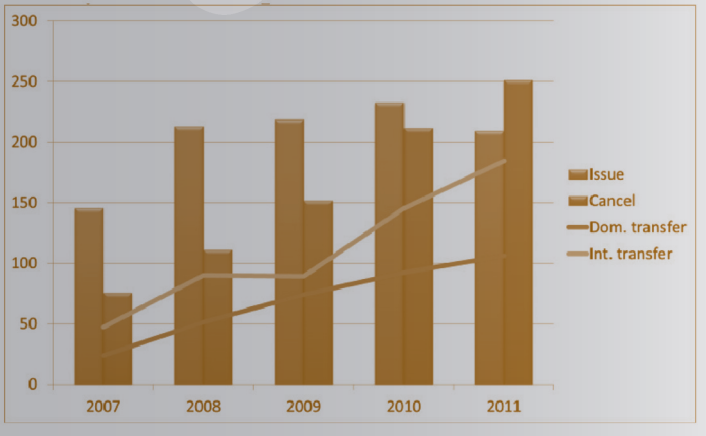


Figure 4 – Transactions of EECS certificates (millions) during 2007 – 2011

a GO exchange in early 2013. EECS certificates are subject to VAT and considered as immaterial rights.

National Quota Certificate Markets

A quota certificate scheme is used for renewable energy support in e.g. Belgium, Great Britain (Renewable Obligation Certificate), India (REC), Italy (Certificati Verdi), as well as Norway and Sweden (Elcertificate). The systems can be compared to the EU Emission Trading System (ETS) with the exception that they are national and promote the positive (renewable energy) instead of capping the negative (CO2). Markets for quota certificates are national, with the exception of the Swedish-Norwegian elcertificate market from the beginning of 2012.
The volume of the elcertificate market was 42.4 million certificates for the 2011 quota and these were traded at an average price of 23.86 euro (currency rate of 18.10.2012). Of the 42.4 million, 99.7 % were Swedish and only 0.3 % were Norwegian certificates, which was due to the elcertificate system only starting in Norway at the beginning of 2012 whereas it has been running in Sweden for more than 10 years. The quota to cancel certificates will be imposed for the first time in Norway at the end of March 2013 against consumption in 2012.
The Renewable Obligation Certificate ROC-scheme has been running in Great Britain since 2002. For the compliance period 1.4.2010-31.3.2011, 25 million ROCs were cancelled. The value of a ROC was estimated at 51.34 GB pounds based on the penalty fee and remuneration (the total penalty is redistributed to those who have complied with the quota).

Market Supervision

Local Authorities

Where, on the technical side the EECS has established harmonized procedures, the market is still rather new and is not regulated as a separate market at EU level, nor are there internationally harmonized responsibilities concerning e.g. reporting to various authorities. However, local tax authorities in several countries have access to central registries based on existing money laundering and tax fraud prevention regulations. Several national central registries have a specific functionality and reports for supervisory authorities.
Quota certificate markets remain the discretion of individual countries who can determine the level of regulation in the market. Though quota certificates are not internationally traded, they have a higher monetary value than tracking certificates, which might attract VAT fraudsters.

Issuing Body Self-Regulation

Many national issuing bodies have voluntarily developed measures to prevent frauds in their own domain. Typically they apply their own Know Your Customer (KYC) procedures to check the background of the applicant prior to opening an account. This may include evaluation of mandatory KYC form, proof of validity of company registration and VAT registration, authorization of signatories using company registration data and copies of passports.

Fraud Prevention Work at the AIB

Being the main international coordinating body in the area, the Association of Issuing Bodies has recognized the threat of fraud in the market, in particular, the missing trader and missing trader intra community – type of VAT frauds and money laundering. To mitigate the risk, the AIB has set up a task force for developing new regulations, guidelines and best practices as well as sharing information among issuing bodies.
So far the task force has developed a KYC form and a best practice recommendation for its member organizations. It has also established operational contacts with the fraud prevention units of tax authorities in different countries and Europol, agreed communication protocols and urged members to be in contact with local authorities to facilitate country level co-operation.

Conclusions

Energy certification enables consumers to reliably select the energy origin of electricity supplied to them, or can be used as a market-based support system for renewable energy. These two tasks are executed with two different types of certificates: tracking and quota certificates.
The Europe-wide tracking certificate market, guarantees of origin, has grown rapidly during recent years (CAGR 35 % of transfers during 2007- 2011). The financial significance the market has gained has brought concerns over VAT frauds and as the coordinator of the European Energy Certificate System the AIB is encouraging its members to implement measures to mitigate the risk. On the positive side, most of the actors in the market are known to each other and credible dealers entering the market require detailed information of the guarantee of origin system. Furthermore, the monetary value of guarantees of origin is not yet

lucrative enough for fraudsters. Sudden growth in volumes and the emergence of new traders would raise suspicions. As the GO market grows and matures, into standardized future products and multilateral trading, more regulations and supervision will be required. It is recommended that tax authorities familiarize themselves with the market and establish connections with the competent national bodies.

The Association of Issuing Bodies (AIB)
AIB is a non-profit international scientific organization registered in Belgium. Members are the issuing bodies with no geographical overlap. Members of the AIB can arrange issuing, trading and cancellation energy certificates under a harmonized scheme. At the time of writing of this article, there are 16 member countries. The purpose of the AIB is to develop, use and promote a standardized system: the European Energy Certificate System - "EECS". EECS is based on structures and procedures which ensure the reliable operation of international certificate schemes. These schemes satisfy the criteria of objectivity, non-discrimination, transparency and cost effectiveness, in order to facilitate the international exchange of certificates.

RECS International

RECS International (RECS = Renewable Energy Certificate System) is a European non-profit association, registered in Brussels. Members are renewable electricity producers, traders, suppliers and facilitating organizations like consultancies, research institutes and brokers, who either have a certificate account at their national issuing body and/or wish to influence policy making on governmental and system level concerning renewable electricity certificate trading in Europe.

National Responsible Organizations

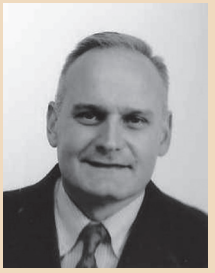
Table 1 Issuing and Competent Bodies of AIB Members

Country	AIB Member / EECS Issuing Body	Designated Competent Body
Austria	E-Control	E-Control (regulator)
Belgium Brussels	Brugel	Brugel (regulator)
Belgium Flanders	VREG	VREG (regulator)
Belgium Wallonia	CWAPE	CWAPE (regulator)
Denmark	Energinet.DK	Energinet.DK (TSO)
Finland	Grexel (Private)	Fingrid (TSO)
France	Observer (Private)	RTE (TSO)
Germany	Oeko-Institut (Private)	UBA (environment agency)
Iceland	Landsnet	Landsnet (TSO)
Italy	GSE	GSE (renewable energy agency)
Luxembourg	ILR	ILR (regulator)
The Netherlands	Tennet	Tennet (TSO)
Norway	Statnett	Statnett (TSO)
Portugal	REN (TSO)	LNEG (energy laboratory)
Slovenia	Agen-RS za energijo	Agen-RS za energijo (regulator)
Spain	GCC (private)	CNE (regulator)
Sweden	Grexel (private)	Svenska Kraftnät (TSO) / Energimyndigheten (regulator)
Switzerland	Swissgrid (TSO)	Swissgrid (TSO)

Box 1 Institutions and Organizations

Reverse Charge Applying to Electronic Telecommunication Services (including VOIP) in France

FRANCE



François TRECHOT
Deputy Head of VAT MTIC anti-fraud units (International Investigations and audits) General Directorate of Public Finances – Direction Nationale d'Enquêtes Fiscales

DNEF – 6bis rue Courtois 93695
Pantin cedex France
Tel : +33 149 91 82 52
E-mail: francois.trechot@dgfip.finances.gouv.fr

François TRECHOT works for the French National Tax Investigation Directorate (DNEF). After four year at the head of the French VAT anti-fraud investigation team, he is now deputy head of a large unit including investigation, and tax control teams, all dedicated to fight VAT carousel fraud. He is also within the Euroofisc network, coordinator of the Working Field 1, dedicated to carousel fraud.

By François TRECHOT

France

The general background

In the European Union, after the dramatic episode of the CO2 fraud, we saw that kind of fraud moving to the energy markets (gas, electricity, "green and white certificates").
This shift led to a vigorous reaction by the French authorities, in order to:

- Protect the French market;
- Alert our neighbours;
- Stop the newly born fraud.

This reaction in France, to protect energy markets also forced the players not only to seek for new commodities (precious metals as well as VOIP and prepaid phone cards) …but also to use different approaches.
For instance, for the past years, most of the companies involved in carousel chains were all EU based. With the intensification of the exchange of information within the EU, and the rapid reaction units set up in the 27 Member States, the fight against this type of fraud has increased in efficiency. The response to this reactivity has been a change of countries involved and more and more channels outside of the EU.
To these new schemes IOTA should be the vehicle with which to provide a pro-active response. The organisation could be used as a precious tool and network to support the operational teams in charge of this type of fraud, always in accordance with the regular and official procedures of exchange of information.

The situation in France

A) A major concern: Defend and protect the energy markets

In order to avoid a repetition of what happened with the CO2 it was decided to launch several operations in the field on a national level, not only against suspicious companies, but also...

B) ...Through the involvement of all principal players in the market

Tax administrations and the business world (EEX etc.) worked together to fight potential fraud. Media, conferences, search and seize operations, tax raids, etc. were used at the same time to reach a common goal.

C) Multi-level action

- These actions, in the field but also on the legal side (reverse charge) had several results.
- Lukewarm results (mainly for other countries besides France):
- Fraudsters started to create companies in other countries (in or outside the EU) to carry on targeting VAT, using wider loop chains.
- But also turning to other commodities, such as VOIP.
- Positive results were recorded in France:
- Almost no attempt to carry on "attacking" the French energy markets.
- Several French suspicious companies were deregistered.
- France gave help and support to other countries detected as targets during the investigation in France, and found out that the VOIP could be a new trend trying to target our country.

The VOIP market

A) What is it? Voice transport via the Internet instead of the standard network

- This new technical tool is aimed to reduce the cost of communication (in particular on the international side).
- How does it work? Calls are made from computer, mobile or landline phones.
- Using dedicated software, such as Skype,
- or dialling a specific telephone number included in a SIM card.

B) The fiscal treatment

As it is a purchase/sales market of minutes, it is considered as services.
(B2B = VAT in the country of consumption)

C) How to use it as a fraud commodity:

The main risk is the B2B market with the following short list providing a few warning signals:

- Sudden increase in volume in transactions on the market;
- Electronic transactions (purchases, sales and immaterial service);
- Fully open market.

D) Main possible features

All these characteristics enable possibilities of fraud, supported by VOIP through:

- "Classical" carrousel fraud;
- Carrousel involving an extra EU company;

Or through a pre-paid card network:

- "Classical" carrousel fraud;
- False invoicing is facilitated through massive cash payments;
- Cards used to pay undeclared workers in the construction industry.

The alarm

Thanks to various alerts from the market and other administrative data, France decided to focus on that trend. According to internal experience and other Member States' experience, such as:

- Italian experience showing that it is possible to use this commodity for fraud;
- French Police and Customs: Telephone interceptions of French mafia leader

It was evident that a major attempt of fraud was about to start, led by major French carousel fraudsters.

France's reaction

A) In the Field

As already tested in the energy market, it was decided to act quickly.

- Major actions were undertaken within 2 to 3 weeks of the warning signals:
- Major telecom operators were contacted and the situation not only explained, but also their possible involvement in the fraud;

- Right of communication gathered information regarding clients and suppliers;
- Invoicing controls were carried out to check the quantities and price ratio;
- Tax audits were carried out rapidly: Most of the companies had already gone…
- …but money could be seized: 300,000 Euro.

B) On the legislative side

In the meantime, a rapid change of the French legislation was implemented. Evidence presented after the detection of a threat of a massive VAT fraud led to an almost immediate entry into action of the new regulation: reverse charge of electronic telecommunications.
At the same time, an important communication campaign with the major Telecom players was launched in order to both inform the market of a potential risk of fraud and to also warn the market of the dangers of their implication in any future fraud. Now they cannot pretend that they were not aware of what was happening.

Conclusion

Strong coordination, determination and will between all the partners is the key to success. The faster we react, the better for our national Treasuries.
That is one step further in the fight, but…what will be the next commodity?
In the meantime, the EU has launched an interesting quick reaction mechanism, a sort of "reverse charge on demand", to combat VAT fraud with greater efficiency and to protect the Member States in a faster way. Time is, more than it has ever been, money! The faster we react, the more we will save.

Which Strategy to Tackle Tax Fraud on the Internet?

FRANCE

Franck BENOIT
Chief Tax Inspector
Direction Générale des Finances Publiques

DNEF – 6bis rue Courtois – 93695 – Pantin, France
Tel +33 49 91 82 98
E-mail:: franck.benoit@dgfip.finances.gouv.fr

My unit is in charge of the detection of tax frauds on the Internet. For now almost three years, we tried to invent a new methodology to tackle it, focusing more on financial aspects, both with good technical skills.

By Franck BENOIT

France

The economic activity on the Internet has expanded considerably. According to a recent study, it reached 4.2 trillion dollars in 2011 in comparison to 2.3 trillion a year earlier. If the Web were compared to the GDP of a country, it would be the fifth largest economy in the world.
This highlights the importance of the economic and legal aspects, and, consequently, the need for States to control an activity that partly escapes the classic controls. Indeed, the economic activities on the Internet are characterized by the dematerialization of sales channels and the difficulty often encountered to identify the legal structure operating on behalf of the website.

Detection of tax fraud on the Internet means, not only of course a good knowledge of the technical aspects, very important to lead relevant investigations, but also the use of specialized tools appears to be the way to reduce material tasks and especially to get a concise overview of all the data, which is multiplied compared to traditional investigation.

However, the technical approach should not be the only way to consider the problem. The risk of losing sight of the tax evasion itself is real as the field of investigation is very large.
It is necessary to define a strategy to tackle tax fraud on the Internet. This leads us to examine the role played by the major Internet companies (I) and to then define a new strategy for monitoring and detection (II)

The role played by major Internet companies

The general Internet structure is based on several stakeholders. To understand the way they work determines how the necessary information can be collected.
This can be divided into four parts:

- The hosts
- Internet Service Providers

- Logistics companies
- Companies involved in the funding of an e-business.

The hosts

Their activity

These activities form the natural support to a website: they enable the storage of information provided to users as well as the connectivity needed for transmitting data through the Internet.

They can deliver several pieces of information:

- Contract signed by the owner of the website
- Cost of service delivery
- Means of payment
- IP addresses of the webmaster
- Volume of data received and transmitted.

The hypothesis of a host located abroad is a major problem for the investigation services as territorial regulations do not make for easy analysis of the company.

How to use collected information?

Knowing who runs or administers a website, especially when the "Who is" data is anonymised, is very useful. However, information about the volume does not allow one to draw conclusions about the real economic activity. Likewise, the cost of service is not always relevant.

Internet Service Providers (ISP)

Their activity

An ISP's purpose is to connect a machine or network to the Internet in order to transmit or receive electronic data.

It can deliver several pieces of information:

- Contract signed by the owner of the site
- Cost of Service
- Means of payment
- IP addresses of the connected machine (or network)
- Volume of information received and transmitted.

How to use the information collected?

The information is very useful to discover who administers a website, especially when the "Who is" data is anonymised.

They are particularly useful in proving the domicile: as the computer is connected to a physical network, it is very strong evidence when it is reported to be in the country of taxation.

Logistics companies

As mentioned above, economic flows linked to the Internet have grown considerably. Physical flows associated with Internet purchases have also increased significantly. We observed the development of firms specialising in the delivery of parcels purchased on the Internet. It is possible to obtain information from here on the number of parcels and their weight.

This is a good indicator of commercial activity and can be used as an evidence for an investigation.

Ways to finance an e-business

The two main ways are: advertising and means of payment. **They represent a major way of detecting tax fraud.**

1) Advertising

Historically, the Internet is free, unlike several national systems, such as Minitel in France: the network connection does not require any payment.
Advertising is emerging as a major way for financing websites. Two models coexist:

- The traditional model: advertising messages are inserted on web pages and their cost is related to attendance and / or numbers of clicks on the banner.
- The new model: the display of advertisements is directly related to the user's searches or his points of interest.

The business operation is the same in both models: the customer (the advertiser) asks a specialist (either a media agency or direct to an advertising agency) to place an advertisement in a space belonging to a third party.
This scheme has two consequences:

- The commitment of an advertising budget by an advertiser is evidence to suggest that an economic return is expected. Information collected by tax authorities on this subject can be cross checked with information from tax returns, and

also provides a good clue for potentially weak sales.

- The third party may also have a tax interest from the amounts of money received for advertising space.

In France, the stakeholders of the traditional model are mostly French companies and it is easy to get information from them.
Considering the new model, it is mainly set up or performed by companies located abroad.
In this case it is impossible to exercise the "right of communication" according to territorial rules. International Administrative assistance is not efficient.
There is a way to circumvent these obstacles: media agencies. They are responsible for implementing advertising campaigns on behalf of the advertiser by determining a communication strategy. They therefore possess information allowing cross-checks.

2) Means of payment

The credit card remains one of the most popular means of payment on the Internet. However, security considerations related to practical issues has led to the creation of a dedicated means of payment for purchases over the Internet. There are mainly two:

a) Micro-payment
Most of the transactions on the Internet consist of small amounts. This is true especially for the communication of a code to unlock a page or a video.

Some companies specialize as an intermediary between the website providing the service and the Internet users who want to acquire it: when they decide to buy, the amount requested is paid by using one of the payment methods at his disposal, such as credit card, SMS, etc. The intermediary then makes periodic payments of the amounts collected to the beneficiary, minus their commission.
Observation of this sector has shown that these companies are mostly national.

b) Electronic wallet
This means of payment is very close to a "classical"bank account but dedicated to Internet purchases.
The user must create an account and link it to a bank account (or a credit card) in order to carry out operations of debit / credit.

After an Internet transaction, the amount received or paid by the user is transferred through the banking system and the counterpart transaction is performed.
One of the difficulties is that the main company handling this type of operation is located abroad.

However, this problem was resolved: after deep web investigations, it was discovered that a banking intermediary established in the national territory, was in charge of clearing operations with the central bank.
Therefore, the revenue body was able to obtain information and draw up an analysis of financial flows.
All these elements lead to a new strategy for fraud detection on the Internet.

The new strategy for monitoring and detection on the Internet

The size of the Internet requires the defining of a strategy aimed to concentrate administrative actions towards the most relevant aspects to identify tax fraud.
Information collected by some stakeholders on the Internet can be very relevant for tax purposes and their use may be suitable for mass operations.
Exploitation of tax databases or of information collected on the Internet is also a way to detect tax frauds.

This approach should reduce the need for specific searches for individual investigations, whose origin is purely "linked to an event".

A. Fraud detection can adopt a comprehensive approach.

1) A comprehensive collection of information from Internet operators

We have already seen the role played by the actors involved in payment and advertising.
It is also a good way for a global understanding of the Internet.

a) Means of payment
The micro-payment: operators are often national ones. This provides an element of trust for the users.
Tax authorities can carry out regular mandatory disclosure of information (annually) to determine repayments made to legal structures / individual beneficiaries, targeting the most important issues.

The experience has pointed out three main tax issues:

- Undisclosed activity
- Hidden sales
- Relocation of the business beyond national borders.

This approach also enables us to have a better understanding of the quickly growing websites' business and

contributes to increasing the service's knowledge.
Electronic wallet: the largest operator is American. For the moment, it does not consider itself to be a permanent establishment on the national soil and therefore does not comply to the mandatory disclosure of information, except through an electronic platform dedicated to the government services, but requires the transmission of a claim in the name of a foreign entity, difficult to implement because of territorial rules.
However, deep investigations made by the service allowed us to circumvent the problem (cf supra).

Thus, "rights of communication" has been made with the intermediary bank between the owner of the electronic wallet and the domestic banks whose accounts they are linked to.
A very large amount of information has been collected, which enabled the detection of tax issues very similar to those already mentioned above for micro-payments.

Other mandatory disclosures of information will be requested from this intermediary to provide a general oversight of the Internet industry.

b) Advertising
The Internet advertising market is mainly held by a U.S. company. It is almost impossible to obtain information through the mandatory disclosure of information.
The question was how to obtain information related to advertising campaigns undertaken by national companies?

- The problem was circumvented thanks to the knowledge of the service about the media agencies' role. They perform intermediary operations between the advertising company (like Google, Facebook, Yahoo ...) and the customer who ordered the advertising campaign. As such, they keep all the invoices issued by the advertising companies.

- We can therefore have some idea of the charges paid by a company for an advertising campaign and compare this with their tax return data, in order to assess the economic coherence.

In other cases, the information gathered from media agencies enabled the establishment of proof of a permanent settlement of companies located in the field of advertising by identifying the inconsistencies between the real location of the company and the legal one, often different.

- However, only large companies are using media agencies. Information on smaller companies is not easy to get.

Advertisers located on national territory: a survey of major advertising companies has been done and mandatory disclosure of information have been forwarded or sent out to find out the repayments they made, with websites that have agreed to join, for insertion of advertising space.

This operation must be conducted regularly. All the information collected is risk rated.

The analysis of these is then processed by the Tax administration experts in this area: using dedicated software, websites' references... Technical knowledge of the mechanisms of the Internet is highlighted.

2) Global collection of information from the Internet

This is essentially the identification of sites most visited through a "hit parade". This operation is a good way to set general monitoring of the Internet. It is made from the "top 100" made by Google and Alexa and on sites visited by French Internet users.

B) Can be also linked to dedicated events:

The service also collects information from the press or from events dedicated to the Internet.

1) Technical and general press
Various newspapers on the subject can contain information regarding operations of Internet companies, useful for carrying out investigations but also to detect tax issues. Thus, a foreign company touting its organization in France could be further investigated by the service.

2) The two events dedicated to the Internet
The same aim is pursued here. This is a unique opportunity to experience changes in the sector and new players. Tax fraud detection on the Internet presupposes firstly a very good knowledge of the key players. This is a fundamental element to establish lines of investigation. Technical elements are also significant but should not be central to the pursuit of Internet fraud. These elements should lead tax authorities to define a strategy for monitoring and controlling activities of the Internet, taking into account all the aspects discussed. Cooperation between member countries of IOTA is naturally still very important. The combination of these components enables tax administrations to fight effectively against tax fraud on the Internet.

Fiscal Monitoring in Italy

ITALY

Valerio RONDONI
Tax Official
Italian Revenue Agency – Central Directorate for Assessment – Central Office for Contrast to International Tax Offences

Corso Vinzaglio, 8 – 10122 Torino, Italy
Tel +39 011 558 7015
E-mail: valerio.rondoni@agenziaentrate.it

Mr. Rondoni holds a degree in business economics. He joined the Italian Revenue Agency in 2003, where he worked in many assessment's areas (e.g. individuals, small corporations, etc.). Since October 2009 he's been working for Central Office for Contrast to International Tax Offences, dealing with both abroad hidden assets and fake foreign residence.

Gennaro AULENTA
Tax Official
Italian Revenue Agency – Central Directorate for Assessment – Central Office for Contrast to International Tax Offences

Via De Marchi 16 – 30175 Venezia, Italy
Tel +39 041.2904184
E-mail: gennaro.aulenta@agenziaentrate.it

Mr. Aulenta holds a degree in Law. He joined the Italian Revenue Agency in 2010, where he worked in the individuals and corporations tax assessment area. Since February 2010 he's been working for Central Office for Contrast to International Tax Offences, dealing with both abroad hidden assets and fake foreign residence.

By Valerio RONDONI and Gennaro AULENTA

Italy

1 – Introduction

a - *Notes on the reasons for the capital outflow from Italy*

Tax evasion is universal, and takes place in all societies, social classes, professions, industries and economic systems. In Italy though, it is very widespread. True, it depends on the general economic and tax structures and types of income but, as regards Italy, it primarily depends on social attitudes. The science that studies the theory of tax evasion, when applied to Italy, shows its bigger limitations, since it primarily rests on attitudes toward risk.

In Italy tax evasion is wide-spread for:

a- historical reasons, since Italy has been a unitary state for only 150 years, and many of its citizens still lack consciousness of national unity, and

b- for geographical reasons, since it borders Switzerland and the Republic of San Marino, both of whom have a long tradition in providing financial services as tax havens.
With its 17% of GDP, tax evasion accounts for a third of all Italian private economic activity.
Measures to address tax evasion include the use of withholding taxes, presumptive and minimum taxes, selective auditing and penalties. Letting aside that in Rome, more than two thousand years ago, Plato wrote, and complained about it, and more recently, during the 18th century in Venice, people used to inform local authorities about tax evaders, through a stone with a hole in it in the Ducale palace. In Italy there is wide-spread awareness of the need to take urgent measures to tackle tax evasion. Effective measures are being put in place to tackle the problem. The Italian Republic may now be considered among the leading countries in the fight against international tax avoidance for a number of reasons:

1) economic, since it is a manufacturing economy, exporting goods and capital, with a very large public debt;

2) political and social, since many wealthy Italians (individuals and companies) used to hide their assets illegally abroad, seeking tax savings and waiting for amnesty that was periodically granted by the government.

Very recently a deputy director-general of the Central Bank of Italy told the parliamentary anti-mafia committee in Rome that 27.4% of gross domestic product in Italy, the euro zone's third-largest economy, is "off the books". It is the result of a study showing that 16.5% of the Italian GDP was underground and another 10.9% of the GDP consisted of criminal activity such as prostitution and drugs. If it was possible to levy revenue on the more than 400 billion euro in unrecorded activities at the 45% tax rate applied to the "White" economy, Italy could eliminate its 2 trillion euro public debt in less than a decade, or reduce it to the critical 60%-of-GDP level by 2017. Local stereotypes suggest tax evasion is particularly high in southern Italy, where Istat (the Italian Statistics Agency) says only 43.3% of adults hold formal jobs, but nevertheless tax evasion has helped Italians to add up over the time an average household wealth eight times greater than their disposable income, according to the central bank. A higher level than in Germany, France or the U.S. Most of this wealth is taken abroad, pushing almost every Italian government to the brink, as they have to manage a choice whether constraining the capital outflow, even though it could lead to conflict both internally and in relation to foreign countries, or tolerating it and trusting it would help the internal economy's growth, even if it could threaten the stability of public finances.

b- Protectionism and EU influence in favour of economic freedoms

If the common trend in international economic policy of developed countries was oriented towards protectionism until the end of World War II, free trade policies have prevailed more recently thanks to the enforcement of international treaties and organizations such as the World Trade Organization (WTO) and the European Union. The EU (former EEC) was founded in order to set up a single transnational market, which is intended to ensure freedom of movement for people, goods, services and capital.
Concerning the freedom of capital movement, Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the European Treaty was implemented by Ministerial Decree of 27 April 1990. The Italian government decided, just for tax purposes, to issue another set of rules that regarded certain foreign money, securities and assets possessions and transfers: it was Decree Law 28 June 1990 number 167, which introduced the Italian fiscal monitoring (a.k.a. tax monitoring).

c- Italian tax monitoring

The new rules were basically aimed to highlight the size and flow of foreign money and assets owned by resident taxpayers, so that avoiding Italian taxation would be less easy. They are based on three main pillars:

1) obligation for resident financial institutions and intermediaries involved in money transfer (banks, investment firms, Italian Postal Service etc.) to maintain evidence of every transfer (to or from foreign countries, in excess of Euro 10,000) and general information on the resident tax payer (individual, non-commercial entity, partnership or association identified by Article. 5 of the Italian Tax Code) which ordered it;

2) obligation on the above-mentioned resident taxpayers to fill a special form of their tax return, named RW form. This form is divided in three sections, which are dedicated to:
I. money transfers to and from foreign countries carried out without going through resident financial intermediaries, for reasons other than investment (cash flows);
II. stocks accumulated abroad (assets and financial stocks);

III. transfers to and from abroad concerning foreign held assets and investments (cash flows).

3) severe penalties were provided for the violation of the above mentioned reporting obligations.

2 – Decree Law N. 167 of 28 June 1990: Tax Monitoring

a- Reporting obligations of financial intermediaries (Article 1)

This set of legal obligations applies to every financial intermediary, which means:

- Banks;
- Financial brokerage companies;
- Ente Poste Italiane (Italian Postal Service);
- Investment trust companies;
- Trust companies;
- Any other intermediary who, by reason of its professional activity, transfers – or takes part in the transfer of money from/to abroad.

Those financial intermediaries have to keep evidence of:

- Transfers to/from abroad of money, securities, certificates, even made through bank accounts, or bank/giro cheques or bank draft;
- Purchase and sell of foreign certificates and securities.

Provided that the amount transferred exceeds 10,000 euro, and such a transfer is made on behalf of **resident** individuals (even those who hold professional or business income), non-commercial entities and ordinary partnerships (and those which are considered "ordinary partnerships" pursuant to Article 5 of the Italian Tax Code) and trusts performing non-commercial activity.
For this purpose it must be kept and recorded evidence regarding:

- personal particulars (or name or trade name);
- domicile;
- tax identification number of the taxpayer concerned;
- date of the transfer;
- reason for and amount of the transfer and, if any,
- essential data of the destination account.

Records of each year are electronically transmitted to the Italian Tax Administration by the 31 March of the following year, and are available to the Tax Administration for 5 years.

Tax monitoring obligations do not apply in the case of

- transfers to/from abroad in connection with agreements and activities concerning Administered and Managed Savings, when the relevant option has been exercised by the taxpayer. These special tax regimes are managed by a resident financial intermediary, who has to withhold the correct taxation on income connected to the transfers;
- capital imports concerning transactions that will yield capital incomes, provided that those in comes have been subject to withholding tax or substitute tax by a resident financial intermediary.

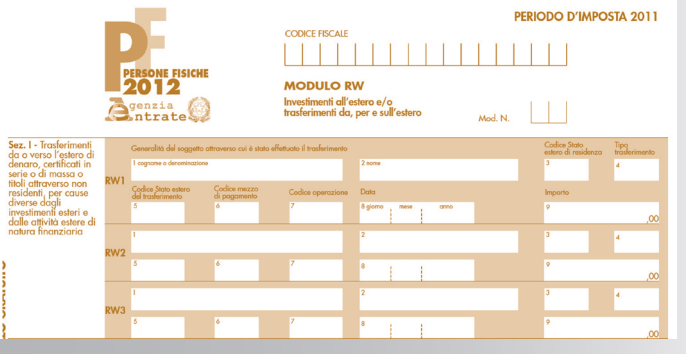
b- Reporting obligations of individuals, non-commercial entities and trusts, ordinary partnerships and s imilar entities (Article 2, 3 and 4)

If capital transfers are performed without any resident financial intermediary, but they are not connected to foreign investment or assets, the above-mentioned taxpayers are obliged to state in their tax return the kind of capital transfers to and from abroad, provided that the total amount of transfers made during the relevant tax year exceeds 10,000 euro.
To this purpose Italian tax return contains, as mentioned above, a devoted part (Section I of form RW).
Tax payers owning foreign investments and financial assets that exceed 10,000 euro which may produce a capital income taxable in Italy (e.g. immovable property, yacht, valuable object, work of art, securities, bonds, derivatives, financial insurance policies, etc.), have to state them in the relevant section of the tax return (Section II of form RW), sum-

Data Movimetazione	01/01/2008	**Importo**	1.500.000,00 Euro
Operazione	EXPORT	**Natura**	FINANZIARIA
Causale	ASSUNZIONE PARTECIPAZIONI NON RAPPRESENTATE DA TITOLI		
IdentificativoTitolo	-		
Ente Fornitore	12345678910		

TIPO DI OPERAZIONE: EXPORT DATA MOVIMENTAZIONE: 01/01/2008
NATURA DELLA OPERAZIONE : FINANZIARIA
IMPORTO MOVIMENTATO : 1.500.000 (EURO)
CAUSALE MOVIMENTAZIONE : ASSUNZIONE PARTECIPAZIONI NON RAPPRESENTATE DA TIT
STATO ESTERO : LUSSEMBURGO
ENTE DOVE E' TENUTO IL CONTO: BANK OF LUXEMBOURG

Image no. 1 – Example of tax monitoring data, available for tax officers



PERSONE FISICHE 2012
Agenzia Entrate
PERIODO D'IMPOSTA 2011
CODICE FISCALE
MODULO RW
Investimenti all'estero e/o trasferimenti da, per e sull'estero
Mod. N.
Sez. I - Trasferimenti da o verso l'estero di denaro, certificati in serie o di massa o titoli attraverso non residenti, per cause diverse dagli investimenti esteri e dalle attività estere di natura finanziaria
Generalità del soggetto attraverso cui è stato effettuato il trasferimento
1 cognome o denominazione
2 nome
Codice Stato estero di residenza
Tipo trasferimento
Codice Stato estero del trasferimento
Codice mezzo di pagamento
Codice operazione
Data
8 giorno mese anno
Importo
RW1
RW2
RW3

Image no. 2 – Individuals tax return for tax year 2011- Section I of form RW

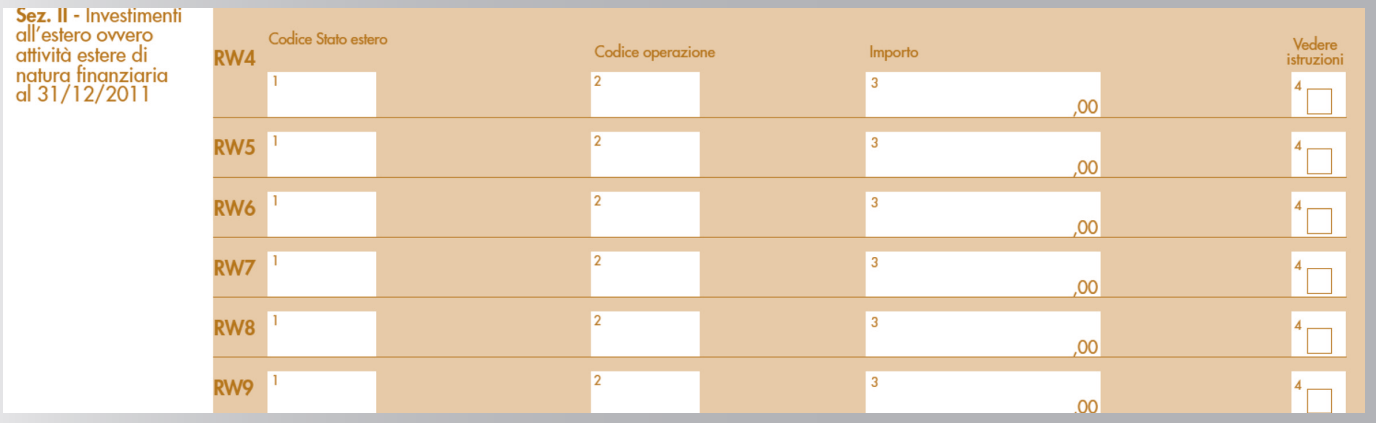


Image no. 3 – Individuals tax return for tax year 2011 - Section II of form RW

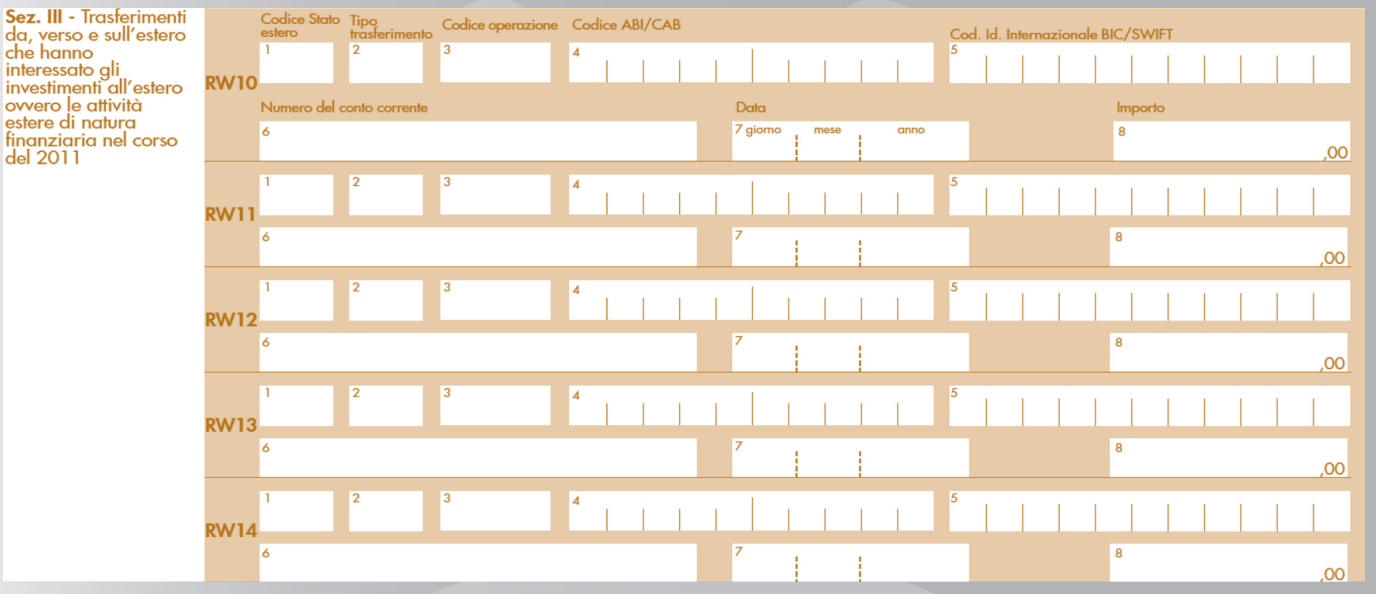


Image no. 4 – Individual's tax return for tax year 2011 - Section III of form RW

marising the stock and the total amount of investments held abroad at the end of the tax year. All financial movements, exceeding 10,000 euro, related to investments and financial assets held abroad, made during the relevant year shall be stated in the devoted tax return section (Section III of RW form). Those movements are usually related to the stocks reported in Section II, however there are some cases when these financial flows shall be stated even if at the end of the year the tax payer does not hold any investment or financial asset abroad.

c- exemptions from "tax monitoring"

In a few cases, taxpayers don't have to return their "tax monitoring" form. These exemptions are strictly related to cases when institutional financial intermediaries are involved, as it could be the case for:

- certificates and securities subject to the relevant substitute tax managed or administered by resident financial intermediaries;
- agreements concluded through the above mentioned intermediaries responsible for collecting the associated income;
- deposits and current accounts, provided that their incomes are collected and taxed through the fore mentioned intermediaries.

It is clear that the exemptions for returning the tax monitoring form, (RW form of the tax return) for tax payers is directly connected to the resident financial intermediaries' compliance, since they are charged with monitoring and/or taxing the flows linked to foreign investments. According to the law, Article 1 Decree Law 167/90, the intermediaries that omit the tax monitoring report, as described above, see chapter 2.a, shall be fined up to the 25% of the money flow they have omitted to monitor and report.

d- Penalties (Article 5)

Failure in monitoring tax obligations can create very severe penalties, which depend directly on the value that should have been reported:

- For financial intermediaries (see Article 1): 25% of the amount not regularly monitored;

- For individuals, non commercial entities, etc. (see Article 2):
- Tax return RW Form, Section I: 5 to 25% of not reported amount;
- Section II and III: 10 to 50% of the non-reported amount and (just in case the taxpayer refuses to settle the violation without argument) the confiscation of unreported financial assets held abroad.

It should be noted that the whole Italian system of tax penalties is ruled by general principles fixed by Legislative Decree Law n. 472 of 18 December 1997.
Article 12 of the above mentioned Decree Law regulates the cases where there is more than one violation, and / or violations have been committed over many tax years; in these cases the sanctions imposed shall be based on the most serious violation, increased between a fixed range taking into account some additional criteria issued by Article 7 (e.g. tax payer's behaviour, etc.), instead of the sum of all the penalties provided for every violation.
As a result, the penalties can avoid the risk of becoming incongruous in comparison to the amount not declared in the RW section.

e- Forfeit taxation (Article 6)

In the case of failure to completely fill section II of the RW form (the statement concerning investments and financial assets held abroad) by ticking a special box, which states that those incomes will be collected in a subsequent year (e.g. a long term zero-coupon bond) or that they yield no gain, certificates and securities are presumed to be productive of an income equal to the average official discount rate.
The taxpayer can prove that the foreign investments have produced no income or a lower income, since the assumption of being productive is only a guide, but evidence must be presented within 60 days from the financial office's formal request.

f- Tax shield (Article 12 and 13bis Decree Law no. 78 of 1 July 2009)

During the last 40 years the Italian government has carried out six tax amnesties. The last one was different from the previous ones, because it was specifically oriented to encourage the "legalization" of investments held abroad through compliance with the Italian monitoring and reporting requirements. It was the so-called "tax shield".
The amnesty applied to citizens who before 31 December 2008, had exported or held investments overseas in violation of tax monitoring rules.
The amnesty enabled "taxpayers" to either repatriate the investments to Italy or to "regularize" their position before the Italian tax authorities started any action, while maintaining the investments abroad. Both taxpayers and tax administration could take advantage of the tax shield.

For taxpayers, joining the amnesty resulted in:

- Suspension of any assessment concerning taxes and charges, even in respect of any third party responsible for taxation (e.g. heirs, donors);
- Cancellation of related penalties;
- Impunity for criminal tax offenses.

The tax shield had no effect on any other kind of criminal offences, such as money laundering, which could still be prosecuted.
For the tax administration, the foreign assets' amnesty linked to tax monitoring obligations has been useful in terms of both direct revenue and improvement in knowledge of activities abroad. According to the data issued by the Italian Treasury in June 2010, the tax shield created a total cash flow of 5,6 billion euro and recovered activities of 104,5 billion euro.
A deterrent to hiding assets in a tax haven or to violation of fiscal monitoring reporting obligations has been added by Article 12 of Decree Law 78 of 1 July 2009, under which investments and financial activities held in tax havens are deemed to result from tax evasion.
It is worth noting that the list of countries to be considered tax havens for the purposes of Article 12 is contained in two ministerial decrees, which are regularly updated to take account of changes in national and international legislation (e.g. OECD's black and grey lists, Double Taxation Agreements, Tax Information Exchange Agreements, etc.).

4 – Practical use of fiscal monitoring:

a- Notes on U.C.I.F.I. and the use of fiscal monitoring for control purposes

Fiscal monitoring data has been available since the early '90ies, but their systematic use for tax control purposes started only a few years ago, mainly thanks to the establishment of a new office within the Central Directorate for Assessment of Agenzia delle Entrate (i.e. Italian Revenue Agency), the UCIFI (Central Office for contact for International Tax Offences). This Office has been developing innovative methods to deal with international tax avoidance, through a fruitful liaison

with both other internal Authorities (e.g. Public Prosecutors, G. d. F., Financial Intelligence Unit by Italian Central Bank, etc.) and Foreign Tax Authorities; as its main goals were fixed in terms of seeking assets hidden abroad and of exposing the fake foreign residence of wealthy individuals. Noticeably the first source of information often came from fiscal monitoring data. The task of the UCIFI is mainly that of checking the flow of capital from Italy to other countries and vice versa, and analysing the foreign tax residencies (relocation abroad) of both Italian companies and individuals.
One of the first investigations carried out by UCIFI concerned wealthy taxpayers exporting capital abroad between 2007 and 2008, using data reported by institutional financial intermediaries about taxpayers who had not submitted the RW section with their tax return. The monitoring of about 3,000 Italian individuals who made significant investments in the Czech Republic without declaring such investments in Italy, confirmed that only 158 had declared their investments abroad, properly filling the RW form of the tax return. The UCIFI identified around 200 individuals who carried out very significant investments of capital and shielded them by means of companies based in "black list" countries, tax haven countries with a privileged tax regime, characterized mostly by low or even non-existent taxes. This scheme of investment involving "black list" corporations clearly showed that their main purpose was to hide capital and assets from the tax administration. The UCIFI was able to discover people previously unknown to the tax administration who didn't declare any income at all, who held investments abroad, and also a series of pre-organized schemes of investments, made available to the public by very active financial promoters, all performed without declaring the capital flowing out of the country.

b- Criticism and proposals for amendments

The serious penalties provided for not complying with fiscal monitoring reporting obligations are definitely an effective deterrent, but there is also criticism, about the frequency and use that they are put to. The main contention to the current penalties rules comes from the Order of Italian Chartered Accountants, who suggested amendments in order to take into account the general principles of Tax Law (e.g. ability to pay, protection for tax payers' confidence and good faith, proportionality between harm and penalty, etc.). The Order strongly contested the sanctions related to form RW's section III – which is dedicated to the flow connected with foreign assets – as the same data is already reported by resident financial intermediaries, except in the case of totally foreign movements.

Last but not least, the preliminary procedure of infringement under Article 258 of TFEU (a.k.a. Treaty on the functioning of EU) has to be mentioned which the EU Commission recently started, asking to indicate the reasons which justify the application of a system of such onerous penalties. Last October the Italian Government provided responses which did not convince the Commission that, the obligations relating to fiscal monitoring might be disproportionate, to penalties for failing to file the RW form.

5 – Conclusion

Since the beginning, fiscal monitoring reporting obligations acted as a precious source of information to direct tax investigation. The good behaviour of taxpayers was a trade-off between the direct cost of additional reporting requirements on the one hand, and the indirect cost of international tax avoidance on the other. It is not easy to estimate, but the data seems to show the existence of a large amount of undeclared foreign assets: according to the press, tax returns submitted to the Italian Revenue Agency for tax year 2011 reported in Section II of the RW form international activities totalling 32.9 billion euro, of which 19.4 billion consisted of real estate property. The official estimates by the Bank of Italy showed that the financial activities hidden abroad and owned by Italian subjects (individuals, non-commercial entities, commercial entities, etc.) at the end of year 2008 could be estimated between 124 and 194 billion euro. Even though the RW form does not consider commercial entities, and the last four years were characterized by the financial crisis, which has generally decreased the value of assets, the existence of an enormous tax gap is likely, which fiscal monitoring obligations can help to prevent.
Confirmation of this comes from the fact that many other jurisdictions decided to require their taxpayers to declare the ownership of relevant overseas assets, although they do not always produce taxable income: as for instance, U.S. taxpayers are required annually to complete the model 8938 for all foreign activities being worth more than $10,000, whereas taxpayers in Japan from the 2011 fiscal year must declare all their foreign assets worth more than 50,000,000 yen (which at the average exchange rate of year 2011 are approximately equivalent to 450,617 euro) every year.

Therefore the Italian Tax Administration is actually keen to defend the value of these rules, which can obviously be modified in order to comply with the changes in international activities, but not easily taken away without the negative consequences for tax compliance.

The Income Yardstick as an Indirect Method for Estimating Tax Liabilities of Individuals

ITALY

Maria Luisa GUERMANI
Tax Officer
Italian Revenue Agency

Via Cristoforo Colombo n.426 C/D, Roma, Italy
Tel + 39 06 5054 3394
E-mail: marialuisa.guermani@agenziaentrate.it

Ms Guermani is currently working at the Italian Revenue Agency in Individuals Unit. She is graduated in Economics, she obtained the chartered accountant qualification in 2007 and a master degree in fiscal law in 2012. Before joining the Italian Revenue Agency in 2005, she had worked for four years for an important law and tax consulting firm dealing with Large Business Companies.

By Maria Luisa GUERMANI

Italy

Background: indirect methods as a valuable tool to support auditing activities

According to Italian tax law, the assessing activities framework embraces a range of different methods and types of auditing in order to foster effective auditing activities applying differentiated strategies to address a broad range of situations.
The different type of assessment in force in Italy can be sorted by the type of control and by the procedure adopted.
With regard to the types of control, an assessment can be qualified as "formal" when based on the submission of the annual income tax return and is carried out through a cross check analysis between declared data and the related supporting documentation; the control is a "substantial" one when performed on an effective examination of documentation, books and records by a competent revenue office in order to verify if tax returns or balance sheets reflect the taxpayer's real economic condition.
Sometimes, detecting and deterring a non-compliant behaviour require different strategies and approaches including methods relying upon verification and adjustments of income supported by specific and direct evidences and reliable facts (direct controls) as well as methods grounding on the determination of tax liabilities on circumstantial evidences leading to a reasonable estimate of the taxpayers' correct fiscal burden. In this framework, to the extent of the substantial controls, the assessment system in force in Italy allows, among others, tax auditors to evaluate higher income/revenues through logical deduction, starting from a reliable fact to demonstrate facts not proved, by using methods known as "indirect controls".
In this work, indirect methods are analyzed with regard to the individual as a natural person.
The recent increase of high net worth individuals as well as the complex business globalization of economic activities, the overseas movements of

capital and goods, had given the floor to a range of complex situations where concealing taxable income, creating opportunities for evading taxes or seeking advantages through the inappropriate use of the tax have become more simple. These concerns had highlighted the need to enhance any efforts and ability to identify and deal with taxpayers who do not voluntarily report their income to better share the tax burden among individuals.

In the actual economic scenario, the use of indirect methods in determining tax liability, even as a supporting tool or a criterium of selection, has become a "must" and the Italian Revenue Agency has developed an up-to-date and most effective tool able to estimate truly the correct taxpayer's financial situation.

An indirect method gives, in such a way, a new approach which would enable tax auditors to make estimations of the global worldwide income of a resident with the joint contribution of different data (e.g. expenses, investments) regardless the source of income.

As a general common remark, for their features and in order to avoid any misuse, indirect methods are applicable only if certain conditions, fixed in advance by the law, are met, as, for example:

- in case the estimated income is 20% higher than the declared one for the individuals' overall assessment; or
- in case the taxpayer acts as a businessman, whenever books and records are either unavailable or do not reflect the financial taxpayer position or are untrustworthy.

To this end, the Italian Supreme Court (sentence no. 26635/2009), with regard to this object, has stated that logical deductions and indirect methods can only be deemed as a supporting process and they cannot replace the auditing activities.

The useful mechanism of indirect methods is used both in creating risk assessment criteria and both as in persuading those taxpayers who do not meet their obligation to be more compliant, reducing meanwhile the need for the Italian Revenue Agency to take follow-up compliance actions.

Benchmarks industries criteria as well as the income yardstick, shortly available, are at the taxpayers' disposal with the aim to make them aware and better understand how the Revenue Agency consider their business/economic situation as in case they want to make voluntary adjustments in their annual income tax return, pursuant to cost effectiveness and economic efficiency criteria. Citizens who play by the rule will not be touched by this tool.

Indirect methods used for assessing Individual's tax liabilities

As a preliminary remark, it's important highlighting the legal condition in force in Italy which makes possible gathering up and processing for assessment aims (estimate undeclared income) information sourced by third parties, either other taxpayers, either other Public administrations, financial institutions or even professional bodies.

According to article 38 of the Presidential Decree on Assessment no 600 of 1973, beyond the analytical assessment through which the taxable income is determined starting from specific elements and proof with respect of source of income, tax auditors can also estimate the taxpayer's fiscal affair applying the "overall assessment".

With this latter method, the estimation of the total taxable income is grounded on the assumption that all the expenses are paid with revenues gained in the same fiscal year. The overall assessment's core point shifts from the examination of source of income, vital for the analytical assessment, to the analysis of the expenses.

Obtaining information and data regarding every financial and economic affair of individuals plays a key role in giving effectiveness to this method. The main challenge to strengthen this tool is gathering, analyzing and matching information reported to the tax administration by a wide range of sources.

This set of information on expenses and other liabilities are obtained from both internal source data, such as information deriving from the tax register, and from external or "third parties" such as data collected from other administrations and institutions (e.g. social security administrations, municipality, motor or naval registration offices, banks and other financial institutions and organizations). Matching third party information allows to detect who has not declared the correct level of income in his tax return. All these bodies aforementioned are due, according to Italian law provisions, to regularly send to the Revenue Agency flows of data regarding each business or agreement, financial dealing, with economic effect involving taxpayers.

Besides the data above-mentioned, more than 100 types of expenses have been collected through specific enquiries carried out by local revenue offices or in cooperation with "Guardia di Finanza". Information on expenses paid by the taxpayers are grouped in the four following macro areas:

- real estate assets: e.g. information regarding purchases in real estate or rent contracts, utility contracts as electricity and gas, loans and mortgages, expenses on house restructuring and

house servants, purchases of white goods;
- means of transport: e.g. purchases of luxury cars, boats, airplanes, cars, motorcycles, caravans, mini-cars;
- free time and leisure: e.g. expenses for travels, horses, beauty farms, hotels, auction houses, art galleries, investments in arts, exclusive clubs or membership, veterinarian expenses for any domestic animals;
- other sources: e.g. social security contributions, financial flows, donations, divorce allowance, insurance payments, bank interests, expenses for education, including prestigious schools, language schools, training and specialization schools, post-graduate masters.

The Income Yardstick as a method to enhance tax compliance

With regard to the overall assessment, the Italian Revenue Agency has been developing, starting from the fiscal year 2009, an inductive process, named "income yardstick" enabling to predict the annual individual income on the basis of tax liability indicators such as: family composition and geographic area of residence.
Any evidences of liability expressions jointly contribute, pursuant to the income yardstick, to estimate the income level through a statistical-mathematical formula, a "regression function", which calculate the overall income having regard to homogeneous clusters differentiated for geographic area and family composition.
Each data and expenses collected will have, for its own categories, a different weight and contribute in determining income referring to the family composition (e.g. single, family with no children, family with two children, etc.) and localization of the territory (geographical residency in the north east, north west, center, islands and south of Italy); consequently, the homogenous groups identified with these characteristics and variables are 55. The steps of the working mechanism of the income yardstick are the following:
- picking out homogeneous family clusters (life stage);
- selection of the taxpayers deemed to be "normal" on the base of coherence indicators between expenses incurred and income declared which are deemed to be the trainer of the models;
- analysis and comparison between declared income and tax liability indicators.

For those whose predicted income level deviate the largest from the confidence interval of declared income, their statuses will have been selected for auditing, taking also in due account that this assessment triggers whenever the estimated income is 20% higher than the declared one according to article 38 of the Presidential Decree no 600 of 1972.
As mentioned before, this calculation will be available to each taxpayer in order to get him aware of his eventual status of incoherence. In this latter case, with regard to the overall assessment, the natural person is free to opt or not to comply with declaring more level of income in order to reduce the discrepancies.
Pursuant to the Italian Supreme Court sentence (no. 12187 of 2009), expenses contribute to the estimation notwithstanding the effective use or the possession of the items/services paid, so that the burden of proof of showing evidences switches to the taxpayer. In this case, the mere incurring expenses is a circumstantial evidence of "ability to pay" until the citizen can prove otherwise. The Italian Supreme Court (sentence no. 17805 of 2012) has stated that the taxpayer is allowed to justify his position also demonstrating that a real estate has been the object of a donation in the form of a simulated sale. To this extent, it's worth stressing that before issuing any tax assessment notice, the Revenue Agency is bound to invite taxpayers in order to allow them to make objections and show evidences in their favour.
In any case, as a condition to ensure taxpayer's guarantees, the statistical/mathematical methods can only support the auditors' assessment activity which have to be grounded on other specific elements of investigations.
The taxpayer can demonstrate, through the cross questioning, that the discrepancies between the declared income and the estimated one might be justified by demonstrating, for example, that his own position doesn't fall within the correct benchmarks' cluster, or, going more in detail, that the gap between the declared income and the estimated one can be narrowed by the ownership of unreported income so as: tax exempted income or income subjected to a withholding or substitute tax (typical in case of passive income), or exempted in application of a conventional agreement on the avoiding of double taxation or even inheritance, win, donation, payment provided with funds coming from another person or relatives or income from foreign source, land income or insurance refund. The Italian Supreme Court (sentence no. 6813 of 6/3/2009) has stated that the taxpayer has to prove not just the mere availability of such income but also that expenses have been paid with such income.
With the overall assessment, the global income is entirely identified regardless its own source and the specific calculation characteristic.

Although concealed tax allowance cannot be considered, tax allowance and tax relief previously declared in the annual income tax return or provided by the law, could be deducted by the overall income so as it comes out.

As a further guarantee, the Revenue Agency is due to start a procedure aimed to settle the assessment pursuant to the so called "agreed assessment institute"; according to art. 2 of the Legislative Decree no. 218/97, within 20 days, the taxpayer can profit by paying the agreed due amount and penalties reduced to 1/3.

If the quoted agreement fails, the taxpayer can propose a judicial appeal against the notice of assessment issued or be compliant by paying the due amount within 60 days with penalties reduced to 1/3 according to article 17 of the Legislative Decree no. 472/1997.

Although this methodology is still being implemented, also by mutual agreement of the trade associations, and is being tested, recent examinations and compliance actions showed to the Italian Revenue Agency that this tool is achieving the objective and the trend of taxpayers' compliant behaviour is increasing.

Green Light for Value Added Tax Fraudsters or Light at the End of the Tunnel for Tax Administrations

LATVIA

Edgars HERCENBERGS
Lawyer in Litigation Division, Department of Legal and Pre-Court Dispute Settlements State Revenue Service

Smilšu iela 1, Riga, LV-1978, Latvia
Tel + 371 670 28 970
E-mail: edgars.hercenbergs@vid.gov.lv

As lawyer in court line at State Revenue Service of Latvia, Edgars Hercenbergs is in charge of representing state's interests in controversies covering direct and indirect tax issues in all court instances. Edgars has prepared position papers in preliminary rulings before Court of Justice of the European Union as well in constitutional compliance proceedings before Constitutional Court of Latvia. Prior to the current position, Edgars served as a judge's assistant in Administrative Court of Latvia as well as served as an associate in Valters Gencs law office. Edgars holds Master's degree in Law (University of Latvia) and studies for Advanced Diploma of International Taxation (Chartered Institute of Taxation, United Kingdom).

By Edgars HERCENBERGS

Latvia

Introduction

While a fictitious transaction does not confer rights to deduct input VAT (Value Added Tax) and such a premise may be assumed as a predominant legal view among IOTA administrations, due to reference for a preliminary ruling lodged by the Supreme Court of Latvia in case C-563/11 (Forvards V) the topic still seems to be a pending matter. Consequently, the purpose of this article is to examine the current and developing trends with regard to the refusal of input VAT deduction in the event there is a connection with fraud and to define changes which could make the risk of such refusal more foreseeable for taxpayers.

Pressing Problem Of the Case Study

The Scheme of Evasion

To summarise the facts of the case, the Tax Administration of Latvia (Valsts ieņēmumu dienests) during an audit denied input VAT that was deducted by company X who acted as the receiver of goods supplied by (the details of motorised land vehicles) from company Y.

The tax administration concluded that invoices that were called into question should not be treated as tax invoices because they involved false information. Hence, the main standpoint that the goods were not supplied from company Y was argued on the following grounds (see also the diagram below):

1) The written agreement regulating the supply of goods did not specify the assortment of goods, nor the quantity, the price or the carriage of goods;
2) Invoices did not include information regarding the carriage of goods, e.g., the factual place of the supply of goods and the carrier;
3) Company X made payment to company Y via the bank account of company Y which was not registered in the tax administration;
4) The declared place of business of company Y was an apartment, the said company did not possess any materials or technical ability to ef fect the supply of the goods, and the company did not possess any tax units for purpose of economic activity;
5) The sole board member of company Y denied any economic activity in the company stating that he became an official of the company at the request of unidentified third persons;
6) As company Y had not submitted any tax related information requested by the tax administration, it was deleted from the register of VAT payers;
7) All in all, the origin of goods under question was not identified.

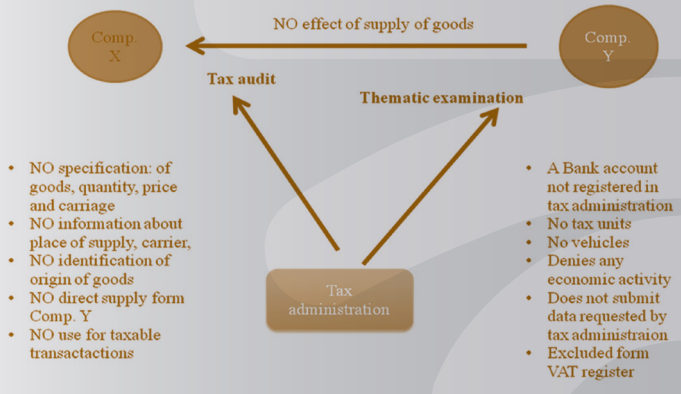


Diagram: the scheme of evasion

Controversially, company X sought to set aside the results of the said audit on grounds that it was not liable for company Y`s inadequacy, therefore, the payment which was made to company Y along with the possession of tax invoices in connection with company Y as a registered VAT payer during the period of the transactions constituted grounds for the deduction of input VAT.

Former Trends

According to case law which has been applied in audits as well as in court judgements as an appropriate interpretation of the Law on Value Added Tax, the right to deduct input VAT shall be denied if it is found that the supply of goods was not actually effected by the other party of the transaction (namely the supplier), assuming that the receiver actually did not receive goods from such supplier. As a result, in order to defend its rights to deduction, the receiver of goods shall provide evidence showing the opposite facts, i.e., that the latter actually received the particular goods from the supplier (hereinafter referred to as to the "burden of proof approach"). Judging from the post event report of the IOTA case study workshop "The use of false or fictitious invoices to avoid the payment of VAT" it could be assumed that a similar approach is being applied among other IOTA administrations, including Member States of the European Union (see, to that effect, page 35-37 of the material, for URL reference see below). In comparison, as it flows from case law of the European Court of Justice, tax administrations or courts may refuse the deduction of input VAT on the basis of objective factors which testify the taxable person`s connection with fraud (see, to that effect, judgement in joined cases Cases C 439/04 and C 440/04 Axel Kittel [2006], para. 51-61; judgement in joined Cases C-80/11 and 142/11 Mahageben [2012], para. 45, 49), hereinafter referred to as the "objective factors approach".

Preliminary Reference

Despite the above-mentioned case law the Supreme Court of Latvia established that the supply of goods as such was not denied by the tax administration, nor had the administration established company X`s abusive conduct or practice, nor searched for the real supplier of goods, if any.
Overall, the Supreme Court of Latvia questioned whether the fulfilment of all essential requirements for the deduction of input VAT (as stated above, consideration being made, the possession of an invoice, the supplier being a registered VAT payer during the taxable transaction) may be overturned due to the fact that the supplier was not able to effect the supply of goods (the first question), and, besides that, such refusal to deduct should be recognised inherently based on the circumstances that the supplier was fictitious (the second question).
In addition, the Supreme Court of Latvia questioned, whether any abusive conduct or practice could be established on the part of the receiver (for URL reference see below).
All in all, the topic appears to be pressing not only for the Tax Administration of Latvia, but also for other IOTA administrations. Hence, the solution to the case

study is proposed through examining such fields like:

1) Objective factors particularly testifying company X`s (the receiver of goods) connection with fraud;
2) Switch from burden of proof approach to objective factors approach and main concerns about the applicability of the former;
3) Necessity to establish a negative fact and any abusive conduct or practice on the part of the receiver of goods.

Grounds for Objective Factors Approach

An Insight Into Terminology

Foremost to distinguish, according to case law of the European Court of Justice there are two main legal grounds for the denial of the input VAT deduction:

- If the taxable person commits an abusive practice resulting in a tax advantage the grant of which would be contrary to the purpose law (see, to that effect, judgement in Case C-255/02 Halifax [2006], para. 85-86). This reason refers to tax planning schemes and therefore as such does not apply to cases involving fictitious supply of goods (see, to that effect, Axel Kittel para. 53);
- If the taxable person commits a fraud on his part or its transaction is connected with fraud previously committed by the supplier or another trader at an earlier stage in the transaction (see, to that effect, judgement in joined cases Cases C 439/04 and C 440/04 Axel Kittel [2006], para. 51, 55, 59, judgement in joined Cases C-80/11 and 142/11 Mahageben [2012], para. 45). These reasons refer to fictitious supplies and the latter reason refers to objective factors approach (see, to that effect, Axel Kittel para. 59, Mahageben para. 45) which may be subdivided into two following approaches.

First, traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud are protected against the denial of input VAT deduction (see, to that effect, Axel Kittel para. 51), in other words – if such reasonable precaution is not established on the part of the trader (the receiver of goods), such deduction shall be denied (hereinafter referred to as the "reasonable precaution approach").

Second, as it is resulting from paragraph 59 of Axel Kittel and paragraph 49 of Mahageben, if a tax administration or a court establishes on grounds of objective evidence that the taxable person knew or should have known that its purchase was connected with fraud, the said deduction shall be denied (hereinafter referred to as the "knew or should have known approach").

A Comparison of Two Approaches

In both cases an examination is being put forward when there is doubt whether there is any objective evidence which allows the conclusion to be drawn that the taxable person`s transaction was connected with fraud. Subsequently, tax administrations:

1) Shall examine the circumstances of a particular transaction (see, to that effect, Mahageben para. 49, 59);
2) Shall examine whether the fraudulent scheme reappears before or after the transaction of the receiver (see, Ibid.) regardless of any profit by the resale of goods (see, to that effect, Axel Kittel para. 56);
3) As far as the said connection is established, tax administrations may assume that the receiver is a participant in that fraud, he aids the perpetrators of the fraud and becomes their accomplice (see, Ibid., para. 56-57).

If to compare the knew or should have known approach, unlike the reasonable precaution approach, may not be determined in law as a compulsory method enforced by tax administrations, because the requisite of legal standards would be satisfied, as long as tax administrations established objective evidence proving the above-mentioned connection (see, to that effect, Mahageben para. 49).

But, as it is resulting from paragraphs 58-60 of Mahageben judgement, Member States shall determine explicit rules prescribing specific obligations how to act with due diligence (i.e., reasonable precaution) in order to check whether the transaction is not connected with fraud (for this purpose see Chapter 4 "Structural Adjustments: "Before, During, After Approach" below).

Another significance, as it results from paragraph 50 of Mahageben judgement, improper actions on the part of the supplier are inherently not sufficient grounds for the denial of input VAT deduction, unless the above-mentioned connection is established. Moreover, the receiver is not obliged to provide additional evidence other than the invoice issued by the supplier in order to show proper actions of such supplier (see, to that effect, Mahageben para. 66).

Since there is a likelihood that the above-mentioned interpretation in principle will change grounds for the denial of input VAT deductions, issues that need a precision and a justification are examined below.

A Switch from Burden of Proof to Objective Factors

As to the degree of the fictitiousness of the supply of goods, which is illustrated in the diagram below, it is clear that in the event of a totally fictitious supply such a transaction actually does not exist, therefore refuting a need to gather evidence which proves the opposite. Alternatively, contrary to the norms of logic, the existence of supply which actually does not exist would need to be proven. For that reason it would be appropriate to conclude that the receiver of goods participates directly in the fraud, in the words of Axel Kittel judgement – the taxable person commits a fraud on his part, and there is no need to apply objective factors approach.

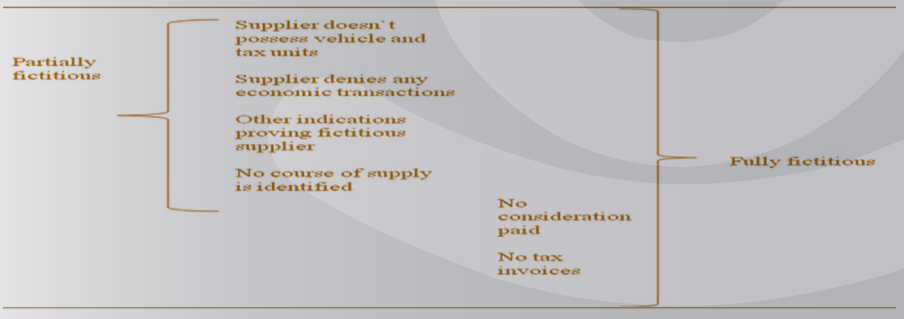


Diagram: The indicators of fictitiousness

According to the case study the supply of goods appears to be partially fictitious, therefore the objective factors approach might be applied to the physical delivery of goods to company X as long as such part of the transaction is missing.

The result from the case study, was that the said course on the part of company Y was not established. Accordingly, it might be assumed that there is no need to require company X to prove that company Y acted properly as long as the evidence objectively proves that the latter did not actually make the supply of goods, nor was in a position to deliver them, whilst keeping in mind the necessity of checking whether and in what circumstances company X physically received the goods. Thus, the justification of company X as the real receiver of goods appears to be an unanswered question to some degree, at least in connection with the evidence which proves the missing part of the transaction. Similarly, other IOTA tax administrations in audits strive to refute the economic reasoning of the transaction (such as, the artificial existence of a supplier or receiver is proved through the analysis of transaction schemes along with the course and the result of such schemes, through the analysis of the roles of persons being involved in transaction and fiscal advantages gained, to name a few) for the purpose of reaching the result that the transaction actually did not exist (to that effect, the post-event report of IOTA workshop "The use of false or fictitious invoices to avoid the payment of VAT").

Therefore, from a practical point of view the aim of the objective factors approach is to evaluate circumstances which on the grounds of objective evidence show a particular part of the transaction to be missing (such as the physical delivery of goods or the receipt of the corresponding goods) for the purpose of arguing the degree of connection with fraud on the part of the receiver. Furthermore, the process of switching from burden of proof approach to objective factors approach appears to be merely partial, because the receiver in the event of such missing evidence will have to justify the said receipt on their part.

What is interesting to add, in Mahageben judgement, as opposed to the case study, the supplier did not dispute that he made the supply and the tax administration examined the former's accounts (see, to that effect, Mahageben para. 16-17). Thus in Mahageben the supply of goods seems to be less fictitious than that of the case study. Therefore, as it flows from Mecsek Gabona's judgement, the trader`s liability shall correspond to the degree of their involvement in the realization of a particular transaction or its part (see, to that effect, judgement in case C-273/11 [2012], para. 28-35), in the light of the said differences the objective factors approach might be applied as follows: **the receiver`s connection with fraud corresponds to the degree of the fictitiousness of the transaction, in other words, the more fictitious the transaction appears to be, the more there is likelihood that the receiver is connected with that fraud.**

Finally, in Mahageben judgement and particularly in its paragraphs 61 and 66, there is no wording which imposes a burden of proof on the receiver in order to show in what circumstances they actually received the goods. As a justification, it is common that the receiver would possess more information than any other person (for example, accounting documentation, persons actually involved in the reception, etc.). Thus, that might provide answers at least to questions which would fill in the gaps, e.g., which physical persons handed the goods to the receiver and which persons on behalf of the receiver received them. It is also in favour of the receiver to show that they participated in the transaction for the purpose of defending their rights against the statement of objections being brought by the tax

administration during a tax audit.

For the above-mentioned reasons, the burden of proof approach shall not be disregarded within the scope of objective factors approach and therefore as a modified approach, mixed between the former and the latter, might be applied as follows: **a connection with fraud shall be established on the grounds of evidence which excludes the existence of transactions or parts thereof, unless the recipient shows their participation in the said transaction or in a part thereof, then burden of proof on the part of the receiver is met as long as evidence provided shows that they did not know and should not have known about the said connection.**

Is There a Need for a Negative Fact and Any Abusive Conduct or Practice

These issues seem to be irrelevant, since they do not fit in the terminology used in case law of the European Court of Justice.
As for the negative facts, so long as evidence proves the non-existence of a particular part of a transaction between two parties under invoice, there is no need to go further, e.g., to check what else did not exist under such an invoice, because the legal standard would be satisfied as far as such evidence was being presented by the tax administration.

As to *abusive conduct*, it is clear from paragraphs 51, 55, 59 of *Axel Kittel* judgement that *a connection with fraud* is not understood as the same term as *deliberately committed fraud.* Furthermore, as stated above, under *Halifax* judgement *abusive practice* (so far as such a term might seem to be similar to that of *abusive conduct)*, does not fall under the term *fraud,* and, for that reason, it is simply wrong to use *abusive conduct* or *abusive practice* in establishing the *connection with fraud.*

Lastly, the objective factors approach is a legal standard which on the grounds of objective evidence permits to establish the said connection through making an assumption that the receiver knew or should have known about it, therefore, more fact finding, such as negative facts and abusive conduct is not needed (see, for that reason, *Axel Kittel*, para. 58). Therefore, if these issues were used as compulsory methods, it would make the objective factors approach less effective or it would even be impossible to prevent fraudulent transactions (see, Ibid., para. 58).

Suggested Solution to the Case Study

Since it was impossible to trace the course of the supply of goods, namely in what circumstances company Y handed the goods to company X and the latter received them, this fact appears to be a cornerstone to the objective factors approach. As stated above (see also the diagram below), if the supply of goods was divided into several deliveries, it would be taken for granted that the receiver or any person on his behalf had to participate in such deliveries and should be able to trace the course of such events, and that without the existence of such events the

Diagram: the course of transaction

transaction would not exist.
It is recommended to methodically divide events where:

1) The physical contact between persons involved should have happened, such as contact between persons who on behalf of the companies signed invoices, written agreements, etc.;
2) Particular actions were not established on the part of the supplier and the receiver, but due to economical sense must have taken place, such aswhere the person (the supplier or the carrier) physically hands the goods to another person (the receiver).

Because of this, the receiver shall show to the tax administration that the former participated in particular episodes and could trace its course.

Therefore with reference to the case study, since evidence did not establish physical contact between company X and company Y, nor the physical transfer of goods from company Y to company X , nor company X was able to show in what circumstances documents (such as, contracts, invoices) were signed and goods physically received from representatives of company Y along with evidence which proves improper actions on the part of company Y, it is allowed to make the follow-

ing conclusions:

- Company X did not trace the course of the said episodes of transactions;
- If company X had traced the course of such epi sodes, company X would have known that company Y was fictitious,
- As a result of the above facts, company X knew or should have known that its transactions were connected with the fraud previously committed by company Y and therefore the deduction of input VAT should be denied.

Structural Adjustments: "Before, During, After" Approach

In brief, the aim of this approach is to guarantee certain indicators for taxpayers in order to encourage them, firstly, to control their transactions in more elaborate manner and secondly, to consider the risks linked to tax liability.

This approach may be used as a cornerstone for further objections during audits on the basis that the taxpayer, in terms of Axel Kittel and Mahageben judgment, did not take reasonably required precautions in order to ensure that their transaction was not connected with fraud.

Therefore, the author sets out the main ideas.

Before the Transaction

The law should set out explicit rules which authorise the tax administration to refuse the deduction of input VAT in the event of fictitious transactions or lack of trading partner, By setting out such general indicators (such as the transaction lacks economic reasoning, the partner of such transaction was not able to effect particular actions, etc.) for the purpose of drawing such conclusions in future audits. It goes without saying that any VAT payer should have been informed about the said rules before a transaction they are planning to carry out.

In addition, the public administration may inform taxpayers by indicating particular blacklist taxpayers or by setting out general rules which characterize fictitious taxpayers so that taxpayers could check the other party of the transaction or even could get a real indicator which would deter them from future transactions.

For example, since 2012 Latvia has adopted a legal approach in which the black list of taxpayers and risky addresses are used. Very quickly (i.e., in five days) from a particular taxpayer registering, the tax unit will identify those where the declared place of economic operations are impossible, such as flats, social establishments or even prisons, the tax administration cancels the economic operation of such taxpayers and makes this information public.

Next, it is recommended to publish data about current risky markets in which taxpayers shall be more aware of risks of fictitious transactions due to the considerable number of risky taxpayers.
Finally, it is recommended that the public authority maintain a closer co-operation with professional and trade associations. As a result of this, such organisations should introduce a code of best practice or due diligence for members in order to offer a common standard of practice. Thus, through determining by degree the said mechanisms in law, such practices might even be used as legitimate evidence proving the said practices as a reasonable precaution taken in a particular market, or on the other hand, as a motivation for other taxpayers to act according to such practices, even though they are not members of the said associations.

During and After the Transaction

The law should set out explicit rules which oblige taxpayers to maintain accounts in a way that third persons qualified in the area of accounting, can obtain true and clear results of the activities of taxpayers and are able to trace each economic transaction from start to finish.

Such obligation might include mandatory identification of persons who physically handed the goods or services to the receiver of the goods.

Furthermore, if a taxpayer did not take any of the above-mentioned precautions, then they would be invited to withdraw input VAT from their VAT declaration before an audit is launched, so that they have an option to refund VAT deducted under fictitious transactions and not to pay a fine.

All in all, the "Before, During, After" approach as well as other approaches with similar aims enforced by all IOTA administrations shall comply with the principle of proportionality in a way that does not go further than is necessary to prevent the evasion of VAT (see, to that effect, *Mahageben* para. 55-57).

Conclusions

The case study reveals issues which raise a need to re-examine former trends only through re-wording, even though questions raised by the Supreme Court of Latvia and interpretation given in *Mahageben* judgement might seem to be a milestone to some degree.

In the author's view, the main problem lies somewhere else, namely, how tax administrations will switch from the burden of proof approach to the mixed approach of the latter and objective factors approach in order to establish the receiver`s connection with fraud.
Therefore the author suggests the following:

First, *abusive conduct* and *connection with fraud* are different terms and they shall not be applied together. In addition, from a practical point of view the former might rather apply to fully fictitious transactions, as opposed to the latter, which reveals partial fictitiousness of a transaction and therefore might be used for the purpose of examining the degree of connection with fraud.

Secondly, with respect to *Mahageben* judgement, the receiver of goods is not obliged to prove proper actions on the part of the supplier of goods, but the examination of possible connection with fraud on the part of the former is left open. Therefore, a switch from burden of proof approach to the objective factors approach is not intended to diminish the former, but rather to raise the significance of economic circumstances being put into question. Thus, as long as evidence gathered during an audit objectively proves that a particular part of a transaction is missing, there are no grounds to ignore such questions, namely, how and in what circumstances the receiver participated in a particular transaction or in a part thereof.

Thirdly, a "more or less" clause shall be applied, i.e., the more fictitious a transaction appears to be, the more the likelihood that the above-mentioned connection existed and vice versa. The burden of proof clause shall then be addressed to the receiver of the goods in order to examine their participation in the transaction and eventual connection with any fraud, bearing in mind that in the event of non-cooperation the connection with that fraud may be established.

Fourthly, there are no grounds for establishing a negative fact. As a solution to the case study the author proposes that the missing part of the supply of goods shows that company X knew or should have known about the connection with the fraud previously committed by company Y. Company X did not actually receive the VAT and there is evidence objectively showing improper actions on the part of company Y.

As to structural adjustments, the author sets out an idea that taxpayers should be more involved in VAT, not merely through satisfying the formal prerequisites of input VAT deductions. Another reason for this, according to *Mahageben* judgement, in principle, it is allowed for Member States to deny input VAT deductions, if the taxable person did not take necessary precautions in order to avoid a connection with fraud, but such mechanisms are admissible only after setting out clear rules.
As to this, the author suggests several mechanisms, such as:

- Clear rules which authorise tax administrations to deny input VAT deductions in the event of fictitious VAT transactions;
- Public rulings about the identification of fictitious trading partners;
- Public information about actual fictitious trading partners, such as a black list, as well as the information about risky markets;
- Closer co-operation with trade associations in order to reach the best practice of due diligence;
- Strict conduct of tax accounting;
- Option to withdraw input VAT deducted under fictitious transaction before an audit takes place.

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New Measures to Prevent and Combat Tax Fraud in Spain

SPAIN

Alfredo ARRANZ SAINZ
Deputy Head
Regional Collection Department Of Madrid

Guzman El Bueno 139, 2º, 28071
Madrid, Spain
Tel +34 915 826 886
E-mail: alfredo.arranz@correo.aeat.es

Mr. ARRANZ is a State Tax Inspector, Budgetary Auditor and Police Inspector (not on the active service). He has a university degree in Law, and has completed the Doctorate Program in Financial and Budgetary Law. He has also a university degree in Police Techniques. He has worked as a Budgetary Auditor in several Ministries and has worked for the Spanish Tax Agency as Head of several Tax Offices in Madrid. At present he coordinates the collection and recovery of the tax offices of Madrid.

Marcos ALVAREZ SUSO
Deputy Director for Legal Affairs. Tax Auditing Department

Calle Infanta Mercedes 37
28020. Madrid. Spain
Tel +34 915 838 985
E-mail: marcos.alvarez@correo.aeat.es

Mr. ALVAREZ has a degree in laws by the Universidad Complutense of Madrid. He's been working as a tax auditor for the Spanish Tax Administration for 15 years, with special devotion to tax crimes, VAT and recovery procedures. He also worked for the Administrative Tax Court during three years. He is currently heading the Deputy Direction for legal affairs in the Tax Auditing Department of the Spanish tax administration (Agencia Tributaria).

By Alfredo ARRANZ SAINZ and Marcos ALVAREZ SUSO

Spain

On the 31st of October 2012 a new Act that modifies the Spanish General Taxation Act and introduces new provisions, in order to strengthen the measures against Tax Fraud came into force.

The aim of the Act is to exploit the experience of the years since the General Taxation Act came into force in 2004, introducing new legislative steps in the fight against Tax Fraud, clarifying the interpretation of some rules and reducing litigation.

This Act includes several measures related to aspects of tax management, tax audit, prevention of tax fraud and recovery of tax debts.

This article is divided in two sections, the first one devoted to tax recovery and the second to tax auditing, control and other antifraud measures.

Measures related to collection and recovery

The Act includes a set of heterogeneous measures related to the collection and recovery actions that can be classified under the following headings:

- Succession of entities and legal persons
- Secondary liabilities
- Precautionary measures
- Suspension of payments
- Bank account attachments

The aim of these measures is to bridge the gaps that the application of the General Taxation Act disclosed during the last seven years and to fight against new fraud behaviours.

Succession of entities and legal persons

Tax regulations state that in case of the liquidation of a company or entity, the tax liability is extended to the shareholders and to the partners, but according to two features: it only reached the amount received in the liquidation and it was a joint and several liability among them. This limitation allowed committing a kind of fraud consisting of, before the liquidation of the company or entity, a distribution of dividends that reduced the amount available to distribute during the liquidation process and thus reducing the liability of the shareholders.

To avoid this kind of fraud, the new Act extends the liability of the shareholders as it also includes all the incomes received from the company during the two previous years to the liquidation.

This regulation will be applied not only to companies but also to all entities that have a legal status.

Secondary liabilities

The law extends the liability of payment of taxes to third persons in several cases. In these cases, the tax liability is extended from the taxpayer or withholder (called the main debtors) to another person or persons as a mechanism for guaranteeing the payment of a tax debt. This extension requires a previous formal administrative decision and that the taxpayer or the withholder did not pay the debt, (that is to say, the lack of payment of the debt by the main debtor). The secondary tax liability arises when, according to the law, a person is held responsible for a tax debt of another taxpayer. It can be either joint and several liability (first degree secondary liability) or subsidiary liability (second degree secondary liability). In both cases the person liable is not the main debtor, but once the debt has not been paid during the normal collection period, the tax office can ask the secondary liable persons for the payment with the following requirements: Without additional requirements for joint and several liability (just the statement of liability). For subsidiary liability, once the tax office knows the main debtor has no assets and this has been formally stated (the measures of enforced collection undertaken towards the taxpayer have been unsuccessful and they have been defined as an uncollectable debtor). The new Act includes new cases of secondary liabilities to avoid tax fraud in specific situations and also modifies several features of previous cases in order to improve them.

Failure to pay ordinary self-assessments:

The new case of secondary liability helps to avoid the following kinds of fraud: companies running a business that are currently trading but have no assets that can be levied, submit regularly and correctly all their tax forms and returns (self-assessments) but without payment. As there is formal compliance of their obligations but no payment, the directors do not commit any administrative offense that can lead to a secondary liability procedure. The new Act includes a new case of secondary liability of the managers when this kind of action is repeatedly conducted by them over a short period of time. The new rule includes the conditions: lack of payment (more than 75 % of the debt is unpaid) in one year.

Extension of the joint secondary liability to the rest of the State public debt

There is a secondary joint and several liability for the following persons:

- Persons who are responsible for trying to hide or transfer taxpayer´s assets in order to avoid attachments, levies or liens.
- Persons who consciously or without proper attention failed to carry out attachments, levies or liens.
- Financial entities and bank that do not cooperate to carry out attachments and levies on bank accounts.

For these cases the liability was limited to the tax debt, but taking into account that the collection function of the Spanish Tax Agency also includes a wide scope of other public revenues, the new Act extends this possibility to all the State public debts (all the revenues included in the General Budgetary Act).

Extension of reduction of debts whose origin is a tax fine to secondary liable persons

As a measure to avoid litigation, the Spanish tax regulations contain a system of reductions for tax fines based on 30 per cent of the fine if the taxpayer agrees with the assessment and does not appeal. Additionally, if the taxpayer pays the fine during the voluntary period of payment and does not appeal, there will be a reduction of 25 per cent.
The new Act has undoubtedly stated that secondary liability is not a penalty by nature, but has extended reductions to debts whose origin is a tax fine when those debts are included in the secondary liability and the secondary liable person does not appeal and pays during the voluntary period of payment as a way of reducing and avoiding litigation. It gives to the secondary liable person the same rights that the main debtor had.

Precautionary measures

In order to secure and guarantee the collection of tax debts if there is a risk that the taxpayer might obstruct the collection the Tax Administration can impose precautionary measures to secure the debt.
The tax administration includes in their statement of precautionary measures the reasons why it considers that there is a risk to the collection and the actions proposed. These actions will usually be attachments, levies or liens on the assets of the debtor (real estate properties and refunds).
The new Act includes several changes in the precautionary measures' regulations:

Related to tax fraud as a criminal offense

When a tax fraud is over a certain amount (120,000 euro per period) it can be considered as a criminal offense (as a deterrence measure of maximum degree). This assumes that when the Spanish Tax Agency detects that kind of fraud, it has to send the case to the Public Prosecution Service to see if there is enough evidence for conviction. If it decides to go ahead with the prosecution they will initiate criminal proceedings. These proceedings will suspend the administrative procedure and most of collection and recovery actions of the debt. As the criminal procedure is usually quite slow and the sentence will be dictated after a long period of time, the debtor has enough time to transfer his assets and avoid our future collection actions. To avoid this situation, the new Act includes as a function of the Tax Administration the ability to start precautionary measures in these cases even in the middle of criminal procedures, although this statement is provisional and requires a judge's statement to be considered as a definitive one. Although it is a provisional decision, its aim is to avoid the transfer of assets before the decision of the judge is made. In this case, the new Act has changed the function of the Tax Administration so that it can carry out precautionary measures. At present the precautionary measures will be defined by the Tax Administration until the judge decides to keep them or not.

Moment of statement of precautionary measures

Even when there is no current debt but the Tax Administration is conducting a tax audit or a tax control procedure on a taxpayer and before an assessment or proposal of an assessment is made, if the Tax Administration decides there is a risk of collection, it can take precautionary measures on the assets of the taxpayer. We must take into account that the aim of precautionary measures is to prevent the debtor avoiding the payment of the debt. As the debt does not currently exist it requires the existence of a previous judgment about the control procedure that is being carried out with the reasons to support the likelihood of an assessment.

Prohibition of disposal of real estate properties

The Tax Administration will be able to prevent a company disposing of its real estate properties when a tax debtor is the owner of stocks of that company that allow him to have control of the business and the stocks have been seized by the Tax Administration.
This prohibition of disposal will be recorded in the Real Estate Property Register and requires an explanation for the reasons why this kind of precautionary measure is made against a person that is not the owner of the assets according to the Register.
The aim of these measures is to avoid transferring ownership of the property by the company in order to obstruct the collection of the debt, as the debtor has effectively control of the firm and the disposal of its estate would mean a reduction of the value of the levied stocks.

Suspension of debts

In case of appeals against an assessment, debt collection can be suspended if the taxpayer supplies a guarantee. With the new Act the amount of the guarantee must include the amount of the assessment, the interest for late payment caused by the suspension and any additional penalty for payment in an enforcement period, normally 20 per cent of the amount of the assessment. This process tries to include in the guarantee all possible penalties and amounts that are collectable at the moment of execution of the guarantee.

Bank account attachments

When conducting a bank account attachment, the Tax Administration had to identify the account that was held by the debtor and also the office of the bank. The attachment was considered to extend to all the assets and money deposited in that bank office. The new Act extends the attachment to all assets and money deposited by the debtor in all the bank's offices in Spain.

Measures related to tax auditing, tax control and preventing tax fraud

As a second group of antifraud measures, the new Act (Law 7/2012) introduces a wide range of provisions related to tax auditing and tax penalties and increases tax control in general. The most relevant of these types of measures are:

- Strengthening of tax penalties
- Prohibition of cash payments when certain conditions are met
- New reporting obligations on assets located abroad
- Reverse charge as a mandatory mechanism for certain supplies on VAT

Additionally, new amendments to the Criminal Code have been introduced to punish more harshly the most serious tax offences.

The new provisions of the Criminal Code came into force in January 2013 and include, amongst other measures, an extension of the statute of limitation period from five to ten years for the most serious tax crimes, an increase of imprisonment penalties from five to six years and the new possibility in Spain to recover the tax liability from the very beginning of the criminal procedures.

Strengthening of tax penalties

Three measures are relevant to tax penalties:

- New tax penalties are introduced for those taxpayers who fail to submit tax returns and tax declarations through electronic means when it is mandatory to do so, which is the general rule in Spain for all economic activities. Penalties are 100 euro (for each non-monetary data, e.g. an identification number or an address) or 1% (for each monetary data) of the information incorrectly submitted, with a minimum fine of 1,500 euro.
- Penalties regarding taxpayers who failed to comply with the requests from the tax auditor (e.g. invoices, contracts, granting access to buildings or warehouses) when performing a tax audit are increased in order to avoid unnecessary delays during the procedure. If the tax audit is focused on economic activities, penalties vary from 3,000 euro (if only one request was not attended) to a maximum of 600,000 euro.
- Non-monetary penalties, such as being disallowed to contract with public entities or to receive public subsidies or funds, were hardly used due to the lack of a proper procedure to do so. The procedure to impose those kinds of penalties is amended to facilitate the application of these penalties on very serious tax infringements.

Prohibition of cash payments on specific operations

Cash payments in economic activities facilitate fraudulent behaviours. Those kinds of payments make it easier to hide from the Tax Administration the real amounts as well as the existence of economic activities or operations.

To tackle those fraudulent moves, tax authorities must not only detect and punish the noncompliant activities, but also prevent them happening by using measures, including legal provisions. There is a common international concern over cash payments as a method to facilitate tax fraud. Many countries (Italy, France, etc.) all over the world have introduced recent limits on cash payments in order to prevent such behaviour.

Reactions in Spain to this problem have previously been devoted to obtaining information about the use of cash as a means of payment, specially focused on high face-value bank notes (500 euro). In 2012, the government decided to prohibit cash payments unless specific conditions were met.

This doesn't mean that cash is no longer accepted as a legal method of payment, but whenever cash payments are used against prohibited items, penalties might be imposed on taxpayers and individuals, regardless of the legal or commercial effects of the transaction.

The main features of the new limits are as follows:

1) Scope of the new prohibition

- There is a general prohibition to pay in cash any supply amounting to 2,500 euro or more. The prohibition is only imposed when at least one of the persons in the economic relationship is acting as an entrepreneur (B2B or B2C, but not C2C transactions). For example, if a house is sold by a private individual to another private

individual for a price of 300,000 euro, there is no limit on cash payments, but if one of the two persons is a real estate dealer acting as such, no cash payment is legally permitted.

- In the case of the recipient of goods or services being a non-resident natural person not acting as an entrepreneur, the limit for cash payments is 15,000 euro.
- Payments in instalments for the same transaction will be added together to calculate the amounts. For instance: when purchasing a car amounting to 20,000 euro, and monthly payments are made during a year, no cash is permitted although every single monthly payment is smaller than 2,500 euro.
- Supplier and recipient must keep the documents to justifying the means of payment for any transaction above the mentioned thresholds for a period of five years, and to show them to the tax administration when requested.
- The limits won't be applied to payments made through credit providers.

2) Infringements and penalties

- When there is a breach of the prohibition both supplier and recipient will be considered jointly and severally liable for their action and penalties can be imposed on either of them.
- The penalty will be 25% of the amount paid in cash that contravenes the prohibition. For instance, if a transaction with a price of 8,000 euro has been paid in cash, a single fine of 8,000 x 25% = 2,000 euro will be imposed, and the tax administration can request either the supplier or the recipient for payment of the whole amount.
- No penalties will be imposed on the person that, although initially accepting to pay or receive an amount of cash against the prohibition, voluntarily decides to report the infringement to the tax administration no later than three months after the date of payment. If this is the case, only the other party in the transaction will be considered responsible for the infringement.
- Penalties regarding this specific infringement will be compatible with those penalties that might be imposed because of a shortfall in any taxes due, such as income tax, corporate tax, value added tax, etc.
- The statute of limitation for these infringements is five years.

3) Additional provisions

- Public authorities or civil servants must report to the tax administration any infringement of the above-mentioned prohibition of cash payments detected when performing their normal activities.
- The prohibition has come into force for payments made since the 19th November 2012, and will be applied to any payments made beyond this date, regardless that the transaction or contract was prior to that date.

4) Further information

At an early stage in the prohibition, some questions were raised by certain economic sectors, for instance, agricultural producers, wage payers, lotteries, casinos, etc. The Tax Administration decided to make public some brief guidelines to clarify how the prohibition affected specific cases, transactions or economic activities. Those guidelines can be found (Spanish version only) on the website of the Spanish Tax Agency, through the following link:
https://www2.agenciatributaria.gob.es/es13/s/IAFRIAFRC12F?TIPO=T&CODIGO=00112

New reporting obligations about assets abroad of resident individuals and entities

Economic globalization, especially associated with the free movement of financial capital, has facilitated fraudulent activities. To improve fiscal control the Spanish Parliament decided to establish a new requirement for resident taxpayers to report assets, real estate properties and bank accounts located outside Spain. To encourage taxpayers to fulfil this reporting obligation, not only were specific penalties regarding the reporting obligation introduced, but also a more severe tax treatment of incomes linked to unreported assets for personal income tax or corporation tax. This severe treatment consists of specific penalties on shortfalls on income tax and the inability of the taxpayer to justify the origin of the asset one year beyond the statute of limitations.
Thus, no matter how old the origin of the asset might be, if the taxpayer has failed to report it in due time, it will be considered as an income for immediate taxation.

1) Assets to be reported (only if located outside Spain)

- Bank accounts
- Any kind of shares, stocks, loans, life insurance policies, temporary or permanent incomes, etc.
- Real estate, and legal rights over real estate

2) Persons obliged to report

Natural, legal persons and entities resident in Spain, as well as permanent establishments in Spain of non-resident persons or entities are obliged to report.
The scope of this reporting obligation is very wide. From the subject point of view the obligation lies not just on the legal owner of the asset, but also on representatives, persons authorized to manage the asset, beneficiaries or whoever has any kind of power of disposal of the asset. The obligation lies with the persons who are owner, representative, etc. at the end of the calendar year, and it also extends to any person or entity who was in that situation during the year and who transferred the asset before the end of the year.

3) Details of information to be reported

Regarding the information to be reported, the regulation establishes specific detailed provisions depending on each kind of asset, but generally speaking the information will consist of:

- Identification and location of the bank account, details of the legal entity whose shares or assets are owned, any investment fund, insurance policy or real estate.
- Date and price of acquisition and value of the asset at the end of the year.

For further details about information to be reported, you can consult the Official Gazette, in Spanish named Boletín Oficial del Estado, of 24th November 2012 (Real Decreto 1558/2012) on the web site http://www.boe.es/boe/dias/2012/11/24/pdfs/BOE-A-2012-14452.pdf (Spanish version only).

4) Exceptions to the general rule of reporting

No reporting obligation will be imposed on certain entities or in certain cases. Those cases considered to be exceptions to the reporting obligation are:

- Assets of public entities
- Assets included in the accounts of natural persons, legal persons and entities, when they are sufficiently detailed and identified in the accounting records
- Assets to be reported because of previously established obligations, as is the case for some obligations of financial entities
- Whenever the value of the assets is less than 50,000 euro
- Whenever the information was previously submitted for the past years, unless the value of the assets had varied in more than 20,000 euro.

5) Penalties for infringements of the obligation to report in due time

- A penalty of 5,000 euro for each element that was not reported with a minimum of 10,000 euro will be imposed for formal infringement
- Additionally, any non-reported assets will be presumed to have been obtained with non-declared revenues. Thus, the presumed revenues will be included by the Tax Administration in the income tax return relating to the oldest tax period open to assessment. This will be the consequence even if the taxpayer is able to prove the origin of the asset in a year beyond the statute of limitation (generally 4 years for tax purposes in Spain). Whenever this provision is applied a penalty of 150% of the tax debt related to this infringement will be imposed.

Reverse charge for certain supplies in VAT

The Spanish Tax Agency detected recently many supplies of goods and services in which, although the VAT was charged by the supplier to the recipient who was allowed to deduct the VAT charged, no payment of the VAT charged was made to the Treasury by the supplier.
In many cases, when trying to recover the VAT charged, the Tax Administration realized that the supplier was missing or was in bankruptcy.
Due to the sudden and significant losses caused by these situations and in order to stop them, the Spanish Government decided to make use of the options provided for the EU Member States under article 199.1 of the EU VAT Directive 2006/122 in three cases:

a) Execution of works or assignment of staff devoted to building construction, restoration of buildings, or to urban development of lands.
b) Supplies of real estate when, although the transaction initially would have been exempted of VAT, the taxpayers have exercised the right to opt for applying VAT.
c) Supplies of real estate when the immovable property had been previously offered as a warrant of a debt, and the supply is devoted to cancel the debt or when the recipient becomes obliged to cancel the debt. In these three cases, the so called "reverse charge" mechanism will be applied, and consequently, the recipient will be at the same time obliged to charge the VAT of the transaction and entitled to deduct the same VAT charged according to general rules of VAT deduction.

VAT Risk Selection: an Approach from a Global Risk Management Model

SPAIN

Juan PONZ
Tax Auditing Coordinator
National Office for Tax Fraud Investigation

Paseo de la Castellana 147. Madrid 28046, Spain
Tel +34 917 498 403
E-mail: jmponz@correo.aeat.es

Mr. PONZ has worked in the Spanish Ministry of Finance for more than 25 years, at first in the economic policy area, and, since 1996, in the Spanish Tax Agency, mostly in economic research units related to tax fraud investigation. He holds a bachelor's degree in economics and a master's degree in economic analysis and public finance.

By Juan PONZ

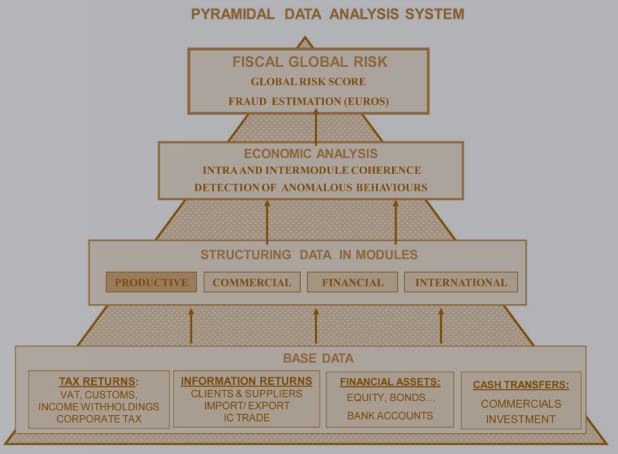
Spain

The model presented here is designed to identify and use all the available information about every company, structuring the information in terms of economic analysis in order to detect conduct patterns (both at individual and group level) and alert administrations about inconsistencies and anomalous behaviour by comparison with those patterns. As a final result, the model generates estimations for both fiscal risk and the amount of fraud.

Over the next few pages we will review the highlights of the model, starting with the pyramidal Data Analysis System. Later we will discuss the risk scoring based on a "peer group" pattern and a non-technical note about the dynamic analysis applied to some time series. Finally, some specific tools for the fight against VAT fraud will be described.

Pyramidal Data Analysis System

The main challenge of the model is the way we can extract all the information from the data, and synthesise it in different levels, into numeric expressions, in order to estimate and compare the fiscal risk of different taxpayers.



The first step consists of reviewing and evaluating all the available information, from:

- tax returns (corporate tax, customs, VAT, income withholdings, etc)
- informative returns (clients and suppliers, import/export, intra-community trade)
- financial assets (bank accounts, equities, bonds, etc.)
- bank transfers, both for commercial or investment reasons
- any other information useful for this purpose

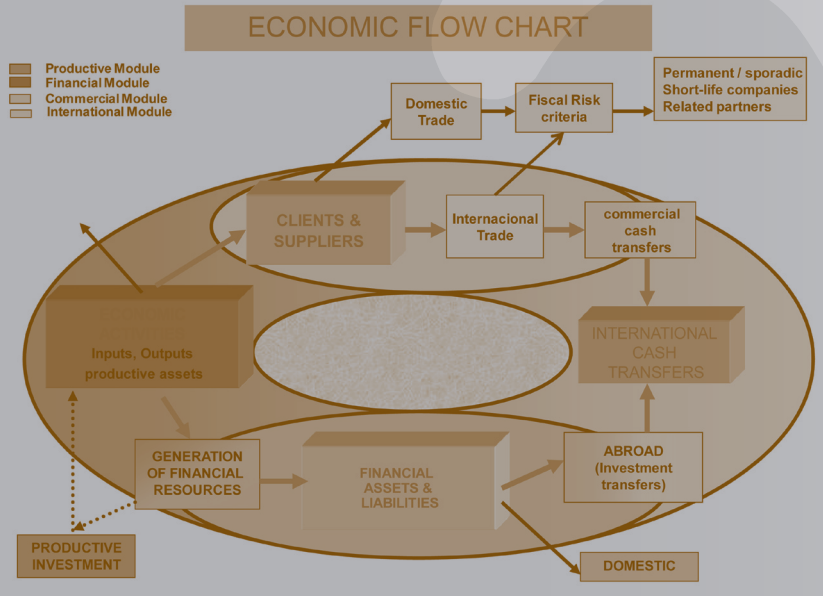
[It is highly recommended to evaluate the reliability of the data, especially with regards to informative returns. Using "garbage data" may add noise to the model, with no benefit at all.]

Once the available data has been defined, and **structured** into an economic framework, (later we will come back to this point) it is the time to apply some economic analysis to the actual data in order to find behaviour patterns (both individual and sectoral), **incoherences** and anomalous behaviours as opposite to the standard ones.

Comparing individual behaviour with this sectoral pattern we can detect "how different" a single behaviour is from the standard of the peer group and a numeric (ranking) amount of risk can be determined for a single company or even a group of them.

Finally, the model produces an estimation of the fiscal risk for every company, and also, when possible, an approximation of the monetary fraud.

Structuring data



One of the key points of this model relies on the design of the relevant relations to be analysed. The economic flowchart attached shows an overview of the main economic relations in regular business and the fiscal criteria that can be used for detecting fiscal risk.

The four modules represent the different aspects of the economic activity of a standard company:

- Productive module, refers to the main activity of the company, including the analysis of the sales, purchases, wages and other inputs.
- Commercial module, shows the relations with customers and suppliers.
- Financial module, includes the financial assets and liabilities, as well as a trace of the surplus.
- International module, monitoring cash transfers from and to other countries. This module is especially useful for import/export companies and international VAT analysis.

Needless to say, different economic sectors will have different flow structures. So, it becomes crucial to define the key economic relations to analyse, depending on the specific circumstances of the sector we are dealing with.

Risk scoring based on peer group pattern

Usually, companies of similar size and working in the same economic sector (what we will call "the peer group") develop similar economic behaviour patterns.

The main assumption is that, if someone acts differently to their peer group, there is a high probability of cheating. So, if we are able to quantify "how different" the behaviour of any taxpayer is in relation to their peer group, we can rank all the members of the group by their fiscal risk, represented by the distance from the standard pattern of the group.

For this purpose, a set of 115 ratios have been designed as numeric expressions for economic relationships. Depending on the economic sector and the type of fraud to be tackled, different ratios would be picked. Within these selected ratios the following variables will be calculated:

1. the value of the ratio for every member of the peer group
2. the average of all the ratio values (arithmetic mean)

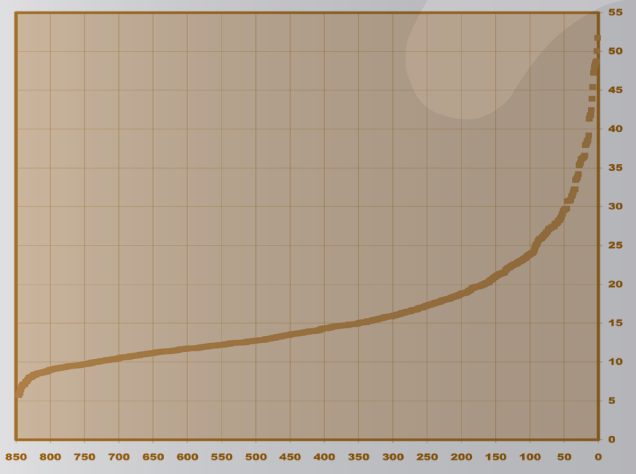
3. the distance for each fellow, defined as (3) = (1)– (2)
4. the relative distance for each fellow, defined as (4) = (3) / (2)

The **relative distance** is the numeric measure of anomalous behaviour we are looking for as an indicator of fiscal fraud. Combining the results for the different ratios considered to be relevant and assigning the appropriate weighting to each one results in the total risk score for each company. The chart below shows an example with 3 ratios.

	Ratio 1	Ratio2	Ratio 3
Value for fellow x	9	100	1
Sector Average	6	80	0.2
Distance (x)	(9-6)/6= **0.5**	(100-80)/80=**0.25**	(10-0.2)/0.2= **4**
Ratio weight	30%	20%	50%
Risk score	0.5 x 0.3 = 0.15	0.25 x 0.2= 0.05	4 x 0.5= 2

In a real case, the method was applied to 850 medium size companies in the construction sector, with four ratios equally weighted (25% each one). The output is shown in the graph, where the companies are ordered by their score, from the lowest (left) to the highest (right). The distribution was surprisingly smooth and continuous, with no clusters (many companies with the same score) in it.

Fiscal risk ranking
Construction sector, 4 ratios, 850 companies



Dynamic analysis

Dynamic analysis applied to a pair of time series shows (in numbers) the relation between both series across time. The obvious candidates for this analysis are the total purchases and sales of a company, with monthly data (48 observations, equal to 4 years, would be enough). In any commercial sector, as well as in most manufacturing activities with a just-in-time production strategy, we should find a strong relationship between both series.

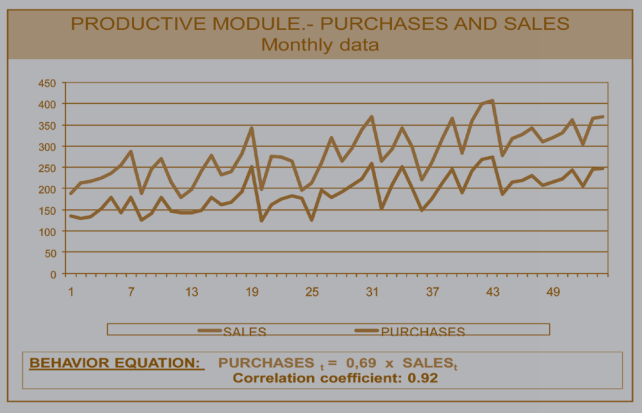
Technically we can run a linear regression (no specific software is required, even Excel can do it) considering sales as the independent variable (economic sense: in business, you buy because you sell). The output (in non-technical words) is a behaviour equation

$$\text{Purchases}_t = \alpha + \beta * \text{Sales}_t$$

Where α is a constant, (it means the month-to-month fixed purchases, independent of the sales volume. Usually, its value is 0) , and β is a coefficient whose value should run between 0 and 1. It represents the part of the sales correspondent to the purchases included in those sales. In other terms, (1- β) is the estimated average gross margin of the sales along the period. The equation also returns the correlation coefficient, in the range (0.1), that means "how well" the equation fits the actual data.

So, the "history" of sales and purchases of every company over 4-5 years can be summarized in three numbers: constant purchases, gross margin and the strength of the relationship between purchases and sales, represented by the correlation coefficient. That is enough to detect anomalous behaviours, as a sign of fiscal risk.

This graph shows a real case. The upper line represents the monthly sales of the company, while the lower line represents the monthly purchases. The observed period of time covers 54 months, that is four and a half years.



At first glance, you can say that both lines look quite similar; but what we need is to translate this impression into numbers. So, the behaviour equation tells us that:

- There are no constant purchases
- Monthly purchases represent 69% of the sales of the same month along all the period (so, the gross margin is 1-0.69 = 0.31 or 31%)
- And the model fits very well (0.92 over a maximum of 1)

So, from the point of view of the productive coherence, this one is a reliable company, and could be used as a benchmark for its peer group.

A special reference to VAT fraud

This global model offers several tools that can be useful for tackling VAT fraud, such as specific ratios about added value, or using the fiscal risk assigned to clients and suppliers (see the economic flow-chart above). Getting a European risk score system will be a fantastic help in the fight against fraud.

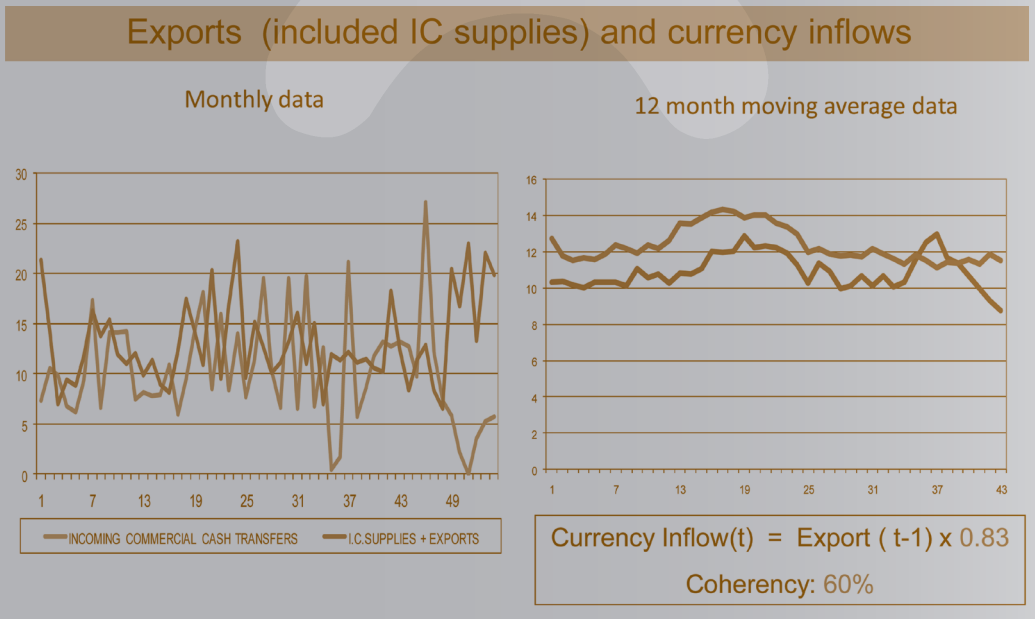
For the specific case of international VAT fraud, the key relation is the international payments compared with their corresponding purchases or sales. If the bank transfer records are available, we can track the coherence of both series across time and even estimate a behaviour equation as we did before with purchases and sales.

The left-hand graph shows exports (included intra community sales) and in-coming transfers from abroad, with monthly data over 54 months. The graph on the right presents the same series but in terms of a 12 months moving average. Obviously, the second one is more "analyst friendly", but both tell the same story.

There is a gap between the exports reported and the incoming payments from abroad, and this gap get broader in the last period. The behaviour equation shows that the incoming transfers are only 83% of the reported exports, with a correlation coefficient of only 0.60. These figures, far away from the peer group pattern, are a clear sign of fiscal risk.

Conclusions

A mathematical model based on the peer group analysis can produce estimations of fiscal risk for hundreds of companies from the same economic sector at a very low cost. A selection for tax auditing based on this model could also include hints about the main inconsistencies detected for each company, as indicators of a concrete fiscal risk. The dynamic analysis, supplementary, can generate conduct patterns from behaviour equations that provide useful information for benchmarking.



FictitiousInvoicing - Seizure of Assets

NORWAY

Bjørn Weider MOEN
Senior Legal Advisor
Norwegian Tax Administration
– Tax Crime Unit

Sofienberggata 55 d, 0563 Oslo Tel + 47 9597 3735
E-mail: bjorn-weider.moen@skatteetaten.no

Bjørn Weider Moen is attorney-at-law and graduated from the faculty of law in 2005. He has since worked in different areas of tax-law, and from 2008 been working in the tax crime unit. Mr. Moen is at present mainly focusing on problems related to fictitious invoicing, and has been dedicated to develop strategies to combat the problem in Norway

By Bjørn Weider MOEN

Norway

Introduction

Fictitious invoicing is a modern type of fraud which was developed to disguise the use of unregistered workers and thus avoid paying tax and employer's contributions (social security). The invoices are made out by people that do not actually serve as sub-contractors, but in the accounts of the receiving company, it is supposed to look as though the work has been performed by this other company. By doing so, the fraudulent company also unlawfully deducts the input VAT.

In this presentation I will identify the fraudulent company as company A, and its accomplice, the supposed sub-contractor, as company (or companies) B.

The typical company A offers services that do not necessarily need any specialized know-how, such as painting, cleaning or traffic-security. They will normally acquire their workforce from people that are easy to take advantage of, such as immigrant workers, unregistered immigrants or even victims of human trafficking. The company may also have registered workers on their pay-roll, but will normally have very few employees. They keep their bookkeeping in order, and they are on time with their VAT and tax returns. They can also compete against much larger competitors, since they charge less than the rest of the market is able to, due to the fact they don't pay taxes or VAT that their competitors do.

The typical company B is normally organized either as a sole proprietorship or as NUF (Norwegian Foreign Company), as this is the easiest and fastest way to establish a company. A NUF is registered in Norway as part of a foreign business enterprise, normally a foreign limited company. The person registered as the owner of these companies is often in a difficult situation. In our experience, they often have problems with alcohol, drug abuse, fake identities or are victims of trafficking, allowing them to be

exploited in the fraud. The common factor for these people is that they have little or nothing left to loose and that ending up with the responsibility for the tax- and VAT-claims does not change their predicament. We have also seen examples of persons brought to Norway for the sole purpose of establishing a company, and then return abroad after giving a letter of attorney to A or another person. Normally there are several "B" companies involved. Their activity is normally to make cash withdrawals and send an invoice. They don't keep books, and they normally don't report any VAT or tax.

Background

Unfortunately, we have reason to believe that this type of activity has been going on for some time without any reactions from the tax authorities. In our experience, the right measures to combat the fraud were not taken until around 2006-2008. The first, and probably most important step in preventing this activity in Norway, was the use of the ability to seize company funds by arresting their assets. An arrest of assets is granted by the court after a petition from the tax authorities, where the grounds for the future claim is presented, preferably without the knowledge of the company in question.

The Norwegian Tax Administration (NTA) started a project in 2008 to organize and administer the work against fictitious invoicing. After the first three years, the project was expanded to run for another year. In this project, all regions in NTA came together to organize their work relating to this problem, and also to share experiences to improve the results.

The obvious intention with fictitious invoicing is to acquire money, so the best way to attack this activity is to take the money. By doing so, the company's liquidity suffers major damage and the activity will normally stop.

In earlier work with these cases, the tax authorities failed to see that company B did not actually deliver the services described in the invoices. Even though it was not possible to find the company B and that there were no signs of activity except the invoices and the withdrawals from the bank account, they were made responsible for the tax and VAT evasion. This led to a number of disasters that it is not possible to revoke. Today, persons behind company B will normally be charged for contributing to money laundering. It is, however, possible for the state to make them responsible for the VAT, as is described under.

Extent

Through IOTA, it has become apparent for NTA that this problem is very common throughout Europe, and it appears in different forms and in different areas of business. Even though the case presented here is not in terms of money a major tax or VAT-fraud, the same system applies for the more complicated frauds involving fictitious invoices. As an example of how big these cases can become, I refer to an earlier IOTA-meeting in Bern, Switzerland during 2012, where the Italian Revenue Service, presented a case involving a massive number of companies and people, and also vast sums of money.

There is reason to believe that fictitious invoicing is a way to finance other criminal activity, and so it is an important element to combat, helping to reduce crime in general, including drugs, trafficking and prostitution.

The structure of the network

The main component in any fictitious invoicing structure is to establish several independent companies that do not have any common owners or other implicated parties. The reason for this is that the companies B supposedly deliver services to company A with arms-length, and the fictitious invoice documents in the transaction is the receiving company A's books. By doing so, the accounts in company A do not seem to be faulty, and the tax authorities cannot detect the fraud solely by auditing company A. It is necessary to check the company that has sent invoices to company A to determine if they have delivered the services described in the invoice. To make matters worse, it is not uncommon to find structures with companies that invoice in a vertical line over multiple levels, thus making it harder to detect the fraud. In fact, the investigating officer has to analyse a number of companies and their bank accounts to be able to uncover the fictitious invoices.

The facts of the case

"A" is a limited company renovating pipelines in buildings, such as wastewater-pipes. They used a patented method where one person monitored the renovation done by a machine on a screen. The machine cleans the pipe, and then sprays a layer on the inside to fill any holes or cracks, making the pipe smooth and whole on the inside. Even though this case does not involve many workers (compared to other cases), the person monitoring the machine did not need any particular know how, which is the most significant feature

in cases involving fictitious invoicing. The company used 4-5 machines at any one time, and the facts of the case suggested that they had 4-6 persons at work.

This technique is a much more efficient and easy way to go about renovating pipes, because the alternative is to tear out all the pipes and replace them. The latter approach is very costly and time-consuming. It is therefore possible for A to get a higher price for their services, thus making a very good profit.

To further increase their profit, they establish other companies (Bs) registered with a phony front man that sent fictitious invoices to company A. The invoices were paid according to the terms of the invoice, but monies were either quickly withdrawn from the recipients' bank account or forwarded to a foreign bank account abroad. The invoice in A's accounts was used to legitimize a VAT-deduction, and to also register the expense as sub-contraction rather than wages to employees. By doing this, A avoided paying tax deductions and employer's contribution for their workers.

In total, the company's turnover was about euro 2.4 million in a period of less than two years, on which almost no tax or VAT was paid.

The detection

Company B's activity is however fairly easy for an attentive bank to detect because of all the cash withdrawals. The money laundering-act in Norway instructs banks (amongst others) to report any money transactions that might originate from unlawful activities, thus giving the police and the tax authorities information of such activity.

After a quick analysis of the bank accounts in question (belonging to companies B), we were able to pinpoint company A, the main fraudulent company. Among the things that we look for in this analysis are large and repetitive cash withdrawals, and also the type of activity within the account: if a large sum of money is withdrawn, the owner of the account does not need to use their debit card for smaller purchases later the same day, unless he has given the money away to someone else. Furthermore, the companies B did not send in VAT or tax returns and had failed to submit mandatory yearly accounts. A quick check of the persons involved showed that there was a history of similar behaviour.

We continued to check out the address belonging to the company, just to find a private address that also housed one person registered as a board member of the company. To prevent detection, we did not contact this person or any other persons supposedly involved in the company. We did, however, get in touch with company A's customers, mainly private housing buildings. The last building to pay told us that the work had already finished, and the company was no longer at the address.

The attack

The information obtained, gave us a chance to examine all of the companies' transactions through their bank accounts, and also give us information that led us to all company Bs that they were used in the fraud. In Norway we also have a currency register that has information about any transactions going out of Norway, so we quickly had a complete overview of the company's transactions and assets.

A preliminary examination of the sub-contractors gave us the information we needed to prepare for a seizure of any assets A might have in their possession, thus making it possible to halt their fraudulent activity. We petitioned the court for an arrest of A's bank accounts and accounts receivable, and also any other asset of value belonging to A. This was granted by the court without any preliminary court meeting, and without the knowledge of the involved companies.

The seizure of funds gave the tax authorities time to produce a report and a tax resolution to claim the embezzled tax and VAT. In our case, the company did not query either the courts' decision to arrest the funds, or the later petition for bankruptcy requested by us. This is however not the most common approach, since company A usually has a thriving business that they want to continue. When the accounts are seized, the activity stops, and the company will most likely go bankrupt. Therefore they will normally challenge the court's decision to arrest their funds, and this will lead to a trial where the tax-authorities will have to defend their claim in open court.

We seized approximately 400,000 euro in the bank accounts belonging to four different companies, and the court gave authority to seize any available accounts receivable.

The assets

Any asset belonging to company A was subject to seizure. This included not only the bank accounts

belonging to A, but also any equipment used for the purpose of trade as long as company A owns it. The decisive factor when determining which assets to secure is in fact if it belongs to company A, not to whom it may be registered to. This means that money in bank accounts registered to company B may be included in the arrest, if it is proven that it contains money belonging to A. This was the case here, and we were allowed by the court to arrest money in several bank accounts belonging to other companies than A. We did, however, not find any other asset to seize, but if the company had in fact owned cars or other items, these would have been subject to arrest.

The Norwegian VAT-act (§ 18-2) states that any invoice including VAT sent as documentation of a sale/transaction, has to be reported to the authorities, even if it's incorrect or false. If this is not done, the tax authorities can calculate the company's VAT based on the information available. This means that all the invoices sent from all the companies B will be subject to such declaration, and results in a VAT-assessment and ultimately a claim of the VAT on B for all the invoices sent. It does not matter that there was no actual sale of services behind the transactions, thus giving the state the opportunity to claim the same VAT twice, both from A and B. This gives us the chance to petition all company Bs for bankruptcy. In our case, all companies B along with company A went bankrupt as a consequence of the arrest. The later estates in bankruptcy are at present working on prosecuting the persons involved in the fraud, and are financed by the money secured by our arrest.

The challenges

It is the state's responsibility to uncover and document the relevant facts of the case when petitioning for arrest. In Norway, arrest can be undertaken without the knowledge of company A. It is therefore an absolute term for arrest that the state has sufficient proof of fictitious invoicing. It is not sufficient to prove that the company has evaded tax and/or VAT. It is also required to show that the debtor's conduct gives reason to fear that enforcement of the claim would otherwise either be forfeited or substantially impeded, or must take place outside Norway. In our case, both the debtors conduct and the fact that money was sent abroad, gave us reason to fear for the enforcement of the claim.

It has been argued by the lawyers of company A that the facts of these cases are so incriminating, that the preponderance of evidence must be "qualified". This means that the case has to be proven with more than 50% certainty (approximately 60-75%), for the arrest to be upheld. It is our opinion that this is not correct juris prudence, and so far, the courts have used the normal preponderance of evidence for civil cases (more than 50% certainty of the facts). However, it is a question that should be given some attention when petitioning for arrest. The courts may be influenced by the fact that the company will go bankrupt if the arrest is upheld. Because of this severe consequence, the presiding judge might not rule in favour of the state unless they feel confident of the fictitious invoicing, and the preponderance of evidence will de facto be higher than 51%.

It has been a teaching point for us how to go about proving that an activity or a company does not exist. It is, in some ways, the same challenge as proving that the world is not flat. You have to go beyond the deception, and look at the evidence from "a bird's eye perspective".

The Involvement of Payment Platforms in MTIC VAT Fraud in a Nordic Perspective

NORWAY, DENMARK, SWEDEN

Guri E. Stange LYSTAD
Senior Tax Lawyer
Directorate of Taxes

P.O.Box 9200 Grønland, NO-0134 Oslo Norway
Tel + 47 94 53 95 26
E-mail: guri-stange.lystad@skatteetaten.no

Ms Stange Lystad is a tax lawyer specialised in VAT. She joined the Norwegian tax administration in 2001. She has previously been working in the Ministry of Finance, Tax Law Department and in the EFTA Secretariat, Brussels. Since 2009 she has been working with VAT fraud in the audit-section, where her primary responsibilities include VAT carousels.

Reino NIELSEN
Chief Inspector
Tax and Customs Administration – SKAT
Anti Fraud Unit Denmark

Lyseng Allé 1, 8270 Højbjerg, Denmark
Tel +45 2067 4460
E-mail: reino.nielsen@skat.dk

Mr. Nielsen started in the Danish Tax Administration in 1976 and has a background as Tax Auditor. Since 1997 specialized in investigation of fiscal fraud and international cooperation. National coordinator in MTIC VAT Carousel Fraud.

Alma OLOFSDOTTIR
Coordinator MTIC VAT fraud
Swedish Tax Agency

106 61 Stockholm, Sweden
Tel + 46 105743572
E-mail: alma.olofsdottir@skatteverket.se

Ms. Olofsdottir has been working with the Swedish Tax Agency for12 years, coordinator for the investigation of MTIC VAT fraud in Sweden for several years. She has Master's degree in business administration and economics from Stockholm University

By Guri E. Stange LYSTAD, Reino NIELSEN, Alma OLOFSDOTTIR

Norway, Denmark, Sweden

Introduction

There are numerous online money transfer solutions available on the market for companies who want to send and receive money electronically, both domestic and cross border. Different types of payment methods, via Internet or mobile phones, are constantly developed. The payment service providers can be situated anywhere in the world and the servers, where the web

sites and all electronic transactions are stored, might be located in other countries than the service-providers.

In general these payment solutions will be different depending on what kind of businesses they facilitate and needs they serve.
The use of Alternative Payment Solutions – or Payment Platforms – is actually not a new phenomenon. It has been used for many years in different forms and for many different purposes.

Most well known is probably the "internal financial accounting systems" which is used widely by large multinational companies and in Internet based business and Internet based gambling like e.g. Internet poker games where "members" can establish a "gambling-account" at the game-provider.

Instead of using costly and time consuming traditional bank transfer services for every internal transfer of goods and services, many multinational company groups have – totally legal – used their own internal financial accounting and payment platform solutions.

Such system is basically a "closed" system only accessible for "members" of the company group, but the idea and the techniques behind can of course also be used in other types of business. A group of "independent" companies or individuals can in principle agree to use the same tools and techniques to clear their financial obligations from their trade. It can be absolutely legal but of course the "model" is also available for the use of more "spectacular groups" to secure rapid payment clearings and to avoid banks, tax and law enforcement authorities to have full access to their transactions and to protect the assets on the accounts from outside creditors and from money laundering suspicion.

During the last 10 years it has been more and more evident for tax authorities and law enforcement that organized criminal groups are using alternative payment solutions to facilitate their criminal activities. It was seen in the organized MTIC-fraud that was carried out in the mid 2000 where organized MTIC-fraud was facilitated by a bank established in The Dutch Antilles that provided alternative payment solutions.

The model from this fraud was later on developed into Internet based payment solutions – payment platforms – that we see widely in use in today's fraud schemes.

MTIC (Missing Trader Intra Community) VAT fraud involving services, i.e. carbon credits and EECS GO (Guarantees of Origin), could be carried out electronically between companies' accounts in different registries in rapid speed, and within only few minutes the fraudsters could steal enormous amounts of VAT from the member states (and even third countries). Therefore it is essential for the fraudsters to be able to control and speed up the money transactions. Consequently they will prefer using accounts held at the same bank or online payment platform to speed up the transfer of money and enable them to transfer money between the fraudulent companies' accounts online 24 hours a day.

They will also prefer money-transfer solutions that reduce the risk of being detected, their funds frozen and confiscated by authorities. The optimal solution for MTIC fraudsters is therefore to organise their own alternative payment platform (APP) for financial transactions in the fraud to control the flow of money and hide it from authorities.

The tax administrations in Norway and Sweden have detected several alternative payment platforms (APP) facilitating MTIC VAT frauds in other EU countries. In this article the APPs are described from a Nordic perspective, taking into account that there are probably huge variations of APPs - their characteristics and functioning will be different depending on what kind of purpose they are serving, and their development over time.

History of alternative banking and payment platforms facilitating MTIC VAT fraud

One early example of fraudsters using the same bank is the First Curacao International Bank (FCIB) in the Dutch Antilles that was closed down in 2006 after fraudsters were found to be using the bank to swindle millions of euro out of European treasuries via carousel fraud. The FCIB provided services to their customers that were particularly attractive to MTIC fraudsters [http://vrritti.com/2012/04/11/dutch-public-prosecutors-office-aiming-for-18-month-prison-sentence-in-relation-to-carousel-fraud-by-john-deuss/ and http:/www.guardian.co.uk/money/2006/oct/23/crime.scamsandfraud].
Fraudsters continuously search for new financial platforms for facilitating fraudulent money transactions, so when the FCIB was closed down in 2006 the frauders had to look for new more secure money transfer solution.

Between 2006 and 2008, numerous Swedish savings and loan associations (SSLA) were registered in Sweden with foreign board members with either a PO Box or an office hotel address. Words as "credit union" or "trusts" were often included in the name of these as-

sociations. Most of the associations were undoubtedly registered only for fraud purposes and some were operating openly as online bank on the Internet without a licence from the Swedish Financial supervisory authority, Finansinspektionen (FI). In some cases their activities were not exposed on the Internet and were therefore unknown to the authorities.
In 2007, FI published 50 notifications to savings and loan associations to end their business activity. Most of the associations had not even been registered with the FI, only with the Swedish Companies Registration Office, and were not qualified to be exempted from supervision and licence requirements. Most of the associations did not comply and were finally liquidated.

There have also been numerous companies who offer complete SSLA formation packages for sale on the Internet, including bank software program. Those companies are typically located offshore, frequently in Panama or New Zealand. SSLA are usually known as a "Swedish Credit Union" on the Internet.

SSLA is an economic association that is registered at the Swedish Companies Registration Office. The business activities of the association are of financial benefit to its members. It is not a bank and the word "bank" cannot be included in the name. The board of directors, minimum three directors, may be of any nationality though 50% or more should have an address within the European Union. If the association has no authorised representative resident in Sweden, the board of directors must authorise a person resident in Sweden as a contact person for the association. The association is allowed to have a maximum of 1,000 individuals as members and the only accepted members are individuals from a limited group of people, identified in advance and specified in the articles of the association. It is also only allowed to receive repayable funds from its members, a maximum of 50,000 SEK (ca 5,000 euro), or from financial companies and only those funds are allowed to serve the member's financing needs.

In IOTA Tax Tribune 2010 the article "The use of Swedish Savings and Loan Associations for the Purpose of Hiding the Flow of Money in Carousel Transactions – VAT fraud" describes in more detail how Swedish saving and loan associations were illegitimately used as APP for payments associated to MTIC fraud.

At least three registered SSLA in Sweden were running payment platforms on the Internet for the purpose of transferring money related to MTIC carousel fraud. The associations had PO Box as registered address and the directors were from other MS, and a third country. Two of the associations had even a Swedish director but he was not running the payment platform. The associations were all connected through the directors and it appears that when one association was in the process of closing down, the next one started operating. Funds were deposited to the member's accounts by other members or a third party, by depositing funds from a regular bank account into the association's bank account. The association's representative then debited the funds on the relevant member's virtual account. The members could then, through the online payment system, transfer funds held on their virtual accounts to other member's accounts. The associations had bank account in other EU countries and offshore.

One of these illegal associations was registered in February 2006. Members of the board were from the UK and India. It had a PO Box address in Sweden and bank account in another MS. It had a website on the Internet where new members could apply for membership and an account and the application form, know you customer documentation, was to be sent via e-mail or to the PO box in Sweden. The server for online transactions was not located in Sweden. In 2007 FI published a warning about the APP and ordered it to end its business activity. Meanwhile the company transferred most of its customers to a new established APP in New Zealand.

Alternative payment platforms - Nordic experience

Online payment platforms operating in Sweden

During 2009 – 2011 three Ltd companies in Sweden were operating online payment platforms used for money transactions in MTIC VAT fraud in EU. The companies where all registered as payment transfer providers with Finansinspektionen (Financial supervisory body), the FI. Companies providing payment services in Sweden at that time did not need a licence to do so, but were obliged to be registered with FI. From August 1st 2010 all companies in Sweden who are offering payment services have to apply for licence from FI, or exemption from licence if the amount transferred is under 3,000,000 euro per month.

The directors of the companies were Danish citizens and had residence in Denmark. None of the companies had a real business address in Sweden, only one operating address at an office hotel. The directors were associated with businesses in Denmark that previously had been suspected to be involved with carousel fraud, and there was a connection between the busi-

nesses. The Swedish companies had a website on the Internet where customers could apply for an account by downloading an application form. After sending in the application form, and know you customer (KYC) documents, the customers received user name and password to their own account in EUR, USD and GBP which made it possible for them to transfer money to other customers accounts. The customers paid fees to the payment platform for every transaction they made on their accounts. The server for the website and online banking program was located offshore. The companies running the online payment platforms had bank accounts in Denmark and in Sweden.

The customers of the payment platforms were associated in a suspected carousel fraud in the EU and there were huge amounts of money transferred between the customer's accounts in a relatively short period of time. Hundreds of companies in the EU, and even third countries, were customers of these payment platforms and about 20 companies were customers in two or three of the platforms. There were even hundreds of companies outside the payment platform, involved with the suspected carousel fraud, making payments in and receiving payments from the customers in the payment platforms.

When auditing the payment platforms in Sweden, as an attempt to get hold of information about the customers and their transactions, a list of all the customers of the payment platforms and information about all the transactions on the regular bank accounts was obtained. Information about all money transactions on the customer's account on the offshore server was also obtained from one of the payment platforms, covering a period of ten months. This platform had been running for almost two years. The payment platform was mainly used for payment related to suspected MTIC fraud in EU. Over a period of ten months the transactions on the regular bank account was 500 million euro which generated transactions of 2,8 billion euro on the customers accounts within the payment platform. The table below illustrates the flow of transactions. The transactions on the customer's accounts, within the payment platform, show that money was transferred between the customer's accounts with only a few minutes apart. The companies involved in these transactions were from various countries and it is not likely that all the "managers" of those companies were making money transfers almost simultaneously in a precise order. It can therefore be assumed that the individuals who were running the suspected carousel scheme also had control of the accounts.

Transfer Date	From Company	To Company	Currency	Amount	Fee Amount	Transfer Type	
2010-02-19 15:42:23.993	Payment platform	A :	EUR	1 900 000,00	0,00	Deposit Transfer	
2010-02-19 15:51:59.467	A:	B :	EUR	1 899 350,00	619,80	Instant Transfer	
2010-02-19 15:56:29.837	B:	C:	EUR	1 898 750,00	619,62	Instant Transfer	
2010-02-19 16:00:38.863	C:	D, Dubai	EUR	1 898 150,00	619,44	Instant Transfer	
2010-02-19 16:05:58.093	D, Dubai	Payment platform	EUR	1 900 000,00	1 970,00	Wire Transfer	Beneficiary Bank: company X
2010-03-24 11:29:10.027	Payment platform	E:	EUR	4 597 200,00	0,00	Deposit Transfer	
2010-03-24 11:30:18.680	Payment platform	E:	EUR	2 869 632,00	0,00	Deposit Transfer	
2010-03-24 11:31:06.210	Payment platform	E:	EUR	3 589 860,00	0,00	Deposit Transfer	
2010-03-24 11:34:50.487	E:	F:	EUR	11 053 325,00	3 366,00	Instant Transfer	
2010-03-24 11:38:07.423	F:	G:	EUR	11 049 962,00	3 364,99	Instant Transfer	
2010-03-24 11:42:56.510	G	D, Dubai	EUR	11 046 598,00	3 363,98	Instant Transfer	
2010-03-24 11:47:37.037	D, Dubai	Payment platform	EUR	10 500 000,00	10 570,00	Wire Transfer	Beneficiary Bank company Y:

The payment platforms were all closed down in Sweden in 2010 - 2011.

Online payment platforms operating in Norway

One of the above mentioned companies running payment platforms in Sweden, also registered a company in Norway in April 2010, but did not register with the Finanstilsynet (Norwegian financial supervisory authority). The company had a bank account in a Norwegian bank and enormous amounts of money in various currencies were running through that account. This company was running an unregistered online payment platform from Norway and the money transactions were related to suspected MTIC VAT frauds in other European countries. The company was operating only for a short period of time and was then replaced with another company running a new APP, however with many of the same customers as the previous one. After a short period of time the new APP closed down and the same pattern was repeated.

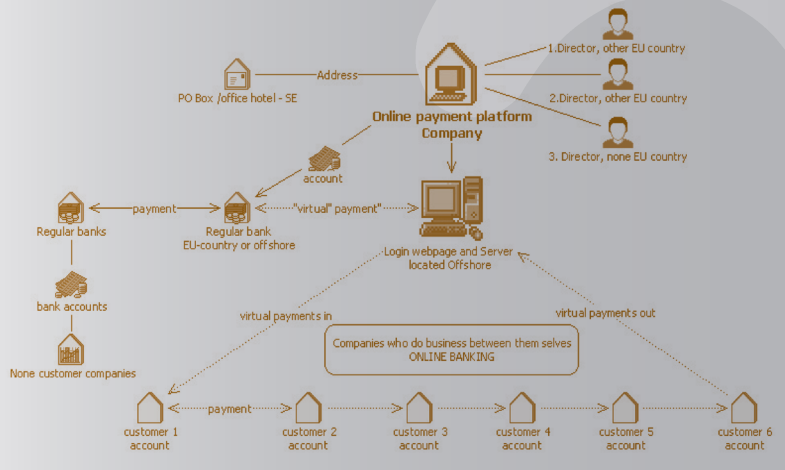
These companies were registered with the business-register in Norway, mostly under non-relevant business sectors. In most cases the addresses of the companies were at business hotels. The owners and management were all non-Norwegian residents. The companies had no other economic activity in Norway

apart from holding bank-accounts with considerable international transactions, and no registered employees. Their websites on the Internet, if they had any, were not found by the use of ordinary search-methods. Only the transactions on their bank accounts indicated that they were running an online payment platform.

Based on the facts that have been found so far, the APPs detected should be considered as providers of payment services as defined in the legislation on financial agreements (Finansavtaleloven). According to the act regulating providers of payment services (Finansieringsvirksomhetsloven) such services can only be provided by enterprises having permission from the Norwegian Financial Supervisory Authority. These are listed at the financial supervisory authority [http://www.finanstilsynet.no/en/Secondary-menu/Finanstilsynet-registry/] (There is a simpler regime for small enterprises, but permission is also required for these and they are under the supervision of the authority.) None of the APPs detected in Norway so far have been registered at the Financial Supervisory Authority.

How the APPs work

The diagram below illustrates how online payment platforms can work. The only "real" money transactions are the transactions between the bank account, belonging to the payment platform, and accounts in other banks. When a company who is not a customer of the payment platform wants to make a payment to one of the customers (x) within the payment platform, the payment is made to the payment platforms registered bank account with instructions to the payment service provider to transfer the amount to their customers (x) account (sub-account).



The administrator of the payment platform then internally transfers the same amount to the customer's virtual accounts within the payment platform. When the customers have received the "money" on their accounts, they can transfer the virtual money to other customers' accounts. Money transferred to the regular bank account of the payment platform can therefore generate a money flow on the customers' accounts that are many times higher. These transactions are not visible to authorities or to the hosting bank.

As regards ingoing payments, they reflect that a non-customer for example has bought something from one of the customers of the APP. Outgoing payments indicate that one of the customers of the APP has bought something from a non-customer. This could for example be payment for commodities used in the MTIC VAT fraud or transport-services.

By operating an APP the customers are able to produce bank-statements and "proof" of transactions from the online-banking facilities, but they do not always have access to make transfers from the account themselves. In this way the organisers of the fraud are able to use straw-men fronting the different companies but still keeping control of the money and transaction-flow in the fraud-chain.

Black-box effect

As regards the transactions on the payment platform, these will in most cases be hidden for the tax administration and law enforcement authorities – consequently the black box effect. Any third-party information from the hosting-bank will not be able to identify transactions within the APP, only the in-going and out-going transactions. It is assumed that the bookkeeping and documentation will be kept in another country (managed by non-residents), or in the cloud. So for the national tax administrations it will be a complicated process to find and access information regarding the customers and the transactions on the platform. However, the experience from the Swedish case mentioned above where that the customer lists and transaction information was obtained by the tax administration, demonstrates that the information can be accessible.

The experience from earlier MTIC VAT fraud cases is that payments were made to third parties – to the company holding the account where the APP was operating from. Third party payments could be an indicator that something is unusual, and should raise the awareness for the enterprises transferring to the bank-account. Now the experience is that the fraudsters have responded by making sure that the docu-

mentation states that the receiver of the money is the customer of the APP, either directly or indirectly, and not the holder of the APP account alone.

Facilitation to the alternative payment platforms

There are numerous websites offering complete online banking software packages for sale on the Internet. They offer a complete program package including all components required to run an Internet bank. Some even recommend registering the Internet bank through a financial institution license from New Zealand, as most of the other offshore jurisdictions impose heavy entry regulations and often discourage the establishment of new financial institutions. On a website with the address www.probanx.com it is explained that *"New Zealand is recognized as a premium jurisdiction for the following reasons: It provides all the advantages of traditional "offshore" financial centres, but is recognized as a true mainstream "onshore" financial centre, which has NOT been black listed by any jurisdiction or authority in the World. It is not perceived by OECD as a harmful tax jurisdiction."* (http://probanx.com/fiformation.html)

Some program providers offer package solutions for starting up a financial institution within a few weeks, i.e.

- Assistance to register the Internet bank & obtain a financial institution license
- Leasing of e-banking software
- Public website domain registration and web design
- Setup of a secure Internet banking website
- Complete system hosting with back up
- Fully comprehensive core banking system
- Back-office management and financial reporting
- Full service and support
- Comprehensive banking system starting from 6,000 euro

When the customers to the "Internet bank" receive their login data they can start their banking activity. Example of online bank screen shots and how the online bank program works is available on https://www.nexorone.com/en/Product-Tour-NexorONE-Online-Banking-Application.html

The Internet bank set up can contain three independent websites. The first one is the public website where the customers can fill in an online application form to open an account. There is also a link to the secure online banking website, the second one. The online banking website is encrypted and used for customers' login to the payment platform. The third website is setup with a secret IP address and only accessible by the managers of the payment platform. From there the managers can access all the accounts.

Consequently fraudsters who want to establish their own online payment platform can easily start operating the "bank" within a few weeks, and at a relatively low cost.

How to detect APPs

It can be difficult for authorities in the country where an APP is registered to detect and investigate fraudulent payments that are running through the payment platform. It is even more complicated when the fraudsters are operating their own APP established only for fraudulent money transactions in carousel fraud.

- The fraudulent APP has usually no visiting address, only PO box or office hotel
- The directors are resident in other countries
- The directors' background can be questionable
- Server(s) for online bank program/website can be located offshore
- None of the companies (customers), involved with carousel fraud, are established in the same country where the payment platform they use is registered.

Fraudulent money transactions through an APP can be detected when auditing their customers. Auditors should, when investigating companies involved with suspected carousel fraud, look closely into payments related to the invoices and when detecting "third party payments" made to an APP send a request /spontaneous information the tax authority where the APP is registered.

APPs need to have bank accounts in a regular bank to operate. Banks hosting payment platforms, like a bank within the bank, should therefore be aware that the bank can unknowingly be involved with fraudulent transactions of money.

- Companies running payment platform services usually have accounts in euro, GBP and USD in a regular bank, often located in another country (preferable in a non-EU country)
- Large amounts are flowing through the bank accounts every day, to and from companies in various countries.

- Payments made to the payment platforms are usually provided with instructions to transmit the money to third party, i.e. to an account holder in the payment platform

In Norway the APP were not even registered as money transfer providers with the company house or the financial supervision authority, but nevertheless large transactions were made through their company accounts in a Norwegian bank.

If the bank suspects that the money transactions on bank accounts can be related to money transfer services, APP, it should control:

- the application for bank account with the bank, and the person behind the application if the company is registered with the company house as payment service provider
- if the company has all necessary license from Financial supervision authority
- Who are the customers to the APP (KYC)

Suspicious bank transactions related to APPs should be notified to the authorities.

As mentioned earlier, Alternative Payment Solutions is also used widely in legitimate business as it is known in multinational company groups and Internet based business models. It is therefore a challenge to distinguish between the legal and illegal purpose of the used Alternative Payment Solution or Platform.

In legitimate business the use of APS will normally be transparent and a legitimate business will normally give tax and law enforcement authorities full access to financial transactions through their accounts. Contrary to this, the lack of transparency and access could be an indicator of the fraudulent purpose of the APP.

The Nordic link - Nordic task force on alternative payment platforms used in MTIC fraud

With regard to the establishment of APPs in the Nordic countries, one explanation might be that some Scandinavian individuals that have previously been involved in MTIC VAT fraud have changed to being facilitators for the fraud. In addition, knowing the legal framework of Swedish savings and loans associations, combined with the general impression of Nordic transparency, has made it attractive to establish them here.

One major difference between the Norwegian and Swedish APPs is the absence of the legal appearance of the Norwegian ones and the seemingly legal savings unions in Sweden. The experience is, however, that no matter if they have a legal exterior or not – the APPs are serving MTIC VAT fraud by operating the financial transactions, and their activity as such should be considered as facilitators to VAT fraud and money laundering.

The question is if there is a link between the Swedish and Norwegian payment platforms: as mentioned above, the parties in the transactions are partly the same. There also seems to be a link between the persons behind the companies operating the APPs. As regards the time-line for the Swedish and Norwegian APPs as a whole, it seems that they are replacing each other, - when one closes down a new one is replacing it. Consequently there are facts that give reason to assume that they are related.

It has been revealed that some of the key-persons administering the Swedish and Norwegian APP´s seem to be individuals living in Denmark and those individuals appear in the same or new roles in replaced APP´s. There seems to be a continuity of individuals setting up the APP and their customers. It has also been revealed that both among administrators and customers there are clear tracks of possible involvement in MTIC fraud in the past. So the individuals involved in these types of APP know the business model and how it works in details.

By using APPs the MTIC fraudsters are able to

- hide the money flow in the transactions from law enforcement agencies, including hiding the onward transactions of money to other jurisdictions. This makes it more difficult to uncover the fraud and seize assets
- speed up the transactions, consequently increasing the amount defrauded from the state budget in the country where the missing trader is established
- maintain the anonymity of the persons involved in the fraud
- avoid risk of money-laundering reports

In 2012 a Nordic task force on alternative payment platforms used in MTIC fraud was established in the framework of the Nordic Agenda cooperation. The aim with the task force is to get a deeper understanding of how these payment platforms are operating. By combining the expertise and knowledge from the different tax administrations it will be possible to get

a more complete way of describing the nature of the APPs. By learning more about their characteristics it might be possible to develop a methodology for detecting new APPS and find a way to approach them.

How to respond to APPs involved in MTIC VAT fraud

- Through Exchange of information (EOI) between the countries affected is important to stop the fraud. (For EU member-countries EUROFISC will be a channel for such EOI, in cases where other countries are involved multilateral or bilateral agreements will be a legal base.)
  - When detecting payments made to APPs it is important to inform the hosting country that they have a platform established there.
  - The country hosting the platform should exchange all available information to the countries concerned if there is a legal base to do so. (However, one problem is to know which countries that are affected since it requires that the VAT registration is known. However tools like eurofisc or other international cooperations might help to solve this problem.)
  - It is important with feedback to information exchanged, because this can confirm if there is an APP or not, and in addition it will give the provider-country a clearer picture of the role of the users and how the platforms function. If a platform is used in VAT fraud, there might be a legal base for a criminal charge of the company for money laundering.
- Inter-agency co-operation
  - Domestic - The tax administration should consider informing relevant bodies such as the national financial supervisory body and national financial intelligence units about the risk of use of APPs, their money laundering function and involvement in MTIC VAT fraud.
  - International – one of the characteristics of the APP is that they are established in another country than where the VAT fraud is done. Consequently the VAT loss will be in another country than where the money is placed and laundered. The fraudsters explore the fact that it is less interesting for a country to spend resources on cases where the VAT loss occurs in another country. Improved international inter-agency cooperation is the only way to make it more complicated to operate such APPs.
- Recommendations to the financial sector and businesses
  - Potential hosting banks should be made aware of the risk for APPs operating from their bankaccounts so that they are able to detect such APPs and inform relevant agencies.
- Enterprises in risky business-sectors should be made aware of the risk of third party payments.

Information Technologies in Support of Tax Administrations

Electronic services are becoming more and more important in the life of tax administrations. They have a crucial role to play in maintaining contact with taxpayers, storing and analysing information and combating tax fraud.

In this section Mikayel Pashayan has written an article about e-Governance in the Armenian Tax Administration. Nowadays complex e-Governance has already become a reality and its structure is explained in detail.

In Belgium the tax administration are using complex data mining tools which are explained by Dirk U. Potvin, a specialist in the field of data mining since 2004.

FIOD, the criminal investigations unit linked to the Dutch tax administration are using forensic ICT investigations tools against tax fraud too. The organisation, the hardware and tools used are explained by Maarten van Barneveld.

The ever growing amount of virtual money is challenging the work of tax administrations. The Norwegians André Heggstad and Espen Norkyn provide an overview and a basic understanding of electronic money and virtual currency schemes to auditors and tax lawyers. David Whyte from the United Kingdom presents the work carried out during the IOTA Workshop in February 2012 on the Use of Forensic Tools and techniques to Combat Fraud. The article includes the collaborative work of computer forensic specialists, EDP auditors and a wide spectrum of countries with varying forensic and audit skills.

E-Governance in the Armenian Tax Administration

ARMENIA

Mikayel PASHAYAN
Head of IT Department, State Revenue Committee of the Government of the Republic of Armenia
State Revenue Committee of the Government of the Republic of Armenia

Khorenatsi 3,7, Yerevan, 0015, Armenia
Tel +374 60 54 47 57
E-mail: mikayel_pashayan@yahoo.com

Mr. PASHAYAN is working in Armenian State Revenue Committee since 2008 as Head of Information Technology Department. Starting from the very beginning of his work he initiated substantial changes in the existing information system from simple data processing towards e-management. He has PhD degree in economics and teaching in the Armenian Slavonic University.

By Mikayel PASHAYAN

Armenia

Armenian legislation provides 3 ways for submitting tax declarations – by hand, postal and electronic. For many years the tax authorities were receiving approximately 80 percent of 1.2 million annual tax reports by hand, the rest by mail. In 2008 the tax reports that the authorities received from 140 thousand registered taxpayers in our country, were entered into computer "by hand". Additionally the maintenance of the taxpayer's ledger, preparation and provision of notifications and all the documentary work needed "hands-on" intervention. This meant that the tax authorities needed to spend a large amount to implement new systems as the documentary work mentioned above was the main reason for the errors and omissions. Information technologies were not available for all functions in the tax system, and those that were; were aimed at providing local functions, subsystems were isolated from each other and were not providing the expected efficiency of the implementation processes, and in certain area IT was generally not used. The analysis of this situation was the turning point for the management of the tax administration: the task was to develop and implement an IT based unified electronic management system.

The State Revenue Committee of RA (SRC), has since 2008, consistently supported the development of IT by implementing modern e-government systems whilst simultaneously adding electronic services for citizens. One of the most important issues faced by the committee was to create the foundation for the improved information substructure and the development of its control mechanisms. The IT Development strategy for 2009 to 2011, which was adopted at the end of 2008, included an action plan and objectives for the next 3 years:

- Automation of the major part of processes and functions in the tax system
- Implementation of an electronic system for submitting tax reports to the tax authorities
- Creation of a database of taxpayer's data and information

- Creation of a risk assessment and management system
- A substantial increase in productivity of tax employees due to the implementation of modern electronic and informative "tools"
- Provision of high quality electronic services to taxpayers

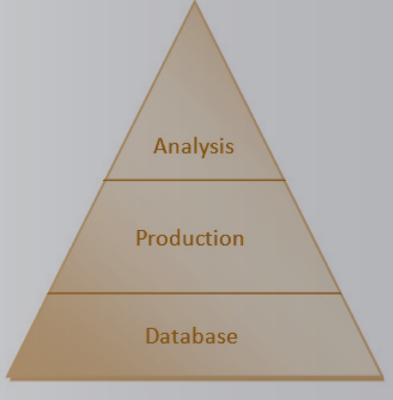
In order to explore the international experiences in the field of e-government systems, experts from the State Revenue Committee visited Kazakhstan, Estonia, Lithuania and the Czech Republic between 2008 and 2009. The achievements of those countries in the fields of computer software design, development, testing and implementation were studied. Three fundamental documents were produced on the basis of the knowledge and experience gained during the visits.

- "The concept of SRC e-governance systems implementation from 2008 to 2011"
- "Work order for the SRC Reforms Council in the area of e-governance"
- "A specialized work order for groups working on the implementation of the SRC e-management system"

These documents allowed us to organize the whole process of design, development, testing, implementation and the use of the separate components of the e-management system according to the concept of "SRC e-governance system implementation from 2008 to 2011", as well as to monitor the relationship between the working groups and the contractor.

Transition to "Taxpayer" version 3 e-governance system

Previously the committee had carried out its work according to the "Armenian tax information system" implemented from 2002 to 2004, which later did not meet the time requirements and in some cases current legislation. The system was outdated both physically and technically. The need to establish a new, flexible system, with comprehensive information and analytical tools, which met the current requirements of the tax authorities, became an urgent matter. We can state that today it is already a reality. In the previous systems, the information was updated at certain intervals and the human factor was the main reason for errors and omissions.



Database – Includes tax declarations, payments and etc.

Production – Includes payment automation, notification system, calculation of liabilities, VAT reimburses etc.

Analysis – Includes cross checking, risk assessment, analytical reports etc.

First level – "Database"

The information at this stage is collected online. The information that is entered or provided from third parties in local tax inspectorates is immediately transferred (online) to the central server where the database is located. This means, that the "Database" is the basis of the system where the complete information about taxpayers' is collected and stored. This includes all types of declarations, tax reports, payments to budget and other information required by the law.

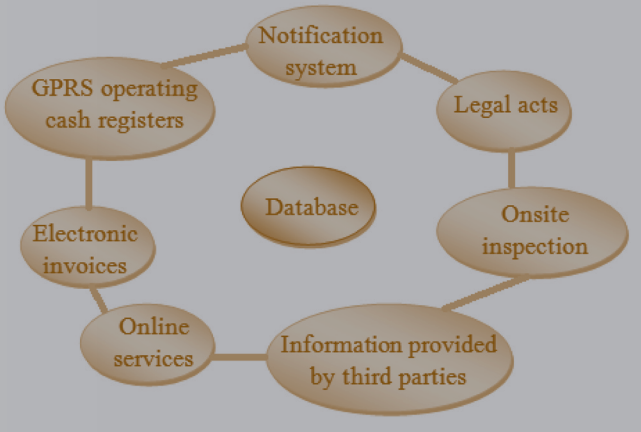
Second level – "Production"

At this level, based on the information provided in the "Database", the automated maintenance of taxpayers' ledgers is carried out as well as calculation of tax liabilities and balances, creation of notifications etc.

Third level – "Analysis"

Based on the information included in the "Database" and the results generated in the "Production" stages, cross-checks of tax accounts are carried out and the creation of standard reports and other operations that leads to analytical results prepared.

Results



Notification system – sending, printing and management procedures of notifications
Legal acts – documentation from legal department and judicial decisions
Onsite inspections – verification of electronic tax declarations
Information provided by third parties – information received from other governmental bodies
Online services – online submission of tax declaration and services for taxpayers
Electronic invoices – electronic accounting system
GPRS operating cash registers – acquisition of cash register turnover through the GPRS network

Short description of "Taxpayer-3" system's main modules

Online submission of tax returns

New dynamic issues such as online submission of tax returns, personal ledger, payments processing, cross-checking, e-invoices, taxpayer risk assessment system and audits have become the core elements in the development of the e-government system. The online submission forms involve the following steps: filling in the tax return, downloading the tax returns as a PDF file, electronically signing a PDF file, submitting the PDF file and receiving a receipt. For the submission of the online forms, it is necessary to register a taxpayer as an online user, which includes the collection of necessary information about them. It is necessary to keep track of users' electronic signatures and CA's. Tax returns are stored for further editing and submission. After filling in the tax return the user signs and submits the completed tax return. Later on, the tax returns are presented to the user both electronically and on paper. The system generates receipts as a proof of successful submission of an electronic tax return. After the taxpayer gets a notification form delivered from the SRC to the user. Upcoming news and events are also being displayed to the user by textual information completed by the SRC. Other electronic services include SRC data registration, received payments review and tracking. Online feedback is also available through the system.

Personal ledger

Personal ledger accounts include electronic documents, paper documents and payments. By summarising these three factors, the personal ledger account automatically and continually calculates (re-calculates) tax liabilities. It is transaction based and each transaction is linked with the source document. The dynamic re-calculation functions on tax returns and payment adjustments are very convenient. In case of any alterations, it will allow manual adjustment. Tax returns are mandatory for registered entrepreneurs and professionals, sellers of personal assets and recipients of other income, which is the reason why functions such as centralized tax returns, payment deadlines and holiday calendars are very useful in the personal ledger. It also provides "targeted" payment support.

Payment processing

The typical network architecture for modern payment processing is a chain of services for receiving payments and registering data. The first option is to receive payments direct from the treasury, then import the information into the system and finally enter information manually at regional offices. After receiving payments the data is registered in the personal ledger and the liabilities re-calculated.

Cross checking, e-invoices

The aim of the system is to improve compliance with tax obligations, because taxpayers may be unwilling to provide the information needed. The information reported regarding payments, through e-invoices submitted is used for data matching to detect those who have not submitted tax returns or included all their income on their tax returns that have been submitted. The system gives the ability to review and search through submitted e-invoices. The cross-checking of e-invoices is carried out for a given date range using predefined rules. Following the cross-checking of e-invoices, there is an opportunity to examine any discrepancies that the system has found. Once inconsistencies have been found, a report about them is sent to the taxpayer either on paper or electronically.

Taxpayer risks assessment system

Risk assessment involves the revenue bodies identifying, analyzing and prioritizing the risks presented by individual taxpayers. So by improving the risk assessment process, we can effectively distinguish between the areas that represent high risk from those that represent a low risk, and respond to them accordingly.
The taxpayer risk assessment system consists of the following steps:

- Assessment of taxpayers on the basis of completed tax returns
- The assignment of a risk score to each tax return.
- Taxpayers are listed in accordance with their risk score

The risk criteria creation mechanism should be user friendly and the system should be extendable, allowing for new risk rules and risk criteria to be added.
Selected taxpayers and periods can be reviewed. It is possible to create risk rules for a group of taxpayers or individuals. There is a centralized control of risk rules and risk criteria, including criteria editing, adding, disabling, etc.

Automated VAT refund

In some cases taxpayers can apply for a refund of overpayments. Usually such overpayments arise if taxpayers pay VAT at the border when they import goods into Armenia. this is a normal process, and the Tax Administration sends an order to the Treasury to make the refund. Sometimes it could be tax fraud, and an overpayment could exist only on paper.
The module analyzes information about taxpayers who exist in the database and calculates the possible risk of a tax fraud. According to the risk criteria two types of decision can be made by the module.

1. The order for refund is issued automatically,
2. The information about any necessary additional audit of the case is given to the Tax Administration Authority.

Acts of audits (Inspection orders and acts management)

Audits are a vital part of the e-government system. It includes an automated registration of inspection orders, management of the list of taxpayers subject to inspection in the scheduled month as well as management of inspection orders published by the head of the tax body and heads of territorial tax inspectorates.

"Tax invoices"- Effective management of tax administration information flows

One of the most important directions in the reforms made in the tax bodies is the investment in an efficient management system for the tax administration's information flows, the key component of which is the electronic tax system for invoices, functioning since 2011: today, it has become available due to the implementation of the "Taxpayer-3" e-government system. Prior to this, the information submitted by the taxpayer regarding tax invoices was entered to the tax information database then collected in the SRC central database. Now, the taxpayer has the opportunity not only to send but also receive electronic tax invoices. As a result of this, the time spent on the circulation of paper and contact between taxpayer and tax authority has been reduced.

GPRS operating cash registers

Two important issues have been resolved by the use of this system:

1. the process of receiving the fiscal statement from cash registers was automated and the impact of the human factor on "risk" was minimized. In other words the contact between the taxpayer and tax-employee was reduced. Being an integral part of the IT departments long term strategic plan, the system is completely consistent with international standards in providing updated management information.

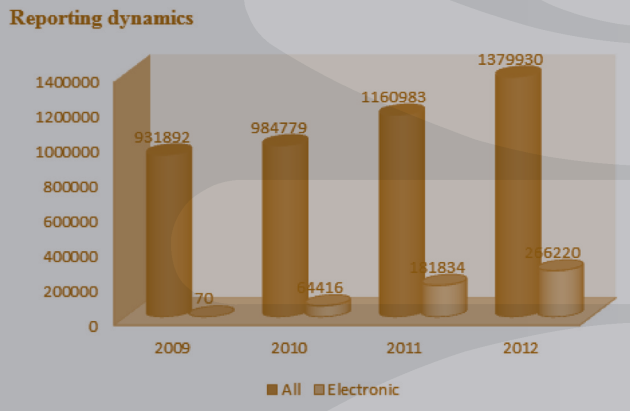
2. Since 2008 there are more than 140 cash registers in the fairs connected to the "Taxpayer-3" e-government system through networking channels. Since 2012 both legal and physical bodies were offered the opportunity to voluntarily submit daily cash register receipts on transactions through the GPRS networking connection. The decision was made based on the positive results of the experimental phase of the system and as a result of legislative amendments. Starting from 2015 all taxpayers will be brought into the system.

Today the automated collection of information and the process of remote controls over the turnover on more than 10,000 cash registers is being conducted through the GPRS system.

Advantages of "Taxpayer-3" e-government system and the expected results

As a result of the work done a modernized flow of management system information was created in SRC, which provided the opportunity to make best use of IT systems and automated functions. A complete information database about taxpayers was created and a move from paper-based to electronic operations made. The impact of the human factor of risk was minimized and, the control and the analytical skills of the tax authorities were strengthened. Finally, the level of work efficiency in the tax authorities was significantly raised.

The "Taxpayer-3" e-government system is a centralized information database, which runs flexible software with in-depth analysis and extensive information capabilities. It is beneficial for both taxpayers and the government. The system provides an opportunity for immediate and simultaneous input of information into the SRC electronic database, as well as reducing the number of reports in hard copy. After adopting the "Law about electronic signature" and implementing the "Taxpayer-3" e-government system, problem about electronic declarations have also been solved.
"Taxpayer-3" e-government system has the ability to accept all types of tax returns in electronic format, as well as to send notifications and official letters to those taxpayers who have unpaid obligations.
A significant result of the "Taxpayer-3" e-government system implementation is that in the period from 2009 to 2012 the number of local tax offices in Armenia was reduced by 25.



Support for the process of implementation of the e-government system in the RA

State revenue committee specialists took an active participation in the implementation of the e-government system in the RA. Negotiations have been carried out within the framework of information exchange using modern methods of WEB services. The State revenue committee specialists also took an active part in the integrated information system, the law enforcement agencies' and other interested agencies' databases. The creation of the network was supported by Ministry of Justice, National Security Service, Police, General Prosecutor's Office and Judicial Department.

New guidelines for international cooperation: First prize for "Taxpayer-3"

The continuous reforms implemented in recent years by SRC have aroused great interest from abroad and international organizations. Based on these reforms there was a report produced by "KPMG Armenia" Ltd. an audit company, which worked in cooperation with the SRC, following a study in 2010 "Reorganization of business processes".

During the development of the "Taxpayer-3" e-government system, the electronic reporting experiences, data processing and call centre work of the RF Federal Tax Service of Moscow and Nizhniy Novgorod were studied. State revenue committee specialists took an active part in discussions in the IT sphere organized by IOTA. The experience gained was later used in the implementation of "Taxpayer-3" system, in particular making the work in the call centre more efficient.

In 2011 by an initiative of the Union of information Technology Enterprises (UITE) a number of Armenian IT companies participated in "Cyber security, information and telecommunications technologies-2011" (GITI-2011), an international annual award held in Georgia. The State Revenue Committee also participated in the annual award, where "Taxpayer-3" e-government system was recognized as the best among the presented projects.

Plans for 2013-2014

The State Revenue Committee has an ambitious and aggressive plan for the future development of its e-government system.
First of all we have an agreement with the Armenian Postal Service and from the beginning of 2013 in every local Post Office there is going to be a tax officer and an Internet terminal. For countries like Armenia, where the Internet infrastructure is not yet developed, this is the best way to provide tax consultations and electronic services to the taxpayers overall, even in far and mountainous regions of Armenia.

As a new e-service for taxpayers, it is planned to give them the opportunity to maintain their accounting books electronically. This will be a good chance for the Tax Administration to obtain and cross-check additional information about taxpayers. We also plan to enlarge our GPRS cash registers network and change the existing registers for new ones. These new generation registers will give taxpayers the opportunity not only to obtain fiscal checks but also simultaneously write out invoices.

The connection is already established between local banks and the treasury, which makes it possible to avoid any mistakes during the tax payment process. Instead of a long flow of information transfers

(taxpayer – bank – treasury – tax office), today the Tax Administration will receive it immediately, online.
The Monitoring Centre in the Headquarters office is ready to start its work with increased functionality. With video cameras installed in local offices, it will make it possible to record and control the work of the Tax Administration online 24 hours/7 days a week.
It is planned to have two Data Processing Centres (Main and Reserve) both constructed using modern technology. The Reserve Centre will be built in a small town, 100 km away from the capital. We also plan to improve the quality of the network using optical fibre cables.
We plan to develop and run a Human Resource Management program in the future. This will give us an opportunity to use our staff effectively, to estimate the value of the work of employees and to organize any necessary training.
Nowadays, one of the most important reforms in Armenia is the Pension Reform. A part of the reform, the Personified Record Keeping System will be established in 2014. According to the Armenian Government's Decree, SRC is responsible for this task.

Our goal is to construct a general e-government system for all governmental bodies of Armenia. For this purpose, using the Taxpayer-3 system as an information platform, we want to connect online to other existing information systems and enlarge the scope of our "one stop" e-services to Armenian citizens.

Data Mining @ FPS Finance

BELGIUM

Dirk U. POTVIN
First attaché
Federal Public Service of Finance: Tax Audit & Compliance Management, General Tax Administration

33, Boulevard du Roi Albert II – boîte 25; 1030 Bruxelles, Belgium
Tel + 32 257 626 92
E-mail: dirk.potvin@minfin.fed.be

Mr. POTVIN was born in Flanders on December 5th 1965. At high school he studied accountancy and at the State University of Ghent general economics (1983-1987), a discipline with quite some quantitative majors. In 1987-1988 he had his first professional experience at the Belgian Service for Foreign Trade: he lived in Copenhagen in the spring of 1988 working for the security industry. In 1988-1989 he obtained a Finance degree at the Vlerick Business School. After his military service he joined the Ministry of Finance. He works full time on VAT Data Mining since 2004.

By Dirk U. POTVIN

Belgium

During the late 1980ies – the time that the European Commission in Strasbourg owned the world's largest Data Warehouse (DWH)– the Belgian tax administration wrote the first plans to develop their own DWH. The first loading finally started in 2007 (consortium Siemens-IBM-Microsoft): customs transactions. Data concerning Personal Income Tax and Corporate Tax was integrated in 2009 and the VAT data in 2012. This DB2 DWH will remain under construction for quite a while … But at last the times that Data Mining (DM) had to acquire the input data as flat files are over. However, we won't forget that everything that can go wrong, will go wrong! I tried to write this article in such a way that the numbers, amounts, etc. which of course represent a Belgian situation, can easily be interpreted by readers in the other IOTA-countries, and adapted accordingly or just used as some kind of inspiration. It's not wrong to imitate.

In 2001 a dedicated unit – joint venture of the Ministry of Finance and the Federal Police – had to start the risk analysis concerning MTIC (missing trader intra community): it was indeed estimated that during this year of disaster in Belgium more than a billion euro were lost as a result of organised carousel fraud. The first licences for a DM tool were bought in 2002: SPSS' Clementine. In parallel work was done on two projects: MTIC and general VAT fraud. This second project – one might call it classical fraud – was also successful and consequently another Data Mining unit was created, within the Tax Administration. For general fraud a DM tool allows us more to make a plain selection (identification of high risk cases), whereas for a topic like organised VAT fraud it truly achieves the early detection: these are two examples situated on opposite sides of the same spectrum. Speaking in plain English: for MTIC-fraud the misclassification cost is considerable, while for selections like general fraud the capacity of the audit forces is the main restriction.

Obviously what nowadays is known as Business Intelligence (BI) is merely the result of the fact that "manual" selection – in fact we should use the word semi-automatic – has become inadequate: resources need to be allocated to areas that need attention ... and fast! Remember the predicate artificial intelligence? It's the combination of three disciplines: mathematics and inferential statistics (macro metrics), ICT and domain (subject matter) knowledge. For Tax – our client isn't it? – domain knowledge still seems to remain dominant: inventing strong predictors is state of the art.

Now we mention a third project: VAT refunds. Every year about 5 billion Euro is reimbursed to our companies: more or less 2% of the gross domestic product. This topic is hybrid: as to speed it resembles MTIC – the administration has to do the audit within one month – but in volume the capacity restriction is essential. The small DM-unit mentioned above started work on this project in the autumn of 2006. By 2008 comparisons could be made between the old system of business rule-selection that dated from the late 1970ies (on mainframe) and a pilot DM-selection. As a result the DM-unit was integrated in "Tax Audit & Compliance", one of the central divisions of the Belgian modern Federal Tax Administration: in the 2x2-matrix our targets are indeed the stubborn taxpayers that don't follow the law, and don't want to follow the law (under-reporting by filers).

By 2010 more than 96% of VAT returns were filed electronically and DM-selection replaced the old business rules. However we stress that business rules never wholly became obsolete: today in Belgium, the decision tree classification is complemented with at least two business rules – maybe typical for the detailed Belgian VAT return – in order to provide a more balanced output. And we don't forget that AID-techniques (automatic interaction detection) date from the 1970ies: remember the famous PhD of Gordon V. KASS.

This brings us to the delicate matter of the make or buy decision. For a small country like Belgium – even densely populated as we are, with almost 700,000 merchants – it was decided not to program an algorithm in house. We knew about decision trees from the last page of the first autobiography of Nathan CHTCHARANSKI. Of course there are many vendors of BI-tools. One of the contemporary market leaders, PASW Modeller, because of its drag and drop is superb on accessibility/usability. But after a while – inevitably – such a product shows limitations. At this moment a migration towards a tool like System Analytics Software is plausible, provided true high level training for syntax is at hand. As I write this article for a tax agency public, it is important to stress that a multitude of algorithms is not the priority : Keep it simple! In tax we need to learn to live with very modest coefficients of determination. Logistic regression is nice to have. But one algorithm – a decision tree that takes care of missing values – can perfectly do the trick. Absorb some literature: over fitting is synonym of the bias-variance trade off. It is fine to publish book on the Cross Industry Standard Process for Data Mining or SEMMA (sample – explore – manipulate – model – assess) – at the end it is always Plan, Do, Check, Action. If your book is not in the list: "Don't shoot the DJ!"

Hereunder we shall mainly talk about the general VAT audit selection and selection for VAT refunds. Two related notions are fundamental: data refresh rates and output periodicity. Of course we want a minimal number of predictors (explanatory input variables). So if we want to use quarterly listing as source data - our production can NOT be monthly. If we need quarterly production we can forget about using annual listings, etc.

What we are doing is not web analytics: it's not big data. Since the thorough European VAT reform of 1992 the data sources for this domain remained very stable. In predictive analytics we distinguish two phases: development and production. For example in France production for VAT refunds is monthly. In Belgium it has to be quarterly: this is simply the national law. Production then is merely applying a probabilistic model on the newest data. And a model is built on historic data. (Remember Thomas Bayes: "Probability is knowing a part, and not knowing the other part"). Consequently in Belgium we started creating a development basis using data since 1992. For VAT typical data is return sheets, national clients listings, suppliers listings (the transposition of the national clients listing), IC clients listings, VAT information exchange system-listings (VIES), customs listings (imports and exports), identification data (VAT regime etc.) and last but not least the audit history.

Development and modelling

Sophisticated guided learning indeed needs a target variable, and this one – the hearth of the project: the metric of primary interest – we find in the audit history: for Belgium when we started doing Data Mining we could use the history since 1992! An additional VAT-source for the Refunds project is the current account of the merchants: we dispose of a history starting in July

1999 (the euro-balance at the end of each month, it's like a bank account).

It is interesting to mention that on the one hand the Belgian VAT audit history since 1992 contains almost 1,5 million audit records (more than 50,000 per year). On the other hand for modelling there is the magic number of about 1,000 historic cases: clean representative cases with a valid target variable and a sufficient number of predictors. For the Refunds project (data since July 1999) after cleaning – this is after eliminating all the records that were incomplete, contaminated with errors, outliers etc. – we kept more than 30,000 valid cases (development population). This is a lot! And for the general VAT audit selection after cleaning much more than 100,000 clean useful records remained, so the population could even be pre-segmented in almost a dozen sectors. Among others on the basis of the Nomenclature des Activités des Communautés Europoéennes (industry codes) eventually it was decided to make a model for each of the following population segments/themes:

- retail
- wholesale
- industry
- construction
- automobiles
- hotels/restaurants/cafés
- big companies
- small turnover
- mixed/partial taxable enterprises
- transport / immaterial services (consultancy etc.)
- other services

And indeed – as hopefully expected – according to the segment, there were different significant predictors! We decided that for a set of 11 models about 45 significant input variables are sufficient: so on average each decision tree has 8 characteristics. (It is obvious that when we make new models today we no longer need to use the data from the early years.)

As we said inventing predictors for our multivariate analysis is state of the art, so now let's talk a bit in detail about our data sources. Last year the European Commission proposed a Common Standard VAT Return (CSVR). Since the reform on services of January 2010 the Belgian VAT return has more than 30 sections, considerably more than the projected CSVR. (The Internet submission method in Belgium is called INTERVAT.) Add to this the sections available in listings and other VAT sources we easily obtain about 100 data fields. On the basis of this somebody who would be entirely ignorant about VAT, for defining variables could construct maybe a billion combinations. As they say in Cuba: "There are a thousand ways to steal petrol." Thus for Belgium VAT experts constructed about 150 plausible variables and they were grouped according to some main categories:

- turnover
- tariffs
- deductions
- credit notes
- international exempt activities (exports etc.)
- purchases (goods, services, etc.)
- investments
- work on real estate
- reverse charge
- corrections
- subcontracting
- VAT regime
- margin
- identification characteristics
- current account
- audit history, etc.

An example:

$$\frac{\text{National Clients + IC Supplies + Exports (source : listings)}}{\text{Output source : VAT return (source : VAT return)}}$$

Of course many of such variables – actually often aggregates and ratio's (remember your first lesson of statistics : nominal, ordinal, interval- and ratio-variables) – depict the audit period (or an abstraction of it) but there can be some that characterise a period that is a bit longer. It is at this point that the road (a construction with numerous SQL-joins) to what eventually results in the "Analytical Base Table" gets long and winding In order to avoid driving your programmer hysteric or pushing him/her into a depression I would advise to start with for example only 5 to 10 predictors and later on work iteratively: VAT is quite abstract, so the program code easily gets horribly complicated. Inventis facile est addere. With time performance will increase. Data understanding and data preparation are indeed almost 90% of the work!

By now it has become clear that we were urged to agree on a number of abstraction formulas in order to calculate most financial variables of the clean valid cases. For example, as there is a great variety in audited periods the tax experts introduced notions like the theoretical year (this is for the project of annual selection) and

the theoretical quarter (Refund project): target and independent variables were converted to the "denominator" of the "Profile Table" that is eventually used in production. We could call this normalisation.

Now something about the math: there are again numerous ways to model a decision tree. After a while it turned out that using a Boolean response (success/failure) is good practice. For this of course a cut off amount has to be determined for each development segment (for example by using the 60:80 rule of V. Pareto).

Deployment/production and evaluation

For tax a satisfying model – with a decent ROC index (a considerable number of false positives and false negatives is inevitable) – can last for quite a while. It's like drinking wine: you have to taste it and after a while try another bottle. For tax the development phases can become thus complicated that modelling new decision trees every year is an illusion.

The Feedback from "the field" of the DM-productions confirms the gains from analytics: for all segments the average of the real audit results is significantly higher for the population percentiles with the highest risk scores. And this often for four years without changing the model!

Let it be stressed that although the story of these pages suggests a happy path, there are many stumbling blocks on the way. Begin with the end in mind, and don't postpone first production too long. Timing is important: you have to grab the kaïros.

As a final remark I express some concern about the above mentioned CSVR. The adoption of a concise standard will have a considerable impact on predictive analytics projects for VAT. Of course VAT returns are merely the reflection of the economy. The economy as such won't change as a result of the adoption of an EC-directive amendment. But the impact on DM-projects (data preparation, modelling etc.) could be huge.

Forensic ICT Investigations FIOD Netherlands

NETHERLANDS

Maarten van BARNEVELD
Forensic ICT Specialist
Belastingdienst / FIOD

Surinameweg 4, 2035 VA, Haarlem , Netherlands
Tel +31 23 546 1268
E-mail: mj.van.barneveld@belastingdienst.nl

Maarten van Barneveld has 10+ years experience in forensic ICT (fraud) investigations. Mainly the larger criminal fraud cases and complex ICT related topics are his specialty.

By Maarten van BARNEVELD

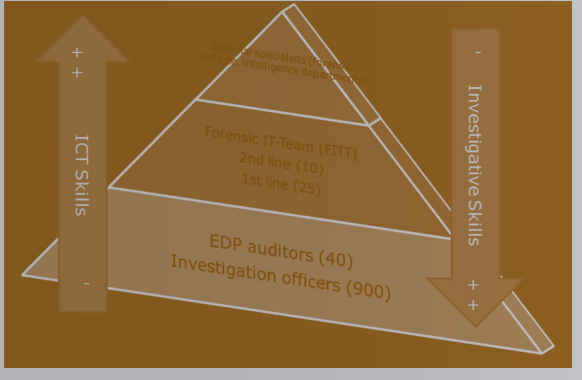
Netherlands

Introduction

The FIOD is the criminal investigations unit linked to the Dutch tax department. The FIOD has around 1100 employees spread over 13 FIOD locations in the Netherlands. Their main task is the investigation of fiscal, financial and customs related crimes. They operate under criminal, tax and economic laws in the Netherlands. Under criminal law the investigators can arrest and interrogate suspects, perform house-searches, seize any needed (digital) evidence, intercept Internet and telephone communications and all other investigation methods allowed under Dutch criminal law. These powers can only be used against suspects with authorization from the national prosecution office and a public prosecutor assigned to a case. The FIOD handles around 500 criminal cases every year.

Organization of forensic ICT investigations

To technically support the 500 annual cases the FIOD has formed the Forensic ICT Team FITT, the FIOD has been doing forensic ICT investigations since the end of the last century. FITT's main responsibilities are the seizure and investigation of digital evidence as well as undertaking research and development into forensic investigation techniques. Further tasks are explained later in this article. Apart from the FITT team, the FIOD has so called EDP (Electronic Data Processing) audit employees in every investigation team. Schematically the forensic ICT organization can be represented like this:



As can be seen from the diagram, the FIOD has about 900 investigation officers, directly supported these officers on IT related issues by about 40 EDP audit staff. Going up the pyramid, the ICT skill and knowledge level rises. In the middle can be seen the Forensic ICT team FITT, which has about 35 staff technically supporting the investigations. There is a difference in skill-set and responsibilities between EDP and FITT staff which will be explained later. At the top of the pyramid the FIOD can ask for assistance from outside their own organization when technical investigations get really complex, for example from the Dutch Forensic Institute (NFI) or intelligence services, the national police etc. Going top down through the pyramid, the investigative skills rise and people are more trained and experienced as professional criminal investigators.

This skill based organization is not accidental since it was found that ICT forensic investigations need very specialized people in terms of training, skill-sets and the required software and hardware. It was also found that it was much easier to train people with a formal background and education in ICT as an investigator than to train investigators as ICT forensic staff. That's why only people with a formal education and diploma in ICT are recruited for positions within the FITT team.

As seen from the pyramid, the FIOD has two distinct roles:- working on Forensic ICT, namely the EDP auditors and the FITT staff. Although both work on digital investigations there is a clear distinction between the tasks they perform on a case. In short, you can say that the FITT team does all the ICT hardcore technical stuff (nuts and bolts), and the EDP staff focus on the auditing- and investigation of data.

In detail, the main tasks of FIOD EDP auditors are:

- Investigation preparation / consultation on digital investigations for investigators
- Audit and analysis of suspect (company) processes
- Determine acquisition strategy during house searches
- Analyze complex systems and data environments
- Develop methods and techniques for digital investigation
- Managing local investigations
- Maintain (inter-)national contacts
- Coach and educate investigators

Most EDP employees have a higher or university level education. Additionally every EDP auditor needs to successfully complete a 1½ year internal auditors course. Every year EDP staff need to do additional relevant training to maintain their skills and knowledge. Apart from that every EDP auditor is trained as an investigation officer.

In detail, the main tasks of FITT staff are:

- Operational Forensic ICT investigations
- Managing local investigations and labs
- Spreading IT knowledge and IT awareness in the organization
- Educating investigators on Forensic ICT subjects
- Innovating forensic investigation process (R&D)
- Software development
- Maintaining (Inter)national contacts
- Supporting other special investigation services
- Development of methods and technologies
- Project management, planning and control of investigations

FITT people have a technical middle, higher or university level educational. Additionally, every year FITT staff need to carry out additional relevant training on ICT forensics to maintain their skills and knowledge. Apart from that every FITT member is trained as an investigation officer.

The FIOD has instigated expert groups on, for us, important forensic ICT subjects. These expert groups have to maintain and spread knowledge on:

- Mobile Devices (smartphones etc. and usage of commercial tooling to investigate these devices)
- Encase (usage of Encase in FIOD investigations)
- FTK (usage of FTK 3.x the FIOD main investigation tool)
- Forensic Standards and Procedures (developing standards and protocols, documents and workflows)
- Apple forensics (focus on forensic apple investigation, software and techniques)
- Live forensics (focus on triage and live investigative techniques)

All expert groups have members from EDP and FITT staff. The groups are supported with a budget and time to develop training, select software, test hardware and disseminate knowledge.

Technology Used

To carry out proper forensic ICT investigations a lot of specialized hardware and software is needed. Over the past years we have built 13 (standard deployed) forensic ICT investigation labs. Every lab has standard software and hardware and operates under the same guidelines and processes. The labs are administered and maintained by 5 MCSE trained systems adminis-

trators who are organizationally separate from FITT and EDP to maintain systems integrity and security.

Software

The prime investigation tool used by the FIOD is Forensic Toolkit version 3 from Accessdata Corporation. In this tool the bulk of the digital investigation is handled. We also use a lot of other commercial software to perform more specialized tasks, for example:

- Encase: to do deep forensic investigations on disk images
- NUIX: for enterprise e-mail investigations (mainly Microsoft Exchange databases containing millions of e-mails)
- ACL: for EDP analysis and investigation
- IBM I2 analysts notebook and Ibase: to do criminal analysis and pattern finding
- VMware (ESX): to virtualise suspect systems and to do live investigations or rebuilding of suspect environments

Apart from the commercial software we have developed some in-house investigation software:

- MUDD 2012: to investigate large amounts of data in a very fast way, including text analysis and language technology like named entity extraction
- DigiBox 6: our own imaging solution to make accurate forensic images of all available data storage devices around
- Selective copy tool: to make forensically sound copies of file servers

All our own developed products are available to tax administrations or law enforcement agencies for free. Of course, every FITT and EDP investigator has received training on the above mentioned products.

Hardware

Apart from the special physical construction of every lab (anti-static floors, special workbenches etc.) a standard set of hardware is deployed in every lab location:

- Forensic investigation computers with forensic software installed
- Digibox hardware to image suspect data devices
- One XRY phone investigation device and one UFED phone investigation device
- Online storage to store suspect images and files
- A Microsoft Windows 2008 domain controller for security and policies
- A backup server with backup units attached to make live backups (on LTO-4 tapes)
- Forensic Toolkit 3 with the needed Oracle server and two Forensic Toolkit 3 worker servers for indexing and investigation of the data

When the FITT people go into the field and perform house searches they are personally equipped with a special case filled with forensic imaging hardware (Digibox), cables, connectors, mobile monitor, keyboard, screwdrivers, etc. See picture.

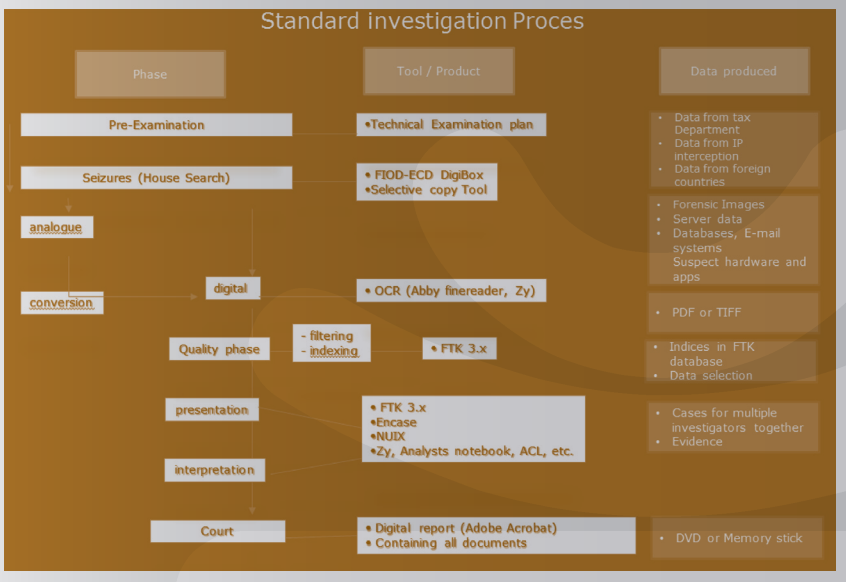
Digital Investigation Process

Every investigation follows more or less the same procedure or process. We have distilled the most common practices for our investigations. In the schematic diagram below you can see the phases in time, the tools used per phase and the data produced in every phase to investigate or further process.

As you can see, every investigation starts with writing down a technical examination plan, our aim is to do this as soon as possible and to use all available open source information on the suspect available. But we also include information from the tax department, IP or telephone interception etc. in the technical examination plan. This way we are best prepared for the following phase, the house search.

During the house search phase we literally search the suspects living area, home , company, car etc. to find all the evidence we need including all digital evidence. For the acquisition of digital evidence we use our own toolkit. In this phase we obtain forensic images, sin-

gle files (from file servers), databases, e-mail systems, backup tapes, physical hardware and all other things you can think of to be used as a source of evidence. All paper evidence obtained during a search is converted into digital form using a specialized scan farm capable of scanning huge amounts of paper in a relatively short period. This makes searching through the paper information much quicker and more efficient.
When all data is available (scanned paper and digital)



on the storage systems in the forensic lab the data is processed to transform the data into information for the investigators. This is called the quality phase, because during this process we can add meaning and value for the investigator to all the chaotic data taken from various places and objects during the house search. In this phase we produce keyword searchable indices, rebuild suspect systems, analyse databases etc.
During the presentation phase we use various tools to present the digital information / evidence to the investigators. Mostly in FTK, but for special needs in one or more of the other tools previously mentioned. The investigator can then find the evidence needed for the criminal court. In most cases the evidence will be delivered digitally to the criminal court containing all relevant evidence, audio and video etc.

Evolution

At this moment we can foresee some changes in ICT forensics in the near future, especially for fraud investigation departments. What are the major issues we as digital fraud investigators will be confronted with?:

1) A clear shift from pure technical ICT computer forensics as used by police departments in, for instance, hacking, child porn, terrorism, homicide cases, to a more fitting fraud / white collar crime investigation method. This method will focus more on documents, e-mail, social networks and databases as a source of evidence rather than on hardcore technical bits and bytes. In literature, people use the concept e-Discovery for this form of digital investigation and the so called Electronic Discovery Reference Model (EDRM) supports this theory.

2) Increasing amounts of data to be investigated. Of course Moore's law is still relevant and storage capacity is growing and growing. This causes major problems for the investigative team in terms of storage (costs) and processing capabilities, but also makes finding the needle in the haystack more difficult.

3) Data complexity increases. Data is coming from more and more varying sources and in many formats. There is no single source of information anymore. Even in people's private homes the complexity of available data increases.

4) Internet (cloud) services are being used to store, transform, maintain and edit data. Data is not in one place anymore but can be spread around the globe. Even one document can be split into pieces and every piece can be in a different country.

Are there answers to these problems? Of course some issues can be tackled with better international legislation, especially when data crosses a national border. A better legal framework should be in place to make cross border digital investigation easier. Also, on the investigative side, smarter tooling needs to be developed to focus more on the investigation of large volumes of information. The need for tooling to be able to incorporate language technology, automated clustering and detection of signals indicating fraud in data sets, with more graphical representation of information is increasing.
The FIOD is researching methods and techniques to improve the search results in large volumes of data. To support this we have started a variety of projects on language technology and smarter searching techniques.
If you would like to receive more information on the topics covered in this article please contact the author.

Peer to Peer

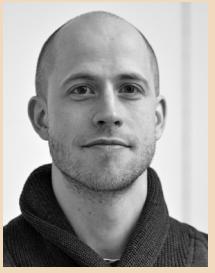
Virtual E-money

NORWAY

André HEGGSTAD
Senior Adviser
National E-commerce Project

Moloveien 20, N-8000 Bodø, Norway
Tel: +47 945 37 305
E-mail: andre.heggstad@skatteetaten.no

Mr. HEGGSTAD joined the Norwegian Tax administration in August 2010. He previously worked at the University of Tromsø as a Senior Computer Engineer and Head of IT at the Faculty of Law. Mr. Heggstad holds a MA degree in Law and Economics, and is currently finishing his MBA Master thesis on Bitcoin.



Espen NORKYN
Senior Adviser
National E-commerce Project

Moloveien 20, N-8000 Bodø, Norway
Tel: +47 9543 04 33
E-mail: espen.norkyn@skatteetaten.n

Mr NORKYN worked 2 years at the Technical Centre in the Norwegian Tax Administration. Before that he worked 15 years in the private sector with web strategy and search engine advertising. He has a master of science degree in Technical Cybernetics.

By André HEGGSTAD and Espen NORKYN

Norway

One of the newest challenges to tax administration is the increased use of electronic payment systems.

Traditionally, credit and debit cards coupled with secured encryption technology, has been used to pay for goods purchased on the Internet.

Today various forms of electronic money (e-money) are emerging and the landscape of financial transactions involves levels of complexity that would have been unimaginable just a few years ago.

The objectives of this article are to give auditors and tax-lawyers an overview and a basic understanding of electronic money schemes, and especially virtual currency schemes. The legal aspects of both the taxation of e-money and the legality of the different types of e-money are outside the scope of this article.

What is electronic money

Electronic money is the digital equivalent of cash.

E-money comes in various forms, and can be hardware or software based. Money stored in a prepaid card like Ucash or GeldKarte, are examples of hardware based e-money. Software based e-money can be stored locally on an electronic device or remotely on a server, like with PayPal, where users store e-money remotely in a payment account on the Internet.

Electronic money can have a physical counterpart with legal tender status, or it can be a virtual currency backed by nothing else than the users trust in the system.

One challenge in discussing electronic money schemes is that the term "e-money" is not used unambiguously.

The European Central Bank (ECB) has, in an article from October 2012, tried to address this issue. ECB argues that a clear distinction should be made between virtual currency schemes and electronic money. In this article they state:

According to the Electronic Money Directive (2009/110/EC), "electronic money" is monetary value as represented by a claim on the issuer which is: stored electronically; issued on receipt of funds of an amount not less in value than the monetary value issued; and accepted as a means of payment by undertakings other than the issuer.

Although some of these criteria are also met by virtual currencies, there is one important difference. In electronic money schemes the link between the electronic money and the traditional money format is preserved and has a legal foundation, as the stored funds are expressed in the same unit of account (e.g. US dollars, euroo, etc.).

A graphic illustration of the difference in electronic money and virtual currencies can be demonstrated as follows:

Differences between electronic money schemes and virtual currency schemes

	Electronic money	Virtual currency
Money format	Digital	Digital
Unit of account	Traditional currency (euro, US dollars, pounds, etc.) with legal tender status	Invented currency without legal tender status
Acceptance	By undertakings other than the issuer	Usually within a specific virtual community
Legal status	Regulated	Unregulated
Issuer	Legally established electronic money institution	Non-financial private company
Supply of money	Fixed	Not fixed (depends on issuer's decisions)
Possibility of redeeming funds	Guaranteed (and at par value)	Not guaranteed
Supervision	Yes	No
Type(s) of risk	Mainly operational	Legal, credit, liquidity and operational

Source: ECB

How big is e-money?

Deutsche Bank Research has, in a publication from May 2012, concluded that E-money is "a niche marked that might be expanding". E-money had a share of approximately 0,002 % of national payments in the Euro area in 2002, rising to 0,02 % in 2010. The number of transactions was 100 millions in 2000, rising to 1000 millions in 2010. Summarized; the number is still small, but the growth is increasing quite steep from 2007.

A very short history of money

The history of money can be traced back over 4,000 years. During this time, currency has taken many different forms, from coins to banknotes, shells to plastic cards.

First money was developed as a commodity - money. Later came commodity-backed money. Cities and empires traded without using coins for over 2,000 years, but when ancient Mediterranean kingdoms like Lydia in modern Turkey began issuing pieces based on a mixture of gold and silver with a consistent weight and purity, the idea quickly caught on.

The Chinese was the first who printed a value on a piece of paper and persuaded everyone that it was worth what it said it was, and today fiat money and fractional reserve banking is common in most countries.

Virtual currencies

Virtual currencies (VC) are nothing new. There has been local currencies and scrip; side by side with official means of payment for ages.

Virtual currencies resemble money in many ways, and today there are a multiplicity of digital virtual currencies around.

ECB has categorized virtual currency schemes into three types

1. Closed virtual currency schemes
2. Virtual currency schemes with unidirectional flow
3. Virtual currency schemes with bidirectional flow

Type 1

In principle, there is no link to the real economy in closed virtual currency schemes. Earning this type of VC is based on the user's online performance inside a specific virtual community. Spending the VC can only be done by purchasing virtual goods and services offered within the virtual community. In theory, it cannot be traded outside the virtual community.

The online role-playing game World of Warcraft (WOW) has its own in-game virtual currency called WOW Gold. This is an example of a type 1 virtual currency. Players have several ways of obtaining and using WOW Gold within the game. Buying and selling WOW Gold outside the game is not allowed, although there is quite a big black market for WOW Gold.

Type 2

In virtual currency schemes with unidirectional flow, virtual currencies can be purchased directly using real currency at a specific exchange rate. It cannot be exchanged back to real currency. The conversion conditions are established by the scheme owner. Type 2 schemes allow the currency to be used to purchase virtual goods and services, and in some cases real goods and services.

Facebook Credits, Microsoft Points and Nintendo Points are examples on type 2 virtual currencies. You obtain these virtual currencies by buying them online with a variety of payment solutions, e.g. credit cards or PayPal. You then use the virtual currencies within the specific virtual community. There are no official ways to convert these currencies back to real world money.

Type 3

In virtual currency schemes with bidirectional flow, users can buy and sell virtual money according to the exchange rates of their currency. The virtual currency is similar to any other convertible currency with regard to its interoperability with the real world. These schemes allow for the purchase of both virtual and real goods and services.

Bitcoin, and spinoffs like Litecoin and Namecoin, are examples on Type 3 virtual currency schemes. These VC's are not coupled with a virtual community or Massively Multiplayer Online Role-playing Game (MMORPG). Project Entropia Money and Linden dollars are other examples of type 3 virtual currencies, but these are directly coupled with a virtual world ecosystem.

Bitcoin

Bitcoin is fully virtual, backed only by the confidence of the users. The system is based on trust, not underlying goods or a central authority. Bitcoin is a crypto currency and the users trust lies mainly in the technical design of the Bitcoin system.

Individuals holding Bitcoin represents a number of interests; including technology early adopters, privacy and cryptography enthusiasts, government mistrust, criminals, risk taking businesses and speculators. Many in the Bitcoin community strongly criticize fractional banking and are distrustful towards governments and authorities in general. Many also see Bitcoin as a way to end central banks' monopoly in issuing money.

The technical aspects of the Bitcoin system are very complex. It requires a technical background to fully understand the design of the system. In short, Bitcoin uses a public-key cryptography, peer to peer networking and a Hashcash proof of work to process and verify payments. Bitcoins are sent from one address to another, and users can have as many addresses he or she likes. One major problem for peer to peer payments schemes is double spending. Bitcoin has solved this with every transaction being broadcast to the network and included in the blockchain. It requires a massive amount of processing power to extend the blockchain, and by this verifying the transaction.

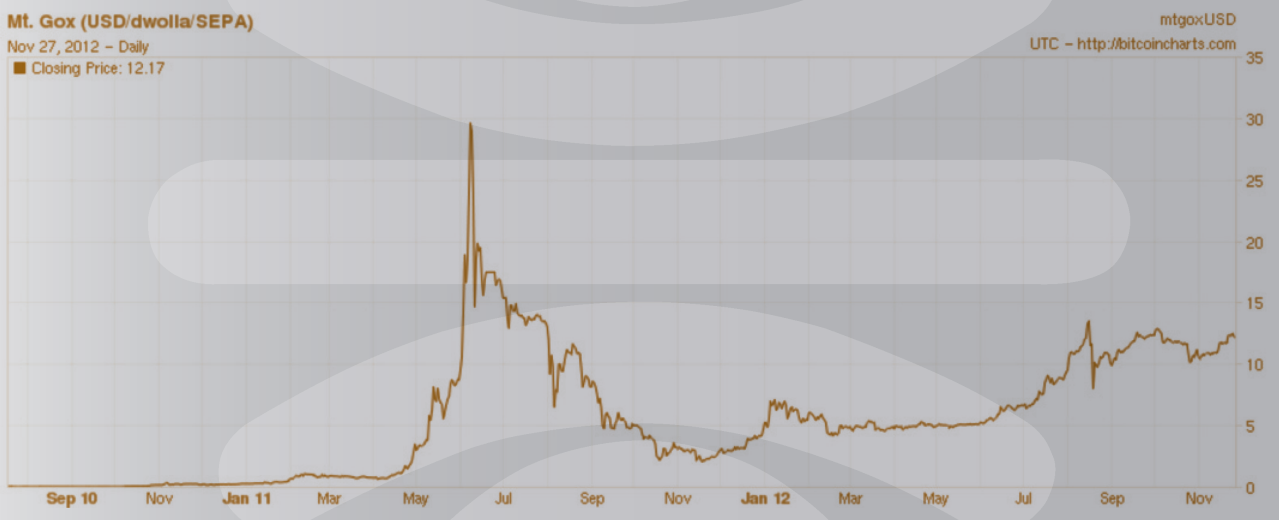
Bitcoin being a peer to peer currency means that no central authority tracks transactions or issues new money. The supply of money is not dependent on the monetary policy of a central authority, or the currency scheme's owners. The Bitcoin scheme is designed in a way that gives a predictable supply of new Bitcoins entering the market, ending on a total number of 21 million Bitcoins.

Bitcoin is well suited for money laundering and tax evasion, because it is difficult to trace and transaction cost is very low.

Moving 1,000,000 euro in 100 different electronic transfers of 10,000 euro might be easy to spot. Using Bitcoin and dividing the 1,000,000 euro into 100,000 transactions in randomize amounts between Euro5 and Euro15, detection would be considerably more difficult.

How to sell and buy Bitcoin

There are several Bitcoin market exchanges. The exchange rates of these markets fluctuate according to the supply and change in demand. The exchange rate and the issuance of new Bitcoins is not created by the markets, but is determined on the action of the traders. In these markets one can buy and sell Bitcoins with a real time rate. The most accepted currency pairs are BTC – Euro and BTC – USD. The largest and most trusted exchange is MtGox which has a 80% market share of all Bitcoin trades.



There also exist several fixed rate trading services. These sites use the rate from the major markets in their transactions.

In addition to the previously mentioned methods for Bitcoin trading there are also several marketing channels on the Internet where sellers can promote their exchange services. These are IRC(chat client) channels, community sites and forums. The standard method for conducting a Bitcoin trade on these channels is by e-wallet transactions. Many also provide alternative methods for payment that are regional based. For example e-wallets are only available in one country or bank wire (not international wire). In all of these methods trading is directly between counterparts, there is no intermediate that checks the transactions. Because of this, most traders are registered users at #bitcoin-otc, which is an IRC channel that acts as an over the counter marketplace for Bitcoin currency. Registered sellers form part of a web of trust, so users can send and receive ratings when they conduct a trade.

Another available possibility for buying and selling Bitcoins is by contacting a local seller and do business directly. On sites like localbitcoins.com one can perform a geo search and find all the traders in near proximity.

The established financial institutions have provided some problems for the exchange services. This has been especially notable in the area of withdrawing and paying for funds. Visa and MasterCard have so far not accepted the use of credit cards as a method to add funds. The same goes for many of the established e-wallet services that exist. PayPal has, for example, stated in their terms of service, that it cannot be used in any transactions that involve currency exchanges or check cashing businesses. The e-wallet provider Paxum, which was a provider for exchanges involving Bitcoin, abruptly terminated doing any transactions involving Bitcoin. This was a result of their banking partners forcing them to stop trading with Bitcoin as the currency was unregulated and therefore considered high risk.

Add and withdraw funds

The main method for adding and withdrawing funds from the major exchange services is by bank wire. This means that it can be a tedious process for a normal consumer to acquire Bitcoin. One needs to send a bank wire transfer, with a special code attached. After the wire is initiated it can take up to 5 days before the money is available for trading. This can take longer as

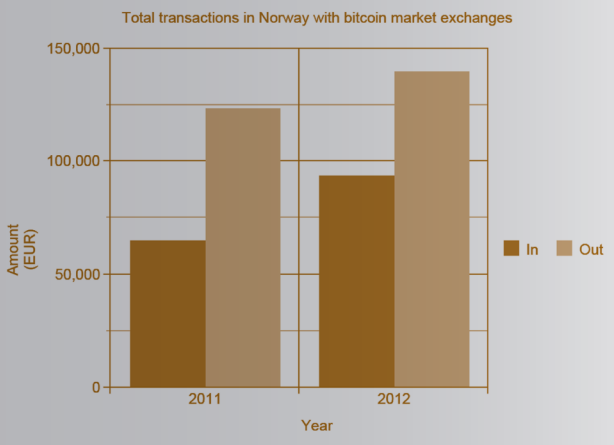
some of the banks the markets use can ask for additional information to protect against money laundering. This happened with us, when we did a test transfer to MtGox. We were targeted for an anti money laundering check and had to provide a copy of the passport and a utility bill to have the transfer go through.
The markets that have the highest volume of trade try to comply with regulations, both from the government and financial institutions. The limited functionality and tedious process for adding funds has created a market for exchange services that don't enforce the same strict rules. Because of this several smaller exchanges and third party services offer transfers to and from e-wallets and prepaid credit cards. As an example, one can buy a Ucash voucher in a store and then use this voucher with a third party service to transfer funds into the exchange. The same procedure is used in withdrawing funds. It's possible to use a third party transfer of Bitcoins to several e-wallets and prepaid credit cards. Bitinstant has also announced that they shortly will provide a visa credit card that will be connected to the Bitinstant Bitcoin wallet. This has however not been officially stated by visa.

Tracking

When it comes to the major exchanges, which as of the moment has about 90% of the exchange transactions, the main method for adding and withdrawing funds is by international wire. With a copy of the bank account transcripts it's possible to find most of the Bitcoin related transactions to the object. With the development of new services that offer transfers to e-wallets and prepaid cards it will be harder to identify Bitcoin related businesses and the risk of tax evasion will increase accordingly.

The strategy in Norway has been to focus on the point of transaction with the markets. This means finding information when people add or withdraw funds from the major Bitcoin exchanges. (see table of statistics of these transactions).

In addition to this we carry out surveillance on forums, irc channels and sites like localbitcoins.com where Bitcoin sellers announce their services. On most of these sites we can find which country they are from, check the ratings on previous trades and the maximum volume they can buy or sell. With test transactions we have identified several subjects for further investigation.



Partially anonymous currency

Bitcoin has been described as an anonymous payment system. This is not entirely correct as the history of all transactions is saved in the blockchain. The blockchain data is publicly available and can be used in further analyses. By using analyst programs on the blockchain, one can discover all actions of a specific Bitcoin address.

One can visualize egocentric networks and trace the flow of Bitcoins through the system. On a broader scale it's possible to find centralized services like mining pools, exchangers and Bitcoin wallets that may have more information about their users.

For tax administrations, an analysis can reveal relevant information in specific cases. If one has found the Bitcoin addresses a subject has used, one can trace all previous transactions going in and out. This gives a complete picture of the cash flow of that Bitcoin-address, and what connections the object has with other Bitcoin users and services.

In conclusion the Bitcoin system is not inherently anonymous. Users have to take an active role to hide their identity. This can be done by using several Bitcoin-addresses, being careful with the private keys and separate their anonymous public keys from any traceable transactions, and spoofing IP-addresses. With these methods it's possible to conduct transactions, to obscure the identity and the complete actions of a user. This is not something that is discussed in the Bitcoin community and the general statement is that Bitcoin is 100% anonymous. Because of this, it's reasonable to assume that most users don't take special measures in the way they conduct their business with regard to anonymity.

Bitcoin as a consumer currency

Many argue that Bitcoin has many properties that make it an ideal currency for Internet merchants and consumers. Bitcoin is highly liquid, has very low transaction costs and can be used to send payments quickly across the Internet.

It is now relatively easy to set up a payment solution for Bitcoin. In the trendy bar Room 77 in Berlin, you can buy a beer with Bitcoin. Room 77 was one of the first places to accept Bitcoin as an over the counter currency. In the beginning customers had to bring their laptop to the counter, and the whole process was cumbersome. Now paying is streamlined and easy, with numerous commercial software available like merchant payment processing systems, web apps, Bitcoin wallets and so on.

In spite of all these factors, Bitcoin is unlikely to be particularly competitive in the traditional e-commerce market. So far the consumer base is too small and the risk of accepting such a volatile currency is too great for many merchants. Additionally, many consumers do not want to shop with an unfamiliar currency like Bitcoin and most of them are not concerned about anonymity or centralization. Bitcoin also lacks built in anti-fraud capabilities like PayPal or MasterCard.

Another hurdle for commercial success is the fact that it is cumbersome to obtain Bitcoins.

There are also many uncertainties concerning Bitcoin. Its legal status is unresolved. Governments may try to shut down the infrastructure because of Bitcoin's potential for money laundering, tax evasion and so on. For speculators it is risky to maintain liquid assets in a virtual currency that might lose 99 percent of their value overnight, especially when storing Bitcoin on a pc is quite unsafe.

Final remarks

Today virtual currencies like Bitcoin do not pose a major threat to most tax administrations, due to the lack of wide user acceptance, low trade volume and fairly low money creation volume.

For the general e-money market, we agree with DB Research in concluding that e-money is a niche market that might be expanding.

But this expansion might come quickly.

Traditional payment providers like Visa seem to have begun taking precautionary measures. The company recently acquired PlaySpan Inc, a privately held company with payment platforms for digital goods, digital media and social networks. Facebook, who is already a major player in the new economy, has also quite recently restructured its payment platform to position itself in this new market.

Suggested reading

- Virtual Currency Schemes, European Central Bank, October 2012.
- E-money, Deutsche Bank Research, May 2012.
- Bitcoin: An Innovative Alternative Digital Currency, Reuben Grinberg, Yale Law School, December 2011.
- Bitcoin Wiki at www.bitcoin.org.

Computer Related Tax Investigations – Issues, Problem and some Solutions

UNITED KINGDOM

David WHYTE
Audit & Governance Specialist
HM Revenue & Customs (HMRC)

South West Bush House, The Strand, London, WC2B 4RD, United Kingdom
Tel +44 207 438 8379
E-mail: dave.whyte@hmrc.gsi.gov.uk

Mr. White has been an e-auditor/technical manager for 33 years specialising in VAT audit, audit standards and forensic computing. His current role is to assist HMRC developing our strategy and capability to tackle Electronic Sales Suppression (ESS) and Merchant Acquirer (MA) risks (including zapper & phantomware programs). He is a member the EU Zapper & Phantomware Activity Team (ZAPAT) which is looking to produce guidance on how to tackle risks in full POS (Point of Sale).

By David WHYTE

United Kingdom

The IOTA Workshop in Oslo in February 2012 on the Use of Forensic Tools and techniques to Combat Fraud was ideal because it brought together people from a wide technical spectrum: computer forensic specialists, EDP auditors and a range of countries with wide spectrum of forensic and audit skills; some had little or no experience.

We formed 4 syndicates. Our syndicate had a wide spectrum of skill and experience levels and included colleagues from Azerbaijan, Croatia, Romania, Georgia, Hungary, Netherlands, Norway, Portugal, Poland, Sweden and the UK.

Each syndicate group met, brainstormed and produced lists of issues and solutions which we individually presented to the workshop. Some of the issues raised were expanded upon in formal presentations by syndicate members during the event (i.e. Cloud Computing issues - from Hungary and how to conduct Forensic visits – (by Sweden). This note summarises the common themes from the four syndicates.

The Cloud was a recurring topical discussion point. Colleagues from Hungary gave a specific presentation on this theme. Our interest centred on whose data it was, in particular, if data from mixed sources was contained within a single container. By definition, the cloud environment may not be linked to a specific country or geographical location - which attracts cross-border and jurisdiction issues – probably requiring collaboration between tax administrations. The groups had concerns about our detailed knowledge of the expanding Web Services being offered from The Cloud and SAST (Software as a service) in general. Some attendees said that audits in a Cloud scenario were more time-consuming – because of the variables and uncertainties described above.

Physically locating where the data is stored has never been more important in planning an audit or an investigation. Some work might usefully be done to work with Cloud service providers to establish their customer-base. Computer audit often involves the copying of data files for file interrogation. In a Cloud scenario, this may add extra complexity and bureaucracy. Even without copying data to interrogate, there does seem to be a need to at least view a customer's data on the Cloud and possibly the ability to interrogate the data in situ. Clearly we should be working with Cloud users to make our audit/tax needs easier. There is always the debate as to whose data it is: the customer or the Cloud owner. The former seemed the most likely to the Oslo group. There are parallels here to old-style computer bureaux in the 1980s which also had third party data and common application software running on a 3rd party system.

Although tablets and other mobile devices (including ever more capable smart-phones) are becoming an issue in themselves – the face of traditional PC and Server architecture is changing with the advent of affordable Solid State Disks (SSD). The consensus view was that SSDs offered obvious performance gains over traditional Hard Disks (HDs) – but the latter still scored better in terms of long-term reliability which may be more important in a business-critical server installation. The groups thought that SSD reliability could only improve with time. Others flagged the issue that mobile devices now have significant storage (and archive) capabilities.

There was a common concern about keeping abreast of all tablet and application (app) developments from an audit/forensic perspective. Some form of on-going and structured R&D and knowledge-sharing is required.

Personal experience has shown how exponentially the size of typical PC, laptop and server HDs have grown; SSDs are generally smaller in capacity and physically smaller in size. The cheapness of increasingly larger HDs puts a heavy load on an investigation where forensic computing techniques are required to capture all potential electronic evidence. The term Triage is now used in the investigation scenario – taking its lead from its medical counterpart.

Triage is about assessing a range of factors/risks and adopting a strategy whereby the evidential value of the available data sources are looked at "in the round" to decide:

- what to image copy (whole or partial);
- what to file copy (whole or specific sub-directories or file)
- and what not to image or copy.

Successful Triage relies on the ability to quickly see and assess the data of interest. The main computer forensic software tools often have a forensically safe and sound "preview" capability - whereby HDs/media can quickly be examined for evidence.

Many attendees reported the massive resource overhead in imaging big HDs, perhaps, on the off-chance that they may contain material of evidential value in tax cases. The overhead is that significant that some countries outsource the process of the imaging of evidence but keep the analysis of the images in-house.

The ability to specify and quickly find individual files within a large dataset is a major asset – even though the file may have been renamed or its characteristics changed to limit identification. Some countries have adapted the forensic computing technique of creating hash signatures of key files or programs – so that automated search procedures can specifically look for them. This technique could work equally well in looking for key sales suppression software programs or data files. The reverse is also true: by knowing the hash signatures of all the normal files produced by a Windows installation, allows the auditor/investigator to automatically dismiss such files from their enquiries. This has an element of Triage in that you are whittling down the number of files you need to examine to a minimum.

Some countries have the benefit of having both computer audit and computer forensics within the same operational group. The potential value of other information held within an image can be invaluable in an investigation. Having access to imaging technology may also open up some (or limited) possibilities in non-criminal cases (depending upon the legislation within each country).
What is still unclear is: are there any forensic tools/techniques available to the investigator which would be of value (in part or in total) to the computer auditor? All syndicates thought that the suppliers of forensic software were not fully aware of the needs of the computer auditor in tax cases.

When discussing Sales Suppression Software (SSS) – the syndicates were looking forward to the OECD and ZAPAT reports and the respective knowledge sharing and training both are suggesting. The group also

thought that SSS required a particular skill-set and a skill-set which differed between ECRs and POS configurations and between how to conduct a basic audit and doing a criminal investigation. We shared concerns about assembling and managing effective case teams. The need to use audit/forensic techniques need to be combined with traditional visiting/credibility skills which put a real-world face on the tax/accounting figures being presented. Clearly having several versions of a transaction file (possibly a deleted file found in an image) can provide useful comparisons. Some countries have found that dealer support on SSS products can be by e-mail. This subject remains a fluid and dynamic risk area which requires continual effort to keep in step (never mind, to keep up).

Our syndicate work confirmed that some countries clearly had more experience and capability than others. As well as looking forensically at PC-based POS systems, some had done work on ECR/Flash memory techniques. Some countries have also gone down the Fiscal Till approach to counter SSS risks. The syndicates had no strong feelings or preferences about which was best; it was very much a matter for each country to decide. However, taking the Fiscal Tills approach might allow tax authorities to poll information from the till network and take immediate temperature checks on transaction values/volumes on specific tills. This could also be relayed using SMS messages. Both can aid audit and investigation. On a similar theme, some countries saw the benefit of a tax authority being copied into E-Invoicing chains.

The syndicates thought that transaction references (e.g. restaurant bills) and other valid/legal intelligence information were vital in compliance and investigations. Test purchasing and other techniques are also included within the broader range of techniques available in full investigation cases.

We discussed carousel and MTiC frauds, counter terrorism and money laundering risks. Once again, international cooperation was required because all are almost certainly cross-border.

In conducting a thorough computer investigation, in particular imaging, one can end up using a customer's software if a virtual copy of their system is produced. The consensus view of the groups was that most countries would accept that copyright issues would not be infringed in such circumstances.

One colleague had recent practical experience of "downing" an entire Cloud container. We had an interesting discussion around loss of service (if the container were shared) and whether businesses had adequate stand-by/back-up services to cover such contingencies. Cloud computer users have to be more careful of putting "all their eggs in one basket"?

The legal basis of individual countries regarding computer audit and investigation also varied. Some countries have had the opportunity to copy and learn from experiences in other countries and to positively legislate to plug loopholes and to maximise the available sentences/penalties for certain types of computer-related fraud or crime. Some countries relayed problems over access rights to private or privilege data (and the protocols required to show such data has been treated correctly).

Some groups also wondered whether adopting wider international standards might help us more in audit/forensics (e.g. ISO and SAF-T Standard Audit File for Tax).

Some attendees also flagged up the difficulties in bringing together multiple data sets of different types to present a single, combined picture. There was also considerable scope for transformation software to enable data sets to be changed into a more usable (or simpler) format. Often, people with particular skills are required to do this work efficiently and effectively.

The value and volume of e-mail data poses specific issues for audit and investigation. Whether a criminal consciously thinks about the folly of committing themselves into electronic communication - with its open-ended and potentially recoverable history – is an interesting point. The same is true of Social Media sites (along with Text Messaging, and other forms of instant messaging, etc). Some countries had a more legitimate access to e-mail data than others.

Computer imaging can also bring the added benefit of virtualisation: the ability to recreate and run an installation – presented in the same way as the person being investigated would have seen/used it. Getting such a system up and running will depend upon whether all the necessary configuration files are also available (in the correct location).

A picture of the factors/benefits of combing computer audit and computer forensics began to emerge, in particular, to countries lacking in either capability. Training and up-skilling requires careful consideration. There are pros and cons over teaching everyone both disciplines; over having separate specialisms but con-

nected by good communication (and case management). Fully trained staff in forensic computing are a particularly valuable and marketable resource - with transferable skills which would be an asset to many commercial businesses and consultancies. There may also be a natural curiosity and migration of key forensic personnel to new technical avenues - such as cybercrime.

The effective working within audit or forensics in a tax administration can be compromised by being trapped in their respective silos. Oslo highlighted the need for closer working both within an administration and across administrations, internationally.

International cooperation and knowledge sharing are also important in the field of common accounting software packages which are increasingly not country-specific. The work on audit-related knowledge-sharing - which OECD is developing (and ZAPAT is also recommending), was recognised by the Oslo group.

All 4 syndicate groups wanted to do more computer forensics as part of audit. Our most experienced forensic practitioners reported a frustration in that forensic software tools come from a police-orientated case background rather than being specifically tax-oriented. There was a willingness to work collaboratively across the groups (and with the suppliers) to see if we (and they) were missing an opportunity.

Although the Oslo audience were computer professionals – thinking of computers and computer-related systems, processes and outputs as being the norm – there are still many (older) tax auditors and operational managers without this knowledge.

Computer forensics is more expensive in terms of the software and hardware costs than basic computer audit requires. There is a need to match the on-going technical developments (e.g. HD sizes doubling every 18 months) with adequate and appropriately targeted funding. There is a fine balance between the cost of specialised hardware and software and the outcome of investigation cases. However, that also has to be set against the deterrent effect of investigating these cases and publicising them.

The technical appreciation of what forensic (and audit) software and hardware does and is required –needs to be articulated and justified to senior management – who may have no IT, audit or forensic background.

A key point which affects a number of countries is that they may require legislative change to maximise the possibilities suggested above.

On reflection, the Oslo workshop really showed the benefits of face-to-face working and international collaboration with like-minded colleagues.

The venue was excellent and although the weather outside was never more than -6˚C, the overall experience was warm, very friendly and most constructive.

We must do this again !

Mutual assistance

Mutual assistance between countries in the field of taxation has become more and more important due to the ever growing globalisation of businesses. Mutual assistance is carried out on the basis of both bilateral and multilateral tax treaties often supported by the European Union or the OECD. The Belgian Patrick De Mets explains the possible bottlenecks and positive effects of the European Union Directive 2010/24. He also explains the possible interactions with the domestic tax collection and recovery processes are.

We can obtain the perspective of the European Commission on tax collection and recovery in the European Union thanks to Luk Vandenberghe. He writes in his article about the history of recovery, assistance and the ever growing need for mutual assistance.

Csilla Petrilla introduces a new initiative within the European Union, the common standard VAT return. The estimated cost of completing VAT declarations in the EU is 20 billion Euro per year, almost a third of the total VAT administrative burden. Therefore the idea of the implementation of a common standard could lead to substantial savings.

Collection and Recovery of Taxes

Possible bottlenecks of Directive 2010/24/EU and its Interaction with the Domestic Tax Collection and Recovery Business Processes

BELGIUM

Patrick DE METS
Auditor general of finance
General Administration of Collection and Recovery of Taxes

Boulevard du Roi Albert II, 33 boîte 40 – 1030
Bruxelles, Belgium
Tel +32 25762827
E-mail: patrick.demets@minfin.fed.be

Mr. DE METS is a director, manager-leader of different units at the headquarters of the Belgian Federal Public Service Finance, Taxes and Recovery Directorate.

By Patrick DE METS

Belgium

This article was written mid 2011, in preparation for the Fiscalis seminar on mutual recovery assistance, Maastricht, 26-28 September 2011. Following this seminar, the article was published on CIRCA website (Recovery Committee Interest Group).

1. Introduction

A new Directive

Council Directive 2010/24/EU of 16 March 2010 had effect from 1st of January 2012. This new Directive is a step forward towards more coherent and effective co-operation in the field of mutual assistance for recovery of taxes, duties and other measures, as it streamlines the flows of communication, removes some of the major obstacles causing the inefficiency of current arrangements for assistance and extends the scope to taxes and duties not yet covered by the present mutual assistance for recovery. The uniform instrument permitting enforcement measures in the requested Member State is but one of the novelties which will facilitate mutual assistance for recovery, and has to be considered a fundamental change for what concerns this item.

Indeed, as set out in the introduction to Directive 2010/24/EU, the original arrangements for mutual assistance for recovery as first set out in Council Directive 76/308/EEC of 15 March 1976 and its subsequent amending acts have, while providing a first step towards improved recovery procedures within the Union, proved insufficient to meet the requirements of the internal market as it has evolved over the last 30 years. A new system was therefore needed.

The Global Economic Crisis: threat and challenge

All Member States of the European Union, and by extension all countries worldwide, are facing unprecedented fiscal and budgetary challenges. In

many countries the debate on whether or not to raise taxes, and how (much) and where to cut government spending is raging. It is against the backdrop of these challenges that the new Recovery Directive has come into force.

Maximising (enforced) collection and recovery, including the use of mutual assistance for recovery, constitutes a critical programme of work in national revenue bodies, given its direct relationship to the achievement of budget revenue targets and the significant level of resources involved. However modest, each amount recovered will help to ease the budgetary problems.

One can hope that by implementing this Directive, not only will mutual assistance for recovery become more efficient and lead to an increase in the amounts recovered, but also that the new directive will be used as a bridge between the different tax administrations through facilitating exchange on domestic recovery processes in order to respond to the continuous quest for a more effective collection and recovery process.

Let us first look at the major positive aspects of this new Directive.

The new system that had to be developed needed to take the following requirements into account:

- Extending the scope in order to better safeguard the financial interests of the Member States and the neutrality of the internal market;
- A more efficient and effective assistance process in order to cope with the anticipated increase in assistance requests and to deliver better results.

In order to fulfil these objectives, important adaptations including defining clearer rules were necessary. These clearer rules:

- promote a wider information exchange between Member States.
- ensure that all legal and natural persons in the Union are covered, taking into account the ever increasing range of legal arrangements.
- make it possible to take account of all forms, that claims of the public authorities relating to taxes, duties, levies, refunds and interventions may take.
- are primarily necessary to define better the rights and obligations of all the parties concerned.

Using a uniform instrument permitting enforcement measures in the requested Member State, as well as a uniform standard form for notification of instruments and decisions relating to the claim, should resolve problems of recognition and translation, which constitute a major cause of the inefficiency of the current arrangements for assistance.

These positive changes are very welcome and much needed. When asking its citizens to make sacrifices in order to keep the budgets balanced and to reduce the national debts, it is the government's obligation to ensure that the tax administration can prevent abuse of the benefits of the internal market, in particular the ease by which money and assets can be transferred throughout the Union and even the world, to escape paying one's taxes, rights or duties.

The continuous search for and implementation of a more efficient recovery process is hence not only a matter of bookkeeping, it's also a matter of equity and fiscal justice.

The big question now is whether Directive 2010/24/EU is up to this challenge.

This paper is not meant as a comprehensive review, but aims to give a sense of the main obstacles and will propose some steps for further improving the current (mutual) recovery (assistance) systems.

When carefully studying the new directive and its implementing regulation, it becomes clear that not all obstacles have been fully removed. A number of improvements and clarifications are still needed. The European Commission did certainly make an effort to start this process by elaborating a series of explanatory notes.

A lot of these remaining issues, such as the privileged status, turnaround time of requests and (in)compatibility of IT-systems,… are important but perhaps not vital to the mutual recovery process itself. Therefore, this paper will not further dwell on them.

It will instead focus on two major bottlenecks that stand in the way of a coherent and effective co-operation in the field of mutual assistance for recovery. These bottlenecks may occur as a result of shortcomings in the main principles governing mutual assistance for recovery as well as of inadequate domestic national recovery procedures or as a combination of both.

2. Main principles of the Mutual Assistance and the bottlenecks linked to them

Two main principles on which the mutual assistance for recovery process is based are the following:

- Any claim in respect of which a request for recovery has been made shall be treated as if it was a claim of the requested Member State (art. 13 of the Directive).

- Before the applicant authority makes a request for recovery, appropriate recovery procedures available in the applicant Member State shall be applied, except in the following situations:

- where it is obvious that there are no assets for recovery in the applicant Member State or that such procedures will not result in the payment in full of the claim, and the applicant authority has specific information indicating that the person concerned has assets in the requested Member State;
- where recourse to such procedures in the applicant Member State would give rise to disproportionate difficulty (art. 11 of the Directive).

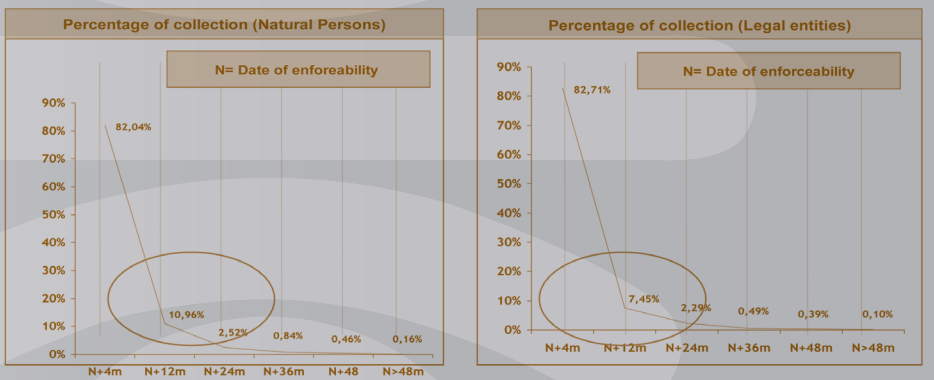
The first main principle implies that the strength of the supranational system depends on the strength of the 27 national recovery systems. Inadequate domestic recovery in any given Member State can affect the application of the principle of reciprocity and therefore the mutual assistance process as a whole, regardless of the origin of these inadequacies: legislation, IT, business process, organisation, human resources, etc.

The second main principle is the principle of exhaustion. The general principle that domestic recovery measures must be exhausted before requesting recovery assistance was maintained as a basic rule but given the exceptions written down in the Directive the principle of exhaustion is no longer absolute. As measures of execution should not give rise to disproportionate difficulties, the most appropriate recovery procedure should be implemented. This would be the most cost-effective one, yielding the best result with the least 'harassment' of the taxpayer.

It is indeed mandatory for recovery actions to pursue payment of unpaid tax debts to be taken as quickly as possible. There is considerable experience in the private and public sector proving that the more timely the recovery action is taken, the higher the rate of recovery will be.

A study conducted in Belgium in 2008 concerning direct taxation (natural persons and legal entities) shows that after 12 months, the chance of successful recovery dropped from 90% to 10%. All debts, including those for which mutual assistance could be requested, were included in the portfolio studied.

Percentage of the collection with respect to the initial amounts after 4,12,24,36 and 48 months of the debts between january 2005 and december 2008



(¹Nat. Pers.: Income tax, tax non-residents Nat. Pers.; Legal entities: company tax, tax non-residents legal entities

The same important conclusion can be found in an IMF Staff Position Note of 2009 (IMF Staff position note, July 14, 2009 (SPN/09/17),'Collecting Taxes during an Economic Crisis : Challenges and Policy Options'), which states that "International experience has shown that the probability of debt recovery declines rapidly when a debt remains outstanding after 60–90 days".

It should be noted that the above-mentioned principle was also included in other legal instruments.

- OECD model tax convention

Article 27 of the OECD model tax convention states that *"in no case shall the provisions of this Article be construed so as to impose on a Contracting State the obligation:*

(…)
c) to provide assistance if the other Contracting State has not pursued all reasonable measures of collection or conservancy, as the case may be, available under its laws or administrative practice;"

- the Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters

The Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters provides in article 19 the possibility of declining a request: *"The requested state shall not be obliged to accede to a request if the applicant state has not pursued all means available in its own territory, except where recourse to such means would give rise to disproportionate difficulty."*

The wording of the new Directive is similar to the terms of the corresponding provision in the OECD-Council of Europe Convention. The explanatory report to this convention also confirms that the cost-effectiveness of the recovery measures should be taken into account. Under these circumstances, it can be expected that the same opinion will be confirmed in the explanatory notes now developed with regard to the EU legislation. This approach will contribute to an increase of the recovered amounts, as it helps to speed up the recovery processes. It will allow to avoid that a lot of time will elapse before mutual assistance is requested and will enable tax authorities to work in real time.

3. National laws and the bottlenecks linked to them

In the report from the Commission to the Council and the European Parliament on the use of the provisions on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures in 2005-2008, two recommendations were made:

- The Member States were urged to strengthen the recovery instruments available in their domestic legislation.
- The Council and the Parliament were invited to adopt quickly the proposal that the Commission had presented on 2 February 2009 to reinforce mutual recovery assistance.

The second recommendation has been fulfilled. The question remains on how to deal with the first one.

Can National Recovery Measures be considered as a bottleneck?

We do not have an overview of all the domestic recovery procedures nor do we want to pronounce on them. But we do know that considerable amounts of tax are written off each year in all countries due to the inability of the taxpayers concerned to meet their tax liabilities. It is likely that a significant part of this written off debt is the result of a slow and/or inefficient domestic recovery process, and could have been avoided using more effective procedures. Clearly, even a relatively modest improvement in tax debt recovery effectiveness could lead to considerable additional tax revenue.

The fact that a taxpayer moved abroad, operates on a multi-national level or has assets spread over different countries may not constitute an excuse for a slow and/or inefficient recovery process. Legal requirements obliging the collection and recovery departments to wait (too) long neither. While one cannot limit the taxpayer's rights in respect to their freedom of movement, the tax administrations should ensure that they do not handicap themselves in the struggle against non-payment and fiscal fraud.

In this context, attention must be given to the specific situation of the collection authority. Unlike other tax departments, this public service is faced with competing creditors who also want to recover their claims on the (limited) solvency of the debtors.

How to overcome the bottleneck(s)?

A combined approach is necessary:

1. On the level of mutual assistance, the principle of "cost-effectiveness" should become a standard, allowing requests for assistance when this is the most 'cost-effective' way to recover a debt, even if not all recovery procedures available in the applicant Member State have been exhausted.
2. On the national level, new and innovative methods to optimise the national recovery process could be developed.

The first proposal can be implemented by ensuring a correct interpretation of the Directive and by trusting that the applicant Member State considers requesting assistance as the most cost-effective way to recover a claim.

As far as the second proposal is concerned, a wide diversity of domestic recovery can be observed in the

fields of, amongst others, legislation, process, IT. Maybe the time has come to turn this diversity into a weapon instead of viewing it as a hindrance. It should be possible to explore all these domestic recovery processes of taxes of the different states, and based on this study, to choose the best elements out of each (Member) State in order to develop an efficient recovery process.

Indeed, certain (Member) States already dispose of an efficient process, or parts of it, concerning, amongst others, legislation, IT, process, organisation, human resources, culture,… During the previous Fiscalis seminars on recovery assistance it became clear that even the most advanced Member States can learn something to make their recovery process more efficient. Looking at the presentations made during the Fiscalis seminar in Antwerp in 2008, one can think of the automated number plate recognition system presented by the Netherlands, the Debt Management and Banking Field presented by the United Kingdom and the outbound activities of call centres presented by Belgium. No doubt, in the meantime new initiatives have been or will be taken in the continuing search of each authority for additional resources. As an example, I refer to a new development whereby bailiffs start to create international clusters allowing them to conduct cross-border solvability research and certainly possibilities offered by so-called 'predictive models' about compliance capacity and behaviour of tax debtors.

Diversity could thus be seen and used as an opportunity.

4. Towards a Holistic Mutual Recovery Process

The aim of this paper is not to explore in full the implementation of an integrated collection and recovery system. In order to do so, one should also investigate the questions related to accountability, the relationship with the treasury, with third parties, etc. This paper aims to launch ideas and provide food for thought.

A holistic and integrated Collection and Recovery system needs to take into account the key trends of a modern tax administration, which include:

- improving service and reducing cost through more efficient/effective channel management;
- increasing the use of third party data for collection/compliance purposes;
- addressing the challenge of cross-border tax issues in a global economy;
- exploring new models which combine government tasks;

Efficient management of (cross border) recovery actions requires a new, innovative and holistic approach that encourages and facilitates voluntary payment by the taxpayer once a tax debt is established and immediately assigns tax debts to the recovery process most likely to result in quick payment of the tax debt(s) at minimum costs when it can be expected that the taxpayer will not voluntarily pay the arrear(s). A framework for the collection and recovery business process should be provided by strategic and operational plans, based on concrete process descriptions, allowing (a cost-benefit) analysis and supported by an efficient performance management system.

In building up an integrated recovery process maximal use should be made of an efficient 'data mining' system. Matching all data available permits an appropriate classification of debts. The final goal of this classification is the establishment of priorities and strategies that may guarantee the collection of debts or their removal from the system. This should, in turn, result in adequate management and optimum use of the scarce resources available within most of the tax administrations. Classification of tax debts will indeed allow a predictive model to be developed, classifying the portfolio of debtors into several categories.

For each category, an appropriate (sub) process should subsequently be developed, whereby it is clear that the administrations will have to give priority to recovery of the youngest and most important debts. Regarding the debtors of which can be assumed that they will voluntarily pay the tax debt, this means above all supportive action, according payment plans and fully using all possibilities offered by the latest information technology and social media (outbound call centre activities, SMS, electronic mail, Internet, social media, etc.).

Difficult issues such as efficient detection and cancellation of irrecoverable debts should not be evaded. The continued inclusion of irrecoverable tax debts in the tax portfolio does not only place a heavy burden on the process, but most of all it risks conveying a completely false signal to the budgetary control authority.

Matching all data will allow administrations to develop a fast, swift and cost-effective (cross-border) recovery process, thus increasing their financial results in the state budget.

A holistic mutual recovery process should focus on the complete system rather than dissecting and analysing each part of it without taking the other parts into account. Within the European Union (and by extension

the whole world) it is clear that not all the countries have the same organisation, level of powers and procedures. The ultimate goal should be an operational recovery process that allows modulated action in order to achieve the best results i.e. maximum payment of outstanding taxes with the least burden on tax services (collection and recovery department) and on the taxpayer.

Let us not forget the possibilities to exchange information at other international levels. Indeed, most European countries are members of multiple international organisations such ass IOTA, CIAT, OECD, IMF, etc. Through these organisations, countries can ensure benchmarking in a large part of the world. The European Commission could play a prominent role in this respect.

As mentioned earlier, the inefficiency of the domestic recovery process can be caused by a number of factors, including the business process, human resources, IT, working culture, etc. All these can be the subject of further elaboration and thus of benchmarking.

It is clear that most of those factors concern the tax administration in general, or even the whole governmental administration. Nevertheless, it is useful and necessary to examine them from the viewpoint of the collection and recovery department. This is especially relevant in those cases where they have a direct impact on the work of this department, including the operational process, as defined by laws and regulations, the IT-structure, the organisational set-up and the working culture.

It is useful to refer here to the recommendations mentioned earlier from the IMF on the challenges and policy options concerning the collection of taxes during an economic crisis.

"Tax arrears tend to rise sharply during an economic downturn. Tax agencies should consider liberalizing the use of payment arrangements to assist distressed taxpayers, though firm enforcement action should be taken against businesses that have the capacity to pay their taxes but refuse to do so.

Good debt collection practices are even more important during a crisis. This is because the window for collecting tax debts may close more quickly in a recession, when taxpayers' cash-flow problems worsen and bankruptcies increase. In this situation, it is essential for tax agencies to (1) ensure early detection of tax arrears and establish appropriate time standards for follow-up, (2) maintain the quality and timeliness of tax arrears data, (3) target enforcement efforts on recoverable arrears—usually by focusing on the most recent and largest arrears first, (4) leverage of the telephone contact centre to place outgoing debt collection calls, (5) write off arrears deemed unrecoverable, (6) implement proper organizational and staffing arrangements for collection enforcement, including a greater organizational focus for large tax debts, and (7) be vested with a full set of enforcement powers.

In addition, tax agencies need to give greater attention to recovering tax arrears from bankrupt companies. Bankruptcies present many challenges to debt recovery because the collection process is normally taken out of the tax agency's direct control and placed under a country's bankruptcy judicial system. To address these complexities, some tax agencies are allocating more enforcement staff to bankruptcy cases; others are creating a special bankruptcy unit within their debt collection departments. Some, like those in Denmark, are working to improve coordination between the tax agency and the bankruptcy court.

The number of taxpayers who fail to file a tax return can also be expected to rise during an economic downturn. To cope with this problem, tax agencies should make greater use of default assessments in determining the tax liability while reserving audits (which are more time consuming and difficult to estimate) for larger nonfiling cases. To avoid the risk that default assessments will lead to large amounts of uncollectible tax debts the assessments should be screened for reasonableness before being issued to taxpayers".

- Legal-powers

There is great diversity between countries. Not everybody has the same organisation, level of powers or structure. In some countries, the collection and recovery department has important powers to assist them. In other ones, recovery is a mixed competence. In yet other countries, recovery of taxes is not even a task of the fiscal administration.

Exchange of information on legislative powers is needed to allow (member) states to examine whether or not it would be useful to adapt their own domestic legislation. The necessity for these adaptations is based on, amongst other factors, the need to integrate an international approach into the domestic debt recovery systems following the increasing interconnectivity among people and companies across the world and the increasing trend to take away privileges from the tax administrations. The big diversity and even disparity

between the respective legal systems provide a wide range of experiences and practices that can serve as a wealthy source of inspiration for changes in the domestic legislation. The choice whether or not to adapt domestic legislation is ultimately a political one.

One of these choices could be to increase the level and quality of information exchange on tax debtors, their liability and assets. This would require correct identification of tax subjects, reason why there is a need to agree on a standardised system for identifying them. Other choices could be made, depending on an in-depth analysis and exchange, on a wide range of topics, including (but not limited to) the executorial title and collection powers, the possibility to take precautionary measures, providing payment facilities and possibilities for fiscal amnesty, creating strategic alliances with third parties, writing off debts, etc.

- IT

It is mandatory for the national IT systems to maximise automated information exchange amongst all stakeholders involved. All countries could strive towards the realisation of a Tax Administration Information System (TAIS). This is an integrated system with functionalities aimed at a broad range of tax-related tasks. Collection and recovery should be a separate module containing an embedded capability for seamless integration with the other modules. The IT-environment must nevertheless be completely compatible with a recovery environment. 'Stand alone' development is possible and while developing, the ever ongoing technical (r)evolution needs to be taken into account (cloud computing?).

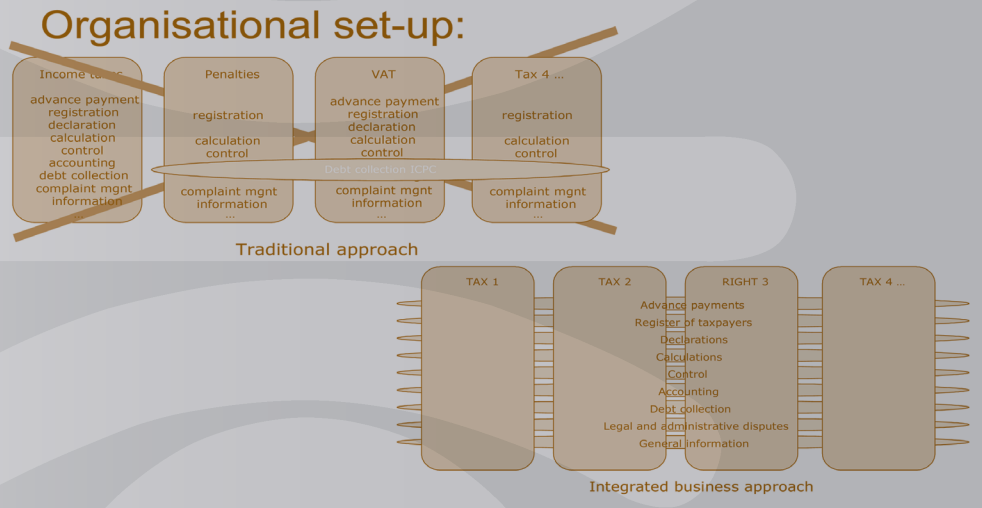
COTS for tax

In most cases, changes in the tax administration's business processes are supported by adapting legacy IT-tools or developing new ones. These tools are mostly developed in-house, with a strong focus on infrastructure. It would be worth exploring if more use could be made of Commercial Off-the-Shelf Tax System (COTS) that already exist and may offer flexible software packages that could be adapted to the needs of the collection department.

Organisation of the collection department

Following international recommendations, the tax administration should be organised according to functions, and not according to types of tax. Collection and Recovery of all fiscal claims is such a function. Additionally, one should consider whether this function should be limited to fiscal claims, or to all claims emanating from official state bodies (national, regional or local), including social security institutions.

The overall aim should be, as far as collection and recovery is concerned, to develop units which can focus 100% on enforced recovery of all claims. This would imply that such units would therefore no longer deal with issues not directly related to recovery such as insolvency matters which require a high level of specialisation.



Working culture

Recovery of debts forms part of the broader work of the tax administration, as well of the social and economic reality of society. Therefore, it should be done with respect towards the taxpayers but should be repressive when needed. This can for instance take the form of assisting companies to comply with their fiscal duties. At the same time, within the organisation, recovery should receive the respect it deserves from the other entities. Collection and Recovery is not an activity that comes second but has its place as a major player in economic life.

One of the current buzzwords in the economic sphere is Corporate Social Responsibility (CSR). CSR can be defined as a method or business process whereby a cor-

poration ensures its active compliance with the spirit of the law, ethical standards and international norms. Looking more in depth at this concept, one can wonder if the time is right to coin the concept of "Corporate Social Collection and Recovery". It is clear that taxpayers are obliged to have a relationship with the tax administrations, a governmental institution, regardless of other legal obligations, business processes and working methods. The collection and recovery process should be applied strictly when necessary but cannot be only repressive. In its global concept and working methods it should be supportive to society, obviously taking into account the principle of equal treatment. Public institutions should indeed be partners in society. The current state of technology allows us to develop a one-to-one relationship with the taxpayer, preferably in a supportive but if necessary also in a repressive role.

The aim of a Corporate Social Collection and Recovery is to provide the Collection and Recovery Departments with a double function: ensuring the collection and recovery of the amounts due and fulfilling an economic and social role in society. The last function would include providing assistance to taxpayers in meeting their fiscal and other payment obligations. In Belgium, a model was developed to predict which companies faced an increased or even acute risk of insolvency. Warning these companies and rendering the possibilities of benefiting from payment facilities conditional to seeking assistance in the field of overall company management will help those companies taking their business seriously to survive. In the long term compliance will follow thus increasing the collection without the need of enforced recovery. Enforced Recovery would become the treatment specially reserved for those taxpayers who escape compliance and/or are involved in fraud.

Corporate Social Collection and Recovery should also subscribe to the political, social, legal and economic environment in which it operates. This environment is first and foremost the European Union.

5. Tax policy and the European Union

Proportionality and subsidiarity

The Treaty of the European Union states that competences not conferred upon the Union in the Treaties remains with the Member States and that the use of Union competences is governed by the principles of subsidiarity and proportionality. The European Union shall respect the equality of Member States before the Treaties as well as their essential State functions. However, pursuant to the principle of sincere cooperation, the Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations resulting from the acts of the institutions of the Union (including Directive 2010/24/EU). Furthermore, the Member States shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardise the attainment of the Union's objectives.

While providing an answer to the requirements mentioned earlier, the Directive 2010/24/EU had to subscribe to the Treaty of the European Union and to the broader tax policy strategy of the European Commission. This strategy allows Member States, as long as they respect EU rules, to choose the tax system that they consider most appropriate and according to their preferences. In addition, any proposal for EU action in the tax field needs to take account of the principles of subsidiarity and proportionality: there should only be action at EU level where action by individual Member States could not provide an effective solution.

There is clearly a tension between national sovereignty and the obligation to create a more coherent and effective co-operation in the field of mutual recovery assistance. This tension can be found in item 6 of the introduction of the Directive, which *"should not affect the Member States' competence to determine the recovery measures available under their internal legislation. However, it is necessary to ensure that neither disparities between national laws nor lack of coordination between competent authorities jeopardise the seamless operation of the mutual assistance system provided for in this Directive."*

What are the possibilities for the Commission to justify intervention in the domestic legal order?

In its judgement of 18 December 1997 in the case Garage Molenheide ((joined cases C-286/94, C-340/95, C-401/91 and C-47/96) the European Court of Justice stated that *"whilst it is legitimate for the measures adopted by the Member States to seek to preserve the rights of the Treasury as effectively as possible, they must not go further than is necessary for this purpose. They may not therefore be used in such a way that they would have the effect of systematically undermining the right to deduct VAT, which is a fundamental principle of the common system of VAT established by the relevant Community legislation. The answer to be given in that regard must therefore be that the principle of proportionality is applicable to national measures which (…) are adopted*

by a Member State in the exercise of its powers relating to VAT, since, if those measures go further than necessary in order to attain their objective, they would undermine the principles of the common system of VAT (…)."

If national recovery measures would, in one way or another, hamper the functioning of the VAT Directive, an individual taxpayer who believes his rights to be infringed upon by the implementation of this measure can take legal action. However, as most national recovery measures are based on civil law, it may be assumed that such infringements would rarely occur.

If those same national recovery measures would however undermine the principles of the Recovery Directive, one could ask whether the Commission could intervene. Whilst each Member State is responsible for the implementation of EU law within its own legal system, the European Commission is responsible for ensuring that EU law is correctly applied. Consequently, when a Member State does not comply with EU law, the Commission has the competence to bring that Member State into line: if a Member State does not fulfil its EU law obligations, the Commission could refer the infringement case to the European Court of Justice.

In order to ensure a mutual assistance between them, Member States have to use the recovery measures available in their domestic systems. However, if the disparities in national law, and/or the lack of internal coordination between the competent authorities (including the liaison offices and liaison departments) would in one way or another jeopardise the mutual assistance system, could the Commission then start a non compliance procedure against the Member State in question? And how would 'disparities between national law' and 'lack of coordination' be defined?

Would for instance an unclear division of competence between the various competent authorities, causing considerable delay in the treatment of requests with non-recoverability of the debt as a consequence, be considered as a 'lack of coordination' jeopardising the mutual assistance process?

Enhanced co-operation

As stated earlier, the ultimate goal should be to develop a holistic and integrated Collection and Recovery Process. In the EU, enhanced cooperation is a procedure allowing a minimum of nine Member States to establish advanced integration or cooperation in an area within EU structures but without the other members being involved. As of March 2011 this procedure is being used in the fields of divorce law and patents. It would be interesting to examine whether such procedure could be used for collection and enforcement procedures.

Recovery and the Own Resources System

As part of the financial framework proposed by the Commission for the period 2014-2020, the European Commission expressed its strong wish to further develop and strengthen the own resources system. Out of different options, two own resources are singled out and could be introduced by 2018: a financial transaction taxation and a new VAT resource. Own resources would by 2020 be the most important revenue of the European Union, making it more independent from the national contributions. In the Commission Staff Working Paper on Financing the EU budget: '*Report on the Operation of the Own Resources System*' it is stated that, if feasible, the proceeds of a new resource should be collected directly by the EU outside national budgets.

It can be assumed that the collection and recovery departments of the Member States will be responsible for the collection and recovery of these taxes. If national law is to be applied:

- the disparities between national laws could have as consequence an unequal treatment of taxpayers subject to pay the taxes constituting the own means between Member States; which in turn could lead to delocation of certain economic entities to the Member States with the weakest recovery procedure.
- an inefficient national recovery procedure could lead to the non-recovery of claims due, thus causing the European Union with a budgetary loss.

Wanted: Best Practices

6. A Way Forward

With the aim to provide the different countries an opportunity to render the domestic recovery process and system as efficient as possible a proposal hereby is made to develop an extended benchmarking activity within Europe. This ambitious goal can only be reached through the implementation of a step-by-step approach.

Mapping the legal and organisational experiences

A first step forward towards further enhanced recovery co-ordination could be the mapping of the experiences of the Member States in their national recovery procedures. When examining all the laws and regulations, as well as the existing processes and supporting IT-structure, stronger and weaker examples and practices will be found. Out of this wealth of experiences the strongest ones, the best practices, should be distilled.

As part of this mapping exercise, a comprehensive database of national recovery legislation and practice could be developed. There already exist a "Taxes in Europe" and a "Tax reforms" database, both developed by the European Commission as an on-line information tool covering the main taxes and tax reforms in force across the Member States. A database "Recovery in Europe" could be added, along the lines of the other databases or taking the form of a '*Recoveripedia*'. As these databases are publicly accessible, CIRCA will continue to serve as a platform for information exchange between the officials concerned within the tax administrations.

The best practices selected after the mapping would serve as the basis for a "Collection and Recovery Guide for Tax Administrations". As an example of such a guide, I refer to the Compliance Risk Management Guide for Tax Administrations published by the European Commission.

The "Collection and Recovery Guide for Tax Administrations" would thus explore the differences and convergences in national Recovery legislation, showcase best practices and suggest concrete actions collection and recovery officials can take when being faced with complex challenges. Furthermore, it would also contain a practical Toolkit for those Member States willing to strive towards the creation of a single collection and recovery point for all claims involving their national, regional and local administrations.

Parallel to the development of the Guide, the e-training module for recovery assistance, of which a lot has been said already in the past, could be finally created.

Expert committee(s)

A standing group of experts could be charged with the overall management of this process, including guiding the mapping exercise, selecting the best practices and assisting in the conceptual development of the database. Different working groups composed of experts in a specific field would be in charge of working out concrete actions and further developing the subthemes. These expert groups could thus focus more on in-depth study while the Recovery Committee would continue to fulfil its current role as defined in the Directive and its rules of procedure. The Recovery Committee would always be in charge of the final validation of the Guide, Toolkit and Database.

Study visits / seminars

In order to exchange and disseminate information between and among collection and recovery officials, the use of the possibilities offered by the FISCALIS programme to organise study visits and seminars focused on recovery should be maximally used. Selected themes, such as best practices in a specific field or the results of an in-depth study on a certain factor facilitating or hindering the recovery process could serve as a basis for such study visits and/or seminars.

7. Conclusions

Directive 2010/24/EU is definitively a step forward towards a more coherent and effective co-operation in the field of mutual recovery assistance. It is against the backdrop of a major global economic crisis that the new Recovery Directive will come into force. The continuous search for and implementation of a more efficient recovery process is not only a way to increase revenue, it is also a matter of equity and fiscal justice. In order to reach these goals, the need for closer co-ordination and even possibly partial harmonisation – on a voluntary basis – is essential.

Is Directive 2010/24/EU up to this double challenge?

This paper does not dwell on the improvements and clarifications still needed to implement Directive 2010/24/EU in the most optimal way. It instead focuses on the bottlenecks which are found in the directive and probably also on the national level.

Two of the main principles on which the whole system of mutual assistance for recovery rests can at the same time be bottlenecks. The principle of recovering a foreign debt as it was a domestic one means that the strength of the supranational system depends on the strength of the national systems. The principle of exhaustion, although not absolute, can result in a loss of time before the mutual assistance process is requested if it is interpreted too strictly.

The overall goal of recovery actions should be to pursue payment of unpaid tax debts as quickly and effectively as possible. Therefore, the most appropriate and cost-effective recovery procedure should always be implemented. This implies that requests for assistance can be made when this is the most cost-effective way to recover a debt, even if not all recovery procedures available in the applicant Member State have been exhausted.

Efficient management of (cross border) recovery actions requires an innovative and holistic approach that encourages and facilitates voluntary payment by the taxpayers once a tax debt is established and immediately assigns tax debts to the recovery process most likely to result in their quick payment at minimum costs when it can be expected that the taxpayer will not voluntarily pay the arrears.

In order to be able to choose the most suitable recovery procedure, a clear identification of, as well as up-to-date and concrete information on, the tax debtor is needed. Linking databases by using the latest in IT-technology can provide a great help in this respect.
A "Collection and Recovery Guide for Tax Administrations", should be developed by expert groups through analysing national recovery systems and showcasing best practices. Involving a wide range of experienced officials through seminars and study visits will ensure dissemination of the best practices across Europe and will possibly serve as a basis to introduce where possible, taking into account the diversity among Member States, these practices in the national recovery process.

Tax Collection and Recovery in the EU: Setting the Right Example

EUROPEAN COMMISSION

Luk VANDENBERGHE
Head of Sector
European Commission, DG Taxation and Customs Union

Rue du Luxembourg 40 B-1049 Brussels, Belgium
Tel +32 2 2954297
E-mail: luk.vandenberghe@ec.europa.eu

Luk Vandenberghe has a doctor's degree in law and advanced master degrees in taxation and European law. He is currently head of the sector "EU VAT Forum, VAT portal, tax collection and recovery" in the DG Taxation and Customs Union.

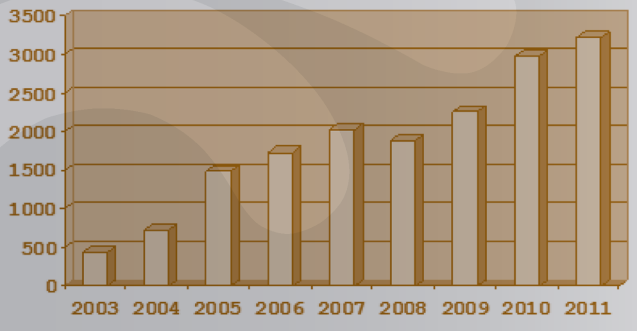
By Luk VANDENBERGHE

European Commission

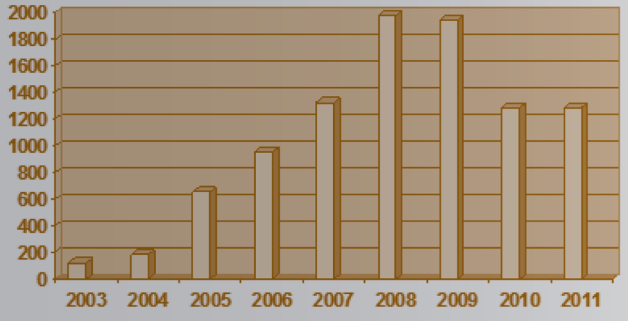
Introduction: a continuous increase of recovery assistance in the EU

Since the adoption of the first recovery assistance directive in 1976 (directive 76/308/EEC), the EU framework for mutual recovery assistance has gradually developed. In recent years, the extension of the scope of this legislation and the accession of new Member States have led to an enormous increase in all types of mutual assistance requests between the EU Member States. In 2011, the EU framework was used for more than 3200 information requests; almost 1300 notification requests, and almost 9600 requests for recovery.

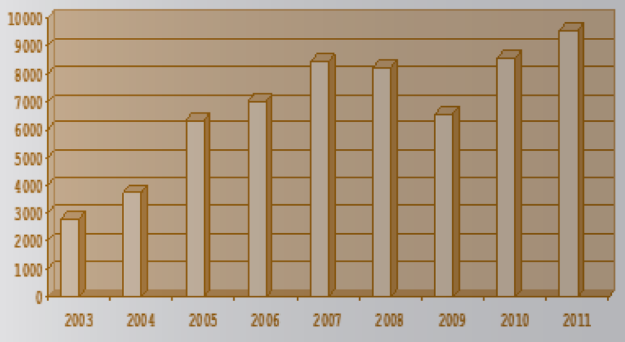
Requests for information - evolution 2003-2011



Requests for notification - evolution 2003-2011

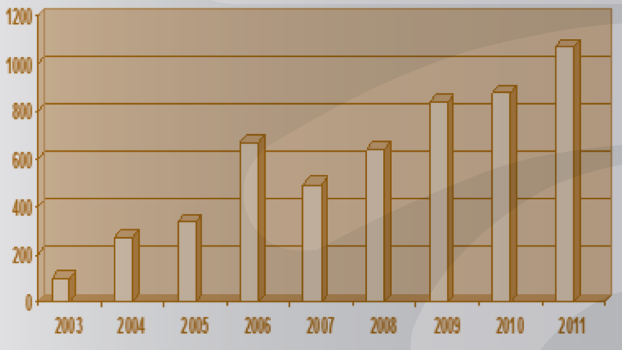


Requests for recovery - evolution 2003-2011



This increase in assistance requests is not surprising: it is line with the increasing mobility of persons, assets and capital within the internal market, and with the growing awareness of Member States that this form of administrative cooperation is needed in order to effectively fight against tax fraud.
The growing use of the EU recovery assistance framework has resulted in a spectacular increase in the amounts recovered through this cooperation mechanism. Compared to 2003, the amounts of tax claims recovered by EU Member States at the request of other Member States have multiplied by more than 10.

Amounts recovered at the request of other Member States - evolution 2003-2011 (2003 = 100 %)



New EU legislation to make recovery assistance more efficient

Since 1 January 2012, new legislation has been put in place: Council Directive 2010/24/EU and Commission implementing Regulation (EU) No. 1198/2011. This new legislation was considered necessary to make assistance more efficient and effective, and to facilitate it in practice, in order to cope with the increase in assistance requests.

The adoption of this new legislation is indeed a major step in the development of recovery assistance between Member States. First of all, the new directive is the first legal instrument offering multilateral recovery assistance for all taxes levied by or within the States, without any possibility for them to exclude one or more taxes from the scope. From now on, one framework covers all requests. Officials dealing with recovery assistance are no longer required to use different agreements or arrangements, all with their own scope and different conditions and limitations.

Moreover, the new legislation extends the possibilities to request recovery or precautionary measures in another Member State. It has become possible for Member States to make a request for mutual assistance, even though the domestic means of recovery have not yet been fully exhausted, inter alia, where recourse to such procedures in the applicant Member State would give rise to disproportionate difficulty.

Another big change is the adoption of a Uniform instrument to be used for enforcement measures in the requested Member State, as well as the adoption of a Uniform standard form for notification of instruments and decisions relating to the claim. These uniform instruments should resolve the problems of recognition and translation of instruments emanating from another Member State, which constituted a major cause of inefficiency in the past.

These uniform documents can be created automatically, once the corresponding request form is filled out. These digital request forms have special characteristics. They are:

- Language independent: thanks to their standardization and the digital format, every form can be filled out and read in each of the official EU languages, and it is possible at any moment to switch from one language version to another;
- Universally applicable: the EU request forms are used by all Member States for all taxes. The same forms can even be used for assistance requests based on legal instruments other than the EU-directive (although this has become an exceptional situation, given the extension of the scope and the possibilities of the EU-legislation concerned);
- Knowledge engineered: the electronic forms contain a lot of smart functionalities, facilitating the work of officials using these forms: forms adapt automatically to specific options selected (e.g. if another legal instrument is chosen as the basis for a request, the computer system automatically takes into account any different conditions or particularities linked to the use of that

other legal instrument); totals of amounts are automatically counted; etc.

Further improvement and increase of international cooperation

The digital format of the assistance request forms and the uniform instruments allows a rapid communication within and between Member States. The updating and further development of the possibilities offered by these forms is a continuous challenge for the Commission and the Recovery Committee.

In 2013-2014, the Commission, assisted by the Recovery Committee, will proceed with an evaluation of the new legislation. This will also include an examination of new possibilities for optimizing the free circulation of information for tax recovery purposes (e.g. multi-purpose request forms; access to databases, also taking into account the developments in the exchange of information for tax assessment purposes). The evaluation will also focus on the need and possibility to reinforce mutual assistance for precautionary measures. Precautionary measures are important to optimize the protection of the recovery possibilities, in particular in cases of tax fraud or dispute.

This evaluation exercise is not only important for the EU Member States. The OECD has already shown its interest. In recent years, the OECD – together with the Council of Euroope – has reinforced another legislative framework for tax recovery assistance: a new protocol amending the 1988 Convention on administrative cooperation in tax matters was presented in 2010, and Article 27 of the OECD double taxation model convention was also adapted in order to extend the scope of this provision. Now the OECD is considering the possibility to promote and facilitate recovery assistance in practice, using the EU experience with electronic request forms and uniform recovery instruments.

This evaluation is probably also of interest to IOTA and its non-EU Member countries. Raising the awareness of the possibilities and advantages of a uniform legislative framework and a universally used technical (plat) form is the first step to a more global cooperation of tax recovery authorities in an economic world that is already globalized. Accordingly, a joint event would provide an ideal opportunity to share these experiences.

Fiscalis project groups for best practices in tax collection and tax recovery

The success of recovery assistance between Member States largely depends on the strength of national recovery actions taken by the respective tax authorities. Therefore, all EU Member States agreed to set up specific project groups to analyze and develop best practices in tax collection and recovery. Three specific project groups were created in 2012, within the Fiscalis-framework. One project group deals with tax collection and recovery legislation. The diversity between the respective legal systems and techniques indeed provides a wide range of experiences and practices, which can serve as a wealthy source of inspiration for changes in the domestic legislation. Another project group has been set up to discuss tax collection and recovery processes. Its goal is to establish strategy suggestions to improve the management of the collection and recovery of taxes, taking into account the limited resources available within most of the tax administrations and the cost/efficiency balance. A third project group deals with IT-issues linked to tax collection and recovery. An important element of this group's tasks is to analyze how tax collection and recovery can be integrated (or how this can be improved) in the global tax administration information system. The activities of these three project groups are coordinated by a Steering group.

It is important to note that this "best practices" work is done in close co-operation with IOTA: an IOTA delegate is regularly invited to meetings of this Steering group (on a basis of reciprocity), and the Fiscalis Steering Group already had a first joint meeting with the IOTA Area Group on Debt Management.

It is expected that preliminary reports of these project groups will be presented and discussed at a Fiscalis seminar in 2014, to which IOTA delegates would also be invited. However, the Recovery Committee has not waited that long to further develop and promote some of the ideas already presented during the project group discussions, and it appears that these project group activities have already increased the awareness of at least some Member States and their willingness to reflect and adapt themselves pro-actively. Small steps for tax authorities may lead to an important step forward in tax recovery!

New Methods in Taxation - Idea of the Common Standard VAT Return

HUNGARY

Csilla PETRILLA dr.
Legal adviser
National Tax and Customs Administration Hungary

Tel +36 96 509-586
E-mail: petrilla.csilla@nav.gov.hu

Ms Csilla Petrilla has a law degree. She has worked for the Hungarian tax administration for five years in the field of VAT audit. She is regularly involved in cross-border audits, participates at seminars and conferences on international matters. She also worked for the VAT department of the Ministry of Finance for three years.

By Csilla PETRILLA
Hungary

A seminar on the Standard VAT return - reducing administrative burdens and improving control took place in Portugal, Vilamoura in October 2012. The purpose of the seminar was to provide a dialogue with officials representing tax administrations of the EU Member States.

Introduction

The use of different VAT returns in Member States is considered to be an obstacle to the proper functioning of the internal market. Requiring different information in different languages, different rules and procedures for submission of the return poses difficulties for businesses wanting to establish and run a company in another member state. The estimated cost of completing VAT declarations in the EU is Euro 20 billion per year (29% of the total VAT administrative burden). Therefore the idea of implementing a common standard VAT return throughout all 27 Member States arose. In 2011 the Commission adopted a Communication on the future of VAT and will propose in 2013 that a standardised VAT declaration should be available in all languages and be optional for businesses across the EU. In the future proposal a fine balance has to be established between moving towards a simpler VAT system, reducing the tax burden for businesses and reinforcing or improving control on the part of the tax authorities.

Benefits of a common standard VAT return for business are considered to be as follows:

- Easier and higher rate of full compliance (especially from SME)
- Greater efficiency, less tax codes, less systems work, less operating costs
- Better use of technology
- Better risk management
- Smoother pan-European operations

For the tax administrations' benefits of a common standard VAT return would be:

- Higher rate of compliance, increased revenues (resources can be focused on fraudsters)
- Better comparable information
- Enabling for better risk management
- Easier and faster administrative cooperation
- Greater efficiency

In the opinion of business organizations, there are some practical issues on submitting a VAT return across Europe:

- Access to the relevant VAT return forms across EU 27
- Understanding, both from a content and a language perspective, on how to complete the VAT returns
- Gaining knowledge on where, how (paper or electronic) and when the VAT returns have to be submitted
- Businesses need to have easy access to the relevant forms
- Businesses need information in EN, FR or GE on how to complete the VAT returns, including which transactions have to be reported into which boxes of the return, how corrections work, etc.
- Businesses need easy, accessible information. Using an agent is costly and should not be a necessity.

From large business perspective submission of VAT returns in all EU Member States results in huge differences in layout, content and the different submission methods. Also the information regarding VAT and the return form required is different.

Having different returns and rules on compliance activities means having more complex processes and systems. Another impact is the need to recruit national VAT agents as a resource.

Large businesses involved welcomed the idea of a standard VAT return, as it would be an important step towards a more simple and efficient EU VAT system.

Representatives of SMEs find the idea rationalised but highlighted that i.e. the UK has 9 boxes to be completed, any increase in the number of boxes will be seen as an increase in the compliance burden for the taxable persons. For SMEs dual system of VAT returns would rise their costs.

Some member states expressed their concern on the use of the VAT return as a relevant source of information, not only for performing basic checks but also for assessing risk. They reiterated their concerns over the loss of information. Other MS added; the difficulties posed to control and risk analysis especially for comparison between different taxable persons and also the same taxable person when they change the declaration used. A question also arises as to whether tax authorities can cope with twin track returns, a dual system with both standard and national returns?

A majority of member states stressed the difficulty of managing a two declaration system. According to them a two declaration system would be very costly and almost impossible to run.

Study by PricewaterhouseCoopers (PWC)

PWC have prepared a study including business consultations and tax administration consultations. It aims at the development of the common return form, procedures for corrections and other issues. The study provided 2 options:

a) Optional EU VAT return for all business;
b) Optional EU VAT return only for businesses with VAT returns in more than one Member State

The study would allow use of the standard EU VAT return **alongside** national VAT returns but with the requirement for Member States to provide the option for all **taxable persons.** Some Member States could still decide on their own to **replace** their national return by the common standard. Taxable persons could opt in

1.General information

(11) Company name Intelligent box
(12) VAT-identification number: country code of the relevant EUMS + VAT number of the relevant EUMS
(13) VAT period

	2. Output transactions		3. VAT due			4. Input transactions		5. VAT deductible	
Standard rate		211		311	Local purchases		41		51
Reduced rate		212		312	IC acquisitions of goods		42		52
Other rates		213		313	IC purchases of services		43		53
IC supplies of goods		22			Imports of goods		44		54
IC supplies of services		23			Domestic reverse charge		45		55
Exports of goods		24			Other cross-border reverse charges		46		56
Other supplies with right of deduction		25			SUBTOTAL	Intelligent box	47	Intelligent box	57
Other supplies without right of deduction		26			Adjustments (+/–)				58
SUBTOTAL	Intelligent box	27	Intelligent box	32	TOTAL			Intelligent box	59
VAT due via reverse charge (including deferred import VAT)				33					
TOTAL			Intelligent box	34					

from the subsequent reporting period following notification and opt out not before the end of the calendar year following that in which the option was effective. There would be no restrictions based on turnover, nor based on authorisation by the tax authorities. According to the study, the content of the proposed standard EU VAT return would be as follows:

Filing mechanism

Only electronic submissions should be accepted for the standard EU VAT return and with a monthly filing for each taxable person.
The submission due date, as the payment due date, should be by the last day of the month following the reporting period.
For the electronic submission companies will use the e-VAT platform in the Member State where the company has to file their standard EU VAT return. The e-VAT platforms should have common procedures for registration, authentication, authorization and submission of the VAT return forms.

Corrections

For a standard VAT return a common approach for corrections is required. Corrections have to be made if the amount of correction reported in a given period exceeds:

- 50,000 euro;
- 1% of the average monthly turnover (i.e. the total amount of taxable transactions performed in the previous calendar year if the amount of corrections is below or equal to 50,000 euro).

Solutions to the problem of loss of information

To eliminate problems that would arise from loss of information one possible option is the Standard Audit File for Tax purposes, which is an OECD recommendation. Benefits identified with the use of SAF-T is that, being an electronic file, there is no need to produce paper reports and all or part of the audit activities can be made remotely from the business premises.
Specifically for the tax administrations, the SAF-T makes it easier to identify and quantify errors and therefore target their audit resources to risk areas. Therefore SAF-T might partially help on covering the loss of information some Member States will face if the common VAT return is adopted.
In Portugal SAF-T became mandatory on the 1st January 2008 for taxable persons subject to Corporate Income Tax who use IT tools for their accounting. The resulting file must state the data existing both in their invoicing and accounting systems.
Another example of implementing alternative tools for risk analyses purposes is the UK. There, the tax authorities use a predictive analytics model that combines the VAT return (comprising only of 9 boxes!) information with other information for risk analyses. Information is gathered from both internal and external sources in order to provide a detailed taxable person's risk assessment.

Final remarks

The seminar provided the opportunity for an open discussion by businesses and tax administrations, bringing together those who submit with those who receive the VAT returns. It also allowed an exchange of information and best practices without making any binding decisions or fixing any details of the future proposals of the Commission. Therefore the proposal of the common standard VAT return might be completely different in terms of its content and structure. At this Fiscalis meeting only the idea was outlined and discussed. As a conclusion we have to recognise that there are different visions on the nature of the VAT return. Member States whose VAT return is more demanding, fear that reducing information on it will invalidate their risk analysis systems. Nevertheless Member States whose VAT declaration is simple expressed their concern that a more complex standard VAT return would represent a higher burden on the taxpayer. In terms of costs for the tax administrations, costs are considered to be even higher with a dual system of VAT returns. Finally we have to keep in mind that the issues of tax administration mainly fall within the competence of the Member States and any decision on a technical or political level on this matter will be taken by the Council.

Compliance

Individuals and firms can evade taxes by underreporting incomes, sales, or wealth; by overstating deductions, exemptions, or credits; or by failing to file appropriate tax returns. Tax administrations must take the necessary actions to ensure compliance with the tax laws. Compliance includes various measures including the providing the best possible information to taxpayers, improving taxpayer services, benchmarking their activities and making collection and recovery of debt more efficient.

Grigori Davtyan from Armenia introduces a possible new solution whereby administrative requirements could be simplified in order to reduce the administrative burden for businesses as well as for tax administrations.
Tax debt management in Azerbaijan is described by Ilkin Veliyev. He takes a special look at information technologies that make tax compliance easier and more cost effective.

In Georgia in the last decade the taxation landscape has changed a lot, including legislation, organisational structure and compliance. Lily Begiashvili explains how they improved their compliance services to be able to change attitudes and to destroy the negative stereotypes linked to tax administration.

The use of Industry Benchmarks in Germany is explained by Martin Zöller. This benchmarking activity is carried out between the federal state in a standard format.

In Norway benchmarking between regions provided a positive experience. In Kjersti Pederesen's article it is described how the project achieved better results and how the participating regions are now closer to the desired results than ever.

OECD's perspective on ensuring tax compliance is presented by Pascal Saint-Amans. There is a perception that large multinational enterprises are increasingly adept at sheltering profits from taxation, eroding the tax base in countries which impose taxes and shifting profits to places where they are subject to low or no taxation. Addressing these challenges is important for all countries but it is particularly important for developing countries. Not only is an effective tax system necessary to ensure tax compliance but there is an ever growing need for international cooperation.

Kaja Zalewska and Magdalena Leki prepared an article based on their voluntary compliance experiences in Poland. It describes what initiatives tax administrations can undertake to change taxpayers' attitudes towards their tax obligations and create a long-term awareness of importance of paying taxes.

The Portuguese experience of new trends in governance is set out by José António de Azevedo Pereira. This article may be of special interest, as the Portuguese Tax Administration hopes to become the most innovative in Europe. Their goal is to become simpler, faster and less expensive, as well as offering a quicker and more effective response to taxpayer's queries.

The Serbian Tax Administration is improving its compliance management which is explained in detail by Aleksandar Dragojlović. This plan was undertaken by exploring new ways of working which could positively impact on compliance levels and taxpayer perceptions of the organization.

Influencing taxpayer behaviour is a complicated task, and new findings suggest new approaches. Traditionally it has been thought that compliance can be achieved purely through the high risk of detection and sanctions for non-compliance. Lennart Wittberg from Sweden offers an insight into new findings from research that can be used for strengthening compliance in, for instance, the field of behavioral economics.

Taxpayer Services in Armenia

ARMENIA

Grigori DAVTYAN
Head of Division for Taxpayer Service and Training
State Revenue Committee of the Government of the Republic of Armenia

7 Khorenatsi str. 0015 Yerevan, Armenia
Tel: +374 60 54 46 47
E-mail: grigori_davtyan@taxservices.am

Mr. DAVTYAN joined the Armenian tax authorities in 2004 and worked sequentially in areas of income and property declaration, and international tax relations. Starting from 2008, he leads a division responsible for elaboration and development of taxpayer services and trainings in the Armenian tax administration.

By Grigori DAVTYAN

Armenia

Background

Armenia is a former Soviet country which means that about 20 years ago no modern tax system existed here, so we can say that the tax system of our country was developed starting from its independence. This fact is particularly important to the Armenian tax administration as they have a situation, where all members of the population over 40 years old have personal experience of wealthy living without having to pay any taxes. I.e. there is a need for a change in the taxpaying culture of our country.

That is why, during the first 17 years of its development, the tax administration was characterized as severe and imposing a harsh regime of tax control and law enforcement rather than offering taxpayer services (TPSs). Things started to change from 2008, when the Armenian tax policymakers adopted a new Tax Administration Reform Strategy aimed at voluntary compliance, the building of service-oriented tax administration and the reduction of compliance costs without any reduction of tax rates. The main actions undertaken included:

- simplification of tax legislation and legal requirements,
- reduction of the administrative burden by implementing risk-based tax control procedures,
- broadening the use of IT in tax administration, and
- implementation of an effective range of taxpayer services.

Since 2008, the development of diversified and effective TPS's became one of the main priorities of the Armenian tax administration with their mission to: *"Provide taxpayers with a wide range of diversified services to assist them to voluntarily fulfil their obligations under tax legislation, with a special stress on (use of) the most effective communications in terms of taxpayer compliance and tax administration costs."*

How taxpayer services are organized in Armenia

The Armenian tax authorities have a single-level organisation, where all functions (accounting, procurements, HR management, etc) are centralised. However, each division is organised on a two-level management basis – the Headquarters and tax inspectorates (mostly distributed throughout the territories).

In the Headquarters almost all subdivisions (including IT, PR, Strategy, Legal, and other departments) are engaged in execution of TPS-related procedures to some extent. However, the core subdivision responsible for TPSs is the - Department for Taxpayer Service & Taxation Procedures, which also includes the Call Centre as an internal division. This Department is engaged in the writing and development of legislation, procedures and methodology, as well as the preparation and provision of information and training materials for both publication and use in training and PR events. They also provide written answers to questions posed by taxpayers and third parties whilst monitoring and coordinating the services provided by other TPS divisions. The Call Centre provides individual answers to taxpayers by phone and e-mail, gives approval to the taxpayers' suggestions, provides feedback to taxpayers, whilst summarising all requests for information received by any TPS subdivision and compiling a Q&A database.
At a local level there are:

- a network of TPS Centres, which are able to provide information on registration-related issues to the taxpayers, and
- information & analyses divisions (IADs) of the tax inspectorates, who are responsible for providing TPSs to businesses registered in the inspectorate.

Communications used for taxpayer services

The types of communication used by the Armenian tax authorities for rendering TPSs include: phone, electronic, paper, and in-person audio-visual communication. They are listed in order of priority in terms of taxpayer compliance and tax administration costs. Each of them has known advantages and disadvantages.
Communication is divided by addressees to: mass (addressed to all taxpayers or groups), or individuals.
In providing a diversity of TPSs the Armenian tax authorities see their mission as offering as many active services as possible.

Figure 1. Communication used for rendering TPSs.

	MASS	INDIVIDUAL
PHONE	sms-notifications and announcements	phone clarifications, notifications and announcements
ELECTRONIC	website, FAQ, electronic mass media & publications	e-clarifications, e-notifications, e-filing, e-invoices, etc
PAPER	periodicals, guides, brochures,	official clarifications,
	booklets, magazines, newspaper publications, etc	paper returns, paper notifications, etc
IN PERSON	meetings, forums, round-table discussions, seminars, workshops, etc	information visits to taxpayers, personal instruction in the TPS Centre, etc

Types of taxpayer services

The three main groups of taxpayer services provided, are recorded in the tax service legislation and include:

- information services: referring to the provision of taxpayers with any information about their rights and obligations under the law, provisions and requirements of tax legislation, complaints procedure,
- tax reports and payment services: relating to the provision of services ensuring taxpayers are able to fulfil their main tax obligations,
- other services: - services aimed at providing taxpayers with information of their rights and obligations stipulated under the (non-tax) legislation.

Information services

Information services; is the largest group and includes a variety of facilities, amongst which the most significant are:

1. Clarifications and FAQ

Relating to the Armenian tax legislation, where clarification actually represents a "question-answer" facility between taxpayer and tax officer in any tax matter. The Armenian law stipulates two types of clarification:

- Formal clarification, which corresponds to clarifying of concrete wordings or provisions of legal acts that objectively contain some ambiguity, discrepancy or contradiction. Such clarification should be requested in a stipulated written form and provided by tax authorities under the time constraints. In case of the failure of tax authorities to provide the requested

clarification in time, the taxpayer is eligible to apply the ambiguous provision at his/her own consideration without risk of penalties in case an application is recognized as non-compliant any further.

- Informal clarification, which relates to providing with information on a whole scope of tax issues at a taxpayer's request, except for the mentioned in clause "a". Informal clarification may be requested in any applicable way (phone, electronic, paper or in-person) and in free form. It has no legal force, i.e. it doesn't release the taxpayer from penalties in case if such a clarification is considered as non-compliant later on.

Under the special procedure, all requests for clarification received from taxpayers by any TPS subdivision, are subject to generalization and collection by the Call Centre. The latter compiles and periodically publishes the most frequently asked questions on the web.

2. Notifications and reminders

For TPS purposes, Armenian tax authorities practice four groups of notifications:

- *on deadlines for filing reports or making payments.* These notifications are automated and based on tax e-calendar service. Software automatically e-mails notifications to calendar subscribers.
- *on successful submittal of reports or payments made.* These notifications are also automatically e-mailed to electronic taxpayers by special software, while taxpayers, who file paper reports, may receive them upon specific request only.
- *on failure to file report or make pament in time.* These notifications to be manually e-mailed to electronic taxpayers, while others to be notified by phone. Additionally, taxpayers, whose tax dept exceeded AMD 500.0 thousand, should be notified on it in paper. Notification procedure for the latter stipulates a three-stage notification (reminders).
- *on discrepancies in reports filed or payments made.* These notifications to be initiated including reasoning and completed manually in a fixed form. Electronic taxpayers receive them by e-mail, while others - in paper and by mail. In some cases, notification procedure stipulates a three-stage notification (reminders).

3. Publications and guides

At the end of each year, Armenian tax authorities compile the list and schedule of publications (magazines, guides, books, brochures, leaflets and other informative materials), which should be elaborated, developed, published and distributed to the target groups of taxpayers during the next year. In common, the list includes two groups of publications:

- *regular publications,* like periodical magazines, tax legislative collections, booklets intended for the main groups of taxpayers.
- *instantaneous publications,* devoted to the expected legislative amendment or event, or considered to be of high interest for taxpayers in coming year.

4. Informative, training and PR events

The same principle of annual scheduling is applied by Armenian tax authorities to organisation of informative, training, and PR events as well.

Informative meetings proved to be an effective way of communication with taxpayers in Armenia. Organized publicly and in series, the meetings may involve up to the several thousands of participants. These events attain double goal:

- informative, i.e. providing participants with information on wide-interest and urgent topics;
- PR-related, i.e. forming a sense of transparency, cooperation, implication and confidence between tax authorities and taxpayers. Usually, these events find reflection in the central and regional mass media, which multiplies their efficacy.

Besides public informative meetings, the Armenian tax authorities practice individual informative visits to the newly established businesses at their request. During such visits, a competent officer provides taxpayers with the necessary instructions and answers the taxpayer's questions as well.

Figure 2. 'Harkatu' (Taxpayer) quarterly magazines - one of two large-format periodicals of the State Revenue Committee of Armenia - and the Tax & Customs Digests monthly periodical

Unlike informative meetings, *training events* require use of special techniques and tools to ensure that information rendered during the event was fixed in the memory of participants and necessary practical skills were adopted by trainees. For costs reasons, the Armenian tax authorities practice small-scale trainings only, and they are rendered to taxpayers by TPS Centres. To improve situation with taxpayer training, the Armenian tax authorities cooperate with public and private institutions rendering similar services to the taxpayers as well as encourage competent tax officers to extra-job in educational institutions.

Being aimed at mass media, PR events usually provide a few pieces of practical information to the taxpayers, but they are intended to direct taxpayers' attention on topics considered to be crucial or urgent.

5. Website information

The official website of the Armenian tax administration seems to become an information junction for enlarging an army of electronic taxpayers. Being conscious of this, tax authorities periodically modernize the website trying to turn it into a portal with an expansible scale of e-services and features intended for both taxpayers and tax officers.

Besides tax news, publications, statistics, laws, drafts, FAQ, feedback and so on, the website provides outer users with an access to the taxpayer virtual cabinet and taxpayer e-services. As of now, the list of latter includes: e-filing, e-notification, e-invoicing and e-mailing services. For inner users (tax officers), the website serves- as a remote access to the e-documentation service and main databases about taxpayers as well.

6. Info-terminals and stands

There are info-terminals mounted in all TPS Centres, which allow visitors to access: tax and customs service websites, taxpayer e-services, electronic customs clearance service, Armenian legislation database, FAQ.

Actually, terminals often used by the taxpayers, who wish to become acquainted with e-services at place or to file electronic report under the guidance of competent officer of the TPS Centre.

Tax reports and payments

Second group of TPSs relates to provision of proper conditions for taxpayers to file tax reports and make tax payments.

a. In Armenia, tax reports may be filed and sent to tax authorities:

- in paper, and sent either by mail or handed in-person to the competent tax officer;
- *electronically*, and either completed manually in online form or generated automatically by accounting software supporting any of 7 acceptable formats.

b. In 2011 the Armenian tax authorities implemented e-invoicing service, which allows electronic taxpayers to issue electronic invoices. With regard to such invoices, the taxpayer is released from duty to file report to the tax authorities.

c. Similar electronic service has been implemented in Armenia with regard to filing reports on turnovers of the cashier register machine (CRM). Taxpayers, who possess CRM with GPRS networking feature, may enjoy this automated reporting service and release themselves from duty to submit tax reports on CRM turnovers. Starting from 1 January 2013, only CRMs with GPRS networking feature will be permitted to use in Armenia, so all taxpayers will report their CRM turnovers in the automated mode.

Figure 3. Schematic illustration of the online filing processes

Other services

The last group of TPSs relates to provision the taxpayers with proper conditions to execute their rights and obligations under the non-tax legislation. These services include providing taxpayers with:

- different registrations stipulated by the law, e.g. granting Taxpayer Identification Numbers to entities that are not subject to "one-stop shop" incorporation/registration by Armenian State Register of Companies, registration of CRMs, registration of cash books and other accounting registers, etc;

- certificates, verifications, references and approvals stipulated by the law, e.g.: paper reference on paid taxes, certificates of Armenian tax residency, certificates on tax exemptions, signature verifications for bank purposes, etc;
- forms & blanks, e.g.: tax forms, excise stamps, enumerated invoices, etc.

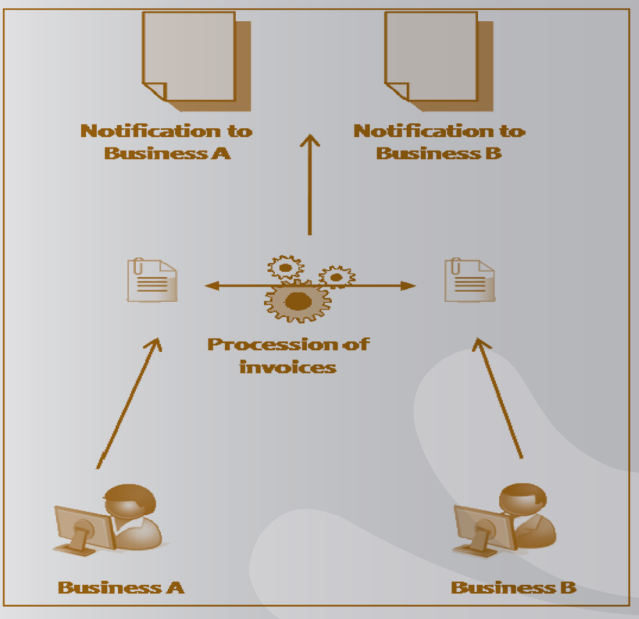


Figure 4. Schematic illustration of e-invoicing processes.

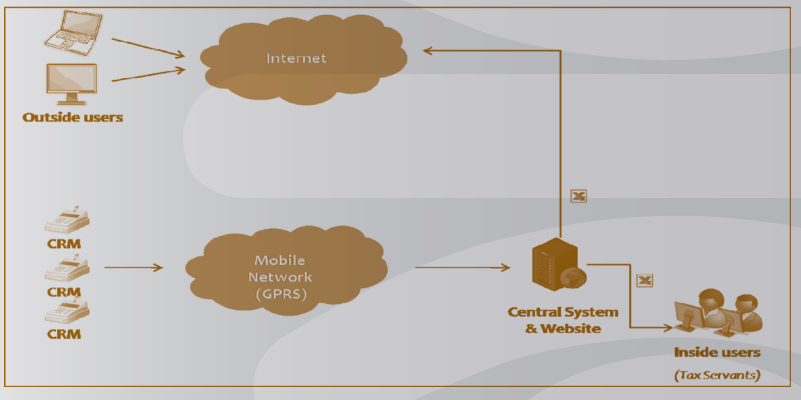


Figure 5. Schematic illustration of the CRM turnover reporting processes.

Instead of conclusion

This was a general overview of the most significant services rendered to taxpayers by Armenian tax authorities. Noteworthily the vast majority of the above-mentioned services were introduced during the last 4 years under the former TPS Strategy Program. Now Armenian tax authorities develop a new TPS Strategy Program for the coming 4 years.

The mainstreams of the coming Strategy is to keep the declared mission of TPS and continue reforms aimed at the establishing of effective organisation and range of TPSs based on the best international practices. Supposedly, the main directions, where actions to be undertaken during the coming years, would be:

- Further development of e-services and IT penetration in TPSs, e.g.:
  - to provide incentives to taxpayers, who voluntarily change to e-services,
  - to implement e-payment system,
  - to simplify e-services by removing the need for e-signature,
  - to apply web 2.0 and 3.0 tools for taxpayer information & training purposes,
  - to introduce mobile version of e-services;
- Further improvement of the quality of TPSs, e.g.:
  - to implement paid TP services,
  - to apply principles typical for business management in tax administration, e.g. «the customer is always right»;
- Further development of taxpayer training, e.g.:
  - to broaden training program for taxpayers,
  - to put into action new training premises & facili-ties of the Training Centre and the TPS Centres,
  - to adopt advanced training techniques and implement remote trainings for tax payers,
  - to deep cooperation with high and secondary schools in order to educate future taxpayers starting from their school desk;
  - Intensive PR policy to suppress propaganda of non-compliant behaviour, carried out by outer antagonistic groups.

Tax Debt Management in the Ministry of Taxes of Azerbaijan

AZERBAIJAN

Ilkin VELIYEV
Head of Debt Collection Department
Ministry of Taxes

L.Landau str. 16, AZ 1073, Baku, Azerbaijan
Tel +994 124038619
E-mail: i.veliyev@taxes.gov.az

Mr. Ilkin Veliyev has been working in the tax administration of Azerbaijan since 2002. He started his career as an auditor. From 2004 to 2010 he held several positions in the International Relations Department mainly performing such functions as exchange of information, bilateral cooperation with international organizations and tax administrations of European states. After working in the area of business registration for one year he has been appointed the Head of Debt Collection Department.

By Ilkin VELIYEV

Azerbaijan

Acknowledgment

Maximising the revenue collected by promoting tax compliance is a main responsibility of a tax administration. In today's world tax administrations apply information technologies to make tax compliance easier and also to reduce administrative and compliance costs. These approaches, which assist taxpayers to comply timely and fully with their obligations, increase the level of voluntary compliance.

The Ministry of Taxes of the Republic of Azerbaijan pays special attention to the process of recovering tax debts to ensure the inflow of tax revenues and an increase in voluntary compliance. This process is based on the strategic approach to debt management, effectively identifying and recovering tax debts as well as adequately monitoring and reporting tax officials' performance in managing the tax debt.

The tax system of the Republic of Azerbaijan is largely based on voluntary compliance, and most taxpayers (71% in 2011) pay their taxes on time. However, some taxpayers do not meet their obligations on time and become the subject of the debt recovering process.

Tax debt enforcement procedures

The debt recovery process is carried out by the debt collection divisions. The debt collection divisions are staffed by 220 employees which is approximately 10 percent of the total staff of the Ministry of Taxes. These divisions are responsible for the collection of unpaid taxes while still respecting the taxpayers' rights and obligations. According to tax legislation, taxpayers are obliged to be registered with the tax authorities, file tax returns on time, report complete information in their tax returns, and pay their taxes on time. Before starting the debt recovery process, officials in the debt collec-

tion divisions confirm whether taxpayers have met the above criteria or not.

If taxpayers do not fulfil their tax obligations on time the tax authority will enforce the collection of unpaid taxes in accordance with the provisions of the Tax Code. However, before starting debt collection enforcement procedures the tax authority sends a payment notification to the taxpayer and asks them to pay the due taxes voluntarily within 5 days. During this timeframe, the tax authority does not have the right to enforce collection of the debt. If the taxpayer does not pay the due amount within the period specified in the payment notification the tax authority can enforce compliance using a range of measures.

The tax authority sends an executive (payment) document to the taxpayers' bank in order to deduct their tax debt from their bank account immediately after the period indicated in the payment notification ends. In other words, the tax authority freezes the taxpayers' bank accounts. The tax authority does not need a court decision for doing this.

If the taxpayer does not have enough monetary to pay the debt, the executive (payment) document shall be paid by the bank and recovered by them from their customer as monies are paid into the account. At the same time, if a taxpayer does not meet his/her tax obligations within the period indicated in the payment notification, the tax authority can seize the taxpayer's property. Seizure of a taxpayers' property is carried out on the decision of the tax authority.

The seizure of property limits taxpayer's rights to their property. Under these restrictions, the taxpayer cannot manage and use the property and the ownership is controlled by the tax authority.

The seizure of property can be implemented in the following order:

- monetary means in cash;
- property that is not directly involved in the production of goods (securities, foreign currency, non-production premises, etc.);
- manufactured goods, as well as valuables not involved and/or not intended for direct production purposes;
- raw materials intended for production purposes (machinery, equipment, building, etc.);
- other property.

If the taxpayer fails to meet his/her tax obligations within 30 days after seizure of the property, the tax authority may appeal to the court for approval to sell the seized property at special auction in order to recover the required amount to cover the tax debt.

Carrying out on-site tax control within the framework of the debt enforcement process as well as temporary limitation of exit rights from the country are additional measures directed at collection of unpaid taxes. These two measures have been widely implemented in the second half of 2011 and considered as good practice in debt collection.

Figure 1: Debt collection procedures:

Sending the payment notification to the taxpayer	*Next day after occurrence of debt*
Sending the executive (payment) document to taxpayers' bank accounts	*Next day after 5 days period referred to in notification*
Seizure of taxpayers' property	*By the decision of the tax authority (in some cases court)*
Carry out tax control in the frame of debt enforcement process	*By the decision of the tax authority*
Temporary limitation of country exit rights	*By the decision of the court*

Tax debt management strategy

The Ministry of Taxes has a sensible tax compliance strategy. This strategy is based mainly on voluntary compliance that is clearly followed by all structural units of the MoT. Additionally, the tax debt management strategy has been effectively defined for recovering tax debts. The actions taken by the debt collection divisions to collect tax debts clearly align with the tax compliance strategy. We try to make it easy for taxpayers to comply, by informing them of their obligations and providing a mix of services to support the payment. If a taxpayer does not meet their tax obligation the debt collection divisions encourage and enforce compliance by a range of both automated and manual methods.

The early intervention into tax debt collection is one of the main principles of the tax debt management strategy. This process starts with the appropriate identification of tax debts.

The debt management system recognizes tax debts:

- when a return is filed but the payment was not made on time;
- when the return is not filed as expected (this can result in a default assessment being made, creating a tax debt);
- when a tax debt has been assessed by an audit.

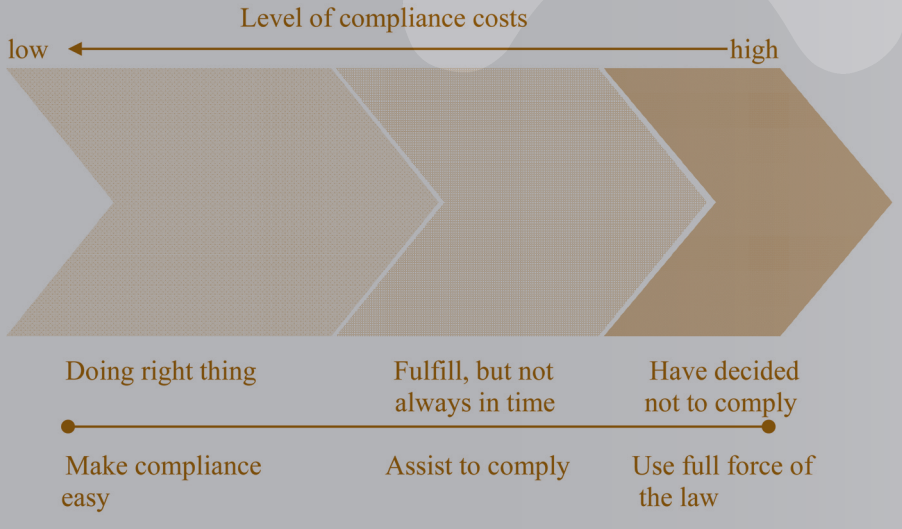
Automated debt recovery action accounts for about half of the debts collected by the MoT. Automated ac-

tions begin with a warning letter and short messages (SMS and voice messages). If the automated actions do not yield results, the debt officer carries out further actions.

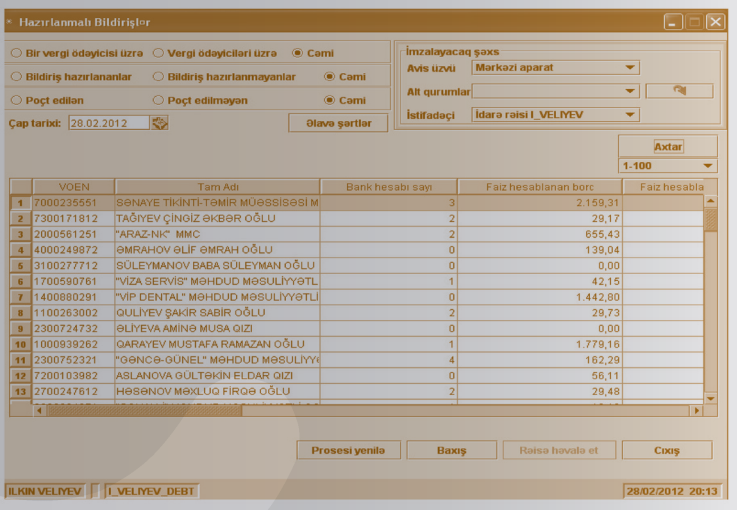
Investigation of the debt together with the taxpayer is considered a major step in the debt recovery process and is aimed at assisting taxpayers to comply without the need for enforcement action. During 2011, about 28,289 debt cases were investigated and 78 percent of debts were recovered. Before contacting a taxpayer, the debt officer evaluates the liquidity and level of compliance of the taxpayer using data provided by the taxpayer and third parties. If the taxpayer has temporary financial difficulties, the fulfilment of their tax obligations can be postponed. The law is applied with its full force if the taxpayer does not respond and/or the result of the evaluation shows that the taxpayer does not want to comply.

Debt collection techniques require the balancing of costs and benefits, including protecting the integrity of the tax system. The MoT is aware that, for some techniques, the costs may exceed the tax collected, at least initially. We consider costs, benefits and the integrity of the tax system when deciding whether to proceed with an action. Evaluation of administrative costs in managing small debts is another important point in the debt management strategy. In accordance with this strategy, collection of small debts is carried out primarily by automated procedures (SMS, voice messages, electronic notification on payment) that periodically notify taxpayers.

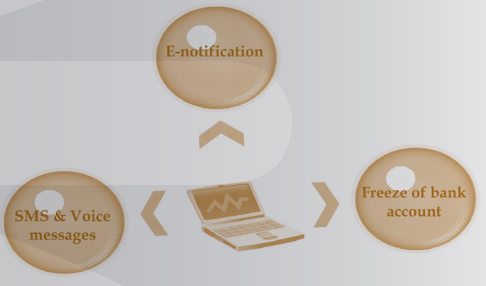
The tax debt management strategy shows how taxpayers' attitudes toward compliance relate to the actions of MoT in encouraging and enforcing compliance.



Automation of the debt collection process



The Automated Tax Information System (AVIS) was implemented in order to ensure that the necessary information was available to support an effective and flexible tax policy. This information system, which is reliable, safe and open to integration by external systems, allows the automation of activities of local tax authorities, integration with other authorities, and selection of taxpayers for tax audits by the use of special models that are based on international experience. It is also used for carrying out different forecasting and analyses. With the implementation of this system, all activities of the tax authority are carried out automatically and with this transparency it has been ensured and the quality of services to taxpayers increased.



AVIS helps debt officers to carry out a more flexible range of automated actions, based on a wider range of information about taxpayers that help it better to collect tax debts. The tax administration can identify tax debts and allocate debt cases among debt officers by using AVIS. Once a tax debt is identified, the debt officer opens an e-debt file where information about all actions

taken to recover tax debt is recorded automatically.
All types of taxpayer actions begin with a warning letter or short messages (SMS and voice messages) sent by AVIS automatically. After this action, if the debt remains unpaid, an executive (payment) document is automatically sent to taxpayers' bank accounts in order to deduct the tax debt to state budget immediately (freeze of bank account).
During the second half of 2011 the tax debt management strategy was updated in order to recover tax debts more effectively. This efficiency is reflected in the tax debt management performance.

New Ways of Ensuring Tax Compliance in Georgia

GEORGIA

Lily BEGIASHVILI
Deputy Director General
Georgia Revenue Service

16, V. Gorgasali Str., Tbilisi 0114, Georgia
Tel +995 577 055 211
E-mail: lily@rs.ge

Ms. Begiashvili graduated from Tbilisi State University Faculty of Law in 1994. In 2003 she has received a LL.M degree from the University of Illinois. From September 2009 Ms. BEGIASHVILI started to work at the Georgia Revenue Service as a Deputy Director General. Before she worked as a legal advisor to the International Finance Corporation, WB.

By Lily BEGIASHVILI

Georgia

After the 2003 Rose Revolution, a range of reforms introduced by the government of Georgia has touched every sphere of life, including the tax field. Proactive reforms initiated within the tax administration are an integrated part of the national strategy aimed at combating corruption and introduction of international approaches to different fields.

The coalition of tax and customs administrations and the introduction of the Georgia Revenue Service in 2007 not only saved administrative resources, but also accelerated the process of transformation and harmonization. Since then the Service has gone through lots of changes. Especially productive were the last couple of years, from 2010 to date in particular, when the Service made a significant and noticeable transformation from aggressive to generous, taxpayer-oriented approaches. The first step in this transformation was the simplification of the Tax Code and the lightening of taxpayers' tax burden in particular, with a reduction in the number of types of taxes from 21 to only 6.

Tax	Rate
1. Income tax	20%
2. VAT	18%
3. Profit tax	15%
4. Tax on import	0%; 5%; 12%
5. Excise tax	Differing by goods
6. Property tax	up to 1%

The Georgia Revenue Service set a goal to destroy an old stereotype, according to which tax administration was associated with, as a violent "racketeer" body. The main principles the Georgia Revenue Service follow are these: simplicity; transparency and fairness of the tax system; business support and encouragement and creation of appropriate environment for their development.

In order to defend those principles, a number of reforms has been conducted and new institutions introduced, including:

- Risk-based audit;
- Web-portal, electronic services;
- District tax officer;

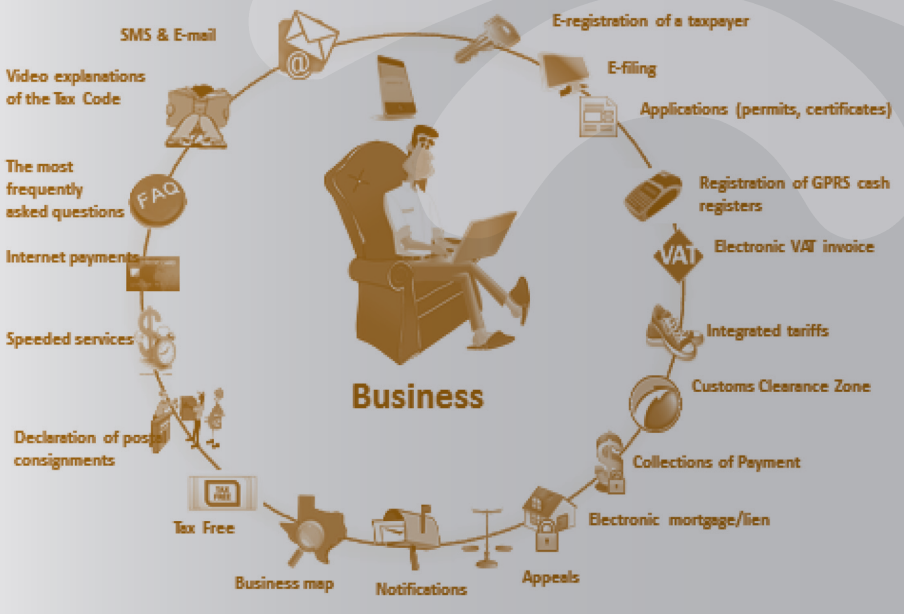
- Personal tax adviser;
- Alternative audit.

Risk-based audit

It fundamentally changed tax audit methodology and grounds – taxpayers' selection for audit is determined by a computer system, used by the audit department that does various types of analyses and assessments.
If only "blind examination" was certified in past, and no risk-factors were taken into consideration; beginning with 2010 only those taxpayers become subject to inspection, whose activities involve elements of non-compliance and risks of tax evasion. The Georgia Revenue Service has introduced various risk criteria and each criterium is weighted. If the gross number of all criteria sums up a particular number of points, the taxpayer is deemed to represent high risk of tax evasion and a tax audit is initiated.

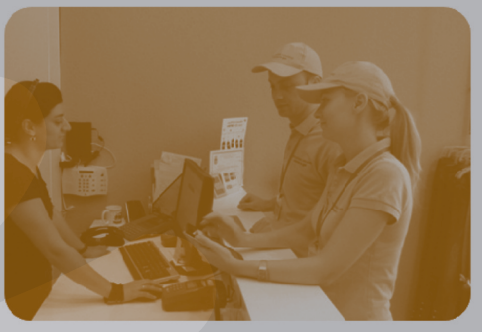
Web-portal – www.rs.ge

For the higher comfort of taxpayers the Georgia Revenue Service has established various types of electronic services. Modern infrastructure is an essential element for providing taxpayer-oriented services.
It was a great achievement of the Georgia Revenue Service to develop a web-portal, which is not only a web-page, where one can pick information on the Revenue Service structure or its activities, but this is a portal for numerous services saving taxpayers time, energy and money.



Via the web-portal, without leaving an office/home and at no charge one can communicate with the tax administration; to file tax returns electronically; to issue VAT invoice electronically; to pay electronically; to submit documents electronically, etc. On the web-portal one can find text and video versions of the Tax Code of Georgia, providing simple explanations for the Tax Code provisions. The web-portal also serves as a tutor for taxpayers and other interested individuals through creating and placing various questionnaires/tests on it.

District Tax Officers



In 2011 the institute of district tax officers has been introduced. Their main function is to assist and consult taxpayers.
Each tax officer has a dedicated district where they walk around, meet taxpayers who run their business in the district and do assist them by providing consultancy services, informing taxpayers on amendments made to the Tax Code or other regulations, responding to taxpayers' questions, etc.
With the assistance of district tax officers, who are equipped with electronic devices, one can make use of multiple services on the spot, which in the past could be provided at service centres alone.
District tax officers are not authorized to impose penalties, they are rather focusing on consultation, assistance and all they can do is to warn taxpayers of consequences of breaching law and trying to avoid tax payment. Taxpayers are eligible to discuss issues of their interest with district tax officers and no tax audit will be initiated against a taxpayer when non-compliance is detected.

To date the project has covered almost all districts around the country.
District tax officers are equipped with Samsung Galaxy Tabs.
Galaxy Tabs enable tax officers to perform the following functions:

1. passportization;
2. passportization history;
3. RS map;
4. taxpayer's card;
5. Q&A;
6. Tax bulletin;
7. warning on violation;
8. taxpayer's registration;

Personal tax advisor

The Georgia Revenue Service has introduced a new institution, that of personal tax advisor. The taxpayer is eligible to make use of the district tax officer service while implementing rights and fulfilling obligations set out in the tax legislation. A personal tax advisor represents the taxpayer's rights at the tax administration; consults the taxpayer and assists in their performing tax obligations. The personal tax advisor is employed by the Tax Administration, which renders services on a contractual basis. The relationship between taxpayer and tax advisor; terms of service, scope and types of services are all set out in agreement concluded between taxpayer and tax advisor. The Personal Tax Advisor's service has been introduced on October 2010 and was intended for large taxpayers use exclusively. By the end of the year, as many as 78 agreements have been concluded. To date, more than 250 companies have joined the project, 80% out of which are large taxpayers.

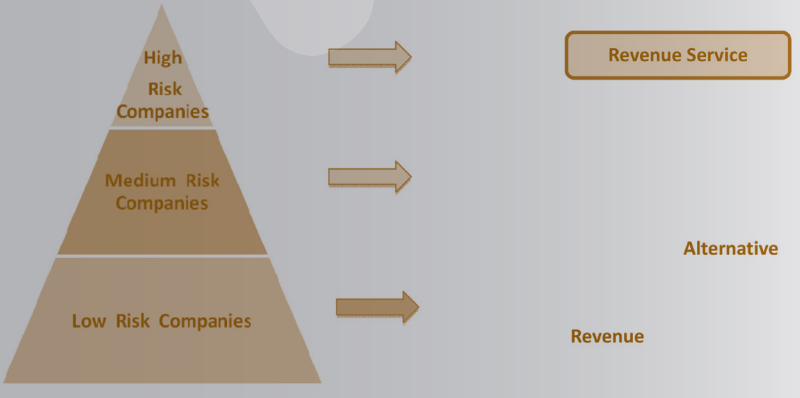
Alternative Audit

Beginning with 2012, the Georgia Revenue Service has launched a new project of the Alternative Audit. The project implies that taxpayers having been classified as low-risk taxpayers, have the right to choose auditing services to be provided by the private audit companies- rather than being audited by state auditors. On the one hand the project encourages the audit department to outsource part of its functions to private auditors and so focus more on medium and high-risk taxpayers. On the other hand, the project creates incentives for developing a competitive market for private audit companies.

The alternative audit service is provided on a contractual basis. The project is performed according to the following scheme:
In order to carry out an alternative audit, private audit companies are divided into 3 categories: A, B and C.

- taxpayers, with an annual turnover under 300,000 GEL, have the right to choose a "C" category company for an audit service provision;
- taxpayers, with an annual turnover under 3,000,000 GEL, have the right to choose a "B" category company for an audit service provision; and
- taxpayers, whose annual turnover exceeds 3,000,000 GEL, have the right to choose only an "A" category company for an audit service provision;

Service price must be agreed between parties.
The advantage of the project is that taxpayers do not become subject to penalty if non-compliance is detected, instead they are given opportunity to correct



defects. In addition, the taxpayer who makes use of an alternative auditor's service, has the right to correct its tax return that had been filled in and filed to the tax

administration incorrectly without imposing the penalties for the fact. The Examination report issued by an alternative auditor has the legal power equivalent to that of a state auditor, as alternative auditors follow the same guidelines as state auditors in their activities.

All activities described above were intended to create a favourable environment for domestic and foreign businesses. As a result, taxpayers changed their attitude towards the tax administration and now treat it as a trustworthy body; the knowledge and awareness of taxpayers has increased and revenue has grown.

The Use of Industry Benchmarks in Germany - The German Richtsatzsammlung

GERMANY

Martin ZÖLLER
Senior Tax Auditor
Bavarian Tax Administration

Prinzregentplatz 2, D-86152 Augsburg, Germany
Tel +49 821 5061745
E-mail: martin.zoeller@fa103.stv.bayern.de

Mr. Zöller is tax auditor since 1999 and member of trainer team for new auditors in Bavaria, Germany. He is a local specialist for EDP (electronic data processing) related to tax audit. He is also an expert within several EU-projects related to "Indirect Methods"

By Martin ZÖLLER

Germany

The German tax administration uses industry benchmarks as a general method for validating tax returns. In addition to the benchmarks which are available online, e.g. compiled by industry associations, the tax administrations in Germany also collate figures themselves. The underlying principle is that there should be similar benchmarks for businesses which are in the same industry and have a comparable structure in terms of business volume.

To gather this information, numerous audits are undertaken every year. The main purpose of these audits is not to validate tax returns, but rather to collect the appropriate data from businesses' accounts. To ensure the data obtained is representative of ordinary businesses, only taxpayers without any anomalies are chosen. The data are standardized as far as is necessary. The collected data are evaluated and published annually on the website of the Federal Ministry of Finance (www.bundesfinanzministerium.de) where they are freely available to every taxpayer and tax advisor.

Naturally, all of the information established during a tax audit is covered by tax secrecy. Nevertheless, Germany's Fiscal Code (*Abgabenordnung*) allows data to be collected and evaluated – especially for the purposes of extracting benchmark figures.

The German *Richtsatzsammlung* contains up to four different ratios for 75 different businesses. The ratios express the relation of turnover to a specific amount of the expenses.

The ratios are as follows:

- **Gross profit ratio I:** (Turnover – purchases) / turnover
- **Gross profit ratio II:** (Gross profit I – wages related to production) / turnover)
- **Intermediate profit ratio:** (Gross profit II – general business expenses / turnover)
- **Net profit ratio:** (Intermediate profit – specific business expenses / turnover)

Whereas Gross profit ratio I is used for trading businesses such as retailers, Gross profit ratio II is used for manufacturers.

Although only businesses that are of equal size and which come from the same branch are compared, there is no assumption that the results of these audits will deliver absolutely uniform results for all of the audited taxpayers. This means that in addition to the average which was found in the majority of all audited cases, an upper and lower limit is also given which can also be assumed to be customary. Audited taxpayers are considered to be suspicious only if they fall outside of this range.

Because economic circumstances are very homogeneous all over Germany nowadays, only one figure is stated for the country as whole. In former times there were different values for some branches in different geographical regions, e.g., after the reunification of East and West Germany.

Example for a retail business (Gross profit ratio I)

Branch / Turnover	Gross Profit I	Gross Profit II	Intermediate Profit	Net Profit
Pharmacy				
all	25-31 **28**		16-25 **20**	5-13 **9**

Example for a manufacturing business (Gross profit ratio II)

Branch / Turnover	Gross Profit I	Gross Profit II	Intermediate Profit	Net Profit
Building contractor				
Up to EUR200,000		39-81 **57**	14-54 **32**	11-52 **27**
EUR200,000 to EUR500,000		32-61 **44**	9-30 **19**	5-25 **14**
Over EUR500,000		23-52 **36**	6-25 **15**	2-18 **10**

The values can be used in two different ways. Firstly, the tax officers dealing with the tax assessment can verify whether the taxpayer is suspicious simply on the basis of this data alone. Secondly, the tax liability can be estimated if the accounts are incomplete, false or not available.

Advantages

The advantage of the Richtsatzsammlung is that it is very easy to use. The current ratio can be determined and compared with the Richtsatzsammlung simply by using some figures from the accounts. The Richtsatzsammlung is known to all those working within the tax administration, and not just to the auditors, which means it can be used in every stage of the taxation process. It is therefore used within field audits as well as simply to ascertain the need for auditing a taxpayer during tax assessment.

Disadvantages

Naturally, there are disadvantages as well. Because it is published it is also known to persons planning fraudulent actions. Tax evaders can consequently adjust their incorrect accounts so that they stay within the limits of the Richtsatzsammlung, and do not, therefore, become conspicuous. In some cases, there is a very large difference between the upper and lower limits. This means that there is a great deal of uncertainty in this method. And because there can be many circumstances that influence the ratios, the German fiscal courts do not take the view that account figures above or below the limits of the Richtsatzsammlung are proof that the accounts are false.

Effective regional Benchmarking

NORWAY

Kjersti PEDERSEN
Senior Tax Auditor
Norwegian Tax Administration

Norwegian Tax Administration, Region South, Norway
Tel +47 975 706 88
E-mail: kjersti.pedersen@skatteetaten.no

Ms. PEDERSEN has been working in the Norwegian Tax Administration since 1986 and has experience from many of the main activities. For the last 3 years she has been working in the regional staff, in the team "Steering and Analysis".

By Kjersti PEDERSEN

Norway

This is a presentation of how two regions in Norway managed to start and implement benchmarking as a way to achieve better results. In the following I will share with you what we have done, how we did it and what we have achieved.

From 1st January 2008 we have only two levels; the Directorate of taxes and 5 geographical regions plus the specialised offices for oil taxation and the tax information office.
The 5 regions are divided by geographical borders and each of the regions has the same structure in organisation and an equal number of tasks. The regions are responsible for managing both VAT and other taxes for all the inhabitants in that particular region. In general there is a balance between resources and numbers of declarations (VAT and taxes).

This exercise started in February 2010 on the initiative of the two regional tax directors in region West and region South. These two regions are the most similar of the five regions, and therefore a good starting point for benchmarking. Placed on the map, region West has the blue colour and region South has the dark lilac colour.
Here is a brief overview of the two regions. Numbers and results for region South are in brackets:

Number of inhabitants: 1,040,000 (960,000)
Employees in region: 840 (780)
Numbers of personal tax payers: 860,000 (800,000)
Numbers of taxable companies: 55,000 (52,000)
Number liable to VAT: 62,000 (65,000)

When the regions were established in January 2008 we were a "new" organisation and because of that there was a need to collect comparable facts about the two regions.

From the start we established a benchmarking-team consisting of members of staff from both regions. Since this kind of work had never been done be-

fore at this level, we had the feeling of ploughing a field for the first time.

The benchmarking-team started the process with working out some kind of framework. We wrote down a list of all our main activities and tried to compare them using relevant quantity and quality indicators. If possible, we also recorded the time of the procedure and resource costs.
At this stage we met our first big challenge. Input was taken from several different systems and some of the systems did not have the necessary levels of detail to enable us to compare with the chosen quantity or quality indicators. So we had to do some adjustments.

It did not take a long time before we saw the benefit of using high quality data in our input. We also very soon experienced that it was important to collect input from the same sources and in the same way in both regions. If not, we could not compare.
During our work with finding numbers and results from the different sources we saw that in the moment we mixed these numbers and the results from some of our activities together we got very different results in the two regions. We found that the only right thing to do was to involve the specialists from the activities concerned to make sure we compared apples with apples. The specialists also engaged themselves in getting the right numbers and results in order to make their "picture" right.

In Tax Norway we have an electronic system where every one of the employees has to record what we have used our time at work for. This system is supposed to match all our different activities at a reasonably detailed level and everyone is supposed to register 100% of their time at work. In the benchmarking we used the results from this system to calculate productivity. Using the results from this system had never been done before, at least not at such a detailed, regional level, so this became a really eye-opener for all of us. For the year 2008 one team managed to register more than 112% of their time at work whilst another team only managed to register about 88% of their time. We all agreed that we had to do something about these poor results. For 2011 the results are totally acceptable.

By going through this process with the specialists from our different activities I believe we moved from a picture of our different activities made by the staff to a picture the specialists accepted as the right picture for their activities.
With this liaison with the specialists over quality in input and results, they saw the need for improvement in some areas too, and the value of the benchmarking project also increased by this involvement.

What have we learned from this project?
During our work we could feel a sense of suspicion. Some asked us if there was a hidden agenda somewhere and how our top leaders were going to use the benchmarking results further. To address this suspicion it is of great importance that the aim of the project is open and clear and leaves no doubts about the purpose in it.

Quality and quantity in input is important to make sure you have a high standard product at the end. It is necessary to take all the time needed to make sure that we compare apples with apples. We used a lot of time on that, and I think it did something towards the acceptance and ownership of this benchmarking exercise.

Norwegians are not normally very open. The first time we published the numbers and results from the benchmarking some of our leaders got a little bit of a shock, especially from the calculations on productivity of all our main activities were a new dimension for many. It is much easier to try to explain or defend differences in results rather than wonder about why and what caused these differences. Now we are more open, not trying to defend or disguise our results and some of our leaders use productivity as a support for their strategic planning at operational level as if they have always done it that way.

I think benchmarking has contributed a little towards

a change in our culture and if it had not been for the engagement and clear initiative from our top leaders, this benchmarking would not be alive as a living document today.

The overall wish at the start of this project was to achieve better results. Both regions are now closer to our desired results than ever. It would be wrong to say that benchmarking alone has caused this improvement, but we are sure that the project has contributed to it.

New Ways of Ensuring Tax Compliance – A Perspective from the OECD

OECD

Pascal SAINT-AMANS
Director, Centre for Tax Policy and Administration
Organisation for Economic Cooperation and Development

2 rue André Pascal, 75775 Paris Cedex 16
Tel +33 1 45 24 91 08
E-mail: pascal.saint-amans@oecd.org

Pascal Saint-Amans, a French national, took up his duties as Director of the Centre for Tax Policy and Administration at the OECD on 1 February 2012. He joined the OECD in September 2007 as Head of the International Co-operation and Tax Competition Division in the CTPA and played a key role in the advancement of the OECD tax transparency agenda in the context of the G20. In October 2009 he was appointed Head of the Global Forum Division created to service the Global Forum on Transparency and Exchange of Information for Tax Purposes.

By Pascal SAINT-AMANS

OECD

Ensuring tax compliance has never been more important than it is today. Governments across the world are having to rebuild public finances by repaying debt, reducing expenditure and sustaining or increasing revenues. At the same time there is a perception that the better off and large multinational enterprises in particular, are increasingly adept at sheltering profits from taxation, eroding the tax base in countries which impose taxes and shifting profits to places where they are subject to low or no taxation. That perception has an impact on tax morale as citizens wonder if large companies are really paying their fair share and whether we are truly "all in this together". Addressing these challenges is important for all countries but it is particularly important for developing countries. There is an increasing recognition that an effective tax system has a central role to play in mobilising the resources these countries need to build and develop their civil societies.

How are tax administrations responding to the challenge? My perspective on that reaches beyond the members of the OECD, as I will be drawing on the work of the Forum on Tax Administration (FTA). The 43 members of the FTA come together at Commissioner level and it includes the G20, the BRICS and a number of emerging economies. Between them the FTA commissioners are responsible for the majority of global revenue collection. Collectively they are focused on finding new ways of ensuring compliance at a lower cost and their approach relies on certain essential building blocks. These comprise a set of strategic trends in tax compliance that the FTA has helped to develop in recent years:

- The application of risk management principles, not only as a way of setting priorities and allocating resources, but also as a new way of thinking about tax administration work;
- The shift of performance management focus from output measures (reflecting the extent of activities carried out) towards outcome

measures (reflecting how these activities actually contribute to achieving objectives); and
- The development of innovative and more sophisticated strategies relying on a much broader toolbox, including some innovative approaches seeking to address risks in more cost-effective ways.

The principles and practice of risk management have been a focus of the FTA's work on compliance for some years now (details of the relevant publications can be found at (http://www.oecd.org/site/ctpfta/productspublications.htm). More recently, strategic thinking about compliance has become increasingly focused on outcomes rather than outputs. This is a logical consequence of new ways of working that extend well beyond traditional audit programmes. An increased emphasis on prevention and cooperation with taxpayers calls for a different way of thinking about success in compliance. At the same time it accentuates the need to track the true impact of activities, as they are often experimental in nature. Without reliable feedback it is not possible to learn from these experiments. But the development of reliable measures of compliance outcomes is not without its challenges. One of the appeals of traditional compliance output measures is that they are relatively easy to count; numbers of audits and intervention yield for example. But as we know, these output measures hide as much as they reveal. Is it a good or a bad thing if many audits are carried out and if they result in a large amount of adjustments? Is it progress if these numbers increase year after year? The answers are often less than clear-cut (and sometimes even quite disturbing) once you start thinking about how these activities actually contribute to the desired state: high levels of voluntary compliance that do not rely on extensive and expensive intervention by the tax administration.

For all their faults, traditional output measures are relatively easy to understand and they are easy to boil down to headline figures for external consumption. The awkward truth is that outcomes are both harder to measure and to communicate. For that reason, a key focus for the work we are doing in the review of the enhanced relationship 5 years on, to which I will return, is how to demonstrate the value of such initiatives, not just to ourselves but to key stakeholders in wider society. The approach needs to be grounded in the practical realities that tax administrations must deal with at a time when resources are scarce and governments are anxious about their revenues. Nonetheless the direction of travel is clear, driven both by an increased understanding of the flaws in traditional measures and the increasing pace of innovation in tax compliance.

In the space available I can only discuss a few examples of these recent innovations but I hope they serve to illustrate the pace of change and invention.

Tax administrations are developing much more sophisticated compliance strategies that draw on behavioural insights and sophisticated analytics to drive a greater variety of better targeted interventions. Traditional one-on-one audits will continue to be part of the toolkit used by tax administrations but often they will be the last rather than the first response. Interventions that influence compliance behaviour through more innovative one-on-many approaches often represent much better value for money. Tax administrations are also spending more time and energy on prevention and early treatment, as distinct from downstream and more expensive (for them and for taxpayers) remedial treatments. This type of action can even be taken in real-time. For example, in Denmark they have introduced a degree of intelligence to the on line filing process for private individuals and in Chile they have done the same for VAT returns. In both cases taxpayers receive a prompt during the filing process if the data in their return conflicts with third-party data already held by the tax administration. Often this will cause taxpayers to correct their returns, eliminating the need for later interventions. There is also a clear trend towards placing a limit on the use of cash for business transactions (most recently in Spain) coupled with other preventative treatments this will help in the effort to reduce the size of the underground economy.

The use of third-party data to verify returns, or even generate pre-filled returns, is just one example of how tax administrations rely on technology for smoother processes and better compliance outcomes. The emergence of new technologies and new forms of service provision provide new opportunities. For instance, the provision of cloud-based accounting systems coupled with electronic invoicing and payment systems may provide the infrastructure for new forms of managing SME compliance. That's something we are exploring in more depth as part of the FTA's current work programme and in particular the scope to apply the enhanced relationship concept to the SME sector.

I said I would return to the subject of the enhanced relationship, or cooperative compliance as I prefer to call it. The use of the word "enhanced" can give the erroneous impression that this is about giving some taxpayers benefits that are not available to all. The truth is that this is one way, albeit a more efficient way for both parties, to achieve the result that is the common goal of all compliance work: the timely payment of the correct

tax. The development of a co-operative approach to compliance has been most pronounced for large businesses and a number of tax administrations have fostered a more cooperative relationship with large businesses. At the heart of the cooperative relationship is an exchange of transparency (credible internal control systems and disclosure of uncertain tax positions) for early certainty. In the large business segment it is now nearly 5 years since this concept was first discussed in the Study on the Role of Intermediaries (FTA-2008). So now is a good time to take stock, which is what we are doing in a wide-ranging project being led by the Netherlands. That study will include a review of what programmes of this kind have achieved and, specifically, how you measure that. It is a specific example of work designed to address the practical challenges that we all face in achieving a shift from the traditional output focus to outcomes.

Tax administrations are now looking to adapt the cooperative compliance approach to fit the SME segment. Here co-operation with intermediaries (advisers but increasingly other intermediaries too, such as the providers of IT services to SMEs) will be vital. This too is something the FTA has targeted with a specific project, which is being led by Norway.
I also see tax administrations making more strategic use of media and communications to enhance compliance. I see less negative communication which tends to give the impression that non-compliance is widespread, even when this is not the case. Nowadays communications are much more likely to be framed around messages that encourage compliance, and to explore the links with broader themes in government that will underline the benefits to society and citizens of good tax compliance. Some are also starting to explore the potential uses of social media but it is fair to say that they are proceeding with caution, which is almost certainly wise.

Finally, it is worth recognising that there is an increasing tendency to revisit legislation on the basis of what tax administrations learn through their compliance activities. The experience so far is very encouraging, as even minor changes to legislation can sometimes lead to significant gains for the government, taxpayers and society as a whole.

So far I have mainly focused on how tax compliance is being improved through domestic measures but the international perspective is more and more important as the global economy becomes increasingly integrated. Improving ways in which the international tax system works, to support improved compliance, is a central purpose of the work of the CTPA. The work that Working Party 6 has taken forward on business restructuring and is now doing on intangibles is a critical part of that and could occupy several articles in its own right. In this article I will just touch briefly on the transfer pricing simplification work we are doing, as it illustrates how we are working to make the international tax system more efficient and so help ensure compliance at that level. In March we held the first meeting of the OECD's Global Forum on Transfer Pricing, bringing together tax officials from 90 countries. As Secretary-General Angel Gurría emphasised when opening the Forum, "the time has come to simplify the rules and alleviate the compliance burden for both tax authorities and taxpayers. Because complicated rules can be a barrier to cross-border trade and investment and place a heavy burden on tax administrations and businesses, we are making our approach simpler without making it arbitrary."
So I see it as essential to simplify and strengthen the transfer pricing rules for the benefit of both developed and developing economies, as well as for businesses. We need to take into account the views of all countries to ensure that the rules will be applied in a globally consistent manner - eliminating double taxation and avoiding double exemption. The Global Forum will play a critical role in achieving this objective.

And we are not neglecting the more practical aspects either. The FTA's study on the challenges of transfer pricing discusses how best to manage a transfer pricing programme and identifies a number of best practices. (http://www.oecd.org/ctp/taxadministration/dealing-effectivelywiththechallengesoftransferpricing.htm). It also discusses the particular challenges that developing countries face in tackling transfer pricing issues. This is an issue that we will be actively working on as we explore the feasibility of creating a panel of experts who can help developing countries progress complex international cases, a concept we are calling "Tax Inspectors Without Borders". There is more that we can do on the practical side, particularly in the field of dispute resolution and dispute prevention. Improving the efficiency of the MAP process, not just in bilateral but also in multilateral cases, is a shared challenge we must address. We also need to reap the benefits of real time working, which are proving themselves in the domestic context, at the international level as well. I am pleased that the multilateral dimension of cooperative compliance is something that the FTA study I referred to earlier will be looking at.
Looking beyond transfer pricing, I see steady improvement in the scope and depth of international cooperation. The Global Forum on Transparency and Exchange

of Information in Tax Matters now has 108 members and is conducting an extensive programme of peer reviews that is delivering improved and comprehensive information exchange. All G20 countries have now signed or made a firm commitment to sign the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. More countries will be signing up to the convention this autumn. And there is the work the OECD is doing to assist with the response to the Foreign Account Tax Compliance Act (FATCA). On 26 July 2012 the United States, France, Germany, Italy, Spain and the United Kingdom released a Model Intergovernmental Agreement which allows for the implementation of FATCA through automatic exchange between governments, which reduces compliance costs for financial institutions and provides for reciprocity. I expect that many countries will enter into such an agreement with the US. We will be working with interested countries to adapt the terms of the agreement to create a common model for automatic exchange of information.

The second Forum on Tax and Crime was held in Rome in June 2012. Over 250 delegates participated in this event, including Ministers and senior officials from over 60 jurisdictions, as well as specialists from the OECD, the World Bank, the IMF, the FATF and the UN; non-governmental organisations, and the private sector.

This is an impressive catalogue of activity and there is more that I could have mentioned. But I want to finish by saying a little more about the issue I raised at the outset: base erosion, profit shifting and the impact on tax morale.

Concerns about base erosion and profit shifting are not just the product of media froth and opportunism by groups seeking to exploit the issue to critique globalisation and big business. Governments are concerned too about the shifting of profits away from the countries in which MNEs are based, whether that is their "home" country, if I can put it that way, or other countries in which they are conducting substantive activity. In this the interests of developed and developing countries are aligned and the potential impact on tax morale in all countries is real enough. This is not just about protecting revenues but also about maintaining the stability of the international standards of taxation, which are critical to the maintenance of efficient global markets and so to future growth in the world. The G20 leaders in their most recent declaration reiterated "the need to prevent base erosion and profit shifting and we will follow with attention the ongoing work of the OECD in this area."

This issue is complex, particularly given the need to avoid measures that lead to double taxation. A number of features of the tax systems of individual countries and how these interact are potentially engaged. Base erosion may result from (i) inappropriate transfer pricing that allows the transfer of intangibles to low-tax jurisdictions, (ii) the availability of regimes that allow for low-taxation, (iii) the ability to strip earnings through deductible payments in the form of interest and royalties, (iv) the abuse of treaties to inappropriately reduce tax at source, and (v) sophisticated and sometimes aggressive structures that take advantage of differences in countries tax systems, such as hybrid mismatch arrangements. The pressure points include transfer pricing regimes, tax treaties, favourable tax regimes (in some case harmful ones but not necessarily), ineffective or outdated domestic responses, hybrids, and finally aggressive tax planning, which takes advantage of all those features.

Many of these issues already feature prominently in the work of the OECD and I think it is evident from the work I described earlier that we are covering much of the ground. But we recognise that we need to make sure that we cover all of it and that all the individual elements of work are coherent with one another. This requires us to adopt a more coordinated and holistic approach to the issue of base erosion. We are committed to doing that so that we fulfil our role in maintaining an international tax system that encourages and supports healthy competition in the global economy, while ensuring tax compliance.

The Income Tax Returns Campaign in Poland

POLAND

Kaja ZALEWSKA
Adviser to The Minister
Ministry of Finance - Minister's Office

Świętokrzyska 12. 00-916 Warszawa. Poland
Tel: +48 22 694 40 74
E-mail: kaja.zalewska@mofnet.gov.pl

Ms. Zalewska runs the Minister's Office in the Ministry of Finance where she coordinates promotion, communication and media units that are in charge of raising society's awareness on public finances. Previously she advised the Polish government and coordinated the work of liaison officers during the Polish EU Presidency, worked in diplomacy for French and Belgian governments and in Brussels' PR and PA sector. She holds Master degrees in Politics, Administration and Management from College of Euroope and Sciences Po Institute of Strasbourg.

Magdalena LEKI
Senior Specialist
Ministry of Finance - Minister's Office

Świętokrzyska 12. 00-916 Warszawa. Poland
Tel: +48 22 694 40 74
E-mail: magdalena.leki@mofnet.gov.pl

Ms. Leki has been working for the Minister's Office in the Ministry of Finance for 3 years. She is working within the Promotion and Education unit and is mainly involved in promotion and information campaign. She graduated from Faculty of Politics and Administration of International School of Political Science at the Silesian University. She holds Masters degree in Economics and Marketing.

By Kaja ZALEWSKA and Magdalena LEKI

Poland

Improving voluntary tax compliance is particularly important for the Ministry of Finance. The aim is to create a system of compliance where citizens report their income freely and voluntarily, calculate their tax liability correctly and fill in a tax return on time. To achieve that level of compliance there are two areas of special importance. On the one hand a good understanding of tax matters and tax administration by the taxpayers, and on the other hand a provision of modern methods and technology allowing the tax administration to increase the quality of service provided to taxpayers.
All initiatives that are undertaken are designed to change taxpayer attitudes towards their tax obligations and create a long-term awareness that paying taxes is beneficial to all of us, and that a well-functioning state cannot exist without taxes. We want to build good attitudes against the "black" economy

and make the taxpayers able to behave correctly when they are dealing with tax applications.
There is no comprehensive communication strategy. However the Ministry of Finance takes a coordinated approach when it comes to communicating with taxpayers, providing them with the information they need, when they need it. The main objective is to enhance the awareness of citizens on how to comply with tax laws and increase their willingness to become a compliant taxpayer.

At the central level there is, within the Ministry of Finance, an organizational division especially dedicated to promotional activities. It is incorporated in the structure of the Minister's Office. The main role is played by the Promotion and Education Unit. Together with the Press Unit and Internet Communication Unit they create some kind of "Press Office," responsible for the creation and maintenance of the Ministry's positive image, conducting the information policy of the Ministry and generally understand communication with taxpayers. At the regional level the information and promotion activities are conducted by the regional spokespersons based in the tax chambers (16 people – one in each province). They cooperate in the everyday work with tax offices (401 tax offices).

The income tax returns campaign – make it easier for Taxpayers!

For a few years already, during tax return period (February – April), intensive information and education activities have been carried out by the Ministry of Finance. The aim is not only to improve voluntary compliance or to help taxpayers in understanding the provisions in force but to also encourage taxpayers to complete their tax returns on time and not to leave it until the last possible minute.
Since 2009 the action has been functioning under the name of "Szybki PIT" (Quick tax return form). In 2011 and 2012 the particular emphasis was put on promoting the e-PIT system and persuading taxpayers to take advantage of the opportunity to submit tax returns electronically.

„You better come to the tax office if you have a good reason to do so. Send your tax return over the Internet" - it is the tagline of the campaign promoting the opportunity to submit annual tax returns electronically. The campaign's goal is to demonstrate the benefits of the e-Declaration System - a modern and friendly program designed for the electronic transfer of tax returns. The e-Deklaracje system was developed in order to shorten the time necessary for taxpayers to meet their tax obligations and to enhance the tax information flow. It enjoys the growing trust of taxpayers - the number of people using the Internet for this purpose has grown from just 320,000 in 2009, to 390,000 a year later to reach more than 2 million taxpayers who decided to send their tax return electronically in 2012. However, to encourage even more people to abandon the traditional form of submitting tax returns and favour the electronic one, the information that such facilities exist have to be heard. Therefore the idea of an innovative campaign was born:
„You better come to the tax office if you have a good reason to do so. Send your tax return over the Internet" consists of three movies and two radio spots that use the media of joke and funny situations at the traditional tax office counter.
The message is clear: e-Deklaracje means time-saving, simple system and comfort.
Films and spots are available on the YouTube channel:

(http://www.youtube.com/user/MinisterstwoFinansow)

Other activities undertaken as part of the action:

- Availability of all information needed is on the website www.finanse.mf.gov.pl. Additionally all tax offices have their own websites presenting documents, legal acts, reports and analyses, useful links, glossary, handbooks with recommended texts, flash presentations, addresses and working hours.
- Preparation and print-outs of information leaflets for taxpayers dealing with the most useful tax matters (Rights and obligations of the taxpayer, PIT - step by step, Tax administration frien-

dly to the taxpayer). They are put at the taxpayers' disposal in the Ministry of Finance, in the tax offices as well as posted on our websites. To promote this action an animated cartoon figure, the symbol of the action was created - the sheriff PIT.

- Creation of a website especially dedicated to the campaign: each year we create a portal for taxpayers, where one can find tax forms, information about tax allowances and the opportunity to submit tax returns electronically. Simultaneously all taxpayers who come across a problem concerning tax issues can ask questions via the portal. Answers are almost instantaneously prepared by experts from the Ministry of Finance.
- An intensive media campaign: for a number of years already as part of the campaign, the Promotion and Education Unit established cooperation with the media - press, television (breakfast TV) and radio.
- Coordination of the action "Open Door Days" at tax offices throughout the entire country as well as extended working hours in tax offices in the last week of the tax return period.
- Broadcasting of promotional and educational spots on TV and radio along with instruction films on how to fill in tax returns electronically via the Internet.

Good Governance - The moving of Tax Administrations from Reactive to Proactive Approaches

The Way Forward for Tax Administrations Moving from Reactive to Proactive Approaches

PORTUGAL

José António de AZEVEDO PEREIRA
Director General of Tax and Customs Authority of Portugal
AT - Tax and Customs Authority
Rua da Prata, n.º 10 – 2º - 1149-027 Lisboa, Portugal
Tel +351 218 823 093
E-mail: dg-at@at.gov.pt

Doctorate in Business Administration from Manchester Business School University of Manchester (1997), Professor in Economy and Management Superior Institute – ISEG - from the Technical University of Lisbon, Director-General of Tax and Customs Authority since 2007, author of several books and articles in scientific journals in the area of economics and finance.

By José António de AZEVEDO PEREIRA

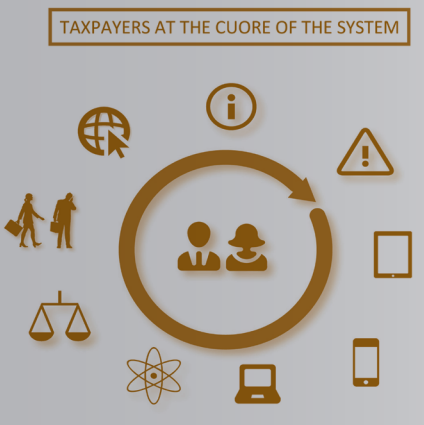
Portugal

Introduction

The Portuguese tax administration (AT) has implemented an ambitious plan with the aim of becoming one of the most efficient and innovative administrations in the European Union, through the adoption of a new Plan, Vision and selection of new Objectives. It is the Taxpayer's Quality Service Plan (TQSA).

Plan, vision and objective

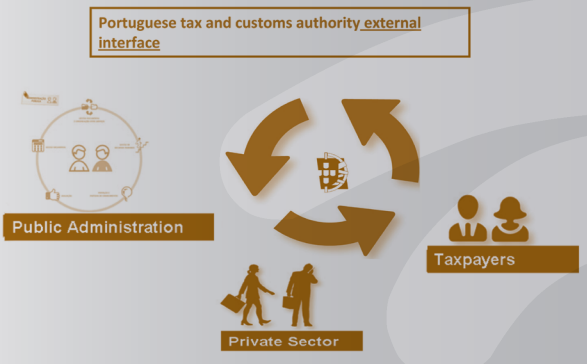
The vision is to put AT closer to the citizens and businesses, with greater facilities to address taxpayers' needs (simpler, faster and less expensive to meet their tax obligations, as well as a quicker and more effective response to taxpayers' queries), in a mutual trust environment. The objective is embodied in a single idea: to place taxpayers at the core of the system, focusing all services on them and turning AT into a model of efficiency to the economy and to society as a whole.



Brief description

TQSA comprises of 39 projects and was implemented in 2009. It is divided into two major chapters:
AT external interface and AT internal functionalities.
In the internal functionalities, the goal is to carry out a re-engineering and automation of back office management systems, preparing them to offer a high quality service, focusing on the interests of the taxpayers.
The aim of the external interface is to substantially enhance the information, interaction, education and mutual collaboration with taxpayers.
Although the Portuguese tax authorities have been recognized in international assessment reports on e-Government as having reached very high levels of service and quality, there is still a significant influx of taxpayers to Local Offices, involving too many face-to-face contacts with the associated staffing overheads. The AT investment in this area, focused on two key factors:

- The information flow between the various tax agencies, in order to eliminate a taxpayers' need to visit more than one location for information and
- Systems integration, avoiding information transmission errors which affect service quality and would likely generate conflicts between the different agencies



Plan implementation - At external interface

The innovative services offered to increase facilities for taxpayer's include:

Internet certificates, proof and other administrative documents (including tax clearance and debt certificates, as well as notification of duplicates) - are currently available on the Internet, free of charge.

E-mail and SMS notices – notification of tax liabilities by personalized individual e-mails.
With the aim of reducing deliberate non-compliance, the AT assumes, with the implementation of this plan, that the information and interaction available for taxpayers is the main system's benefit towards promoting voluntary compliance. This new focus transcends the traditional one which concentrated on the system's security and efficiency in the functions of tax administration (audit, enforcement, sanctions and offenses).
AT provides information services via personalized e-mail in the following situations:

1. Prior to the end of the statutory period (on the 1st day of the month in which their return is due and again three days before the end of that period, ending with a SMS message on the last day),
2. Whenever a taxpayer starts a new business, acquires real estate or in other ways establishes a relationship with the AT, he/she is sent information about all his/her rights and obligations;
3. Whenever a taxpayer commits a tax offense, he/she is duly informed of the fact and also that he/she should settle his/her tax account, thus benefiting from a reduced fine;
4. Whenever the AT has different values compared to the ones contained in the returns submitted by the taxpayer, it informs them of the fact and requests them to correct it voluntarily,
5. The AT informs taxpayers, by SMS, of their repayments,
6. The AT automatically completes 90% of the Income Tax Returns of Individuals, and issues an "on line" alert when the declared values differ from those known by AT.

The aim of this project is to reduce non-compliance costs both for the taxpayers and for the AT. In 2011, 27.1 million communications using this method were sent.

Twitter – In operation since early 2010 as a regular information service. AT posts support messages to taxpayers (292 tweets with general information have been posted up to now to assist and increase voluntary compliance).

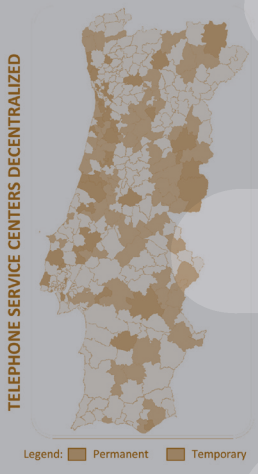
YouTube – Used as a means of information, its main goal is to publicize the new services.

Electronic documents and notifications – Communications on VAT and corporate income tax organisations started to be made electronically. From January 2012 it is mandatory that notification for these taxpayers is electronic. Some 2,830,069 notifications have

been sent by this means, reaching about 70% of the target audience.

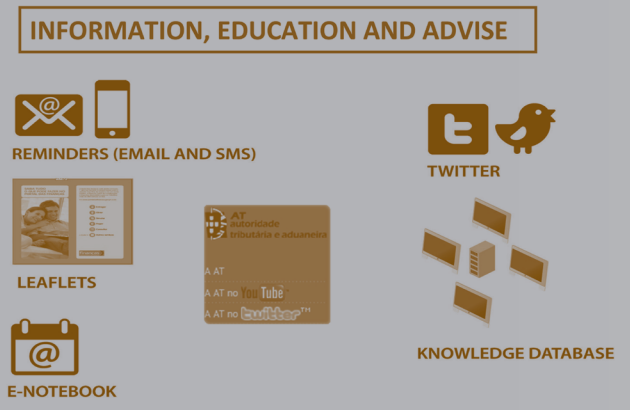
Integrated attendance and communication channels management – A computer application, CRM (Customer Relationship Management) has been installed, creating an integrated management system, using a variety of communication channels.

Telephone Support – Coordination of every communication channel, with decentralized CAT - Telephone Service Centre -, and implementation of clusters (in 14 regional offices and in 75 local services) using the same network throughout the country created a significant saving in both efficiency and cost for both taxpayers and for the AT. As a result, an increase in calls from 460,000 in 2009 to nearly one million in 2011 (equivalent to a rise of more than 90%) was seen.



CAT's	Decentralized structure
Central	1
Regional	14
Local (permanent)	75
Local (temporary)	100

E-mail support– A restructure of the e-mail address service was carried out to make it a part of the CRM system, using the same network and operated using the same resources that were previously allocated to the face-to-face and call services. During the current year, the challenge is to add an additional special facility, staffed by skilled officials who have completed specific postgraduate studies at certain Portuguese universities.



Information leaflets - Available leaflets with complete information about taxpayer's rights and obligations.

Electronic Invoice – This project has been developed in two parts:

- Electronic, web-based invoicing system for self-employed persons, supplied on the AT webpage. Designed for the issue of payment receipts allowing customers online access to information,
- System of electronic invoice and electronic communications for AT, of all the invoices issued by taxpayers.
  Starting 01.01.2013, AT will have a database of all invoices issued by Portuguese companies which will be sent electronically every month.

A Letter of Commitment to Quality – along with a public poster was issued Publicizing the buy-in of all AT offices to the new Tax Service Quality Plan, and the swift resolution of taxpayer claims with details of the average time taxpayers could expect to wait for resolution of particular issues.

ADVICE

Plan implementation- internal functionalities

The aim is full transparency of all AT internal procedures. Through the full disclosure of internal procedures, taxpayers are able to check via the Internet, their status and, at the same time to interact with the relevant services. As part of this process, a GPS (Services and Process Management) system across all AT offices (central, regional and local), scans all incoming paper documents, progressively eliminating, paper as a work medium, the flow being replaced by simultaneous and shared access to information, enabling any AT department, regardless of its geographical location, to make an assessment or decision based on the shared information over the network. The human resources saved by these efficiencies and back-office procedures brought an increase of quality to the service.

New Taxpayers' Rights

Following the implementation of the Plan, the 2012 State Budget included three new rights for taxpayers to be electronically informed by AT: i) to be informed

of their tax obligations; ii) to be informed of their tax rights, including tax benefits whenever the AT becomes aware of them, and iii) to be informed of the voluntarily settling of any detected non-compliance situations, saving a reduced 12.5% statutory minimum fine.

Electronic Services

The Plan has led to increased levels of voluntary tax compliance and citizen's degree of satisfaction.

The level of voluntary compliance involving the submission of personal income tax returns reached 98.84% in 2009 (this is to say only a 1.16% non-compliance rate).

Showing a similar performance, Corporation Income Tax (CIT) and Value Added Tax (VAT) returns had in 2010, levels of voluntary compliance of 89.17% and 93.4% respectively.

As for the citizen's level of satisfaction, it is currently defined according to the following criteria:

- Taxpayers' Internet channel level of satisfaction: (%);
- Average response time to taxpayer service claims: RCM 189/98 (%);
- Average waiting time attendance at tax offices (minutes);
- Number of Income Tax returns electronically submitted (%);
- Handled/received calls at Call Centres (%)

With these objectives, the AT provides on its webpage, relevant questionnaires to be completed by users, by notaries and by chartered accountants, in order to gather their perception of the quality of services provided. In 2010, a total of 33,439 responses were received and as per the evaluation of the Internet channel itself, among the 32,223 respondents who reported having used it in 2010, 87.4% qualified the service provided as "very good" (24.3%) and "good" (63 1%).

Conclusion

The implementation of the Plan for Quality (TQSA), occurring during a difficult time in Portugal, recognizes that a modern tax administration must be seen to be more proactive, preventive and educational, but above all must promote the taxpayers' obligation towards voluntary compliance as the most important task.

Given that voluntary compliance is much less expensive than coercive enforcement, the AT has increasingly invested in the improvement of its relationship with citizens and businesses, effectively and systematically adopting the motto that what is more important than (or at least equally important) reacting to non-compliant tax situations, is to prevent them happening by informing, assisting and supporting taxpayers, "walking side by side with them" towards their timely, accurate and complete tax compliance.

Improving Compliance Management in the Serbian Tax Administration

SERBIA

Aleksandar DRAGOJLOVIĆ
Head of Group for strategy, planning and risk analysis
Ministry of Finance - Tax Administration

Save Maškovića 3 – 5, Belgrade, Serbia
Tel +381 11 3950 581
E-mail: aleksandar.dragojlovic@poreskauprava.gov.rs

Aleksandar Dragojlovic was born on December 5, 1982 in Belgrade. He holds MSc in Public Administration and MSc in Business management. Employed in the Ministry of Finance - Tax administration on the position of Head of group for strategy, planning and risk analysis. Engaged in the planning and project management, strategic planning, and cooperation with international institutions.

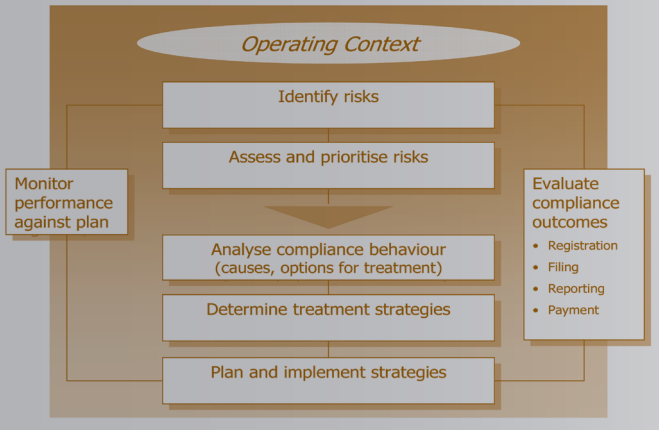
By Aleksandar DRAGOJLOVIĆ

Serbia

Background

Following a comprehensive environmental scan of core tax functions about eighteen months ago we realized that our business model, although generating government revenue targets, was outdated and that in essence our organization was not entirely risk focused. Deeper analysis showed that our approach was heavily audit orientated with a predominant focus on micro and small taxpayers with little emphasis given to the medium to large segment. This can be explained by the fact that the medium to large segment is more difficult to audit and requires higher skill levels. Coupled to this practice we acknowledged that operationally our focus was largely audit oriented with little attention being given to other core tax functions i.e. collection of arrears and taxpayer services. This provided a good opportunity and reason for the Serbian Tax Administration (STA) to start exploring new ways of work which could positively impact on compliance levels and taxpayer perceptions of the organization.

The first steps towards improving tax compliance



A strategic decision was made to adopt the OECD Compliance Risk Management Cycle and further develop the model in our own context as to what actions were necessary to ensure successful implementation. Putting this model into operation was a challenge to get off the ground as it necessitated an integrated risk management approach which was very different to the way compliance was previously managed. Formally adopting the Compliance Risk Management process immediately alerted us to a new set of issues and challenges that provided ample opportunity to streamline operations and focus on areas of highest risk.

Adopting the OECD's Compliance Risk Management Cycle highlighted the need to improve the STA's organizational structure which was largely outdated with little design capacity and insufficient staffing, resulting in headquarters not being able to carry out its primary strategic function in design, planning and monitoring. This resulted in uncoordinated activities at regional level with no master plan in place to improve compliance in high risk sectors. The new structure proposal is heavily design oriented and "future looking" and will provide the additional resources required to adopt a risk based approach to compliance management – it places additional emphasis on taxpayer services with a more balanced approach between service and enforcement.

The design of a new corporate strategy highlighted the need for a more extensive modernization program guided by the OECD's Risk Management Model

STA's corporate strategy includes its mission, vision and values. It provides a robust and clear context for the future development and modernization of the organization and the services it provides to the people and Government of Serbia. It describes the internal and external environment in which the STA operates as well as the weaknesses that currently stand in the way of our ability to operate as a truly modern tax administration. Most of the objectives described in this strategy in support of goals represent the STA's change agenda and this strategy could be seen as a roadmap for reform. This overarching corporate strategy is used to set the context for operational plans developed by each of the respective business and functional units of STA. The Corporate strategy consists of 8 specific goals:

a. General goals:

- Encouraging and marketing compliance
- Maintaining compliance
- Enforcing compliance
- Supporting compliance

b. Management goals:

- Organization and management
- Information technology
- Human resources
- Capacity building

These goals were further broken down into actions and prioritized. A decision was then taken at senior management level to introduce a Modernization Team to facilitate the implementation of these newly defined goals and other modernization activities decided upon.

Designing a risk based Compliance Plan emphasized the need to maximize the use of internal and third party information

In designing the STA's compliance plan for 2012 a considerable effort was put into researching compliance levels across different industry segments. Industry profiles were developed which included the size of the economic sector and its contribution to overall tax revenues, whether registration into the tax system was a risk and whether the sector participated in the grey economy. Extracting information from the STA's data warehouse further provided information regarding the number of audits previously conducted in the sector, the results of those audits and issues identified. Analysis was carried out on tax arrears which included the percentage of overall tax debt attributable to different industry segments and the risk of non-payment. Further analysis was conducted on non-filers. This information provided a comprehensive view of different segments and assisted the STA in prioritizing which sectors, as a first step, needed to be included in the 2012 Compliance plan. Formalizing the creation of a Risk Management Unit (RMU) was a key to success. Developing a compliance strategy is heavily reliant on credible risk based information upon which the design and implementation of compliance management initiatives can be based. Although the STA's VAT audit case selection system includes important information regarding risk, there were certain streams of information such as the percentage of total turnover contributed by each industry, anecdotal information on tax evasion, severity of the grey economy in the segment, filing rates and arrears trends which were not included.

In addition, third party information and other sources of internal intelligence were not fully maximized. In order to resolve this issue a dedicated RMU was created to conduct a more intense approach to revenue analysis and identification of current and emerging compliance risks. This is an essential step towards gathering crucial information and trends that are decisive in the compliance management decision making process - taking into account that resources are limited and a more focused approach is warranted. The STA's Risk Management Unit, although still in its infancy has produced good results with its framework firmly based on the OECD's model.

In designing the Compliance Plan there was a need for building intelligence to understand taxpayer segments. The STA environmental scan and benchmarking against international best practice showed that the STA needed to adopt a more balanced approach to compliance management. We also acknowledged that a considerable effort would have to be made to introduce the philosophy behind the Taxpayer Compliance Model. Historically the STA business model had not emphasized the need to treat taxpayers in line with their behaviour but adopted a one size fits all approach with emphasis on audit and arrears collection. Introducing a risk management approach would mean introducing fundamental changes to the management of core tax functions i.e. taxpayer services, audit and arrears collection. In essence, and in line with the Taxpayer Compliance Model, we had to accept that taxpayers are not a homogeneous group and that their circumstances and behaviour can change over time. Having developed industry profiles provided us with the opportunity to evaluate what type of intervention or compliance strategy is necessary to address the identified risk. The macro analysis conducted across different taxpayer populations provided the STA with good framework to better differentiate its responses to each level of risk presented by the unique characteristics and circumstances of each group. The ultimate aim of this approach is to, over time; maximize the number of taxpayers who choose to voluntarily comply with the tax laws. In summary, getting to know the taxpayer population enables the design of intervention strategies to match risks, be it in filing, payment or to improve tax administration organization or processes.

Managing the Compliance Plan through a Compliance Council should be seriously considered

The successful implementation of a Compliance Plan is reliant on ensuring that all activities decided upon are implemented and aligned to the overall compliance improvement strategy. The role of the Compliance Council can be described as follows: "To assess the health of the tax system and provide high-level guidance to the Risk Management Unit on strategic issues related to risk identification, prioritization, risk mitigation decisions, and resources allocation". The Compliance Council constitutes a group of six senior managers who facilitate implementation of all Compliance Plan activities. Their role is to ensure that tasks are planned, implemented and processes in place to measure the effectiveness of each intervention, a very important part of the process. In other words, the Compliance Council should coordinate all operational activities in order to:

- Monitor Compliance Plan activities
- Address newly identified risks
- Monitor monthly performance through newly developed Management Information Systems
- Ensure operational linkages
- Monitor regional office performance
- Ensure that the RMU's research is noted and acted upon

Other roles of the Compliance Council are improving domestic and international collaboration, improving the legal framework, developing counter measures for aggressive tax planning, high risk industries and specific sectors where high non-compliance is relevant and, strengthening the use of third party information.

Mobilizing operations to implement a coordinated approach to managing risk

Audit

As a transitionary measure 60 percent of available audit time was allocated to high risk industries identified through risk profiling. It is the intention to move this closer to 80 percent over the next two years. These cases, identified through the case selection system are allocated to the regions and closely monitored. These industries can be summarized as follows:

COMPLIANCE STRATEGY FOCUS FOR 2012	
1.	Wholesale
2.	Construction
3.	Processing
4.	Transport and warehousing
5.	Restaurants and hotels
6.	Rental income
7.	Capital gains
8.	Cash Economy

A review of previous audit results highlighted that too much focus was being given to the micro and small segment. Segmentation of the tax base allowed for the more even distribution of audits across turnover segments.

The tax base has been segmented on turnover as follows:	
Micro	Turnover less than RSD 4,000,000
Small	Turnover from RSD 4,000,000 to RSD 100,000,000
Medium	Turnover from RSD 100,000,000 to RSD 1,000,000,000
Large	Turnover over RSD 1,000,000,000

Collection of arrears

The industry analysis provided a clear picture of current outstanding debt which included collectible, uncollectible, amounts currently under enforced collection and details of those cases where an instalment arrangement has been entered into. However, to effectively reduce large volumes of arrear taxes across the micro, small and medium segments it was essential to determine the degree of risk dependent upon the amount and age of the debt. This exercise provided additional insight into how the current debt collection process could be improved. It resulted in a three pronged approach being developed: (1) a general initiative improving arrears collection business processes; and (2) a focused approach on industries with highest arrears. Activities included: (1) a "soft" letter to remind taxpayers of their arrears and asking them to make payment as soon as possible; (2) friendly and scripted telephone calls to remind taxpayers to liquidate debt or face the possibility of enforced action and making it clear that instalment arrangements could be entered into; and (3) an email to all indebted taxpayers with a valid email address which included an information brochure on how to go about paying arrear taxes. This approach, which also included a focus on new debt, has generated successful results. New procedures to remove uncollectible debt from the arrears inventory are also being undertaken. A new IT application has recently been launched which provides up to date live information on debt trends and also separates old and uncollectible debt from the new. This effectively removes non collectible cases from the inventory and allows staff to focus on new and collectible cases. A feature to show debt per industry type is currently being developed.

Improving taxpayer services

The STA is currently devoting time to improving this function taking into account that the micro, small and medium segments of taxpayers present a big challenge as they predominantly have less knowledge of the tax laws and thus require more help and assistance to meet their tax obligations. At the same time, small taxpayers may be reluctant to approach the STA for assistance for fear of being audited. To raise taxpayer services to a higher level the STA recently completed a taxpayer services strategy and included the unit in the proposed new organizational structure. Steps taken to date have included the design of general educational material and material with a specific industry focus. Outreach activities have commenced with industry groups and Chambers of Commerce who have welcomed the tax administrations new approach of getting alongside taxpayers. To reduce compliance costs and simplify procedures for taxpayers they can now file electronically for VAT with other taxes will follow in 2013. A campaign to encourage e-filing was launched through the STA's contact centre.

Building a relationship with the accounting profession and developing industry association partnerships to improve voluntary compliance

As part of the Compliance Plan the STA aims to influence taxpayer behaviour by demonstrating willingness to educate and assist those willing to comply and to take a tougher approach towards those who deliberately do not. Serbian accountants play an important part in the lifecycle of taxpayers and with support from the tax administration can help influence taxpayers to comply with their obligations. A strategy was developed to encompass three key compliance objectives which accountants could support:

- Tax returns being filed on time;
- That returns filed are correct (all income declared and expensed correctly accounted for);
- Tax paid on time.

In addition, accountants are in a strong position to:

- Help the STA understand the barriers and difficulties they and their clients face;
- Provide ideas on how compliance can be improved;
- Work with their clients to promote good practice and voluntary compliance;
- Provide feedback to the STA on matters which discourage or prevent compliance;
- Be a source of information

In developing the 2012 Compliance Plan it became obvious that non-compliance is deep rooted in certain industries and furthermore, that improving compli-

ance will need a broader approach , encompassing important stakeholders who have the potential to assist in improving compliance trends. These stakeholders include Industry Associations who can play an important part in promoting compliance amongst their members. The STA's strategy encompasses the following objectives:

- Building relationships with industry groups;
- Targeting the cash economy;
- Identifying barriers to compliance within selected industries;
- Encouraging and enabling voluntary compliance;
- Improving overall compliance.

The benefits for industry groups can be summarized as follows:

- Visibly working with the tax authorities to improve compliance in their respective industries;
- Working with the STA to level the playing field for their members with regard to the cash economy.

Concluding remarks

Implementing a Compliance Plan requires strong leadership, coordination and a continual evaluation of activities to ensure the desired outcomes are being achieved. A Compliance Plan, in effect, represents an integrated compliance strategy across core tax functions which require strong coordination by managers to ensure that implementation takes place effectively and that the desired results actually materialize. This approach is very different to the old traditional style of tax administration and although exciting, will take time and considerable effort to implement. The change management aspect of this new approach to compliance management cannot be ignored and considerable effort should be made across the organization to create an awareness of a more focused and scientific approach to improve compliance management.

Influencing Taxpayer Behaviour – Recent Trends

SWEDEN

Lennart WITTBERG
Compliance Strategist
Swedish Tax Agency

Skatteverket, 171 94 Solna, Sweden
Tel +46 10 574 96 22
E-mail: lennart.wittberg@skatteverket.se

Lennart Wittberg has worked at the Swedish Tax Agency since 1988 and is currently working as a Compliance Strategist. The work is about designing compliance strategies based on research and international experiences. Lennart is also a member of OECD Forum on Tax Administrations Compliance Subgroup and was its chair 2006-2010.

By Lennart WITTBERG

Sweden

Tax compliance is about influencing taxpayer behaviour. Tax administrations need to understand their behaviour in order to influence it. There is an ongoing and growing trend among tax administrations to use knowledge on human behaviour when designing compliance strategies. Today tax administrations know that compliance cannot be achieved through deterrence only. Other forms of treatment are also needed. This article briefly describes the on-going development and gives some examples of the research.

Developments in research

The traditional view for tax administrations have been that compliance can be achieved through high risk of detection and sanctions for non-compliance, i.e. deterrence. This line of thought originates from the traditional economic model of rational actors. Taxpayers calculate the risk of detection and the potential punishment and choose the alternative that gives the best monetary outcome. Michael Allingham and Agnar Sandmo presented a famous model in 1972 on tax evasion based on this traditional economic model.

Allingham and Sandmo adapted Gary Becker's model of the economics of crime. Gary Becker is a professor of economics and sociology and was awarded the Nobel Memorial Prize in Economic Sciences in 1992. He is known for arguing that many different types of human behaviour can be seen as rational and utility maximizing.

Research and experience by tax administrations has shown that taxpayers do not evade taxes to the extent predicted by models based on classical economic theory and rational choice. Other explanations have therefore also been taken into account, such as personal and social norms, fairness and similar "soft" factors.

An important piece of research was presented in 1979, the "Prospect Theory" by psychologists Daniel Kahneman and Amos Tversky. They showed that people don't behave rationally according to the classic economic model. Prospect Theory says, among other things, that people evaluate losses and gains using different heuroistics.

People are generally risk averse for gains (e.g. preferring a certain 50 euro to a 50% chance of 100 euro even if they are equivalent in economic terms) and risk seeking where losses are concerned (e.g. most choose a 50% chance of losing 100 euro over a certain loss of 50 euro even if they are equivalent in economic terms).

Heuroistics or rule of thumbs can be seen as shortcuts and a way to make decisions in an efficient way when available information is incomplete or too burdensome to analyse. This field of research is today known as behavioural economics. Daniel Kahneman received the Nobel Memorial Prize in Economic Sciences in 2002 for this work (Amos Tversky died in 1996).

The research on human behaviour and especially economic behaviour has also influenced the thinking among tax administrations even if it sometimes takes time for the theoretical knowledge to be transformed into concrete practice. The strategies of tax administrations have evolved over the years in line with the findings from the research. The interest today in behavioural economics is growing and so is the practical use in the public sector.

Developments in tax administration strategy

Tax administrations' strategies and ways of thinking have changed in the last 10-15 years. It is possible to see a clear line of development from a strong focus on enforcement to a broader perspective on compliance behaviour. This is reflected in the work done by tax administrations cooperating in different international forums.

At the turn of millennium there was a focus on risk analysis in the compliance field. The main interest was to find better criteria for selecting audit cases. However, this interest in risk soon led to a wider interest in and understanding of the concept of risk management as a whole.

In 2004 The Organisation for Economic Co-operation and Development (OECD) published a report; *"Compliance Risk Management: Managing and Improving Tax Compliance"*. The report gives a comprehensive view on risk management and shows that a holistic view on compliance is needed. A tax administration needs to understand the risks and choose the right form of treatment. In 2006 the European Union (EU) published a similar report; *"Risk management: a guide for tax administrations"*.

The international interest in risk management is still great. Risk management provided a lot of benefits but the important contribution to the strategic thinking was the holistic view. Problems need to be understood and put into a context. Before risk management was introduced the thinking was, to a large extent, based on the assumption that heavy enforcement will produce compliance. This is sometimes referred to as the blind assumption theory because there was no real evidence that this approach would work.

The international interest in risk management and compliance strategies was not limited to OECD and EU but the work done in OECD is a good indicator on how the thinking has progressed. OECD published a report in 2009; *"Managing and Improving Compliance: Recent Developments in Compliance Risk Treatments"*. The report describes more innovative or unusual risk treatment approaches to address non-compliance in the small and medium enterprise sector. This was a logical next step after establishing risk management. The holistic view called for more treatments than just enforcement and the OECD report described what different countries were doing in order to expand their toolboxes. There was a clear trend towards more tailor made treatments for each compliance risk. It was also common to combine different treatments, for instance a combination of education, communication and enforcement.

The idea of multi-treatment strategies led to a need to understand taxpayer behaviour better in order to choose the most effective forms of treatment. OECD published a report in 2010; *"Understanding and Influencing Taxpayers Compliance Behaviour"*. The report describes the findings from a survey to member countries and studies of scientific literature on taxpayer compliance behaviour and points out: *"The increasing knowledge on taxpayer behaviour has caught the interest of revenue bodies and is influencing compliance strategies. The shift from the classical economical model of rational agents to an understanding of behaviour can have great impact on how a revenue body designs its work."* (p 11).

The report also says that deterrence is a double edged sword with both potential positive and negative effects and makes references to behavioural economics: *"Deterrence can be better understood if people's general economical behaviour is considered. As mentioned above, humans do not act in a total economical rational way. The research on behavioural economics draws on insights from economic experiments to bring a deeper understanding of human behaviour into economic theory."* (p 14).

An updated EU risk management guide in 2010 has been added with a section on taxpayer compliance behaviour and argues similarly: *"The considerations on compliance behaviour have important implications for revenue authorities, as they provide for new perspectives and possibilities."* (p 23).

The thinking has thus far evolved from enforcement to a holistic view with multi-treatment strategies based on knowledge on taxpayer compliance behaviour. The increased knowledge has influenced the compliance strategies. The next step from OECD has therefore been the report *"Right from the Start: Influencing the Compliance Environment"* published in 2012.

This report describes a compliance strategy for small and mid-sized businesses. An important message in the report is that behaviour is best influenced by changing taxpayers' circumstances or *"…creating an environment conducive to compliance."* The report acknowledges that there are different forms of taxpayer behaviour but the observed behaviour should be seen as signals or symptoms rather than problems as such. The report says (p 9); *"Compliant and non-compliant behaviours are a function of many factors and therefore the result rather than the starting point. So compliance behaviour can be influenced by influencing the external factors."*

Non-compliant behaviour can be influenced by changing factors in the compliance environment, preferably in such a way that non-compliance is prevented and compliance achieved by making it right from the start. The report also mentions that cooperation with taxpayers and stakeholders will be essential in order to influence the environment.

Growing interest in behavioural economics as a practical tool

As stated above, behavioural economics is not something new. What is new is a strong and growing interest among both researchers and policy makers. The interest can be detected in the great number of bestselling books on the subject, books not just written for a small group of researches but for the general public.

One such book is *"Predictably Irrational – The Hidden Forces That Shapes Our Decisions"* from 2008 by Dan Ariely, professor of psychology and behavioural economics. The book gives many examples of when human behaviour is not in line with rational choice theory. But Ariely also explains that this "irrational" behaviour is systematic and predictable.

Another example is the book *"Nudge: Improving Decisions about Health, Wealth and Happiness"* from 2009 by Richard Thaler, professor of behavioural science and economics and Cass Sunstein, professor of law. The book draws on research in psychology and behavioural economics in order to describe how to influence what is called the choice architecture, i.e. factors in the environment that affects behaviour. These changes can be small and therefore referred to as *"nudges"*. One example of a nudge is changing the order in which food is arranged in a cafeteria so that the healthy food is placed before unhealthy snacks, which can lead to customers making more healthy food choices.

But the most important book is probably *"Thinking Fast and Slow"* from 2011 by Daniel Kahneman, who at age 77 published this summary of his and Amos Tversky's work on behavioural economics. The book's title refers to two different ways the brain thinks; thinking fast, called System 1 and thinking slow, called System 2. System 1 is fast, automatic, frequent, emotional, stereotypic and subconscious. System 2 is slow, effortful, infrequent, logical, calculating and conscious. These differences explain why humans' behaviour is not in line with the rational choice theory.

System 1 is used when we for instance judge a person's state of mind by looking at that person's facial expressions. We do not do a comprehensive analysis. We just know if a person is happy or angry, it is effortless. System 2 is used for instance for math problems like 17 x 24. You know you can solve the problem but it needs a conscious effort (the answer is 408).

System 1 runs automatically and system 2 is normally in a "low-effort" mode. System 1 continuously gives suggestions to system 2 based on impressions and feelings. Normally system 2 adopts the suggestions of system 1 with no or little modification. System 2 can override system 1 but that requires a conscious effort. This is in most cases not a problem but because system 1 relies on shortcuts and heuroistics we, as humans,

sometimes run into difficulties.

One such heuroistic is called the anchoring effect. For example, consider these two questions:

- Was Gandhi more or less than 114 years old when he died?
- How old was Gandhi when he died?

The first question is easy to answer but the guess for the second question will be affected by the number given (114) even if you know that this number is irrelevant. System 1 understands sentences by trying to make them true and they therefore tend to be the starting point or anchor. System 2 adjusts from this anchor to come up with a better answer but tend to make insufficient adjustments. If you are asked whether Gandhi was more than 114 years old when he died you will end up with a much higher estimate of his age at death than you would if the anchoring question referred to death at 35 (unless you actually know the right answer of course).

This is just one example of a heuroistic. There are a number of these heuroistics and biases that can affect behaviour which means that human behaviour is not always rational.

Kahneman doesn't want to say that humans are irrational. He is just saying that the classic rational actor model does not describe human behaviour very well. He says (p 411); *"Although Humans are not irrational, they often need help to make more accurate judgements and better decisions, and in some cases policies and institutions can provide that help."*

The government in UK tries to use this kind of knowledge in order to increase the effectiveness of the public sector. They have established the Behavioural Insight Team, popularly known as the "Nudge Team", at the Cabinet Office.

The Behavioural Insights Team was set up in 2010 with the purpose to find innovative ways of encouraging, enabling and supporting people to make better choices for themselves.
The Team's work draws on insights from the growing body of academic research in the fields of behavioural economics and psychology on how subtle changes can have big impact on behaviour.

The team's report *"Applying behavioural insights to reduce fraud, error and debt" from 2012 claims the following (p 3): "By understanding better how people respond to different contexts and incentives, we can develop a more nuanced understanding of human behaviour that can ultimately help us to design more effective interventions to tackle fraud, error and debt. Many of these interventions are relatively simple and cheap, and can be introduced alongside some of the more traditional methods employed by public bodies."*

One example refers to letters reminding people to pay their tax debts. A standard letter that was sent out led to responses (payments) in 67% of the cases. But a small change in the letter increased this number to 83%. The new wording took advantage of social norms. People want in general to behave as other people behave. The statement "9 out of 10 people in your local area pay their tax on time" did the trick. Such a change is a nudge and a change in the external compliance environment. Changes do not need to be expensive.

The Swedish compliance strategy

The compliance strategy in the Swedish Tax Agency has not been unaffected by these thoughts either. The main theme in the Swedish compliance strategy is "right from the start", in this case meaning a strong focus on preventive measures. The strategy says that *"We create conditions so that information which is submitted is right from the start. We see to errors which we have been unable to prevent, learn from our mistakes and try to prevent them from happening again."* The idea is to minimize the number of unintentional mistakes and unnecessary errors so we don't need to spend time on simple corrections. We want instead to be able to focus more resources on serious tax evasion and crime. Prevention is better than cure but at the same time we know that not everything can be prevented. We still need to have a competent investigation function to detect tax evasion.

Enforcement is needed and the most important purpose is to demonstrate for honest taxpayers that evaders will be caught. Enforcement is thus more about convincing taxpayers that other taxpayers will comply and less about deterrence. Enforcement can strengthen social norms and social norms affect behaviour. This awareness based on research influences the enforcement strategies and also communication strategies.

Right from the start is achieved through making it easy to comply and difficult not to comply. This is very much related to the compliance environment. User-friendly e-services, simplifications and support can for instance make it easy to comply. Preventive inspections before

the time of filing and the use of third party information can for instance make it difficult not to comply.

The Swedish Tax Agency has also, like many other tax administrations, initiated enhanced relationships with large businesses and increased cooperation with tax intermediaries. Cooperation with taxpayers and stakeholders is an important part of the strategy; "We cooperate internally and with external users, private and public parties as well as with other countries to the benefit of all concerned."

The purpose of the strategy is to build and support the willingness to comply and to build trust in the tax system and in the tax agency. Knowledge from research and a taxpayer perspective is necessary in order to achieve this.

Conclusions

Tax administrations do not operate in isolation from the rest of the society. It is natural that the findings from relevant research will influence its strategies and ways of thinking. This is probably the case even if the findings go against strong traditions; it will just take more time. Compliance strategies will continue to evolve and knowledge of human behaviour will become even more important.

A single focus on enforcement has been the traditional strategy. The argument here is not that enforcement won't work. The argument is that the effects of enforcement must be understood and that enforcement together with other forms of treatment should be used in a way that fits the context. Enforcement is and will continue to be a necessary tool for tax administration, but its effects on behaviour can be enhanced if it is applied in a way that is in line with how people actually behave.

The developments in research from the economic view of rational actors to behavioural economics should not be seen as a fight between economists and psychologists or as a fight between a view on humans as rational or irrational. Humans are capable of being both rational and irrational. All research and theories contribute to increased understanding and the accumulation of knowledge. Knowledge is the key to better strategies and more effective tax administration. Tax administrations have a responsibility to use the knowledge currently available to them and to have an open mind when new knowledge is gained.

Behavioural economics and other research have the potential of increasing the effectiveness of tax administrations because many changes in the external compliance environment can be simple and cheap. It is however important to make these changes openly and in line with high ethical standards. The purpose is to make it easy to comply and difficult not to comply, it should not be about trying to manipulate taxpayers. The work must be carried out in such a way that it builds trust in the tax administration.

More knowledge on human behaviour has also the potential to alter tax administrations' view on taxpayers. Risk management has, unintentionally and not by design, led to a view on taxpayers as the risks. Taxpayers are sometimes described as more or less risky implying that the taxpayers are the problem when it comes to non-compliance. This view can change, and has already changed to some degree, when behaviour is understood also as a result of external factors in the compliance environment. When the taxpayer is not seen as the problem, the taxpayer can be part of the solution. The compliance environment can be improved more effectively if it is done in cooperation with those involved. Tax administrations are today expanding their cooperation with taxpayers and stakeholders. This development can be seen as another result of changed strategies and changed ways of thinking. If this line of thinking is correct then it is reasonable to assume that cooperation with taxpayers and stakeholders will increase even more in the future.

Human Resources

Tax administration's budgets haven't been changed due to the financial crisis of the recent years. Therefore, the promotion of efficiency and effectiveness of Human Resources is more necessary than ever. Besides budget determination rules there is also the important issue of the size of the tax administration, a question on which theoretical prescriptions are available.

In this section the first article is provided by Alakbar Mammadov about the Training strategy adopted by the Azerbaijan Tax Administration. In Azerbaijan there have been significant tax reforms in recent years. Parallel to these, there has been a need to increase the professional level of tax officers as well as to create a favourable tax environment and tax culture in the country. One important step in supporting these changes was the establishment of a new Training Centre.

The first of the two Finnish articles in this section has been written by Juha Lindgren and Tiina-Liisa Huhtanen. It describes how tax administrations can achieve more with less. The Finnish Tax Administration has selected a process approach as their strategy in operations development. This is considered the way to ensure smooth operations through the whole process chain from customer to customer and to avoid sub-optimization between functions. For process development initiatives the principles of Lean management provide a strong background, and the changes have also had a strong influence for the employees. The measurement of the effects of training is a complex challenge.

Merja Kujala and Sanna Alamäki wrote their article on how in Finland they have developed ways for doing this. They begin by explaining how their strategy has affected the training system and why it is vital to connect performance and training directly with each other. They continue by illustrating how, by whom and why they have measured the effects of training in the Finnish Tax Administration. They go on to describe what the effects are of how training support is organized in order to support effective training and what have been the changes and differences between the previous Tax Academy model and the current training support.

Training Strategy within the Azerbaijan Tax Administration

AZERBAIJAN

Alakbar MAMMADOV
Advisor to Minister of Taxes on international relations and taxpayers' services
Ministry of Taxes

L. Landau str. 16, Baku, Azerbaijan, AZ 1073
Tel +994 12 403 86 63
E-mail: a.mammadov@taxes.gov.az

Advisor to Minister of Taxes of the Republic of Azerbaijan on international relations and taxpayers' services dealing with formulation of tax policy and tax administration on relevant spheres providing realization of this policy as well as carrying out important activities towards improving the activity of the Training Centre under the Ministry of Taxes and providing methodological supervision and control upon its activity.

By Alakbar MAMMADOV

Azerbaijan

In recent years, due to the significant tax reforms carried out in creating an efficient tax system and improving Azerbaijan's legislative basis, there has been a need to increase the professional level of tax officers as well as to create a favourable tax environment and tax culture in the country. One important step in supporting these changes was the establishment of a new Training Centre complex in September 2011 in the Shamakhy region of Azerbaijan, which meets all modern standards.

The Training Centre of the Ministry of Taxes (MoT) was established according to a Decree by the President of the Republic of Azerbaijan, dated July 19 2001, as a scientific and educational centre having advanced facilities for training and retraining.

The main purpose for establishing this Centre was to carry out training and related projects focused on raising the level of knowledge and professionalism of tax officers, providing retraining where necessary, and to carry out scientific research into tax policy.

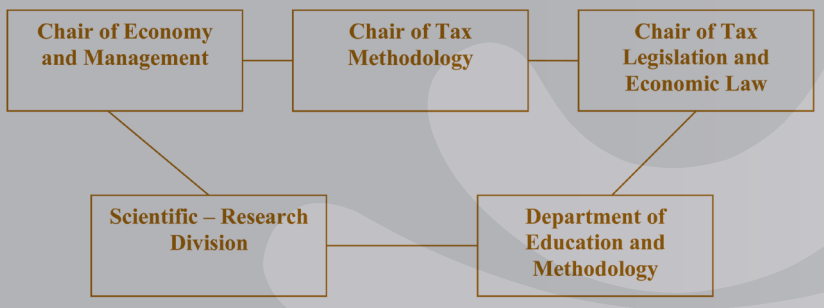
The activities of this educational enterprise are based on the **Concept of Human Resources Development Strategy**, which was approved by the MoT in 2004.

The main objective behind this concept is to ensure a clear and detailed understanding by the employees of the MoT of the strategic objectives of the organization including the processes involved in the implementation of tax reforms.

The Training Centre has directed its resources towards the following activities:

- professional training of tax authority personnel, their retraining and advanced training;
- development of proposals relating to the personnel policy of the tax authorities;
- carrying out scientific research into the formation, development and legal provisions of the tax system.

The Training Centre possesses the following structure:



The State Tax Administration's employees receive a high level of professional training from the following courses and groups:

	Training Courses	Training groups
1	Preliminary training	Chief Managers training group
2	Extension courses and retraining	Senior Managers training group
3	Practical work	Middle Managers training group
4	Professional training	Specialists training group
5	Education and scientific activity	
6	Physical training	

The object of the preliminary training courses is to prepare new employees for their new working environment by teaching them subjects related to tax and taxation in order to expand their professional knowledge and at the same time introduce them to the structure of the MoT, and the theoretical and practical duties related to tax and taxation.

The preliminary training consists of two stages. First, a 2½ month preliminary training course at the Training Centre and second, performing practical work in accordance with their work status. The period of practical work can vary from one to two months.
When the State Tax Administration's employees are transferred from one office to another, retraining courses are organized to provide them with the knowledge and skills necessary for their new place of work. Those employees who return to an office where they have previously worked for more than 3 years are not sent on retraining courses.

The State Tax Administration's employees participate in extension courses held in the Training Centre and if necessary; they may also participate in training courses held by other organizations, once every three years.

The extension courses are defined to be not less than 80 hours (10 training days).
Extension courses in the form of specialized training modules are held in accordance with The Law of Education of the Republic of Azerbaijan in order to raise the level of professional skills of the Tax Administration's employees. These courses are organized for staff of the Tax Administration (employees from different management groups, including specialists and tutors) and also for taxpayers. These courses are an integral part of the general training plan.

Each tax employee who belongs to a specialist training group should participate in a 2-week seminar or training session every two years on average. If necessary, the period of these courses can be extended up to 3 weeks or reduced to 1 week.

Management training in line with the Human Resources Development Strategy of the State Tax Administration is structured as follows:

- for the General Manager training group – 1-week training annually;
- for the Senior Manager training group – 1-week training every six months;
- for the Middle Manager training group – 2-week training every two years.

Practice - in order to ensure that they possess the full range of knowledge and skills required to perform effectively their new position, the State Tax Administration's employees initially work with and are supervised by professionals whilst carrying out their duties.

Professional training – Continued professional training is one of the main types of courses delivered and is organized at the student's place of work, allowing them to study the theory and skills necessary to carry out their duties at a higher level whilst continuing to apply them in everyday activities.

Combined education system

During the period of combined education the pre-

liminary training and retraining courses last up to 3 months and the extension courses up to 1½ months.

Extension courses are held in a traditional classroom format during the first 3 days and the last 2 days of the course, whilst the first 24 days and last 4 days of preliminary training and retraining courses are also classroom based. The remaining period of the courses is carried out by distance learning at the students' workplace.

According to statistical data, between 2003 and 2012 there were 1,283 persons who attended extension courses using the traditional, classroom-based training methods, 264 persons using the combined training method and 18 persons using distance learning methods. During 2003-2012 462 persons attended preliminary training courses using the traditional training method, 281 persons using the combined training method and 20 persons by distance learning.

Between 2003 and the first six months of 2012 the Training Centre held 95 extension courses, 38 preliminary training courses and 90 short-term (1-5 days) training courses or workshops. Those courses were attended by 1665, 763 and 1800 persons respectively.

Information about the number of training courses and workshops as well as the number of attendees can be seen in the following diagrams:

The following subjects are taught within the training process:

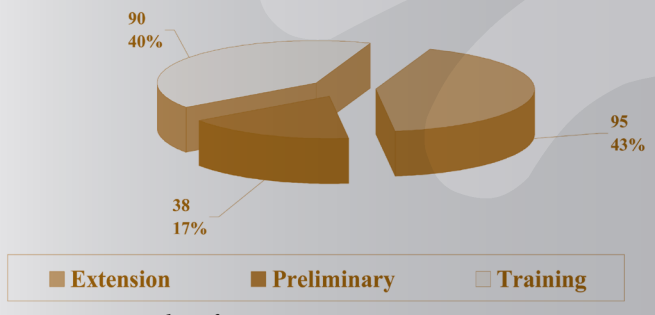


Diagram 1. Number of training courses

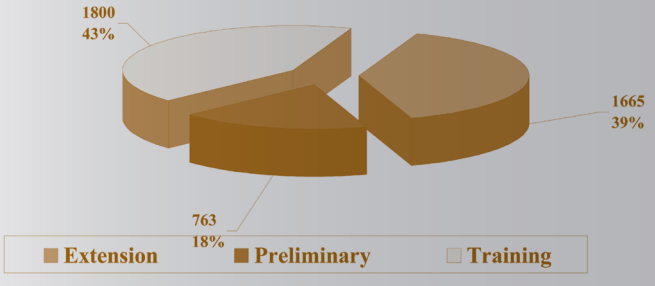


Diagram 2. Number of employees – attendants of training courses

- Tax organisation services delivered to taxpayers;
- Tax legislation and administration;
- Legal aspects for applying the Tax Code;
- Taxes for legal entities and physical persons;
- Application of tax legislation in municipalities;
- Tax revenues;
- VAT;
- Application of cash registers, etc.

Preparation of the training materials

The preparation of training materials for the tutors and the students/training groups is carried out in the following order:

- selection of topics for the training programme based on the training needs assessment;
- selection and compilation of materials;
- presentation of materials during the training course;
- assessment of the materials by the participants;
- finalisation of the training material;
- preparation of practical supplements for answers to the participants' questions during the courses: charts, examples of right and wrong practices etc.

Methods of conducting training courses

The training strategy should connect the contents of the training programme and the functional activities of the employees. This is achieved as follows:

- effective selection of the students and configuration of the courses;
- putting participants into groups according to their training needs;
- exchange of knowledge during the training and application of that knowledge;
- definition of the specific needs of the participants and special tasks which need more attention during the initial stage of the training course;
- use of practical examples and analysis of proven cases during training;
- assessment of the usefulness of the training at the end of each course.

Training methods

The training methods are selected by taking into account the following significant factors:

- initial objectives and expected outcomes of the training course;
- contents of the training form;

- training means and additional equipment;
- category and main characteristics of the participants;
- possibilities of the application of concrete methods and ways;
- structure of the acquired material.

Consideration of the above factors should be taken into account when deciding which of the following *training methods* should be used:

- Discussions- Detailed presentation of the subject by the instructors during direct communication between the instructor and the participants;
- Seminars- Analysis of important aspects of particular subjects of the training programme;
- Specialised studies- Solutions to problems or implementation of tasks under the instructor's supervision;
- Analysis of different cases- Within the framework of this activity the participants work on an individual basis. They get information about tasks to be accomplished by them by combining the knowledge they possess with the acquired means;
- Consultations- Opportunity for each participant to discuss his/her individual training needs.

Special attention is paid to the inclusion of the following *means* of training, which accelerates and stimulates the participants' active participation:

- Work games. The participants are asked to deal with specific topics in a role-play situation. This prepares them for similar situations in the real work environment;
- Analysis of specific cases. The participants are provided with the details and actual analysis of a given event. They examine the critical situation, identify the problems and find a suitable solution whilst learning from other people's experiences;
- Study games. Participants, either separately or in a group, are provided with the opportunity to solve a specially prepared task in order to gain a better understanding of the subject by means of analysis;
- Collective discussions- "brainstorming". The problem is presented to the participants and they are asked to find the maximum number of possible solutions to the problem in a very short period of time. The collection of ideas, their division into groups and categories leads to a better understanding of the problem and increases a sense of working together (Team Building);
- Practical work. A form of training at the place of work.

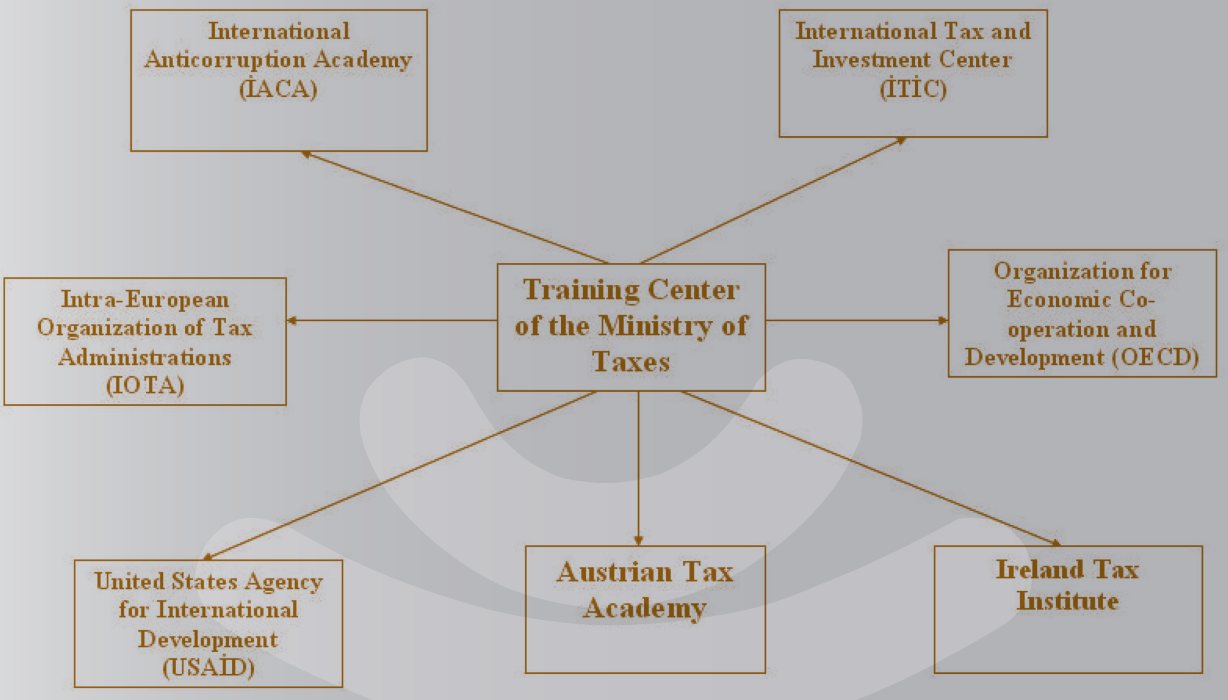
Modern assessment methods are used in order to effectively organise the training programme and measure its success. With this in mind; complex assessments are performed by applying the following methods:
Assessment of the training needs of personnel. The management of the tax authorities define the training needs of each employee in the way described above. This information is submitted to the appropriate structural divisions responsible for the organization of training.
Assessment of the professional level and knowledge of the participants. At the end of the training course the Commission established by the Ministry assesses the professional level and knowledge of the participants. The assessment is made either by means of a test or an oral examination on the taught subjects.
Assessment of the training course by the participants. All participants are given the opportunity to assess the content, the methods and the organisation of the training course by means of completing a questionnaire at the end of the course. The information obtained from analysing the questionnaires is used for the preparation of the next training curriculum and the selection of subjects.

In many cases, at the end of a course, participants take part in discussions with the tutors, the leaders of the Training Centre and specialists from the appropriate departments.

Perspectives of Training Centre

- To research and find solutions to the main socio-economic and public-cultural issues related to the tax system ;
- To provide a means of developing investigation techniques;
- To strengthen the training of staff in human resources;
- To use innovative methods to identify the scientific and applied bases of tax legislation and prepare suitable practical and legal models;
- To strengthen international relations and learn more about the tax systems of foreign countries;
- To provide continuous education of the tax administrations employees;
- To strengthen the understanding and education of taxpayers and their representatives in order to improve compliance

Cooperation between the Training Centre of the Ministry of Taxes and international organizations



More with Less - Developing the Ways of Work in Finnish Tax Administration through a Process Approach

FINLAND

Juha LINDGREN
Senior Director
Joint Services unit, Finnish Tax Administration

P.O Box 325, FI-00052 Vero, Finland
Tel +358 40 8281303
E-mail: juha.lindgren@vero.fi

Mr. Lindgren is a doctor of Economics. He holds a master's degree in education. Mr. Lindgren first joined the staff of the Tax Administration in 1987. Then, he has worked for six years on two Finnish universities and has written his doctoral dissertation on interpretation of tax law. He joined the Tax Administration again in 1999 and has since worked in different managerial and directorial positions. He is now senior director in the Tax Administration and head of the joint services unit

Tiina-Liisa HUHTANEN
Process Owner, Taxation
Joint Services Unit, Finnish Tax Administration

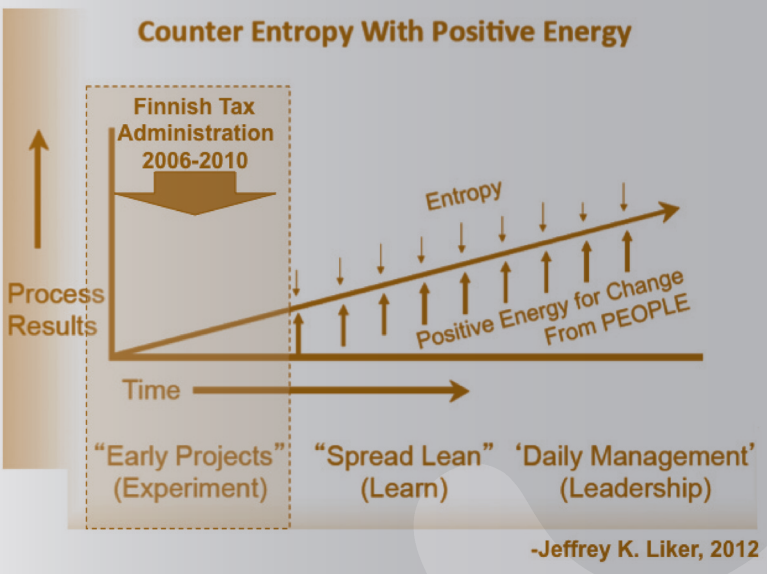
P.O Box 325, FI-00052 Vero, Finland
Tel +358 40 1484784
E-mail: tiina-liisa.huhtanen@vero.fi

Ms. Huhtanen works as a Process Owner (Taxation) in the Finnish Tax Administration. She holds a Master of Science degree in Engineering (Quality Management and Measurement Technology). Ms. Huhtanen has a central role in developing the process management system in the administration. She has worked with Process Development and Management Systems in several multinational companies since 1997 and she joined the Finnish Tax Administration in 2010.

By Juha LINDGREN and Tiina-Liisa HUHTANEN

Finland

The Finnish Tax administration has selected a process approach as their strategy in operations development. That is the way to ensure smooth operations through the whole process chain from customer to customer and to avoid sub-optimization between functions. For process development initiatives the principles of Lean management form a strong background, even though within internal communications the term 'Lean' is not used at all in the Finnish Tax Administration. A typical approach to deploying a Lean culture proceeds in three stages (J. Liker): 'Experiment phase' with some early projects, 'learning phase' where lean principles are systematically spread within the organization and finally the 'leadership phase' where lean culture has become an integral part of the way people think and act in the organization.



Picture 1: Phases for lean culture deployment according to Jeffrey K. Liker

Phase 1: Experimental projects

The first phase of experiments usually starts with a set of individual projects applying the Lean tools. That kind of approach is more a short or a mid-term one and the work is based strongly on the Lean 'tool kit' for waste reduction. The fundamental Lean principles and the profound cultural change within the administration are still missing. In the Finnish Tax Administration this early phase was experienced around 2006-2010. During that time several individual projects were run with process waste reduction as a guiding principle.

At that time both the strategy and the organization structure were still very different from the ones that exist today. Today's strategy is based on risk management. On the other hand the organizational structure was built on strong regional tax offices and it has only been since the beginning of 2012 that nationwide units have replaced this structure. Therefore, the background to gain the benefits from this kind of improvement has changed.

Three waste reduction projects from that phase are summarized here as examples. Topics of the projects are: 'Reducing over-processing in case monitoring', 'Eliminating rework in change application handling' and 'Decreasing process throughput time by applying continuous process flow'. In these projects different types of waste (over-processing, rework, waiting) were eliminated with the help of the Lean analysis tools. These projects were conducted with the lean six-sigma method, with special focus on the lean part.

Project 1: 'Reducing over-processing in case monitoring'

Manual case monitoring is the most labour-intensive part of the Finnish Tax Administration's operations. It was suspected that an unnecessarily large proportion of cases from the automated monitoring system were redirected into manual case monitoring without proper added value. The aim has always been to get the masses monitored using an automated process, especially in personal taxation.
The selection criterion for manually processed cases was systematically analyzed against final assessment decisions. It turned out that, depending on the monitoring phase, 50-80% of the selected cases were not changed nor updated in the additional manual phase.
Analysis helped to recognize several fully non-value adding selection criteria, over-lapping criteria and logic errors in criteria definitions. It also provided a background for removal of fully non-value adding criteria. Although not all identified changes were implemented immediately, the need for a thorough analysis of the selection rules became apparent for all tax types and all process phases. This has been the basis for subsequent risk analysis initiatives where the point was to reduce non-value adding handling (waste in the form of over-processing) and focus those resources more effectively towards the reduction of the tax gap.

Project 2: 'Eliminating rework in change application handling'

Process metrics showed that the number of change applications for individual taxation was very high. There was a need to further ensure that taxation decisions were made correctly in the first place and not postponed until the change application process.
Systematic analysis was conducted to identify the most important parameters and root cause as to why cases went all the way to change application processing. The analysis was done based on statistical data.
The most significant causes for defects in the first decision phase were identified as: Fragmented working days, ambiguous paper handling during the process, defects in data conversions and lack of availability of specialists in the correct places at correct times during the process.
New methods were defined to avoid workday fragmentation, to organize the timely availability of expertise and for paper document handling in data conversions during the process. The project also showed the importance of widening and keeping up one's "know how".

This project took place in the biggest regional tax office with 40-50% of change application handling cases at that time and the lessons learned have been utilized nationwide in organizing the change application handling on Personal Taxation Units from the beginning of 2012.

Project 3: 'Decreasing process throughput time by applying continuous process flow'

In corporate taxation the workload in monitoring was always piling up towards the end of the monitoring season (May-September). Therefore the completion of the whole work amount - getting the job done - was at risk.
Systematic analysis was conducted to recognize the most important parameters and root causes for cases that were still undone at the end of the season. The analysis was done based on statistical data. Process throughput time had huge variations among the case population. The majority (80%) of all tax assessment was finished during the last 4 weeks of the monitoring phase.
New working methods were developed in order to ensure a continuous flow in the process. The most important changes to be made were as follows:

1. Process continues through the summer holiday period without breaks,
2. Cases leading to changes are completed immediately and final decisions are not postponed,
3. Workload planning methods were revised and
4. New metrics for controlling the constant flow of the process.

It was especially important to spread the understanding about the importance of process flow continuity, controlling the throughput time variation (instead of throughput time average) and true percentage of value-adding time during the case handling.

This overview on these projects gives the reader an idea of the starting point for the development we are facing today. These kind of projects revealed the need to shift our competence and know-how in these kind of operations to the next level. At the same time the changes in strategy and organization gave both the support and the challenge to the process work. As a third main driver, the planned changes in the IT-systems of the Finnish Tax Administration can be mentioned.

Phase 2: 'Learning phase' for building the basis for the new culture

In the second phase the Lean culture starts to spread within the organization. In this phase the emphasis moves from 'waste reduction tool kit' towards a long-term cultural change. At the Finnish Tax Administration this phase started around 2010 and is still going on.
The trigger for this phase came from several sources: the organizational strategy was revised, significant changes in the organization were made when regional tax offices were replaced with nationwide customer-group based units and extensive needs for IT-systems replacement were identified.
It also became apparent that individual projects with lean tools were powerful enough to bring good results in the short term, but the systematics, the culture and the structure to maintain and further develop the improved process performance were still missing.
There are some fundamental ideas that well describe this learning and spreading phase and the qualities of the management system needed.

Mindset change: Welcome problems!

First of all there is a mindset change when talking about problems. Traditionally the western style of management considers problems as something to be avoided or, in the worst case, even hidden. In lean culture problems are welcomed as a valuable opportunity for improvement and therefore revealing a problem is a good thing. If problems cannot be revealed and recognized you do not have any opportunities to become better! Welcoming problems also leads to an emphasis on systematic methods for problem identification and solving. Those need to be widely known and used in the organization.

Long-term view instead of short-term gains

One of the fundamental problems in the 'Experiments phase' was the fact that improvements were successfully identified and implemented during the project stage but the results started to decay over time.
In the second phase, improvements are still implemented during the project phase, but there has to be clear long-term ownership and responsibility for problem identification and sustaining performance in all operational processes.

Making processes leaner, fitter all the time

The constant strive to make processes leaner and fitter means that we need to have the ability and skills to effectively recognize value adding and non-value adding work in all processes and at all organizational levels. People working in processes and developing them need

to be aware and trained about the principles of waste recognition. In each and every working process there is a huge potential to find and remove non-value adding work such as waiting, inventories, rework caused by defects, over-processing, overproduction, movement or transportation.

Empowering people

The Lean culture is strongly based on people, trusting them and empowering them. This supports active problem solving at all levels, reduces unnecessary bureaucracy and motivates people. This also causes a shift in the role of a manager from telling and ordering; towards questioning and challenging.

Deployment approach in the Finnish Tax Administration

How are these principles deployed today in the Finnish Tax Administration operations?
First of all we're not talking about 'Lean' at all because we do not want to create an impression of 'one more –ism', one of those coming and going. Instead we want to integrate the above-mentioned principles in our management system as a part of everyday management and work.
A long-term view in development initiatives is ensured through defined cross-functional process ownership. A network of process owners, sub-process owners and process development teams has been established according to the process architecture. The people in the network have responsibility for operations analysis, problem solving, initiating improvement projects and maintaining the long-term benefits of those implemented improvements. Networks deploy the 'learning by doing '- approach, which gradually starts to mould attitudes and values among all within the organization.
Staff are trained in the use of tools and methods for problem identification, problem solving, waste recognition and running improvement projects that are used among the process networks.

Reflection: Challenges expected and confronted

The third 'Leadership phase' of a full Lean organization culture is not easy to reach.
Culture change is always a gradual process and seldom a quick one. Paradigm changes are sometimes extremely difficult (for example, the role of monitoring the non-value adding functions).
Progress can occur only through 'learning by doing'. Doing things in a new way, which gradually starts to change values and attitudes and this eventually forms the basis for the change in organizational culture.
One of the biggest threats and mistakes preventing success is the tendency to mill problems, ideas and definitions endlessly on paper without moving into action. Instead we should take the problems in small portions and in a quick and iterative manner; proceed through systematic problem solving to real changes and action.
In order to maintain enthusiasm small successes along the way are needed to fuel the process.

Measuring the Effect of Training and Organizing Training Support at the Finnish Tax Administration

FINLAND

Merja KUJALA
Personnel Services Manager
Finnish Tax Administration

Haapaniemenkatu 4A, 00520 Helsinki
Tel +358 40 822 1581
E-mail: merja.t.kujala@vero.fi

After graduation (MA, English Philology Major) she have been involved with developing learning and training all my life in various roles. In the private sector she worked as a teacher, coach and senior consultant as a multicultural cooperation expert. For the last eight years in the Finnish Tax Administration she worked as an expert, senior advisor and currently as a Personal Services Manager in the Human Resources Unit.

Sanna ALAMÄKI
Deputy Director
Finnish Tax Administration

Haapaniemenkatu 4A, 00520 Helsinki
Tel +358 40 821 5842
E-mail: sanna.alamäki@vero.fi

After graduation (MA, Political Science Major) she started her career as a tax secretary and supervisor in a regional tax office, after which she has moved on to develop processes and functions in many different posts. She was first a regional training manager for Uusimaa Tax Office, an Administration Manager for the Corporate Tax Unit and at the moment she works as a Deputy Tax Director for the Corporate Tax Unit.

By Merja KUJALA and Sanna ALAMÄKI

Finland

Assessing the effects of training appears to be one of those ideas, which many consider a good idea, but difficult to implement in practice. Comments such as "How can you quantify learning?" usually stems any further discussion about the topic, as indeed, you cannot do that.

Yet, we need to evaluate the effect of training, if we want to know what really helps people to learn, what does not, and above all, what the actual effects of learning on performance are.

The purpose of this article is first to show how we analyze the effects of training. We will begin by explaining how our strategy has affected the training system and why it is vital to connect performance and training directly with each other. We will continue by illustrating how, by whom and why we have measured the effects of training in the Finnish Tax Administration.

The second part of this article will focus on describing what the effects of changing the organizational responsibilities and structures have been. We will show how training support is organized in order to support effective training, and what have been the changes and differences between the previous Tax Academy model and the current training support. The last part of this article will focus on needs for further development.

The effect of strategy on determining the results of training

Strategic Objectives

The strategic objectives of the Finnish Tax Administration are:

We will ensure the tax revenue by providing practical guidance and good service as well as by conducting sound tax control.
Our customers can contribute to their tax issues with as little cost and inconvenience to themselves as possible.
Our operations are both productive and economic.
These objectives are described in a reasonably general way, and as such, might not have directed us into the changes, which we will describe later. However, as achieving these objectives is directly linked with measuring their outcome, it means that we must understand which activities and organizational systems will help us to achieve the targets on a tangible level, and which do not.

We measure our success as follows:

1. The number of compliant customers increases.

2. A higher percentage of customers are willing to comply.

3. A higher percentage of customers consider that managing tax issues is convenient.

4. Inconvenience to customers decreases.

5. Costs offset to the customer decrease.

8. We reach the targets set in our strategy.

9. Our capability to renewal improves.

10. The willingness of management and other personnel to change increases.

Figure 1: The strategic targets and their measurement in the Finnish Tax Administration

Personnel, who are able to perform and fulfil their responsibilities, are naturally one of the core elements in order for us to achieve our goals. Therefore analysis of what helps people to learn and what are the concrete results of training is fundamental to understanding how we can support our personnel to realize the objective. When we are able to connect performance results with training results, it is also possible to understand other elements, which affect people's performance, and thus we can evaluate the effect training has on performance.
In basic terms, when we can see improvement in performance due to training, the training has achieved its purpose. If there is no link between the training and performance, the training has failed.

How to measure the training needs?

As explained in the previous chapter, the need to understand how training affects performance in practice arises from the strategy. So, how do we link performance and the results of training?

The Finnish Tax Administration uses processes as one of the main tools to develop efficiency and improve performance. As part of the normal performance analysis, processes also analyse possible competence deficiencies and follow up the results of any actions taken in order to improve competency. This means that learning and evaluating learning results is flawlessly interwoven with performance.

Processes indicate which areas they want to measure for possible competence deficiencies, i.e. the process manager with the project group decide which area is most important at the time to analyze. When he has decided what area is most critical, he will then analyse the actual performance of that area as part of the processes´ quality control.

For example, if a process manager wants to analyze how well the personnel have performed in writing customer letters regarding prepayment registration, he will use computer archives of the letters, and acquire two letters from each employee working for the process. The manager will then use a project group to examine the letters manually and compile the results statistically. These results are correlated with every tax office. If the results are not satisfactory, the group evaluates whether the reason for the poor results was the lack of training, or some other motive. If they decide that the reason for the poor result was in lack of training, they will produce a new training program.

Also it is important to notice that this method enables the project group and the manager to analyse other reasons behind poor performance. For example, if the reason lies within unclear instructions, they can immediately focus on the matter of improving them.

The direct result on performance is clearly demonstrated in picture two (see graph below). However, as a result of the analysis, it was noticed that when people's work role was wider and more complicated, the link between training and performance was not so clear. Despite training, the performance was not higher. This will be one area which needs further analysis and development in the future, particularly as the work roles are becoming wider and more complicated.

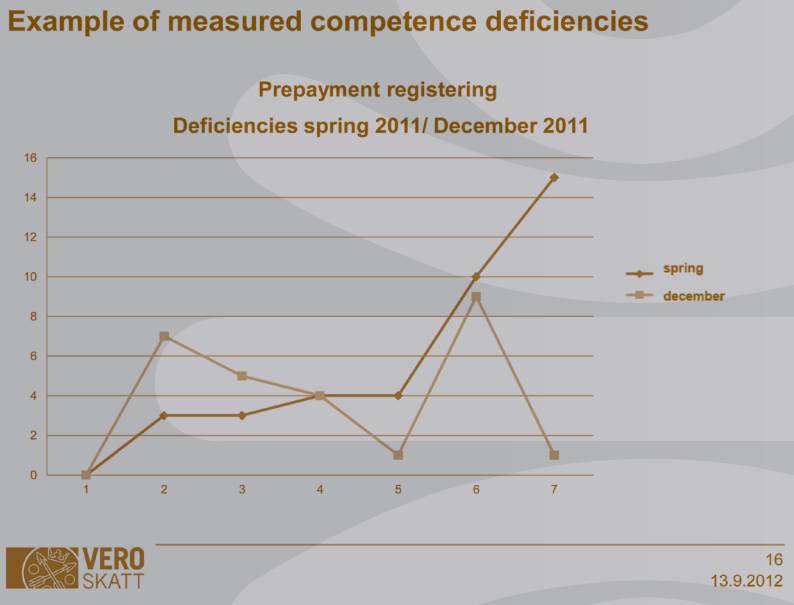


Figure 2: These are the results of performance between seven offices. Those, which delivered their personnel training in the spring, the results in performance were much better, compared to those (2 offices), who did not provide training, the results in performance were less satisfactory.

The new organisation of the Finnish tax administration and it's effects on organizing training

The purpose of our personnel is to help tax payers to fulfil their obligations to pay taxes as effortlessly as possible and, consequently, the purpose of all support units is to help our personnel to achieve their goals. Understanding what the supportive role really means has not been easy, typically the role of HR and administration was seen either as passive or invisible caretakers who made sure wages were paid, or who laid down instructions, rules and policies for the rest of the organisation to follow. Support units often had different priorities and targets than taxation units, which further separated them from the work at taxation units.

The new organisational structure changed this. Now all units share the same strategic objectives. This means that in order for a supportive unit to succeed, it needs first to understand what the needs of the taxation units are, and how well the support units succeed in fulfilling those needs. Secondly supportive units need to understand how their activities and services help the personnel to achieve strategic goals.

The guiding questions for the support units are "What are the needs of our personnel, how we can fulfil them and how can we help our personnel to accomplish these goals?"

Responsibilities of the Taxation Unit and Training Support Group

The change of focus for support units had huge effects on how training and learning was organised.

Each taxation unit now has responsibility for both performance and learning. This means that the connection between training and performance is embedded directly into the structure. There is no intermediate body outside the taxation unit to define the needs, evaluate the results and allocate resources. This way all those responsible for performance automatically have and are part of the learning process.

Figure 3: The purpose of all support units is to assist our personnel to help our clients, i.e. tax payers, to fulfil their requirement to pay their taxes with as little effort as possible, as reliably as possible and in the specified time given.

The role of the Training Support Group is to help the tax units to carry out the training and provide them with instructive pedagogical expertise, training models, and support for the trainers, whenever it is necessary, as well as to take care of practical arrangements. The Training Support Group is also responsible for e-learning applications.
Firstly this organisational structure enables taxation units to focus on developing those skills employees need most to improve their performance and to evaluate the effects of the training. Secondly it allows the Training Support Group to focus on understanding what type of pedagogical support is most needed at the taxation units and which methods work best in practice.

Tax academy model vs. training support model

Tax Academy Model

Here we have listed a few main differences between the previous Tax Academy Model and the new Training Support Model.
First, the Tax Academy was an HR - driven unit, whose priorities and services were defined by HR. The role of the taxation units, i.e. customers, was usually to participate in meetings and to comment on topics the Tax Academy had prioritized. This meant that from the customer's point of view, the questions and topic were not always relevant to their work, and as a result, all undertakings at the Tax Academy were not directly linked with the work of customers.
Also because the Academy was not directly connected with the business, it was slow to understand, react and adjust to changes in business, which happen much faster than before and are continuous. Communication was often slow at times and contained many misinterpretations, as the taxation units did not share common targets and objectives with the Tax Academy.
Another problem was that as the learning was separated from business and nobody was answerable for the whole learning process. As the vast majority of learning takes place at work, this division made it difficult to understand the effect of learning. At best it was based only on questionnaires sent a few months later to some students and their supervisors. As a result, it was difficult to know whether the students had learned the right skills on time. Finally, the development of training methods was not based on solid learning results and needs derived from work, but only on feedback passed on via questionnaires.

In brief, the Tax Academy model could not meet the new demands in a rapidly changing environment. Focusing on the needs of taxation units was difficult and providing the educational support did not meet the needs, as evaluating the end result, the effect on performance was not sufficiently measured.

The Training Support Model

In the new model all training activities are based on direct needs of the customer, as taxation units are responsible for developing learning and providing training.
The basic model for co-operation between taxation units and the Training Support Group is a partnership, in which taxation units order the services they need and the Training Support Group provides them. This resembles public-private partnerships, the difference being that the Training Support Unit is an internal unit.
As a result, all activities and services the Training Support Group provides are based on the needs of taxation units. The key questions for both the Training Support Group and those responsible for learning at taxation units are:
"How did the training help the student to perform better to serve the client or to collect taxes?"
"What works, what doesn't and why?"
"How did the training help to implement our strategy?".

These simple questions are the guidelines for developing training processes, methods and structures. If we cannot answer these questions, we have failed in defining either the needs of the target group of the training, applied wrong methods or not connected the strategy with training. When we can answer these questions, we know the training has been a benefit to implementing our strategy.

What were the Consequences of the Change?

It was interesting to notice how fast organizational changes affected some elements of learning. The table below helps to illustrate some of those changes.
The results of change

Tax Academy	Training Services Group
Training programs lasting 1-2 years, with 2-8 months application times *	Training modules lasting 1h-4 days, with. application time 0-8 weeks- Learning paths/ study paths to help to learn large entities.
Contents, goals, resources, training model and methods were defined by TA, some tax experts commented on content.	Taxation units define the content, goals and resources.
Training was separate from developing learning at work (e.g. workshops).	Training is part of developing learning at work.
Effect of training was evaluated via questionnaires.	Effect of training is evaluated via results in performance and questionnaires.

The staff consisted of: Training program coordinators, training planners, learning environment experts and course secretaries.	The staff consists of: Key customer managers for each unit, pedagogical experts, service managers, e-learning experts and course secretaries.
Training on offer available for each taxation unit only	All training on offer for all who need it at work
Different schedules for gathering needs for training and displaying it	Mutual schedules for gathering needs for training and displaying it
Training experts at taxation units did not meet systematically with each other, nor with Tax Academy	All taxation units and Training Support Group meet regularly and cooperate actively developing mutual systems to improve learning.

- Splitting these long programs into shorter modules already began in TA-model

Future development

The new system for organizing training has been operating for a year now. The first results have been promising, and do show that this was a step to the right direction. Still, this is just the beginning, and there are numerous areas, which require development.

First and foremost, one of the immediate needs for further development is to define what the key elements are in integrating all learning methods into a continuous learning process. This analysis should also provide us with the knowledge of what elements interfere with learning.

Secondly, we need to raise our awareness of the main elements of learning across the whole organization so that all who make decisions affecting that learning will be aware of the consequences of their verdicts.

And finally, there is an enduring necessity to improve training methods in order for us to accomplish and maintain our levels of competence in the business market thus projecting our professional image we have all endeavoured so hard to achieve.

On 1 January 2013, the Organisation consisted of 46 full Members from the following states or entities:

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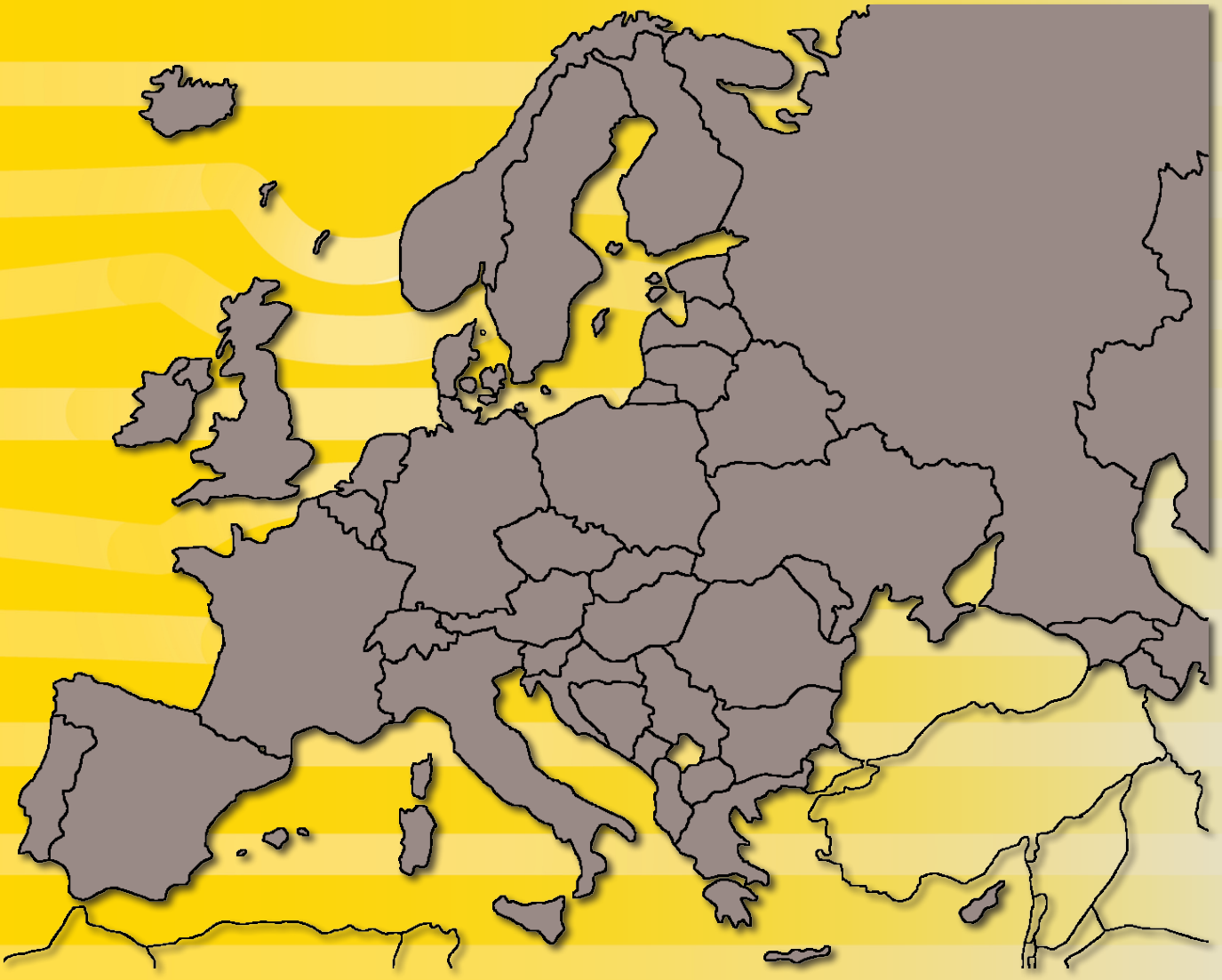

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