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RISK MANAGEMENT IN ORDER TO ENHANCE COMPLIANCE OF TAXPAYERS IN HUNGARY

Csilla TAMÁS CZINEGE

National Tax and Customs Administration of Hungary

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Intra-European Organisation of Tax Administrations

Csilla Tamás Czinege

Director General for Taxation

National Tax and Customs Authority of Hungary

+36 1 455 7472

remenyi.gabor@nav.gov.hu

RISK MANAGEMENT IN ORDER TO ENHANCE COMPLIANCE OF TAXPAYERS

Tax Authority risk management system

Assessing and analysing available data from risk point of view are elements of core importance in the modern tax and customs administrations. Segmentation from risky point of view is indispensable in order to resources effectively and to take targeted tax authority measures being in line with the level of taxpayers' compliance. Risk assessment tools make it possible for the National Tax and Customs Administration of Hungary (hereinafter referred to as NTCA) to be able to identify volume of risks.

By using risk indicators, it can be presumed that certain taxpayers mean outstanding risks and further interventions stimulating their compliance level are needed or they mean decreased level of risks, which can even be handled without carrying out a tax audit only by making use of the possibility provided by the supportive procedure. Risk assessment lies on objective bases. Risk analysis enhances targeted distribution of restricted resources onto areas meaning the biggest risks in order to achieving the appropriate level of tax payment and decreases, by doing so, burdens lying on taxpayers with low level of risks.

Risk analysis-selection and risk management system of the National Tax and Customs Administration is built on more elements and serves all professional fields of the Tax and Customs Administration, including evaluation of customs data from risk points of view as well. This paper focuses on risk analysis from taxation point of view.

Selecting taxpayers for tax audit based on risk analysis

As of 1st July, 2016 onwards, Risk Management and Selection Department of NTCA's Central Management carries out centrally selections both for tax audits and supportive procedures.

Tax audits must primarily be focused on those taxpayers, at which the risk of significant tax concealment and of unauthorised claim for tax refund or subsidies, respectively, is the biggest.

When selections for tax audits are made, the following risk factors can primarily be evaluated: risk and tax audits aspects included in the yearly tax audit areas; taxpayers' tax performance established according to centrally unified approaches; qualification of taxpayers; experiences of tax audits and supportive procedures carried out earlier, information on serious infringements of taxation rules; correlations amongst tax returns and data disclosures; information disclosed by third parties (other authorities and other taxpayers); data disclosures; data bases; data from international data exchange system; taxpayers' taxation history; irregularities and contradictions emerged earlier at owners, representatives business partners and companies founded by them; publicly available data; other information that is available in data bases of the Tax and Customs Authority and has risky value.

The NTCA operates centrally developed selection method and systems supporting risk analysis to assist in selecting taxpayers for tax audit.

Data making basis for risk analysis and selecting taxpayers for tax audit

The risk analysis system of NTCA builds on existing data sets that are available on data warehouse basis. The data can be grouped according to the place of their origin, thus they can be those provided by taxpayers, data originating from third parties and own data of the NTCA.

Such data are, for instance, the following: core data of taxpayers that are available to the Tax Authority; data from tax accounts and tax returns; data from real estate and vehicle registers; data from requests initiated and received by EU Member States; data from different business databases; data from EKÁER (Electronic Public Road Trade Control System) notifications; VIES control data; data from online cash registers or itemized VAT data.

Fictitious invoice issuers and recipients, who possibly take part in VAT frauds, taxpayers indicating domestic supplies as intra-Community supplies and taxpayers concealing their acquisitions and re-sales can be filtered out by making comparisons between data of invoice issuers and of invoice recipients, by analysing data and by revealing and using differences. Not only can invoicing chains affected by tax avoidance be filtered out but role of companies forming the chain (e.g. defaulting / missing traders, traders issuing invoices without real transactions and beneficial owners) can also be determined. By initiating tax audits at the same time at members of a suspicious chain, risk of becoming unavailable decreases.

International exchange of information

Increasing taxpayer and financial mobility have been more and more shading light on the importance of exchange of information on request. Furthermore, as a consequence of possibilities offered by the quick development of IT technology, automatic exchange of information on bulk data has been more and more becoming emphasized, such as: VAT Information Exchange System (VIES); information provided on the basis of Foreign Account Tax Compliance Act (FATCA); information on financial accounts (DAC2/CRS); country-by-country reports (DAC4/CbC); and information related to rulings received in the framework of spontaneous exchange of information and to resolutions on advanced price arrangements.

In the field of VAT, Hungary is the most often requested by Slovakia, Romania, Czech Republic, Poland and Germany, while in the field of direct taxes the majority of requests are sent by Slovakia, Germany and Austria.

Own data

Data mining software selects those risk indicators from hundreds of pre-developed indicators being available in tax authority's records and characterizing taxpayer's taxation history, profitability of taxpayers and taxpayers' business connections system through their owners and managers, which have the greatest capability in respect of the given risk. These model rules assign scores to every evaluated taxpayer. Based on taxpayers' order, taxpayers are categorised into categories with high, medium and law risks.

Taxpayer risk management process of the NTCA

Based on taxpayers' attitude to taxation, volume and probability of damage potential, the NTCA determinates forms of its actions and usage of available resources.

In the case of compliant customers, the NTCA lays emphasis on facilitation of fulfilling obligations (providing services and simplifying tax obligations) while in the case of customers inclining to compliant behaviour the NTCA emphasizes information and prevention. The NTCA takes the opportunity to nudge taxpayers towards compliant behaviour against customers inclining to minor misdemeanours or in the case of lower potential damage (warning, issuing notice and carrying out supportive tax audits). Where the chance of doing harm and its volume are bigger, application of the methods mentioned above does not result in a solution and enforcing compliant attitude (tax audits and enforcement procedures) is necessary by applying official means in targeted and consequent way. In the case of those taxpayers, in relation to which neither the latter solution is effective – because taxpayers have been ab ovo founded or have been operated with fraudulent intention or with the aim of tax evasion – close cooperation is needed with the criminal specialty as well as with bodies dealing with investigating frauds in other countries to eliminate risks and to exclude taxpayers from the economy.

The aim of risk management is to support the decision making process that is necessary for creating the groups mentioned above. In the course of detecting risky taxpayers, analysis of the concerned customers is performed by monitoring the whole taxpayers' taxation history while we separate risky taxpayers from the compliant ones.

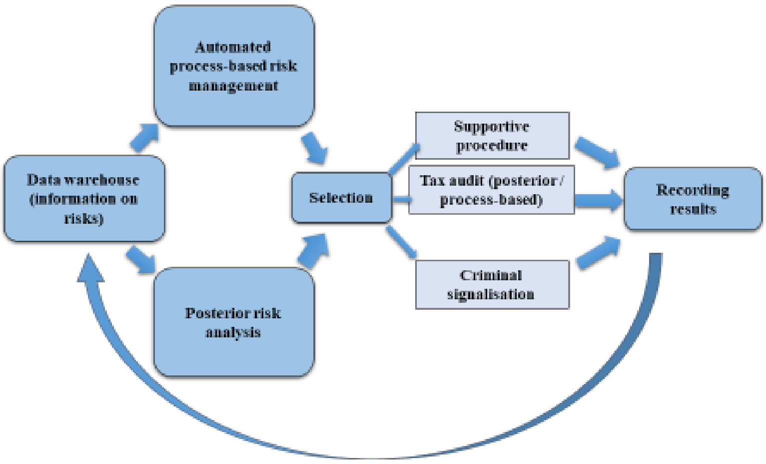
The risk analysis can be segmented into following groups:

- Risk management built in tax administration procedures: with the help of which movements of goods can be tracked and unlawful claims for tax refunds and subsidies can be tackled even before their remittance would take place. The following actions can be mentioned under this point: risk analysis of tax returns (e.g. VAT returns) before remittance; furthermore customs procedures' risk analysis built in administrative procedure and EKÁER notifications' risk analysis built in administrative procedure.
- Posterior risk analysis: in the course of which the specialty performing the risk analysis makes a proposal for taking actions, based on overall analysis of data being available for the NTCA (e.g. supportive procedure, supportive tax audit, tax audit, criminal notification, etc.).
- Random selection of taxpayers for tax audit (VAK[1]): In order to enforce general basic principles of ban of discrimination and bias, random selection of taxpayers for tax audit is applied together with targeted selection. The random selection is continuous, which is applied in such cases when tax audits affected by other methods of predetermined number of selections have already been closed in a group of taxpayers having a given tax performance. In these cases, the system will automatically generate the next tax audit.

Complex selection lists are compiled on the basis of risk indicators and the form of proposed action as well as the proposed method and subject of examinations are determined on the basis of individual analyses, concerning taxpayers enrolled on the lists. When measures have been completed, the system measures results of performed procedures in order to increase efficiency of the selection and experiences will be taken into account already in the course of the next selection for tax audit.

[1] The word „*VAK*" means blind in Hungarian.

Procedure of risk analysis and risk management



Monitoring

Risk assessment provides the continuous development of central risk management and selection in a dynamic way, by reacting to feedbacks within the Tax Authority. The methods used must be reviewed and updated from time to time in order to decrease the possibility of causeless selection for tax audit of taxpayers that are otherwise compliant. Furthermore, the methods must also be reviewed just to provide a possibility for managing newly emerging risks, which have not been identified previously, in a proper and targeted way. Risk assessment tools must also exclude the possibility for more risky taxpayers to avoid, by behaving in fraudulent way, being enrolled into risk management system.

The centralised risk management and selection organisation monitors performance of each field organisation and makes the necessary amendments. As an example for this, it can be mentioned that new companies are established in large numbers on the territory of competence of metropolitan and Pest county field directorates and the number of personal changes is significant in existing companies as well. That is why, in order to secure proportional distribution of tasks even in the case of companies established with territorial differences because of concentration of the economy as well as to secure the assessment based on unified principles, risk analysis of newly established companies and companies affected by personal changes (transformation) is carried out centrally at one territorial body.

System of handling revealed risks

Once the risk analysis procedure has been completed, the Tax Authority initiates a supportive procedure in order to eliminate revealed risks, selects the taxpayer for tax audit or informs investigation body of the State Tax and Customs Authority in order to prevent committing a crime, to detect the given crime or to hinder continuing the crime.

Consequently, once the detected risk has been evaluated, the State Tax and Customs Authority may take measures, which

- promote accomplishment of tax liabilities (e.g. informing the taxpayer; calling upon the taxpayer to make conciliation, to submit data disclosure, to make a statement, to complete data of his / her tax return or to submit a self audit form);

- stimulate eliminating tax risks (e.g. deleting the tax identification number, informing investigating body of the NTCA); or

when these measures cannot be applied because of the nature of the risk revealed, the Tax Authority may select the taxpayer for tax audit.

Digital data revolution – selecting taxpayers for tax audit with the usage of real-time data

Real-time data provide the possibility for effectuating immediate and real-time decision making.

Data from online cash registers and vending machines

Data warehouse containing data from online cash registers was established in 2013, in the course of establishing the online cash register system. Interrogation interface of the data warehouse has been built on Oracle Business Intelligence tools, which effectively supports interrogation and analysis of stored / processed data.

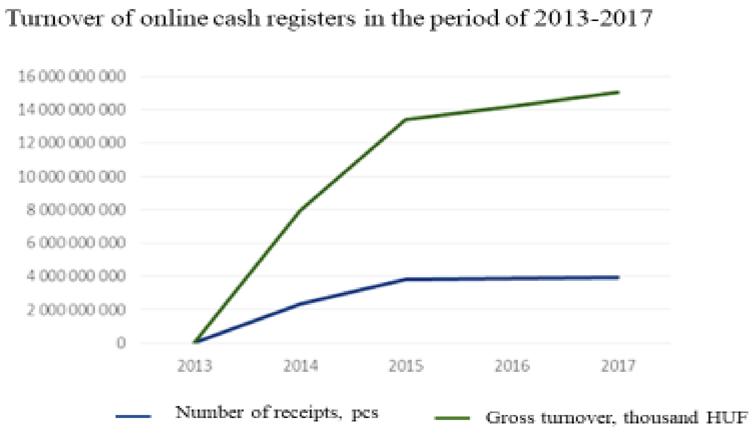
Besides data from online cash registers, data markets containing Itemised VAT data as well as data from EKÁER and data from detecting vehicle movement and from measuring axle weight has also been created in the data warehouse. The online cash register system provides an insight much wider than earlier on business activities of taxpayers because all such pieces of information are available in real time and in the course of their origin, which emerge in relation to supply activities of taxpayers.

On the online cash register data market, GPS coordinates sent by online cash registers and turnover data of vending machines have become available. The Tax Authority continuously analyses effects of a given action (e.g. tax audit, tax traffipax, etc.) on turnover in order to monitor effects on taxpayer's behaviour and compliance.

Immediately available data provides the Tax Authority with the possibility of filtering out shops issuing too low number of receipts or those having suspiciously little turnover.

Total comparison of data from data sheets submitted by taxpayers fulfilling their voucher issue obligation only by issuing invoices with data from VAT returns and other control data is also accomplished.

78.7% of tax audits carried out with the usage of data from online cash registers resulted in assessing tax arrears.



Data from the Electronic Public Road Trade Control System (EKÁER)

The importance of this system is that risky consignments can immediately after the notification be filtered out in the course of immediate risk analysis of data from notifications, which risk analysis is built into the risk assessment process. Risk profiles integrated into processing taxpayers' notifications made in the Electronic Public Road Trade Control System, which provide immediate risk analysis, were introduced in 2016.

According to our experiences, consignment movements have become more traceable with the help of EKÁER System, thanks to which tax avoidances without economic operations and based on fictitious transactions diminished.

Data from Online Invoice System

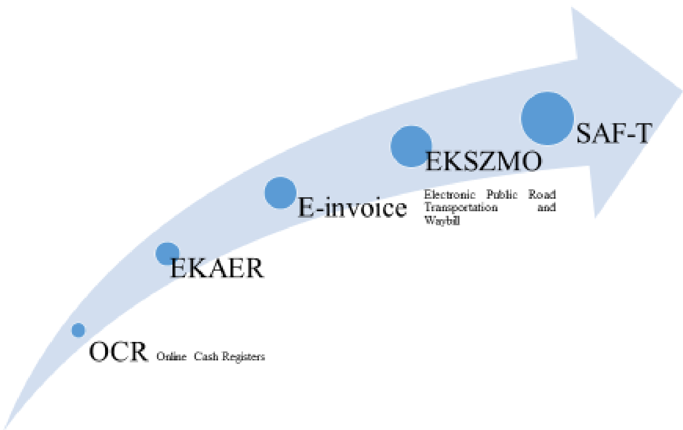
As of 1st July 2018, the threshold value for the obligation of submitting domestic VAT summary statements has decreased to HUF 100,000. By applying this modification, such a data set has got into the NTCA's field of view, which was not available earlier and with the help of which NTCA will also be able to track links missing from invoicing chains (i.e. smaller defaulters).

The Online Invoice System aims at fostering more targeted counter acting against taxpayers carrying out non-compliant activities and, by doing so, it serves the most important priority of the Tax Authority, which is defending voluntary tax compliant taxpayers.

The Online Invoice System makes analysing data content of issued invoices possible after their issue in real time not only afterwards, in the course of a tax audit. A preventive effect of this feature can be expected on the one hand and, on the other hand, tracking economic transactions can foster voluntary compliant behaviour. The Online Invoice System can significantly support the following actions: selecting tax returns containing tax refund claims for pre-remittance tax audit, becoming thoroughly acquainted with invoicing chains, clarification of risk models created earlier and introducing newer tax audit methods.

Further ways of the risk management using taxation aspects

Processes for tax risk assessments form a part of comprehensive risk management framework of the Tax Authority. The International Organisation for Standardization (ISO) has created basic principles and guidelines concerning risk management and risk assessment, which contain guidelines on creating, auditing, revising and continuous development of risk management framework.



In order to exploit NTCA's data set in as comprehensive way as possible, tracking automatically tax law risks integrated into processing customs procedures has been introduced in the fourth quarter of 2018. For instance, the following features have been built in the processing procedure: risky taxpayers according to qualification performed in accordance with the Law on Tax Procedure, furthermore companies dealing with illegal dissolution of companies, defaulting submission of tax returns, features implying sleeping companies or tax minimising companies. The overall aim with these features to be built in the processing procedure is to identify fraudulent behaviours and to identify taxpayers well in advance (pro-actively).

According to the Council Directive (EU) 2016/881, which has been promulgated in Hungary by the Act XCI of 2017, on the multilateral agreement concluded between competent authorities on country-by-country reports (so-called CbC Agreement), partner jurisdictions shall exchange with each other country-by-country reports compiled by multinational groups of companies having yearly revenues of 750 million EUR or more, which contain relevant data in relation to economic operation of the group of companies. Deadline for automatic exchange of information is the 18th month following the financial year of group of companies' final mother company, which was the 30th June in 2018 for the first time. Up to now, altogether 29 countries have sent data concerning the financial year of 2016 affected by data disclosure. Based on international experiences, it can be seen that tax risk assessment processes are continuously evolving and changing.

Some of these changes directly connect to introduction of the CbC reporting system in order to make use of information available this way for evaluation of tax risks of large multinational enterprise groups in such a way that confidentiality of CbC information is secured.

Closing remarks

A significant part of NTCA's digital data set contains relations amongst taxpayers from different points of view (with different contents). With the usage of these, it is possible to build up more-level connection networks amongst taxpayers, based on which taxpayers' connections system and its dynamics can be scrutinized generally or even thematically. The aim for the NTCA is to acquire such knowledge and technology, which are suitable for analysing these networks thematically and automatically.

Direction of further developments is provided by the following requirement: knowledge base and technology of network analysis and data mining should be used as effectively as possible within the organisation with the aim that they effectively foster risk analyses either built into the process or the posterior one, furthermore they foster tax audit procedure, carrying out supportive procedure and other necessary interventions to stimulate taxpayers' compliance.