

IOTA PAPER

Megatrends and Emerging Risks in Tax Administrations

Torsten Cumberland Jacobsen

Divisional Manager
Chief Process Officer
Process Development

**The Danish Tax Agency
Denmark**

Chair of the Enterprise Risk Management Community of Interest
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Introduction

An efficient tax administration is based on strategy, planning and risk management. Our organisations are not small nimble speedboats, but more like super tankers. We need to see strategic risks well in advance so we can steer clear of obstacles. To mitigate the potential impacts, we need legislation, IT systems, new competences, and other time-consuming activities. So, to avoid ad hoc firefighting, we need to get a longer-term view on the risks facing our administrations. Furthermore, if we are engaged in firefighting the short-term risks, we are not able to take advantage of the upside of the risks – the opportunity risks. That is the topic of this paper – what megatrends are we facing and what are some of the risks and opportunities facing tax administrations on a medium (3-5 years) and long term (6-10 years) basis?

Emerging risks for tax administrations - the project

For a number of years, the Enterprise Risk Management COI in the OECD has conducted a yearly survey on the short-term risks (1-2 years) facing tax administrations and presented these to the Commissioners of the member administrations. The survey has functioned well, supporting strategic decision making in the administrations, and has proved to be an excellent tool for risk management functions. But something was missing. The short-term risks were already there, and many had already had an impact. However, without a longer-term activity horizon it is difficult for large and complicated organisations like tax administrations to act and steer away from risks. So, it was a natural step to expand the survey to include medium- and long-term views.

Therefore, we brought together a group of some of the tax administrations with the most experience in foresight and horizon scanning to prepare an annual survey on emerging medium- and long-term risks. The members of the group are the United States, Australia, New Zealand, Canada, Norway, Finland, the United Kingdom, with Denmark as coordinator.

The goal is to present a number of megatrends with resulting risks and opportunities for the administrations, which can aid in planning and strategy.

Megatrend

A megatrend is a major movement, pattern or trend emerging in the macroenvironment that could impact individuals, organisations, and societies. Megatrends are not defined exclusively to other megatrends, but often have overlaps.

Emerging Risk

Emerging risk is a novel, unforeseen or re-emerging uncertainty in a new context. They are often characterised by their uncertainty, unpredictability, and potential to rapidly evolve. They have a potential to affect an organisation by exposing it to entirely new circumstances and challenges that were previously unidentified, especially in areas where the body of available knowledge is weak. Thus, it may be difficult to fully assess their likelihood or consequence.

Opportunity risk

Opportunity risk is a risk of not taking advantage of a potentially beneficial situation. Like emerging risks, they are often characterised by their uncertainty, unpredictability, and potential to rapidly evolve. There is often a limited timeframe to make decision. If the action is taken it would have a positive effect on achievement of organisation's goals.

So how did we go about shining a light on longer term trends? Well, there are a great number of forces affecting our administrations. But they are not all significant or important. We need to limit ourselves and focus. Therefore, we chose 7 megatrends, based on existing studies such as the World Economic Forum reports, Gartner, and the collective experience of the horizon scanning functions of the participating administrations. We believe that these megatrends will impact tax administrations significantly and create a range of risks and opportunities.

Megatrends in the PESTLE model

I will go briefly through each of the megatrends that we have chosen.





Geopolitical Instability

The first megatrend that we see is geopolitical instability – one of the currently most evident megatrends. The world is facing a more uncertain future where heightened geopolitical tension in the form of armed conflict, competition for resources, proxy interference and unpredictable policy etc., are creating instabilities in the established world order. Tax administrations must be ready for change and be proactive in meeting these challenges to ensure a stable operation and contribute to solutions as well as hone potential benefits.

As with all megatrends, it carries both negative and positive risks. Some of them – and this is not an exhaustive list and might not apply to all regions and administrations – are mentioned here.

Potential Emerging Risks for Tax Administrations

- International conflicts may disrupt supply chains and trade.
- Sudden changes in tax legislation may challenge organisational agility.
- Unpredictability may necessitate a heightened focus on risk management to ensure a stable operation.

At the same time, we have options in this trend if we act, such as in ensuring greater cooperation between tax administrations and greater exchange of data. Unstable conditions will also test the resilience of the administrations and force us to evolve.

Potential Opportunities for Tax Administrations

- Instability may create the need for more cooperation.
- Instability may provide the needed circumstance for change.
- Instability may put to light underlying issues.

Economic Globalisation

Economies are increasingly interconnected through globalisation and digitalisation, where the local quickly becomes global. This influences trade and cross border money transfers, which necessitates the ability to adapt in order to take advantage of the benefits. The digitalisation of the economy has also created new methods of payments, such as mobile payment options or digital currencies, which have changed the way money moves around. As the world's economies become more interconnected and cooperation becomes essential for individuals and businesses, this development also makes the economy more vulnerable to supply chain insecurity outside of individual nations. Examples include events such as the effect of COVID-19, the computer chip shortage and higher production costs due to the scarcity of fuels.

This megatrend has been around for some time. This is also reflected in some of the risks involved, of which several have already impacted or will do so in the near future.

Potential Emerging Risks for Tax Administrations

- Tax administrations may find it challenging to address tax evasion in cross-border transactions, depending on legal tools and cooperation between countries.
- New methods of payment may make it easier to hide revenue.
- Tax legislation will be challenged to adequately address changes in the economy effectively, depending on the legal framework.
- Cross-border transactions may challenge the ability to follow revenue.
- Tax administrations may be challenged with stimulating and supporting businesses via tax policy in the event of issues with supply chains and cross border exchange of goods and services.

Here we also have a number of possible opportunities. If we have enough time and focus strategically, we can mitigate the risks and take advantage of the opportunities in the megatrend.

Potential Opportunities for Tax Administrations

- Increased tax revenue through new types of business opportunities and business models.
- Advantageous cooperation with international tax bodies and improved cross border exchange of tax information through international agreements and legal cohesiveness.
- Implementation of flexible tax policies to support economic stability and growth.

Societies in Flux

Over time, changing attitudes, behaviours and social norms are affecting how societies operate. The spread of misinformation and disinformation, increasing polarisation, and declining trust in institutions are further impacting these changes. Pressures on parts of society may include - but are not limited to - housing unaffordability, economic inequality, movements addressing how societies respond to Indigenous cultures, rise of mental health issues, growing diversity in how people identify themselves and demographic changes. The increased rate of migration within and between countries may also have an impact on population composition and societal cohesion. This can create divides that can have a negative effect on social capital, trust, and growth, eroding the relationship between citizens and institutions and making it more difficult to form and implement new policies.

Potential Emerging Risks for Tax Administrations

- Lower dependency ratio of workers to non-workers decreases potential tax revenue.
- Polarisation within societies damages willingness to participate in taxation, eroding tax morale.
- Slow-to-change policies and services are seen as out of step with reality for citizens, decreasing compliance.
- Misinformation and disinformation cause customers to do the wrong thing, knowingly or unknowingly.

Some of the questions that might be asked are whether we, as tax administrations, are able to change quickly enough to deliver the right services or combat the rapidly moving risk of disinformation?

Potential Opportunities for Tax Administrations

- Adjusting tax policies and services to support an ageing population.
- Defining key data resources and algorithms as critical state infrastructure.
- Agency workforce reflects demographics of the general population.
- Support for migrant communities to understand tax and transfer systems.

Future of work



Next, we have the future of work. Both employers and employees must consider how they can harness new technologies and respond to evolving worker values and needs in order to seize opportunities. Flexible and borderless work, the influence of automation, and continuing globalisation change how, where and when some people choose to work. Employers must be prepared to respond to changing worker values, especially as the workplace experiences a generational shift, and ensure that their workforce has the capacity to respond to technological changes. Employees must consider these same changes and how they may affect their work and their career path.

Potential Emerging Risks for Tax Administrations

- Public perception and security concerns may limit the ability of tax administrations to compete in an international labour market that is increasingly driven by flexibility.
- Tax administrations may be challenged to compete in a competitive labour market for high value skillsets (e.g. cyber security and Artificial Intelligence (AI)).
- Tax administration employees may not be adequately prepared for, or have access to, the skillsets required because of the introduction of new technologies (e.g. automation, quantum computing).
- There is a risk of losing information and skills required with the retiring population.

To what extent can and do we want to compete with other sectors? On the other hand, we already see that shifts in employee value proposition away from just financial reward and towards elements such as flexibility may help tax administrations compete for key skills. The rapid change of needed skill sets presents a great challenge to administrations.

Potential Opportunities for Tax Administrations

- Shifts in employee value proposition away from just financial reward and towards elements such as flexibility may help tax administrations compete for key skills.
- Technological advancements, such as Artificial Intelligence (AI) present new opportunities to increase the efficiency and effectiveness of operations.
- The growing popularity of virtual work broadens the talent pool available to tax administrations.
- Non-traditional methods to engage with a wider talent pool (e.g. metaverse job fairs).



Technological disruption and digital transformation

Technological changes are moving faster than our ability to fully understand their potential impact. Transformational technologies such as AI, quantum computers, robotics, automation, virtual community and blockchain are fundamentally transforming the global economy and societies. Technological disruptions will also significantly impact tax administrations in many ways, providing both opportunities and risks. Tax administrations will need to balance resources so they can invest in pursuing opportunities while defending against vulnerabilities.

Here I would point out the risks relating to AI, which are really evolving. It is a double-edged sword. There are so many possibilities in AI, not only to administrations, but also to criminals. And it is a technology that is evolving as we speak. Are we, as traditional state agencies, ready to move with high-tech? Are we perhaps moving away from having a core competence in tax knowledge and moving towards needing core competences in digitalisation?

Are we ready to harness our data and reap the benefits? AI also brings out some traditional discussions and issues, such as data quality, bias, and process management. If our data quality is low, AI will damage our reputation rather than enhance it. At the same time, AI is an area with great opportunities. We can mitigate a lot of risks with smart use of AI. We can achieve higher production with less resources, we can give a better service, identify tax fraud much more easily, etc. AI can be applied almost everywhere in a tax administration. But are we ready for it? That is a key question. The same goes for process management. Are our processes documented and updated? Do we have an intimate knowledge of the value chain of our core services?

Potential Emerging Risks for Tax Administrations

- Perpetuate biases and increased concerns about fair tax treatment because of use of AI algorithms and other technology.

- Decrease in customer satisfaction and lack of trust due to the complexity of automated technology (non-human interaction) and spread of inaccurate information, some of which will be intentional, e.g. fraudulent or spam advertisements and communications.
- Bad or counteracting actors leveraging new technology such as AI to introduce new methods and techniques to perpetuate fraud or tax evasion.
- Complexity in managing and tracing the digital economy, especially in a growing virtual community landscape.
- Great reliance on systems and digital solutions may result in vulnerability regarding energy security and supply.

Potential Opportunities for Tax Administrations

- Improve operational efficiency by automating repetitive tasks or physically demanding work to focus on more complex work.
- Perform complex and large data analytics to monitor tax compliance and identify potential tax evasion.
- Digitally transform services to increase accessibility and simplify tax filing through online services or mobile apps. Technologies such as AI can offer personalised tax information and assistance, thus improving taxpayer experience.
- Increased cross-border or cross-agency collaboration through information sharing.

Cyber Security

Cyber security is already important to national security, innovation, and prosperity. It aims to keep information safe while supporting industry to capitalise on the growing hyper connectivity of the world. However, the cyber security landscape is changing and will continue to evolve in new and unpredictable ways. As we move to more digital interactions and become more dependent on technology, the importance of protecting systems is increasingly necessary. It is even more important to protect and ensure the integrity of data and protect user identities as cyber criminals develop more sophisticated ways to breach the data.

Potential Emerging Risks for Tax Administrations

- Poor data protection may affect reputation and make national and international cooperation and exchange of tax information difficult.
- Vulnerability of old systems, contractors, suppliers and third parties may result in breaches or losing access to important assets or services.
- More complex and advanced attacks such as phishing, malware, deep spoofing, fake websites, fake digital and physical identification, and ransomware are more difficult to detect.
- Additional planning and investment are needed as new technologies emerge, leading to the necessity for ongoing improvement to identity, security and privacy practices, and rising cyber insurance costs.
- As cyber security improves there may also be an increase in physical attempts at gaining access, for example through insiders.

Challenges for the future include, but are not limited to, an insufficient understanding of cyber vulnerabilities, ease of use and access to new technologies, as well as actors' willingness to circumvent and negatively affect systems. And it just takes one successful hacker to damage our reputation seriously.

Potential Opportunities for Tax Administrations

- Well-managed cyber risks and resilience can enhance an organisation's reputation and reliability.
- Taking advantage of new technologies such as quantum-enabled cryptography to develop cybersecurity and resilience.
- Opportunity to improve cybersecurity while developing digital services.

Climate change and sustainability



Mitigating and adapting to the effects of climate and environmental change is a global issue. The effects of extreme weather events include destruction of infrastructure, disruption to communities and business, and migration. Linked to this is the loss of biodiversity which threatens primary industries and environmental sustainability. Increased awareness of climate change is a driving force towards sustainability. Governments and consumers may increasingly favour companies that prioritise environmental responsibility. Examples may include carbon credits, clean tech, Environment, Social and Governance credentials or renewable energy sources. All these issues are at the same time being balanced with increasing demand for energy, resources, produce etc.

Potential Emerging Risks for Tax Administrations

- Disruptions to potential revenue collection from industries negatively affected by climate crises.
- Unreliability of digital services with disruptions in energy supply.
- Pressures on agencies to increase revenue collection to meet costs of country emissions reductions and infrastructure replacement etc.
- Appropriately addressing possible climate emigration, which may affect tax-base and economic stability, and immigration, which may necessitate ensuring that affected individuals can participate in tax and social policy programs.

Potential Opportunities for Tax Administrations

- Implementing climate-related taxes to incentivise reductions in emissions.
- Reimagine taxation to work alongside business models based on circular economy, non-profit or de-growth economics.
- Agency operations become carbon neutral supporting climate change mitigation.

The way ahead

In conclusion, we need to look ahead and study the challenges we will be facing in good time so we can steer clear of obstacles and make use of the opportunities that the fluidity of the world creates for tax administrations. The potential of a survey which can help us in strategy making, resource distribution and creating the skillset of future tax administrations – to name some central areas – is enormous. At OECD level the emerging risks group will, in the coming months, analyse the responses from the tax administrations. We plan to have a report on the survey ready by autumn 2024. This can be used by administrations to help them horizon scan for risk, seek opportunities, and build flexibility and resilience into their long-term strategic plans.

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For general information on our other print or online publications, please contact us via

 Secretariat@iota-tax.org

 12-14 Dohány Street, H-1074, Budapest, Hungary



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