

The Role of Tax Administrations in the Current Political Climate

Transparency

The author places the debate on tax evasion and avoidance in a broader perspective and argues that effective tax compliance will only be achieved if society perceives that the tax burden is fairly shared and that the tax administration has the right balance between good tax enforcement and tax payer service.

1. Introduction

Over the last year there has been unprecedented attention focused on the role of tax administrations in delivering the revenues that governments need. Much of this attention has been on the question of whether or not multinational enterprises (MNEs) and high net wealth individuals (HNWIs) pay the right of amount of tax. There has also been a renewed interest in tax gap analysis. Yet, in many countries governments are cutting back on the resources available to tax administrations and, at the same time, asking them to do more, including the delivery of expenditure programmes. This article places this current political debate on tax evasion and avoidance in this broader perspective.

It suggests that, despite the current focus on adopting a tougher stance on tax enforcement, effective tax compliance will only be achieved if it is combined with good taxpayer service and where there is a constructive and transparency dialogue between tax authorities, taxpayers and their advisors. It also counters the impression that nations, such as the United Kingdom and the United States, have become nations of tax evaders. The reality is that the vast majority of taxpayers pay the right amount of tax, in the right place and at the right time.

In this respect, this article examines the following four related issues: the change in attitudes to tax compliance on the part tax administrations (see section 2.); how tax administrations have responded to the challenges of operating a tax system in a rapidly changing global environment (see sections 3. and 4.); what new challenges are tax administrations facing (see section 5.); and the role of international cooperation (see section 6.).

2. Change in Attitudes on the Part of Tax Administrations

In the latter half of the 20th century, the traditional approach of tax administrations to tax compliance was very much based on what I call a military analogy: identify the target (evaders), take them out. The focus was to detect and deter evasion primarily by blanket auditing. Tax administrations were the "cops" in the system: their role was to police the system. Audits, usually confrontational, were at the centre of the strategy. Success was measured by the yield from these audits; the number of assessments made; the number of court cases won, or in some cases even lost; the extra revenue brought in. Most tax administrations were headed by either lawyers, with a natural inclination to litigate, or tax technicians that had worked their way up through the audit chain. Tax administrations found it relatively easy to gain more resources: most tax administrations were much larger in 2000 than they were in 1980.

Tax administrations are now moving towards developing a more behavioural response to compliance: shifting towards prevention rather than just detection and non-compliance. Why this change? The reasons include: recognition that the majority of taxpayers want to voluntarily comply and the tax administrations main task is to help them do that; taxpayers are becoming more assertive and insisting that they have rights as well as obligations; taxpayer segmentation, in the acceptance that different groups of taxpayers have different types of needs; a move away from a tax-by-tax approach to more of a taxpayer-by-taxpayer approach; most tax administrations, certainly in the developed world, are now under severe pressures to do more with less; and a recognition that the informal economy cannot be dealt with effectively just by stricter enforcement.

3. The Pressures on Tax Administrations

Over the last three decades, the role of tax administrations has changed. Tax administrations have become not just collection agencies but also spending agencies. Many are now responsible for implementing social programmes, for example, family credits and student loan schemes. Many governments also look to the tax administration to implement part of their structural programmes to exit from the crisis. Increasingly, tax authorities are taking on the role of regulators, for example, in the environmental area.

All of this has changed fundamentally the way that a tax administration operates, the profile of the staff needed and the political risks for tax administrations. Few citizens complain if their tax bills are late, but they complain loudly if their benefits payments are late. Some Tax Commissioners are ambivalent about this trend and we are beginning to see a reversal, with some tax administrations curtailing their functions as spending agencies.

Tax administrations now have to live in a global environment where MNEs operate as global entities, with more tenuous links to their own countries. They operate and plan on a global basis and this applies to their tax affairs. Similarly, the advisory profession has become increasingly global. Nowhere is this process of globalization stronger than in the financial sector. Foreign exchange controls have largely disappeared; controls on inward and outward investment have gone. Technology has enabled financial institutions to move vast sums of money around the world at the click of a mouse. Despite the challenges globalization poses for tax administrations, one should not underestimate the benefits of globalization: benefits for citizens; for governments; for business. But we must make sure that the costs and benefits of globalization are fairly shared.

This globalization of national economies poses new challenges for tax administrations, as they have to operate behind national barriers.

Another transformation in the global environment is the growth of new types of HNWI's. We have always had the very rich, but what we are now seeing is a tendency to move towards what some investment bankers have called the "ultra-rich"; or what many call "Davos men", and, generally, they are men rather than women. These are individuals who have much weaker ties to any jurisdiction; who are more aggressive and hands on in managing their wealth. And who are more "footloose" and more at ease with each other than their fellow citizens. They are also more prepared to take more risks in their management of their portfolios, including in their tax planning.

We have also seen governments putting more pressure on tax administrations to reduce compliance costs for taxpayers. This is not new, but it has taken on a new dimension with the recognition that compliance costs can be a factor in defining the competitiveness of a country.

This new environment has, nevertheless, opened up new opportunities for tax administrations:

- new technologies which enable tax administrations to provide e-services to a wider range of taxpayers;
- software that makes it far easier for tax administrations and taxpayers to calculate the amount of tax due;
- acceptance that in a global economy there is a need for greater tax transparency and the elimination of bank secrecy as a shield behind which tax evaders can hide; and
- new opportunities for tax administrations to learn from the experiences of each other and to intensify their cooperation and coordination.

4. How Have Tax Administrations Responded to These Pressures?

4.1. Introductory remarks

Tax administrations today are very different organizations to what they were even ten years ago. Some of the major changes are considered in sections 4.2. to 4.6.

4.2. Structural changes

Tax administrations have moved away from a tax-by-tax approach to an integrated approach to dealing with the taxpayers. Today, there are very few OECD member countries that have not integrated direct and indirect tax departments and many have also brought in social security. For large taxpayers, we increasingly see that VAT, corporate income tax and other taxes are dealt with in a highly integrated approach, with many countries having relationship managers that are dedicated to a particularly large company. We have also seen the move towards the creation of independent revenue services, especially in non-OECD countries, and this has minimized political influence, encouraged a move towards a more realistic pay scale and also made a clearer distinction between policy formulation and policy implementation.

In addition, we have seen most tax administrations establish special units to deal with groups of taxpayers which are particularly important in terms of revenue contribution. Many tax administrations now have large business units and these are generally responsible for dealing with MNEs. A growing number of countries have created units which focus on HNWIs and some have specialized units to deal with small and medium-sized enterprises (SMEs). We can expect this to tendency towards taxpayer segmentation to continue.

4.3. A new emphasis on risk management

Increasingly tax administrations are adopting a more sophisticated approach to risk management, which can be seen as part of the segmentation approach referred to in section 4.2. The basic idea is simple: by focussing resources on higher risk segments and taxpayers, tax administrations can make a more effective use of their limited resources. This requires a systematic approach to the identification, assessment, prioritization and treatment of compliance risks.

Successful risk management requires:

better access to information both domestically and offshore, and information that is needed to identify both low and high risk taxpayers;
 this, in turn, requires the ability to integrate information from different sources; and
 a communication strategy, explaining why a taxpayer is in the high risk category, what are the criteria, and what are the consequences.

4.4. A more behavioural approach towards compliance

This approach recognizes that the taxpayers' attitudes towards compliance are more complex than just being driven by the fear of detection. Behavioural scientists and economists have developed a new approach, largely pioneered by Australia (the Australian Tax Office (ATO) was far-sighted enough to support academics undertaking research in this area). The key idea is that those taxpayers who want to comply should be helped to do so, whereas the persistent evaders should be targeted for investigations and subject to strict penalties.

The ATO developed a compliance pyramid that placed taxpayers into the following four categories:

those who do not wish to comply;
 those who do not comply, but will do so if the tax administration focuses on them;
 those that try to comply but do not always succeed; and
 those that are willing to do the right thing and end up doing so.

This model went on to identify the five factors which may influence taxpayer behaviour:

the business type, i.e. sole trader, MNE, etc.;

the industrial sector, for example, whether or not the sector is heavily regulated;

the economic environment, i.e. what the macro economic situation is like;

the psychology of the taxpayer, i.e. fear, concepts of fairness, etc.; and

sociological factors.

The implications of this new approach are that it generally enriches the tools available to tax administrations to achieve good compliance that go way beyond just enforcement. It encourages them to educate taxpayers on their rights and obligations; to put in place mechanisms to improve service; to move towards a more targeted enforcement activities.

4.5. Putting tax compliance in the broader governance and/or social responsibility framework

For far too long tax administrators talked just to tax professionals, whether in the advisory community or in business. This is changing. Commissioners are now spending more time talking to Chief Executive Officers (CEOs), Chief Financial Officers (CFOs), Audit Committees and corporate boards. Getting them to see that good tax compliance should be part of their good corporate governance strategy, and this is not an easy time when the financial crisis is putting pressure on corporations.

The attractiveness of this approach is that it forces corporate boards to discuss more frequently tax issues and to take ownership of a company's tax strategy. Boards are more likely than tax directors to weigh up the financial and reputation risks associated with an aggressive tax strategy against a potential saving in tax. Some boards may decide to continue to pursue an aggressive strategy, others may not, but at least the debate goes beyond just minimizing the effective tax rate.

When the OECD started to explore this new approach in its Forum of Tax Administration (FTA), many Commissioners were sceptical. Some countries had rules that forbid the Commissioner to go into a board room; some Commissioners were concerned about being accused of doing "sweet deals". And some felt that this was not part of their job description.

Not unexpectedly, there was also a reluctance on the part of the business community and the advisory profession. They argued that tax was just too complex to have the board engage in detailed discussion.

The corporate governance community, as represented in the OECD's Corporate Governance Group, was reluctant to make the link between good corporate governance and good tax compliance. But after five years of work by the FTA, things are changing. Increasingly, Commissioners are spending more time talking to board members and this has resulted in a move towards boards accepting they must respect both the letter and the spirit of the tax laws. A view reinforced by the recently revised OECD "Guidelines on Multinational Enterprises",¹ which now explicitly refers to the need for MNEs to respect the spirit and the letter of the law.

This message has also been reinforced by the way in which civil society has taken up the issue of tax transparency and good tax compliance. And governments, both of the left and the right, have been responsive to these campaigns (the effect of the "Occupy Wall Street" and "Tax uncut" campaigns cannot be overestimated). Tax Commissioners and Tax Directors need to reflect on how they can operate in this new, more politically inclusive environment.

4.6. The move to more tax transparency

Tax administrations have built on the political support from the G20 and other groups towards more transparency in taxation and the elimination of bank secrecy as a shield behind which tax evaders can hide. Tax administrations are putting in place voluntary compliance initiatives to encourage taxpayers to come forward and declare their assets held illegally offshore. Other countries are putting in place tax amnesties. Some countries now require taxpayers to disclose uncertain tax positions. All of these initiatives recognize that we must deal with the legacy of the past if we are to move on to a new, more, cooperative future.

We have also seen a tougher approach adopted towards aggressive tax planning. Many governments have put in disclosure rules. Others have targeted not just the users of the schemes but also the promoters and many countries are using sophisticated communication campaigns to show why it is socially unacceptable to engage in these types of practises.

5. Upcoming Challenges

1. OECD, *Guidelines on Multinational Enterprises* (OECD 2011), available at www.oecd.org/daf/internationalinvestment/guidelinesformultinationalenterprises/oecdguidelinesformultinationalenterprises.htm.

In the context of the current media and political campaign to counter tax evasion and aggressive avoidance, tax administrations will come under unprecedented pressure to adopt a tougher approach to non-compliance. How effective they are in responding to these pressures will, in part, depend on how effective governments are in dealing with some of the broader challenges that will face tax administrations over the coming decade. What are these upcoming challenges? There are many which will materialize, but I will identify the following nine that may be particularly problematic:

- (1) The risks of breaches of confidentiality. While welcoming the spread of tax information exchange agreements, whether bilateral or multilateral, and the move towards automatic exchange, it is clear that in this new environment there is a risk that information will be leaked which could jeopardise the move to better exchange of information.
- (2) The increasing role of medium-sized enterprises in cross-border trade will also challenge tax administrations. These enterprises are far less familiar with the international tax rules and, therefore, may find themselves in a situation of non-compliance, in part, because they are not familiar with the rules. Tax administrations will need to consider how they can actually help these taxpayers, particularly in the area of transfer pricing.
- (3) Working closely with other tax enforcement agencies. Tax administrations need to accept they have a role in counteracting all forms of illicit activities and that information shared with other government departments does not represent a breach of confidentiality. There has been significant progress here over the last 18 months with the Financial Action Task Force making tax crimes a predicated offence. We have also seen unprecedented cooperation between tax and other law enforcement agencies but again, this does pose risks for tax administrations and does change the nature of their work.
- (4) The emergence on the global scene of MNEs that are from the BRICS (Brazil, Russia, India, China and South Africa) and other economies in transition. Since 2006, the Boston Consulting Group has been producing an annual list of "global challengers" from emerging economies. In 2006, its top 100 challenges was dominated by 84 large companies from the BRICS, with 34 being China based. By 2013, the number of companies from the economies in transition other than BRICS had increased from ten to seventeen and there was a much broader range of activities carried out by these companies with the emergence of high tech and more consumer orientated groups. These new global challengers are buying up firms in OECD member countries as a way of acquiring new skills and entering new markets and are particularly strong in developing markets, for example, Chinese contractors now account for 37% of the African construction market. They are also making a significant contribution to OECD economies, for example, TATA, the Indian conglomerate, now employs 45,000 individuals in the United Kingdom. These examples show how non-OECD-based MNEs have begun to go global and are now some of the fastest growing MNEs in the world. Inevitably, they have less familiarity with the international rules of the game whether in the area of treaties or transfer pricing and, therefore, perhaps may inadvertently or consciously non-comply with these rules; some may have weak corporate governance cultures.
- (5) Pressure to produce a business friendly tax environment. We can expect this pressure to increase as governments recognize that a competitive tax environment is not just a question of putting in place the right policy environment, but it is also a question of how the rules are administered in practice. The challenge for tax administrations is to avoid that a business friendly tax environment becomes an excuse for weak tax compliance as a means of attracting business.
- (6) Recruiting and maintaining high quality staff. A tax administration is only as good as its staff. Yet, today we see many tax administrations with an aging workforce facing the risk of a generation gap. Morale is weak and training programmes are being cut. A worldwide shortage in qualified tax professionals is emerging and governments will find themselves competing with the private sector for this diminished pool. One response may be to adopt more of a revolving door policy, whereby it becomes acceptable for tax experts to move freely between the private and the public sectors.

- (7) Maintaining taxpayers' trust in the system. A tax system is only as good as it is perceived to be. There must be a relationship between taxpayers, tax advisors and tax administrations that is based on trust; a mutual understanding. An inclusive and constructive dialogue on issues is the most effective way of preventing that these issues become problems.
- (8) Outsourcing of functions. Already we have seen many administrations undertake a substantial outsourcing of information technology (IT) functions, but there are also other functions that are being outsourced. Financial institutions are being asked or required to play a more important role, not just in the collection of tax (the traditional role of withholding agencies), but also as assessors of tax due and verifiers that the tax obligations are met. You can see this with the US qualifying investments (QI) arrangements and with the US Foreign Account Tax Compliance Act (FATCA),² initiatives. You can also see it in the Rubik agreements that are being pushed by Switzerland.³ In addition, we are seeing the beginning of a process by which tax authority's role as the collectors of data becomes less important as they rely on the information stored in the "Cloud".
- (9) Attitudes are changing towards tax disputes. Today, tax administrations and taxpayers increasingly recognize that they have a shared interest in minimizing and resolving quickly tax disputes and a recognition that this requires focussing not just on one particular issue, but on the whole process by which they can avoid disputes. This requires engaging taxpayers in the process of policy formulation and implementation. It requires identifying and discussing issues before they become problems. It requires pre-filing resolution, the type of programmes that we see in the United States (the compliance assurance program (CAP)) or the Netherlands horizontal monitoring programmes.⁴ It also requires a greater use of informal mediation, particularly in the area of establishing the facts in transfer pricing case. And it requires a wider use of advance pricing agreement (APA) type of programmes and mandatory arbitration. All of this will require a new type of commitment from tax administrations and willingness to devote scarce and highly trained officials to resolve tax disputes.

6. The Role of Increased International Tax Cooperation

Better cooperation between tax administrations can help to resolve some of these challenges. Many of these challenges come about from the intensification of the process of globalization and that in turn requires an increased cooperation between tax administrations. We have to accept that this will be a messy process with different actors playing different roles. Those who advocate that the solution to this is to create a "World Tax Organization" have to recognize that whilst, in abstract, this may be desirable, in practice it is a political non-starter.

We will continue to have many actors on the scene, regional groupings (the Intra-European Organisation of Tax Administrations (IOTA), the European Union, the African Tax Administration Forum (ATAF) and the Centre for Inter-American Tax Administrators (CIAT), The Commonwealth Association of Tax Administrators (CATA); smaller groupings (the BRICS), and more global groupings like the FTA, the UN Tax Committee and the Global Forum on Tax Transparency (at the last count, there were more than 15 organizations working on tax administrations around the world). In an ideal world, these organizations would come together under an umbrella organization (an approach that I tried with the creation of the Committee of International Organizations of Tax Administrations (CIOTA) in the 1990s, but which failed, although the International Tax Dialogue does bring together many of these organizations and has the potential to play this role). Nevertheless, we need much closer cooperation between these organizations. We need a sharing of best practices

2. US: Foreign Account Tax Compliance Act. This Act represents US: Internal Revenue Code of 1986 (IRC), chapter 4 and was introduced as an amendment of 18 Mar. 2010, enacted as Title V of Public Law 111-147 or the Hiring Incentives to Restore Employment Act.

3. For a critical view of Rubik agreements, see P. Pistone, *Exchange of Information and Rubik Agreements: the Perspective of an EU Academic*, 67 Bull. Intl. Taxn 4-5 (2013), Journal IBFD.

4. For more on the latter, see L. van der Hel-van Dijk & M. Pheijffer, *A Tailor-Made Approach to Fiscal Supervision: An Evaluation of Horizontal Monitoring*, 66 Bull. Intl. Taxn. 10 (2012), Journals IBFD.

and global benchmarks for the performance of tax administrations. This requires a South-South as well as North-South dialogue.

We also need to move from cooperation towards better coordination between tax administrations: moving beyond the exchange of information, having simultaneous examinations, joint audits all of which offer new and exciting opportunities for coordination. The legal framework is there in the Multilateral Convention on Administrative Assistance, which now has over 70 signatories. We also need more effective mechanisms to share information on aggressive tax planning schemes. So yes, tax administrations will remain national, but they can overcome these geographic barriers by better cooperation and better coordination.

Finally, for tax administration to effectively implement the tax laws and to ensure that MNEs and other taxpayers pay the right amount of tax, in the right jurisdiction and at the right time requires the governments provide a clear legal framework and the resources that they need to achieve this. It also requires a coordinated approach by governments to review the existing international tax arrangements to ensure that the division of the tax base between countries reflects the economic contribution that each part of an MNE has made to global profits of an MNE and it requires a common understanding on what constitutes fair and unfair tax competition. Hopefully, when G20 Leaders meet in Turkey in November 2015 to finalise the base erosion and profit shifting (BEPS) recommendations, they will provide this new framework.