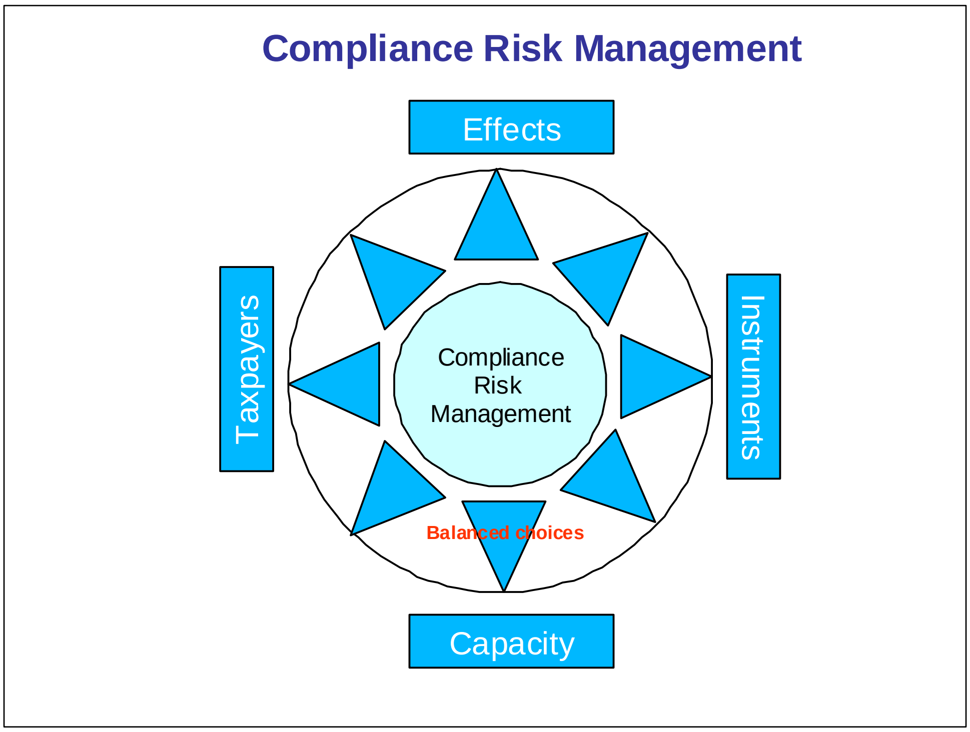
EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Indirect Taxation and Tax administration
Administrative cooperation and fight against fiscal fraud

COMPLIANCE RISK MANAGEMENT GUIDE

FOR TAX ADMINISTRATIONS

Fiscalis Risk Management Platform Group

(FINANCIAL CODE: FPG32/GRP4)



PREFACE

Since 2008 a Fiscalis Risk Management Project group has been working on the update of the original Risk Management Guide. This is a Guide prepared by tax officials for tax officials[1]. Member States approved the original Risk Management Guide in 2006. It was discussed at a Fiscalis Risk Management Seminar in June of that year and published on the Commissions 'Europa' website:

http://ec.europa.eu/taxation_customs/resources/documents//taxation/tax_cooperation/gen_overview/Risk_Management_Guide_for_tax_administrations_en.pdf

The Guide provides background information, best practices and a framework for the implementation of modern compliance risk management principles for tax administrations. Compared to the original Guide, the up-date focuses more on influencing behaviour. A few years ago Risk Management was more or less applied as a form of risk analysis, focused on a better selection for tax audits. In more recent years Risk Management has been significantly developed, both within and outside the EU. It has evolved as a systematic process in which efficient and effective choices are made. These choices, to stimulate compliance and to prevent non-compliance, are based on the behaviour of taxpayers. These developments are reflected in the up-dated Guide with the introduction of a new section about influencing behaviour (part B). The emphasis on compliance is reflected in the new title of the Guide: *Compliance Risk Management Guide.*

Reading guidance

This Guide is targeted at policy makers, management and staff of tax administrations working in the area of compliance risk management. Chapters may have different relevance for different groups. Some reading guidance is set out in the following table:

Chapter	**Readers**
1. Introducing Compliance Risk Management	Policy makers, management and staff
2. The Compliance Risk Management Model A. The Risk Management Environment B. Influencing Behaviour C. The Risk Management Process D. Organisational factors	 A. Policymakers, management B. Policymakers, management and staff C. Management and staff D. Management
3. Examples	Policy makers, management and staff
4. Data, techniques and tooling	Staff
5. Organisational aspects of Compliance Risk management	Management

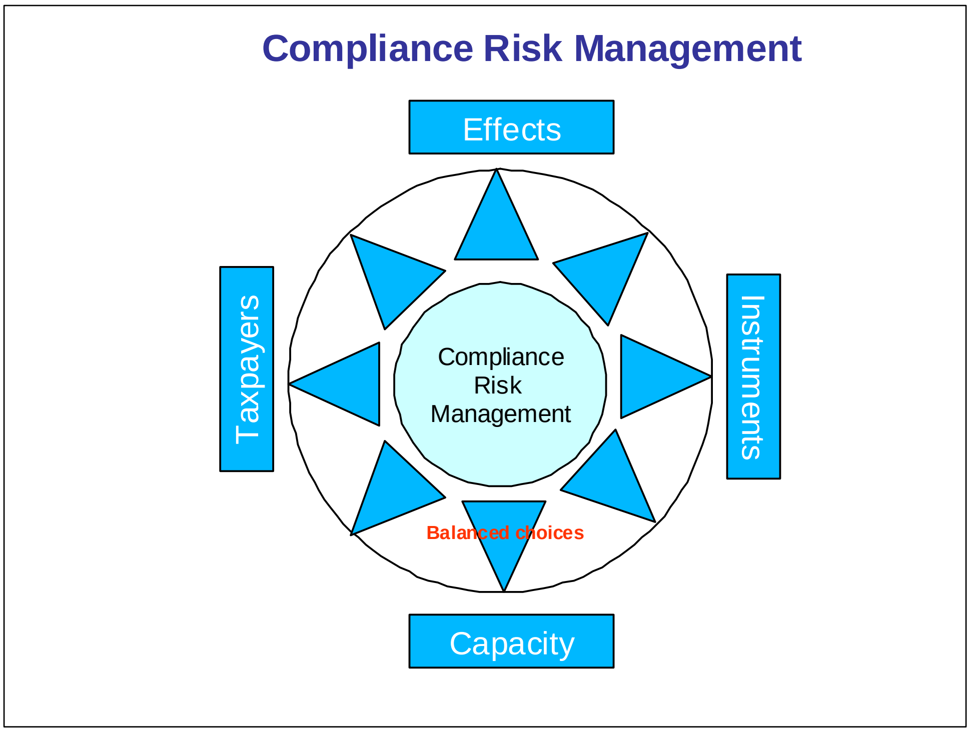
[1] The working group was headed by the Netherlands and comprised of delegates of the following Member States: Finland, Ireland, Latvia, The Netherlands, Slovenia and Slovak Republic. Three working groups headed by the United Kingdom, Italy and Sweden, comprising nearly all Member States, delivered input for the up-date.

INDEX

0. EXECUTIVE SUMMARY

A tax administration is part of a society in which citizens, businesses, organisations and public bodies react to each other's actions. Certain actions on the part of a tax administration lead to a reaction from the taxpayer and vice versa. In order to influence taxpayer behaviour a tax administration needs to be aware of its own behaviour but also of behaviour within society. It is important too to know what causes non-compliant behaviour by citizens and businesses. Making mistakes because of ignorance differs from aggressive tax planning and from tax fraud. Behavioural science has shown that criminal sanctions are not the appropriate response (and may have an adverse effect) when non-compliance is caused by complex legislation or a lack of knowledge on the part of the taxpayer. A tax administration should match its (compliance) strategy to the taxpayer's attitude and motives.

Compliance Risk Management could be described as a systematic process in which a tax administration makes deliberate choices on which treatment instruments could be used to effectively stimulate compliance and prevent non-compliance, based on the knowledge of all taxpayers (behaviour) and related to the available capacity.



The objective of Compliance Risk Management is to enable a Tax Administration to accomplish its strategic objectives by facilitating management to make better decisions.

This Compliance Risk Management Guide brings together a unified view of the relevant factors that form the environment in which Compliance Risk Management takes place, as well as the sequence of steps that need to be taken to implement the process. The theoretical framework is supported with some examples that have been provided by Member States.

The Guide is a practical reference for a full range of readers from policy makers to operational staff. A reader's guide is provided in the Preface.

The Introduction to the guide describes the Compliance Risk Management Model and shows the steps in the process, (identification, analysis, prioritisation, treatment and evaluation), set in context, objectives and strategy.

Chapters 2.1 to 2.3 deal with the Compliance Risk Management Environment. It sets out in more detail the external and internal context as well as objectives and strategy. Special attention is paid to the influence of changing economic conditions.

Chapter 2.4 discusses the role of Influencing Taxpayer Compliance Behaviour. This is still a developing and relatively new area for most tax administrations. It comes from the basic principle that understanding behaviour is the first step towards influencing behaviour. In their efforts to advance the desired patterns of behaviour of taxpayers, tax administrations are guided by perceptions of what drives behaviour and consequently what treatments are most appropriate when it comes to influencing it in a desired direction.

Chapters 2.5 to 2.9 set out in more detail each of the Compliance Risk Management steps (identification, analysis, prioritisation, treatment and evaluation). Evaluation focuses on outcomes. This is a more difficult area than output measurement. However, it is recognised as a more reliable measurement of the effectiveness of treatment strategies and actions to stimulate better levels of compliance.

Chapters 2.10 – 2.14 deal with some Organisational Factors that need to be considered. These include corporate governance, organisational culture and human resources. There is also a summary of the type of “shifts” that a change to a risk management approach will require.

Chapter 3 brings together all of the examples used to demonstrate the practical implementation of different aspects of the Guide. These examples have been provided by Member States.

Chapter 4 sets out a picture of a risk identification model, combining levels of knowledge, focus and IT. This forms a backdrop for more information on the risk tools and statistical analysis that are necessary to support a risk-based approach to compliance.

Chapter 5 has contributions from nine Member States where they set out a brief description of how Risk Management is handled in their countries.

The Guide specifically reflects the new directions that are emerging in relation to influencing compliance behaviour and a shift in the evaluation of effectiveness through a focus on the measurement of outcomes rather than outputs.

1. INTRODUCING COMPLIANCE RISK MANAGEMENT

Risk Management is part of our subconscious behaviour that guides us in making the best possible choices each time we have to make a decision. Usually, this can be seen as a human instinct, for instance when we have to make a choice between the different queues at the post-office, where we detect the shortest line, the least likely troublesome clients, etc.

Tax administrations have to deal with a large number of risks. These may concern the risk of non-compliance, including risk of tax fraud, the risk of insolvency by the taxpayer etc. Compliance Risk Management allows us to deal with these risks by looking at the behaviour of taxpayers (causing the risks). The term (compliance) 'risk management' can have many different meanings depending on the area in which it is used. However, they all have one thing in common; it helps us to treat risks, which appear to threaten our objectives. It can also provide us with a quality assurance for our actions.

The objective of applying Compliance Risk Management in this context is to enable a tax administration to accomplish its mission(s) by facilitating management to make better decisions. The Compliance Risk Management *process* helps to identify the different steps in the decision-making cycle, and allows us to make explicit and more educated decisions, in each stage of the process before moving on to the next one. As a result, Compliance Risk Management allows us to better measure the quality of each of the individual stages of the decision-making process, making it easier to detect mistakes.

Furthermore, Compliance Risk Management helps us to:

- achieve equal treatment of the taxpayers;
- focus the burden of audit to non-compliant taxpayers;
- make best use of the available human, financial and technical resources;
- increase the level of voluntary compliance of taxpayers;
- adjust available resources to the levels of risks;
- weigh the possibilities that a compliant taxpayer could become non- compliant.

In the context of this Guide, Risk Management can be defined as a technique to improve the tax administration's effectiveness in dealing with compliance risks. This may result in measures aimed at improving compliance and at avoiding non-compliance by taxpayers. It also helps us when it is decided that active treatment is required, by better targeting the available treatment options.

As such, this Guide provides a common foundation for decisions at all management levels within tax administrations, where each has to make the most informed decision about budgets and resources.

1.1. Introducing the Compliance Risk Management Model

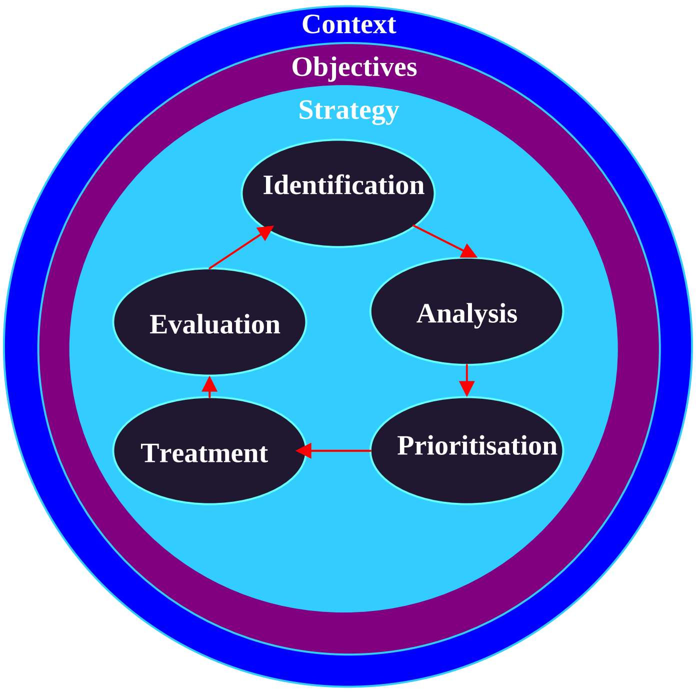
The primary goal of the tax authorities is to collect the taxes payable in accordance with the law, in such a manner that will sustain confidence in the tax system. Some taxpayers, due to ignorance, carelessness or deliberate actions, as well as weaknesses in a tax administration, fail to meet their obligations. Therefore, tax administrations should have in place strategies that strike a balance between traditional enforcement activities and innovative treatments seeking more effective ways to arrive at high levels of compliance and high taxpayer satisfaction.

Increasing the *effectiveness* of the Compliance Risk Management function is now more important than ever. There are several factors, which are recognised as increasing the risks faced by the tax authorities. These include such factors as the complexity and innovations in business structures, new financial products, large numbers of taxable persons and services, e-commerce developments, etc. At the same time, tax administrations are faced with the need to work more efficiently both in the eyes of public opinion (which demands new levels of efficiency and accountability of government services), and in view of reductions in budgets and restrictions to hire new personnel.

This all dictates new and flexible actions and approaches for tax administrations. Many tax administrations, in order to cope with the above-mentioned challenges, have introduced specific procedures incorporated in a general framework, the so-called Compliance Risk Management Model.

The Compliance Risk Management Process can be illustrated as a continuous loop, having the following steps: **Identification, Analysis, Prioritisation, Treatment and Evaluation**. The Compliance Risk Management Process takes place in a context, with objectives and a strategy and these links have been inserted into the model.

Fig. 1 Compliance Risk Management Model



Central to this process is the context. This can be defined as the combination of all facts or circumstances that surround an organisation, and which, in the short to medium term, should be considered as a given. Context can also be defined as the 'environments' in which the tax administration operates. As can be seen from the model, the context and objectives are not part of the Compliance Risk Management process itself.

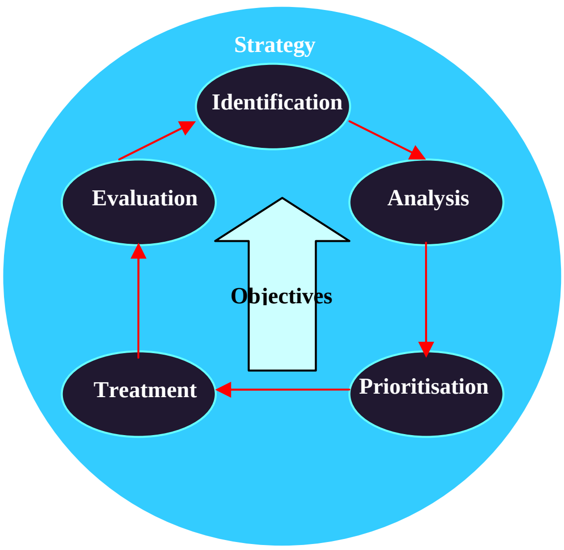
The objectives of the organisation are the specifically measurable results and outcomes which, when completed, will achieve the stated goal. Such goals can be defined at central level, but also at regional or operational level. Usually, the central objective for a tax administration is to collect the correct amount of taxes at the right time.

In general, the European tax authorities have the (implicit or explicit) strategic goal to stimulate compliance and to prevent non-compliance. The willingness of a taxpayer to fulfil his/her tax obligations has a major impact on compliance levels. Therefore, it refers to behaviour. In order to select the most efficient (low costs) and effective (best outcome) way to achieve the optimal level of compliance it is necessary to pay attention to taxpayer behaviour and methods of influencing that behaviour.

Compliance is the willingness of taxpayers to fulfil their tax obligations. In accordance with international standards this relates to registering, filing, correct declaration of the tax return and payment of the tax due.

In short: context can be viewed as the playing field together with the rules of the game. This is the framework that compliance risk management is applied within. The objectives describe the purpose of the game, what to achieve. The strategy describes how to play the game in order to reach the objectives. Within this framework, compliance risk management is used to decide what to do in order to achieve the objectives.

Fig. 2 Compliance Risk Management Process



The Compliance Risk Management Process is based on 5 consecutive steps. These steps form the Compliance Risk Management cycle. The first two steps relate to risk identification, analysis of risks and the behaviour of taxpayers that cause the risks. The next two relate to treatment planning i.e. making choices – about (groups of) taxpayers, risks and options for treatment - and the implementation of the treatment. The final step relates to measurement, evaluation and learning. All steps revolve around the goals implied by the strategy of the tax administration: e.g. higher compliance (leading to a lower tax gap) and higher taxpayer satisfaction. In the paragraphs 2.5 to 2.9 each step in the Compliance Risk Management model will be explained in more detail.

1.2. Limitations of Compliance Risk Management

While Compliance Risk Management is an instrument to allow tax administrations to make best use of their resources, we should also look at its limitations. Solutions to reduce non-compliance or to fight fraud need more structured approaches. Sometimes, it is the tax laws that represent a category of risk. The treatment required may be to change the legal framework rather than any administrative changes. In practice, many factors may directly influence Compliance Risk Management decision-making such as:

- variations in a tax authority’s financial resources that may substantially affect its capacity to deal with all of the risks identified;
- likely government position on specific tax legislation changes, e.g. powers for officials, that may represent an opportunity to deal with a risk;
- weaknesses or shortages in staff skills that may seriously prevent a tax authority’s ability to deal with major risks.

1.3. Compliance Risk Management in a future perspective

As much as Compliance Risk Management is based on universal and basic theoretical concepts it can be said that, when applied to tax administrations, it is a way of working and thinking that develops continuously. A Guide like this would not be complete if it could not contribute to this ongoing development.

A few years ago Risk Management was more or less applied as a form of risk analysis, focused mainly on better selection for tax audits. As the Risk Management approach has evolved, it is now applied in a more structured way and is using more advanced technology. This evolution will continue and some new elements will emerge.

This leads to a way of thinking that, in the long run, will change the administration in a more profound way (Compliance Risk Management). Tax administration is not about detecting tax evasion and applying sanctions. It is about ensuring compliance. In order to achieve this, a holistic and cooperative approach is necessary. New risks will emerge and new forms of treatment will be necessary that involves different parts of society.

In practice, this means that for the coming years the following developments may be predicted:

- *Influencing of taxpayer behaviour* will be developed further and will lead to effective and efficient use of different enforcement instruments based on knowledge of the behaviour and of the risks related to taxpayers;
- Compliance Risk Management asks for a *pro-active and preventive approach* to enhance the more traditional repressive approach. An enhanced relationship

between a tax administration and tax intermediaries and the use of pre-filled tax returns are illustrative for such an approach;

- More tax administrations will make Compliance Risk Management an explicit part of their organisational structure by creating risk *intelligence* units and use Compliance Risk Management as an integrated tool for all planning and decision processes;
- Concentration on Compliance Risk Management asks for building a learning circle and as such includes a focus on measurement of *outcomes* (effects) rather that a concentration on outputs;
- Compliance Risk Management strategies not only concentrate on lowering the *'tax gap'* but also on the level of assurance of the tax yield (*compliance map).*
- Enhanced co-operation in the area of Compliance Risk Management by sharing strategies, the development of common criteria and exchange of best practices (in the area of both direct and indirect taxes) through *mutual assistance* between Member States;
- Concentration and specialisation of Compliance Risk Management will allow for a higher level of professionalism and as such, tax administrations will be better equipped *to exchange risk information* to or from tax administrations in other Member States.

2. THE COMPLIANCE RISK MANAGEMENT MODEL

In an ideal, law-abiding society, people would pay the taxes they owe, and tax administrations would only facilitate provisions for citizens to carry out the responsibility. No such society exists. Compliance with tax laws must be created, cultivated, monitored and enforced in any society.

The administration of taxes is a complex task. The "best" tax administration is not simply one that collects the most revenues; facilitating tax compliance is not simply a matter of adequately penalising non-compliance. Tax administration depends on much more and there is a complex interaction between various environmental factors.

The purpose of applying Risk Management is to enable a tax administration to accomplish its objective(s) by facilitating management to make better decisions.

The *Compliance Risk Management Process* (see figure 2) is a dynamic and structured process. A systematic identification and analysis of risks and behaviour of taxpayers is followed by the determination of treatment options, the selection of treatment areas and the treatment itself. It concludes with the measurement of output and outcome and evaluation of the project or activity.

Compliance Risk Management looks at 'basic' risks that affect the fulfilling of fiscal obligations. These are registration, filing, declaration and payment of taxes. All steps in the compliance risk management process revolve around the objectives of the tax administration and should lead to higher compliance levels (lower tax gap) and higher customer satisfaction.

Purpose of Compliance Risk Management

Compliance Risk Management means taking deliberate action to improve the odds of a good outcome and reducing the odds of a bad outcome. Compliance Risk Management is not a magic formula that will always give the right answers. It is a way of working and thinking that will give better answers to better questions. It is a tool for decision-making and will help the organisation to reach its objectives.

The general objective is to provide value for the administrations stakeholders. Value is created, preserved or eroded by management decisions ranging from strategy setting to the day-to-day operation of the administration. Inherent in decisions is recognition of risk and opportunity. This requires that management considers information about internal and external environments, deploys precious resources and recalibrates activities to changing circumstances.

No administration operates in a risk-free environment and risk management does not create such an environment. Compliance Risk management enables management to operate more effectively in environments filled with risks.

Definition of risk

> The threat or probability that an action or event will adversely affect an organisation's ability to achieve its objectives.

The concept of risk has its roots in the ancient Italian maritime trade. It stems from the combination of the concept of chance or uncertainty on the seas and the materiality of loss of ships and cargo (regretfully, crew was expendable). In order to have risk, one must have both uncertainty and exposure to loss. Risk consists of the following characteristics; vulnerability, severity or significance and relative occurrence or frequency.

Risks are events or circumstances that could or will result in problems for the organisation. Risks should be defined to a level such that the risk and the causes of risk are understandable and can be accurately assessed. Risk covers all of the following:

Hazard	- bad things are happening
Uncertainty	- things are not occurring as expected
Opportunity	- good things are not happening

In simple terms, risk is '*uncertainty of outcome*'. This covers pursuing a future positive opportunity as well as an existing negative threat in trying to achieve a current objective. If the outcome would be a higher level of compliance, risk could also be understood as the chance of non-compliance.

The understanding of this concept is imperative. The risk definition makes it clear that the organisation's objectives are the starting point for identifying risks. Without an understanding of the objectives, it is not possible to identify risks. The identification of risks has to start with high-level objectives and continue with other objectives on different levels. The risk is the events or circumstances that could result in a bad outcome (not reaching the objectives). These events or circumstances must be identified.

It is the objectives that decide what the risks are. The risks will be quite different depending on the objectives. Both external and internal risks should be identified but focus should be on risks that are possible to be influenced in some degree by the tax administration. External risks are, for instance, taxpayer behaviour and different factors depending on the external environment. Internal risks are, for instance, tax officer behaviour (like corruption). It is important to cover both external and internal risks in some way.

A. The Compliance Risk Management environment

2.1. Context

Central to the Compliance Risk Management process is the *operational context*. This can be defined as the 'environments' in which the tax administration operates. There are a wide variety of environmental and organisational factors that have to be considered. The administration works in both an external and internal context. These can range across the economic level, governmental level, national and regional level.

2.1.1. External context

A number of factors in the external environment affect the operation context, including legislation, public opinion and economic conditions. Examples of external factors are described below.

Legislation

The laws provide the basis for taxation. It is not possible to appraise the efficiency or effectiveness of the tax administration without taking into account both the degree of complexity of the tax structure it is expected to administer and the extent to which that structure remains stable over time. Even the most sophisticated tax administration can easily be overloaded with impossible tasks. Enforcing a bad tax law is usually not a good idea. For a law to be enforced properly, it should both be appropriate to the environment and enforceable: good enforcement requires good tax law. The law also sets the framework for the Tax Administration's formal powers.

Public opinion

Examples of important public opinion are taxpayer attitudes toward taxation and toward government in general. Attitudes affect intentions and intentions affect behaviour. Attitudes are formed in a social context (social norms) by such factors as the perceived level of evasion, the perceived fairness of the tax structure, its complexity and stability, how it is administered and the value attached to government activities and the legitimacy of government.

Economic conditions

The economic environment also has an important impact on the effectiveness of a tax administration. Factors to consider could be the size of the economy and its influence on trading partners, its accessibility to and from other markets, the competitive tax policies of its main trading partners and the nature of its economy.

Many administrations focus upon existing processes within the administration, with a lower priority being given to consideration of the industrial and commercial world. In addition to perhaps placing unnecessary burdens on business it is possible that the administration could be creating risks to the revenue. It is therefore important to consider taxation from the taxpayers’ viewpoint. Globalisation and internationalisation influence the capacity to collect taxes and examine taxpayers. Corporations that operate internationally no longer consider national borders as an impediment to their activities.

Economic conditions are part of the taxpayer's context and the same behavioural drivers in a *changing context*, e.g. economic recession, will have some impact on behaviour.[2] This impact is complex and therefore difficult to predict. Besides the obvious payment problems that can occur there is no straightforward correlation between tax compliance and economic recession.

Economic recession

A basic starting point is to conclude that taxes on profits can only be evaded if profits exist. Economic recession can lead to no profits, which lead to no taxes, and therefore to no tax evasion or no reason for advanced tax planning. But reality is more complex than this. Many taxes are not related to profit (but to work or consumption) and many businesses are handling VAT even if they are not actually paying VAT themselves.

Some behaviours observed in economics, like risk avoidance or risk seeking in case of gains or losses, can be explained by referring to the prospect theory.[3] Among other things, the theory says that people are willing to take risks in order to avoid losses but they are not willing to take risks that might cause the loss of an otherwise certain gain. This means that tax evasion is more likely when a taxpayer faces a tax bill than a tax refund. This is supported by several studies.[4]

People are willing to take big risks in order to avoid big losses or failures. It is therefore a possibility that a taxpayer starts to evade tax in a situation where his business and life's' work is threatened.[5] This kind of evasion is often directed towards those taxes that have an impact on the liquidity in the short run (e.g. VAT).

Another issue is whether a higher rate of unemployment means more informal work (underground economy, cash sector, illicit work)? Will unemployed people find work in the informal sector and thus evade more tax? Studies in UK and Sweden indicate that the unemployed are underrepresented in the informal sector.[6] People that tend to do well in the formal sector are the same people that are doing well in the informal sector and vice versa. An economic recession will in this regard not increase the informal sector.

These are just a few examples but it shows that it is a complex question with no simple answers. Some compliance risks increase and others decrease in a changing economic environment. There are of course also other factors besides those described in these few lines. Changes in the economy will always present new businesses opportunities and behaviour that can be difficult to predict. It is important for a tax administration to closely monitor compliance behaviour at all times.

An economic crisis increases the relevance of the compliance risk management model. If a tax administration has to operate with budget cuts and reduced staffing levels it must carry out its tasks with limited resources. This makes it even more important to systematically handle the risks that threaten the compliance objectives of the tax administration.

2 Collecting Taxes during an Economic Crisis: Challenges and Policy Options. IMF Staff Position Note, July 14, 2009.

3 Prospect Theory was developed by Daniel Kahneman and Amos Tversky.

4 Pieter J D Drenth, Henk Thierry, Charles J de Wolff, Work Psychology, p 271, Psychology Press, 1998. Swedish Tax Agency report 2005:1B Right from the Start.

5 Lars Korsell, Tax, risk and crime, Expert report to the Swedish Tax Base Commission 2002.

6 Raymond E. Pahl, Does Jobless Mean Workless? Unemployment and Informal Work, AAPSS 493, September 1987. Swedish National Audit Office RRV:1998:29.

2.1.2. Internal context

A number of key internal capabilities impact upon risks associated with the administration of a taxation system. These include organisation, resources and tools. Examples of internal factors are described below.

Organisation

The organisational culture and structure is important. First and most importantly, risk awareness and awareness about taxpayer's behaviour at all administrational levels is necessary to manage compliance risks successfully.

All officials have to understand and accept what they are doing and why they are doing it. Like in a gear mechanism, all parts of the administration must fit their contributions together, or the whole mechanism will not work.

The structure and characteristics should be aligned to the mission statement and treatment strategies so that the organisation can operate effectively and efficiently.

Resources

The number of employees and their level of training and education are also part of the context. As a consequence of a risk-oriented approach, the allocation of human and other resources must be made according to risk and not the other way around. This means that treatment strategies should not be based on the current knowledge or location of staff. Treatment should be based on the prioritised risk and knowledge, the location of staff will need to adapt to this over the course of time.

Tools and access to data

The availability of IT-tools and access to data is of great importance. Intensive use of information technology creates opportunities to improve the performance of the Tax Administration. It affects factors such as reliable and updated taxpayer files as well as databases with crosschecking possibilities. Advanced tools are of no use if access to data is poor. The level of gathering data in digital form is therefore crucial to the administration.

2.2. Objectives

Objectives describe the desired outcome and state what has to be achieved at any administrative level within an organisation. There is a direct relationship between objectives, which are what an organisation strives to achieve, and the risk management process, which represents what is needed to achieve them.

Every tax administration within the EU is a law enforcement organisation with the statutory duty of levying and collecting taxes. By which methods a tax administration intends to implement its statutory remit, and which values and standards it adheres to in doing so, depends on its mission and the strategic goals it pursues. With respect to these missions, research shows that within the EU roughly four categories of strategies can be distinguished: some Member States strive for a higher level of 'compliance', others want to 'levy tax efficiently and accurately', others strive for a 'modern customer-oriented tax organisation' and the rest have the 'payment of taxes' as the central objective.[7]

The objectives decide what risks are to be identified. The objectives also have an impact on the risk assessment and on how the risks are being addressed. Every decision that is made in the compliance risk management process must take account of the objective(s) the organisation is trying to reach.

Risk is derived from the objectives. One *example* can describe this.

> Your objective is to increase voluntary compliance of all taxpayers including new businesses. Based on this objective, you can start identifying risks. Risks can be that new businesses fail to register as a taxpayer, fail to file their tax return on time, fail to completely and correctly declare their taxes or fail to pay on time. These risks need to be assessed and prioritised. According to the objective of voluntary compliance, it is important to determine what could be the reasons that caused the risks. Is it because the new businesses have a lack of knowledge, or the legislation is too complex, or their internal or social norms are not strong enough? If the objective is voluntary compliance, it is important to address willing taxpayers in such a way that they will be able to comply voluntarily with their fiscal obligations. If the objective was different, e.g. to maximise tax revenue, the focus could be to raise additional tax from the incorrect tax return and to impose penalties.

When risks have been derived from the objectives is it also possible to derive new objectives from the risks. In order to address a risk, an objective to achieve something could be stated. This objective would be a lower-level objective targeting a higher-level objective. For instance, if tax fraud is perceived as a risk, an objective could be that a good mutual administrative assistance process should be developed. This new objective (better administrative assistance) could then be used for identifying new (lower-level) objectives (for example: lower levels of irrecoverable losses for foreign taxpayers.

For a tax administration, it could look like this:

High-level objective:	Increase voluntary compliance
Identified risk:	Lack of confidence in the tax administration
New objective:	Increase confidence in the tax administration
New risk:	Tax officers treating taxpayers badly
New objective:	Change attitudes amongst tax officers etc.

This shows that an objective must exist in order to start working with compliance risk management. The objective is the starting point but when the process is working, it can also have an impact on the objectives.

2.3. Strategy

Strategy is an approach that is used in order to reach an objective. The objective describes what to achieve, the strategy describes *how* to do it. Strategy bridges the gap between objectives and activities. Strategy, which by itself depends on the context, has

7 European Co-operation and Legal Guidelines for an intra-community tax audit. A comparative survey of legal guidelines for tax auditing in the 27 Member States of the European Union (March 2009) E.C.J.M. van der Hel – van Dijk.

no existence apart from the objectives sought. It is a general framework that provides guidance for actions to be taken and, at the same time, is shaped by the actions taken.

Compliance Risk Management is a process that supports the development and review of strategies, but it does not create a strategy itself. The implementation of risk management must start with the development of a strategy.

A strategy could be a set of *methods or principles* describing how to act. However, strategy also incorporates principles for *ways of thinking*. It is also necessary that the strategies be based on *knowledge*. Knowledge is an absolute necessary part of risk management, regardless of risk model, structure and definitions. Without knowledge about the tax gap, taxpayer behaviour and the effectiveness of different treatment options, Compliance Risk Management is of no use. Based on methods, principles, a way of thinking and knowledge it is possible to decide how the objectives are going to be reached.

See example 1 Denmark (par 3.1.1.): The Danish Compliance Risk Management Model

2.3.1. Methods, principles and ways of thinking

Strategic thinking involves thinking and acting within a certain set of assumptions and potential alternatives as well as challenging existing assumptions and alternatives, potentially leading to new and more appropriate options.

The strategy should make it easier to choose an appropriate line of action. Some assumptions and principles could be established. These must be based on the objectives. If the objective is to increase voluntary compliance such assumptions or principles could be:

- as first priority address future taxpayer behaviour - to identify and correct historical errors are not equally important;
- an assumption that the taxpayer is honest as long as nothing else is proven;
- that there is not justification to use extreme measures against one or a few taxpayers in order to influence behaviour of others;
- to detect small errors early rather than to detect big errors late.
- carried out in a way that shows respect and understanding for the situation of the taxpayer.

Predefined principles and assumption can be very useful but it is not enough. Strategic thinking must also incorporate methods of how one should think, and not only what to think. This is necessary in order to constantly develop the work and to cope with new situations.

When a strategic decision has to be made it is important to focus on what the organisation wants to do or achieve. This focus on intent is important because it prevents the organisation from only looking at the obstacles. If focus is on limitations and obstacles it will be more difficult to find solutions and a possible way forward.

All members of an organisation have an understanding of how it works. These individual understandings are structures that affect the behaviour of the organisation. New ways of working fail to get put into practice because they conflict with deeply held ideas of how the world works, ideas that limit us to familiar ways of thinking and acting. Individual understanding’s can be improved or changed by surfacing the existing ideas and confronting them with facts about how things work. New knowledge, reflection and discussions tend to be an effective recipe for influencing work practices in an organisation.

It is also important to be able to think outside the box and to see the big picture. Most problems have a series of different inter-related causes. To understand the patterns will make it easier to identify possible solutions. It is seldom that there exists a quick fix for complicated problems. A holistic view of risk management (from an organisation-wide perspective) is necessary to successfully achieve the objectives of the tax administration. It would be very difficult to optimise the outcome for the end user without a holistic view, based on a dynamic way of thinking.

2.3.2. Knowledge

Historically, many tax administrations have addressed compliance risks only in terms of enforcement programmes. Traditional reactive intervention strategies, such as comprehensive audit, represent expensive, though necessary approaches to addressing some aspect of non-compliance. But a "single action" strategy is unlikely to be successful, particularly one based solely on enforcement actions. By giving greater attention to understanding the factors that shape taxpayers' compliance behaviour, a more effective set of responses can be crafted and implemented.

What induces compliance with tax laws has been subject to extensive research. The traditional view in economic models of taxpayer behaviour has not proven consistent with empiric evidence. A host of other factors such as social values, public morality, and people's perception about the fairness of the system also matter in shaping attitudes to tax laws.

This knowledge in itself is not part of the strategy, but the strategy is that decisions should be based on knowledge. Without knowledge about taxpayer behaviour and the effectiveness of treatment strategies, good decisions cannot be made.

2.3.3. Implementing strategy

Based on methods, principles, way of thinking and knowledge, it is possible to decide how the objectives are going to be reached.

Tax administrations must foster, and not simply enforce, tax compliance. This includes facilitating compliance, monitoring compliance and dealing with non-compliance.

Facilitating compliance involves such elements as improving services to taxpayers by providing them with clear instructions, understandable forms, and assistance and information as necessary. Monitoring compliance requires information systems as well as appropriate procedures to detect non-compliance. Improving compliance requires a mix of both these measures and additional measures to deter non-compliance such as the effective application of penalties. As a rule, successful strategies require an appropriate mix of all these approaches.

Compliance is most likely to be optimised when a tax administration pursues a citizen-inclusive approach to compliance. This can be done through policies that encourage dialogue and persuasion, combined with an effective mix of incentives and sanctions. Integrity and compliance are most at risk of parting ways when a tax administration seeks to improve compliance solely through making changes to the administrative or legal infrastructure without regard to the sensibilities of citizens.

Based on this a strategy on how to act could have the following approaches:

Increase the willingness to comply

Influence attitudes and norms

Reduce neutralisation factors (like “everybody cheats”)

Explain why one should comply

Make it easy to comply

Simplify

Assist

Inform

Use incentives

Rewards for compliance

Detection of non-compliance

Punishment

While there are three different approaches here, approaches two and three have an impact on the willingness to comply (approach one). The actions should therefore be done in the order they are described, but all three should be used. If taxpayers are mostly unwilling to comply and if it is difficult to do so, incentives will have little chance of success. Incentives can encourage and support certain behaviour but it can’t change behaviour in any fundamental way.

B. INFLUENCING TAXPAYER COMPLIANCE BEHAVIOUR

2.4. Influencing taxpayer compliance behaviour

In general the European tax authorities have the (implicit or explicit) strategic goal to stimulate compliance and to prevent non-compliance. Compliance is about the willingness of a taxpayer to fulfil his tax obligations. Therefore, it refers to *behaviour*. In order to choose the most efficient (low costs) and effective (best outcome) way to achieve the optimal level of compliance it is necessary to pay attention to taxpayer behaviour and the methods of influencing behaviour.

Understanding taxpayer behaviour is about understanding human behaviour. The specific behavioural aspects of paying taxes must be understood in the context of a broader perspective on human behaviour in general. Understanding behaviour is the first step towards influencing behaviour.

Research into tax compliance and taxpayers' behaviour started to attract attention in 1972 as a result of the research conducted by Allingham and Sandmo[8]. They presented a model, which, in simplified terms, explained that tax evasion was a product of the risk of detection and punishment in the form of tax penalties. Higher risk of detection or higher sanctions leads to less tax evasion. Based on this, the best and only way to increase compliance is to use traditional enforcement, i.e. audits and sanctions.

It is very important to note that taxpayers all over the world evade much less than these purely economic models predict. There must, therefore, be other explanations for compliance behaviour. This has put a focus on wider behavioural issues. Research has identified a number of factors and drivers that influence compliance behaviour.

Some of these factors are briefly described below:

Opportunity

Perceived justice

Social norms

Personal norms

Deterrence, i.e. perceived probability of detection and sanctions

(a) The *opportunity* for cheating is an important factor in order for cheating to occur. For example, a business-owner has considerably more opportunity than a wage earner. But this knowledge does not explain the behaviour. While this is an important piece of knowledge when one is looking for tax evaders, it does not explain why non-compliance occurs.[9]

(b) The way *taxpayers perceive equity and fairness* in a tax system has importance for whether the system is accepted or not. Three areas of justice can be identified; *distributive justice* refers to how taxes are paid and spent, *procedural justice* refers to the quality of treatment in interaction between taxpayers and authorities and *retributive justice* refers to perceived appropriateness of sanctions in case of rule breaking. Justice

---

8 Allingham, M., G., Sandmo, A. 1972, Income Tax Evasion: A Theoretical Analysis. University of Pennsylvania, Philadelphia, USA and The Norwegian School of Economics and Business Administration, Bergen, Norway.

9 Webley, P. 2002, Tax Compliance, Chapter from Economic Crime presented at Linköping International Conference on Economic Crime 2002.

must be perceived to exist in all three areas in order for the taxpayer to perceive equity and fairness in the tax system. This perception will increase the willingness to comply. All areas are therefore important, but tax research shows that procedural justice is of particular importance.[10] If the procedures are perceived as just and fair, the authority will be perceived as just and fair. The decisions of the authority, that is to say the outcome, will therefore also be perceived as more just and fair. An individual may thus perceive an authority as just and fair even if it has made a decision that goes against the individual, if the authority acts fairly when dealing with the case. This leads in turn to fewer complaints about the authority's decisions.[11]

(c) *Social norms* can be seen as the values of a certain social group. *Personal norms* are the individual's own ethical values and moral convictions. Social norms can be transformed into personal norms when norms are internalised by the individual and become a real part of his or her values.[12]

(d) *Deterrence* is not the most important factor behind compliance behaviour. Most of the research points in the same direction: the fear of feelings of guilt and the risk of social stigmatisation, i.e. personal and social norms, have a considerably greater effect on the decision to pay tax than pure economic self-interest.[13] This means that the direct effect of deterrence should not be overestimated. But deterrence also has an indirect effect of supporting social norms in favour of tax compliance. The most important aspect of deterrence is probably this norm-reinforcing function.

Influence of the factors on compliance behaviour

Norms and punishment are consequently both important for whether a person chooses to comply or not. A person can choose to comply with rules because social norms have been internalised in that person and become a part of his or her convictions. They have become personal norms. A person who is ruled by personal norms (his conscience) is always controlled. The person will follow his own conviction regardless of a potential risk of detection. Rules can also be followed in order to avoid trouble in the form of informal or formal punishment. To act on the basis of threat of punishment is to act in accordance with self-interest. No one wants to be punished; avoiding punishment is therefore in line with self-interest. But this also means that rules will not be followed when there is no punishment.

Compliance based on one's own convictions or personal norms mean that the person has an internal motivation to do the right thing. To comply based on the risk of punishment means that the person has an external motivation to do the right thing.

It is therefore likely that the highest levels of compliance would occur when *internal motivation and external motivation* are aligned. People are then compliant because they want to and because non-compliance will result in some form of punishment. Research shows that this can be the case but research also shows that external motivation (punishment) can influence and change the internal motivation.

---

10 Kirchler, E., Hoelzl, E. 2006, Modelling Taxpayers Behaviour as a Function of Interaction Between Tax Authorities and Taxpayers. Managing and Maintaining Compliance edited by H. Elffers, P. Verboon and W. Huisman. Legal Publisher, The Hague.

11 Murphy, M. 2003, "Trust me, I'm the taxman": The role of trust in nurturing compliance (draft). Centre for Tax System Integrity, The Australian National University

12 Wenzel, M. 2002, An Analysis of Norm Processes in Tax Compliance. Centre for Tax System Integrity, The Australian National University. Working Paper No 33.

13 Taylor, N. 2001, Understanding Taxpayer Attitudes Through Understanding Taxpayer Identities. Centre for Tax System Integrity, The Australian National University. Working Paper No 14.

All forms of external incentive, both positive in the form of rewards and negative in the form of punishment, influence the internal motivation. Of great importance is the fact that external incentives can either *increase* (support) or *decrease* (destroy) the internal motivation.[14]

Whether the internal motivation decreases or increases depends on the following factors:

1. The internal motivation *decreases* if the external incentive is perceived as *controlling*. The person's willingness to comply is not recognised which leads to reduced self-esteem and engagement. This means that if a person that wants to comply is forced to comply, the person will change, and will no longer want to comply. The internal motivation is replaced by the external motivation. In this case the external motivation is (punishment) counterproductive.
2. The internal motivation *increases* if the external incentive is perceived as *supportive*. An external incentive can reinforce the internal motivation and confirm that they are right. If the individual feels supported and has freedom to act, self-esteem and engagement increase.

The practical conclusion from this is that all forms of external incentives (punishment) should be used and designed in such a way that they support social and personal norms. This is not primarily a question about the severity of the sanctions but more a question about perceived justice and that people's good faith is recognised. Most people accept a system with sanctions but they want to be recognised for their good intentions. If a regulatory authority treats people like untrustworthy cheaters they tend to respond by behaving that way.

Strategy to influence compliance behaviour

A higher level of compliance can be achieved if knowledge on behaviour is used. A successful strategy for measures to combat tax evasion must attend to all the relevant factors and how they affect one another.

The considerations on compliance behaviour have important implications for revenue authorities, as they provide for new perspectives and possibilities.

It has already been argued that the task of revenue authorities is to promote compliance and reduce non-compliance with tax legislation. In their efforts to advance these desired patterns of behaviour, tax administrations are guided by perceptions of what drives behaviour and consequently what means are most appropriate when it comes to influencing it in a desired direction. These perceptions are often not explicit, but rather deeply rooted in staff experience and organisational culture, and consequently reflected in strategies and the day-to-day business of tax administration. Revenue authorities can therefore benefit from increased awareness on the relevance of behavioural considerations and how these reflect back on strategies, culture and practices.

In the framework of compliance risk management, revenue authorities can start by conceptualising compliance risks and treatments in behavioural terms. This will serve to direct additional attention to the root causes of compliance risks and provide a framework and a vocabulary for the systematic discussion on what treatments would be most appropriate for what behaviours. This discussion should ideally be informed by all

14 Frey, B. S., Jegen, R. 2000, Motivation Crowding Theory: A Survey of Empirical Evidence. Institute for Empirical Research in Economics, University of Zurich. Working Paper No 49.

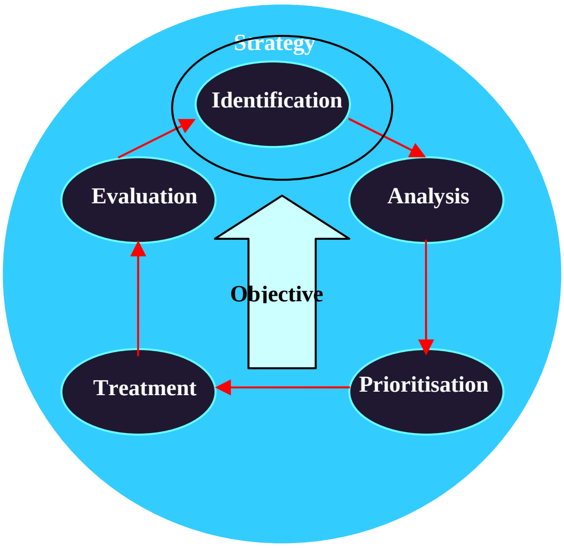
available sources of knowledge on behaviour (including accumulated experience and insights from the behavioural and regulatory sciences) and the means of influencing it.

At a very basic level this would involve distinguishing between intentional and unintentional non-compliance. A distinction can then be made between unintentional non-compliance caused by rules being unknown and unintentional non-compliance caused by rules being difficult or even impossible to follow from the perspective of the taxpayers. Such distinctions will help couple compliance risks with the most appropriate treatments and facilitate learning, as explicit assumptions guiding the choice of treatment are tested against reality. This, in turn, will increase the chances of success and reduce the risk of offending feelings of procedural justice by, for instance, directing traditional enforcement at unintentional non-compliance. They will also serve to promote a modern compliance risk management culture as opposed to a traditional enforcement culture.

Therefore compliance risk management is more than just identifying risks: only knowledge about the reasons for non-compliance, that caused the identified risks, facilitates an appropriate treatment, leading to a higher level of compliance.

C. The Compliance Risk Management Process

The Compliance Risk Management Process (figure 2) is based on 5 consecutive steps. These steps form the compliance risk management cycle. The first step in the risk management process is the *identification of risks*.



2.5. Risk identification

Objectives describe the desired outcome and state what has to be achieved within a tax administration (e.g. to increase compliance). The first step in the risk management process is the identification of risks that act as a barrier to achieving the objective. Risk identification is an important phase because if risks are not identified here, they are unlikely to be identified, and therefore, may not be covered. Also, *when* a risk is identified is crucial. The earlier a risk is identified, the earlier it can get appropriate attention. Therefore, a shorter time period between detection and remedy reduces the collection risk of non-payment and increases the preventive effect. The phase of risk identification results in *a list of potential risks.*

2.5.1. Risk Genres

Risks can be categorised under four basic *genres*:

1. Register Risk;

2. Filing Risk;

3. Declaration Risk;

4. Payment Risk.

1. Register Risk: risk *that tax yield is reduced by;*

   - *Those that are on the register but have no entitlement to registration:* within this category the full range of taxpayers can be found, ranging from ‘Carousel’ fraudsters and classic repayment frauds through to potentially compliant taxpayers who by act of error or omission have remained registered when entitlement ceases.

   See example 2 Italy (par 3.2.1.): Risk Analysis on new VAT identification numbers

- *Those who fulfil the requirements to register but fail to do so*: this encompasses the informal economy, taxpayers who remain unregistered for some taxes and taxpayers who use avoidance devices to remain unregistered;
- *Incorrect information about a taxpayer being held on the register:* data quality will always be an issue, and there is also a danger of carrying out inappropriate treatments based on incorrect information as well as the potential for tax loss due to incorrect information being held.

2. Filing Risk: *risk that tax yield will be understated/reduced by taxpayers not filing their returns by the due date.*

In order to provide the correct preventive and corrective treatments there is a need to be able to target those taxpayers likely to file their returns late, or not at all. There are many treatment options available to tax administrations to cover this risk before an audit is considered.

3. Declaration Risk: *risk that tax yield will be affected where the amounts shown on the tax return are incorrect by error or deliberate act.*

Traditionally, many tax administrations concentrated on this risk area with the intention of determining which cases should be selected for conducting audit activity. It is now being increasingly recognised that other treatment options are available to verify that the declarations made by taxpayers are correct and where error or fraud is discovered, to allow for corrective action to be taken. Tax administrations also have the option now to carry out preventive programmes to help and encourage taxpayers to get it right from the start.

4. Payment Risk: *risk that tax yield will be reduced by non-payment of amounts due on tax returns and assessments.*

Payment risk and filing risk could be closely related but it is important to analyse them separately since the treatments may vary. In times of economic recession it is especially important to manage taxpayers debts and to avoid accumulation of debts.

By classifying risk under these headings, any tax administration will be in a stronger position to determine the appropriate treatment technique. Within each of these *genres,* there is a wide spectrum of sub-sets and individual risks.

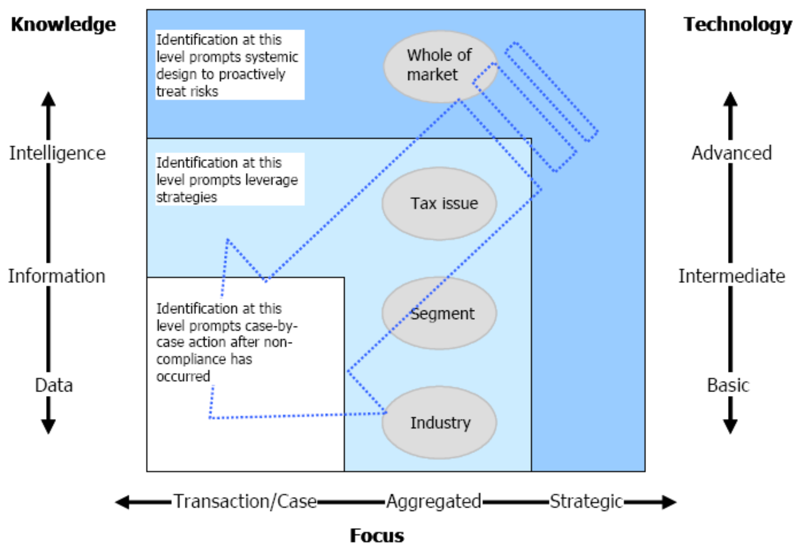
2.5.2. Levels of identification

Risks can be identified and described at different levels, using either top-down techniques such as macro-economic analysis or by bottom-up processes such as case-based risk assessment systems.

Figure 3 illustrates the combinations of knowledge, technology and focus that come together at the high, medium and case level of risk identification. The direction of the arrow suggests an approach that commences at the high strategic level and leads down, through the medium, to the case level.[15]

15 This figure is a copy of figure 2.1. from page 21 of OECD Compliance Risk Management Guidance Note (Oct 2004) Risk Identification Diagnostic.

Fig. 3 Risk Identification Diagnostic



One way of identifying risks is to start at the high level and drill down to detailed and taxpayer level:

High level – high level identification starts with the composition of a *general risk overview* of risky areas or of groups/segments of taxpayers with different compliance levels e.g. large, medium or small. A general risk overview can be helpful at an early stage because it provides insight without too many details. Simply recorded, such a document gives a general overview of the risk areas and how it is divided in different taxpayer groups. It can also give a description of demographic and economic development and possible regional differences including major risks and recent trends. Last but not least, it provides the direction for identification of risky activities.

Medium level – the entrance to the medium level of identification is a risk area or a group of taxpayers e.g. the area of under declared income or the risks related to a group of taxpayers with a specific compliance level.

Something to keep in mind is the difference between risky activities and risky taxpayers. Some activities possess a higher level of risk than others. Also, taxpayers can have different compliance levels. Risk identification will therefore always refer to both of these elements.

(1) Risk area

A risk area is a collection of connected risks, for example, risks referring to turnover or to a specific part of tax legislation. Different risk areas can be identified and described in a risk register, a national risk database.

See example 3 The Netherlands (par 3.2.2.): National Risk Database

It is important to identify risks area by area but it is equally important to recognise that a risk in one area can have an impact on one or more risks in other areas.

(2) Groups of taxpayers (segmentation)[16]

In a tax administration context, segmenting the taxpayer population into sub-populations of taxpayers with similar characteristics and behaviours facilitates more precise identification and categorisation of compliance risks.

Taxpayers can be grouped in different ways, from business size (large, medium and small) to economic activity sector (construction, wholesale, professional) to tax type (direct, indirect). Criteria for segmentation are e.g. level of economic importance, legal form, compliance level or a combination of these.

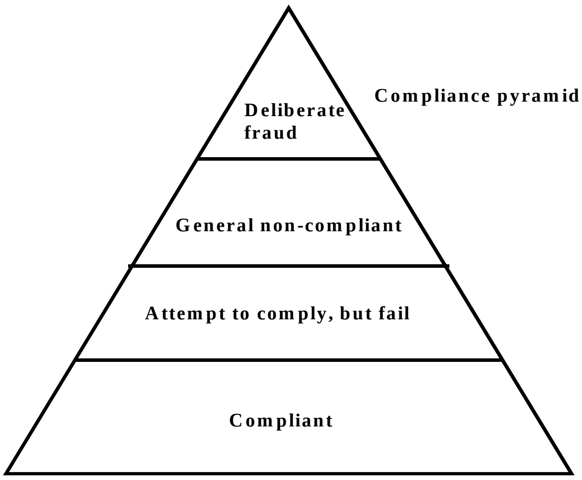
There are several options for getting a measure of the level of economic importance. For example, the turnover is an indicator, or the total net assets or number of employees. Specifically for fiscal purposes, the annual tax paid (only VAT or VAT plus direct taxes) can be used as an indicator.

The compliance level is of course always a rough calculation based on a number of criteria that says something about the degree of the known (tax) behaviour by a taxpayer, for example:

- the regularity of the tax returns;
- the appearance of any supplementary payments;
- the quality of the administration (bookkeeping);
- the appearance of corrections on the tax return in the past;
- the regularity of payment.

The compliance level can be shown in the shape of a triangle, the compliance pyramid.

Fig. 4 Compliance pyramid



Detailed level: – this level leads to the area of identifying individual taxpayers. An example here is the list of taxpayers with a high risk of under declared income. Another is a list of taxpayers with an expected relative low compliance level and an overview of the related risks.

See example 4 Italy (par 3.2.3.): APPLE

16 Segmentation breaks down the client base into sub-populations or segments with similar characteristics and features. Differentiation in this way enables an organisation to better understand the behaviours and demands of its clients.

The levels described are based on a top down model that works on a top down basis. However, it is also possible to use a bottom up approach, involving staff at all levels of the organisation, related to the risk sources used for identification e.g. random audit, test audits and insights of revenue officials on the shop floor.

See example 1 Denmark (par 3.1.1.): The Danish Compliance Risk Management Model

2.5.3. Tax Gap

As one of the main objectives of the tax administration is to ensure that the right amount of tax is paid, one starting point of the phase of identification is to try and find an answer to the question 'what is missing' (the tax gap, the potential tax yield minus the actual tax revenues). This approach has now been taken by a number of Member States. The tax gap reflects the estimated financial extent of the risk. The determination of the tax gap is not a perfect science. Sometimes statistical support is possible, based on research, data and analysis. However, often the only calculations that can be done are a rough estimation.

Ideally, the calculated gap should be further broken down into areas such as *aggressive tax avoidance, fraud, serious non-compliance, error and non-payment*. This would provide additional information on areas that should be addressed. The gap can also be broken down into *economic sectors*. In some instances, the major problem may be that many potential taxpayers are simply not known to the tax administration. In others, it may be that many taxpayers who are in the system are substantially under declaring their tax liability. There may also be instances where both problems may be important. The final focus for the tax gap is the contribution by the *different categories of taxpayers*, for example what is the extent of the tax gap accounted for by large businesses, by medium businesses and by small businesses? Insight into this can support the direction of risk identification. Theoretically, the monetary value of the individual risks identified must be equal to the whole of the tax gap.

See example 5 Sweden (par 3.2.4.): The Swedish Tax Gap Map

2.5.4. Sources for risk identification

There are several sources available to assist with risk identification. None of them can give a perfect result. Risk identification can only be approached by a balanced and combined use of the relevant sources.

1. *Horizon scans*: Monitoring external developments assists the identification of new risks or a mutation of an existing one. This is a continuous process. It includes information from media, research (horizon scanning) and other sources. In addition, cooperation with other tax administrations and law enforcement organisations may result in an exchange of developments and the awareness of new risks. The task is to get insight about the present in order to have foresight about the future. For example, research in the area of the development of new traders not only gives information about the expected number of start-up businesses but also the sectors that are booming. Depending on the risk level of those sectors plans can be made for covering the risk.

2. *Society support:* Another source for risk identification is the support from society. Trade sector organisations, consumer organisations, tax consultancy organisations and support from individual citizens can all contribute. In some cases, the interests of organisations are equal to those of the tax administration and cooperation is possible in a 'win-win' situation. In addition, facilitation of incidental reports is needed. Trade or

sector organisations can give, for example, information about the risky areas in the business but also information about non-compliant businesses.

3. *New legislation*: New tax legislation, but sometimes also other legislation, could result in new risks and the disappearance of some existing ones. It is important here to step into the shoes of the taxpayer and try to see which elements of the new legislation will offer new opportunities to be non-compliant.

4. *Information from other Tax Administrations*: In a world where economic activities have a more global dimension, information from other tax administrations provides a very valuable insight into the emerging risks in your own administration. Active co-operation between member states improves this source of risk identification.

5. *Information from Third Parties:* This is a valuable source for some independent verification of the presence or absence of risks. Information from other government departments external sources as well as information within the administration can be harnessed.

6. *Random audits*: The use of audits on randomly chosen taxpayers has more than one aim. As well as being used to gain knowledge on the general level of compliance of taxpayers, it can also be used for the identification of new risks. A side effect of random audits is that it leads to unpredictability in the supervision process of a tax administration. The best result from random audits will be when they are undertaken by experienced and skilled staff.

7. *Pioneer investigations*: 'test drilling/piloting'. Within some areas, groups of taxpayers are identified as probably having a higher or emerging risk, so pioneer investigations may be effective. This can help identify the real risks, and also offer insights into how these risks can be treated in the most efficient and effective way.

8. *Signals from the shop floor*: Last but not least, an important source for risk identification is the tax official, the professional, and the front-line staff. They are in contact with the taxpayer every day. An open mind is needed to spot new things, new developments in the trade of the taxpayer. Some of them may indicate new risks or changing of existing ones. A simple process to facilitate reporting new risks will encourage officials to share knowledge with others.

The last three sources give input for a bottom up approach of risk identification. Risk identification does not only take place at a central level. Parts of it also can be done at regional or local level, probably in combination and in cooperation with the other level(s). The combination of the identified risks and the estimated occurrence gives a picture of the risk field.

While the risk analysis phase normally follows the risk identification phase, a by-product can be the identification of new risks.

2.5.5. Risk identification output

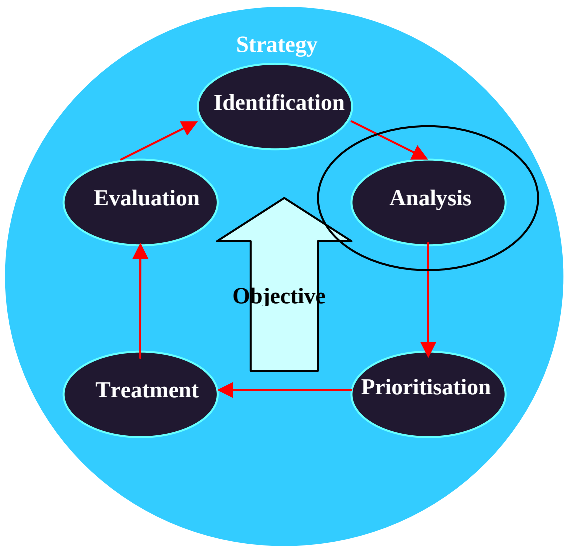
The output from the risk identification stage is the *list of potential risks* that shows areas, groups of taxpayers or sectors where risks are expected. This list can facilitate choices for the next phase, risk analysis, particularly pointing to areas that must be the subject of such analysis. Attention has to be paid to the description of the risks to avoid possible duplication i.e. that the same risks, explained or categorised differently, are duplicated on the list. This list could be used to paint a risk picture. The risk picture is not a one off. It is a continuous and dynamic process, following the dynamics of the world around the tax administration. This means that a holistic approach is absolutely necessary in order to do an appropriate identification of risks. The speed with which changing risks can be incorporated into risk identification contributes to the flexibility and effectiveness of the tax administration.

In summary, the identification step has the following input-throughput-output schedule:

Input	*Throughput*	*Output*
Sources/signals	Description of: - risky areas / taxpayers - risks	List of potential risks (Risk Picture)

2.6. Risk Analysis

The second step in the risk management process is the risk analysis phase.



In the risk analysis phase, risks and risky taxpayers identified in the previous stage are systematically weighed and grouped in relative order. Aspects that play a role here are frequency (the number of risks/risky traders), the likelihood (the chance that the risk materialises) and consequence (for example how much money is involved). However, finding out *what* is occurring and *who* is doing it is not enough.

Risk analysis must also involve the *why* question: what is the reason for non-compliant *behaviour* in the specific areas. This is important because it contributes to the assessment and to the choice of the most efficient and effective treatments. For example, if the reason for non-compliance is the complexity of a specific part of the tax legislation, the possible treatment could be education or a change of the legislation to remove the complexity.

Risk analysis normally requires the use of computer systems because of the sheer volume of data. However, manual analysis and weighting is possible and the application of human intelligence and professionalism is indispensable. There is no absolutely correct method. Combinations are possible with an electronic analysis followed by the application of human intelligence. Risk analysis can be done within the administration, centrally or locally, or in combination.

2.6.1. Sources

Risk analysis is carried out on the data gathered from multiple sources. There are many possible sources but not all of them are relevant for risk analysis. They can be grouped into:

- economic and tax data, for example ratio's about the economic growth, average wages;
- data supplied by taxpayers, for example the data from the tax return(s);
- tax data acquired by administrations, for example the date of last compliance activity, number of returns filed late or outstanding;
- data supplied by a third party, for example a bank or other state department;
- information available on the Internet.

See example 6 The Netherlands (par 3.3.1.): External Sources, Internet (web robot)

The information or data that can be used in analysis is limited by:

- the ability to capture the information;
- the legality to capture the information;
- the value that new information or data adds on top of what is already available (risk of information overflow);
- the ability to accurately associate data to the correct taxpayer;
- the capacity of IT systems in use;
- the costs related to obtaining new data;

2.6.2. Analysis

When data is ready, the identified risks can be analysed. Risks are examined in order to discover essential components and features. The pure analysis phase is a process performed by gathering and understanding computer held data and harnessing human knowledge and intelligence. By adding *data* and *information*, *knowledge* (intelligence) about the risks and the behaviour of taxpayers related to the risks can be attained. It is this knowledge that gives a deeper understanding of the information.

In most cases items of data on their own have no ‘value’. They get their value by being compared or related with others. Such a comparison is called a *variable*. A variable must be weighed in order to create a possibility for pointing to a risk. The result is a *risk indicator*. Risk indicators can point to several sorts of risk.

In an automated area a risk indicator can have the shape of a selection rule, which in combination with certain parameters ‘throws out’ tax returns when the figures in the returns exceeded the parameter. These returns can then be considered for appropriate treatment.

For example, in some cases, the risk of under declaration of turnover can be calculated. The amount of turnover can be obtained from several sources but the most accurate source is the VAT declaration. An element of the tax return is the turnover (data). The turnover can be related to the amount for the last period or the amount of other similar taxpayers (variable). A risk indicator can be established if the variable is weighted, for example if the growth of the turnover is less than x %.

In addition, more complex indicators and variables occur. That's why in the analysis phase specific knowledge is necessary. The use of techniques such as data mining and data warehousing require knowledge of EDP (electronic data processing). The continuing IT developments ensure that the possibilities in this area are constantly evolving and continue to grow.

See example 7 Ireland (par 3.3.2.): REAP

2.6.3. The timing of analysis

The longer a taxpayer remains registered, the more data that can be collected. Risk analysis requires accurate data to be effective. It follows that the more relevant data that is available the more likely it is that any probability predictions will be accurate. Deciding on when or if an intervention is required is as much a skill as it is a science and will depend on many factors, not least the overall strategy of the tax administration. As with risk identification, timing is important in the phase of risk analysis. The earlier a risk is analysed, the earlier it can be treated, the lower the risk that the tax money is lost and the bigger the preventive effect for the future.

(1) Pre-registration

Traditionally, when looking at Register Risk, the aim of administrations has been to ensure that anyone who is obliged to register is identified and registered at the appropriate time. Whereas this still remains the case, the area of e.g. *Carousel Fraud*, asks for checks to ensure that the applicant has a lawful reason to become registered. As part of the registration process, tax administrations may wish to compare the application with such items as:

- other registrations at the same postal code;
- known accommodation addresses;
- tax history;
- mobile phone only contact available;
- bank accounts;
- databases of suspects;
- credit reference agencies;
- other government department's data, etc.

Early contact with a taxpayer to establish that he exists can be considered in an attempt to thwart fraud. It must be recognised that the number of fraudsters trying to obtain tax registration, where no entitlement exists, is likely to be a very small percentage in relation to the total, and any treatment option must be proportionate to the risk. Notwithstanding this, there are options for treating potential risks even before a taxpayer becomes registered and these will include the provision of clear and helpful advice and education: prevention rather than cure.

See example 8 Germany (par 3.3.3.): Qualified new registrations by using checklists

(2) Post registration

Except for advice and education regarding filing, payment and declaration risks, the only time that intervention can take place is when the possibility of a risk materialises, and that is after registration. There are several opportunities for risk analysis.

(a) On receipt of returns

When *returns from a taxpayer* are received by the administration it is possible to carry out a number of 'rule based' checks:

- the inter-relationship of different figures on the return can be checked to test both accuracy and the credibility of the tax declared;
- the return received can be compared with previous returns submitted by that taxpayer to highlight apparent inconsistencies;
- comparisons can be made with other taxpayers who have a similar profile (size, type of trade, mark up etc), and,
- comparisons with norms and standards.

These checks are particularly useful when a tax refund is being claimed, but will also enable an assessment of the accuracy of payment returns that can be beneficial to the tax administration. The results of any checks will inform the decision process on the type of action needed to address the perceived risk.

(b) Periodic

Either in addition to, or as an alternative, administrations will need to carry out analysis over a *period of time* to ensure that risks are being adequately identified. It follows that the timing of any treatment will follow that periodic analysis. Unless there is an imperative need to tackle a risk within a short given time frame, then most tax administrations opt to spread their activity over several months or years. Some risks can be identified at the pre filing stage and the tax administration can target the risk area in advance to prompt correct filing and assist in getting it right first time.

(c) Incidental

Sometimes *events* will arise that require immediate attention. When these events occur the analysis has to be carried out as soon as possible after receipt of the data.

2.6.4. Risk analysis output

Risk analysis results in knowledge about one or more of the following areas:

- the characteristics of the taxpayers involved
- the reasons for taxpayer behaviour
- the likelihood and frequency of the risk
- the indicators/ selection rules and parameters
- the consequences
- the trend, i.e. is the risk becoming more or less severe
- possible treatment options
- cost of treatment
- the impact on the tax administration's objectives: low, medium, high, very high

The *likelihood* represents the probability that something will occur. *Frequency* tells how often something will occur. By studying a risk area the likelihood of tax evasion is often 100 %, but that, in itself, is not interesting information. The information needed is how common tax evasion is in the risk area, that is, its frequency.

The *consequences* incorporate a lot of different factors but must be based on the administration's objectives. A negative consequence is when the administration cannot reach its objectives. This normally means that the consequence has to be broken down into different factors such as tax amount (extent), impact on public confidence in the tax system, likelihood of the risk spreading etc.

It must be acknowledged that a 100% analysis is not feasible. Not only is this due to missing or inadequate data or inadequate techniques but also it would be an underestimation of the human possibilities and creativity in tax matters.

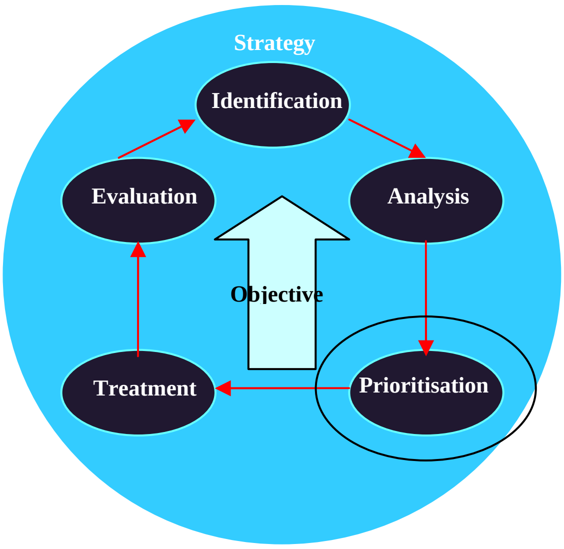
See example 9 Italy (par 3.3.4.): FALCO

In summary, the analysis step has the following input-throughput-output schedule:

Input	*Throughput*	*Output*
List of potential risks (Risk Picture)	Weighing and detection of: - risky areas / taxpayers - risks	List of risks, risky taxpayers, including - characteristics - reasons behaviour - selection rules - (cost of) possible treatment options

2.7. Prioritisation

The third step in the risk management process is the *prioritisation of risks* that have to be treated.



The preceding step of the process, risk analysis, results in knowledge about the risks and taxpayers (behaviour) related to the risks, in terms of numbers, level, extent, options for treatment and costs. The central goal of this step is to select the taxpayers that are to be treated. This is based on the effect the tax administration wants to accomplish, the risk assessment, available treatment forms and resources (for example, staff time in hours and competence). Information about risks and about available resources is therefore necessary for this stage. The extent of the risk gives an indication of the direct loss of tax if the risk was to be accepted. Other tax losses are possible, such as the possible decrease in the compliance level of a group of taxpayers. There can also be other consequences beyond direct or indirect tax losses e.g. unfair competition, feelings of inequality or social criticism that can have negative effects on the tax administration's reputation.

2.7.1. Risk assessment

Risk assessment must proceed and inform the prioritisation step. Factors that play a role in this process include:

- the amount of tax which is involved directly or indirectly: this amount is more or less determined in the risk analysis phase;
- the resources for treatment; this can be expressed in staff days or hours or "tax per hour" – the return on investment;
- social effect and political objectives: the treatment of some risks can have a positive *deterrent effect* on society and the taxpayer, while covering others may have a negative result. The tackling of some risks or taxpayer groups may have a greater *social acceptance* and have a more positive effect on general *compliance levels* of taxpayers. The image that the tax administration wants to portray can play a role in the choice of what specific risks are to be covered. Paying extra attention to the specific risk of new legislation and educating the taxpayer in an effort to get it right from the start can have a positive effect. Sometimes specific risks have to be covered for political reasons. Awareness of all of these factors is crucial, because it gives the tax administration the opportunity to take the correct approach, with the same resources, and have positive indirect effects in the areas of compliance levels, social support and perception;
- random: to ensure that every taxpayer has an equal chance of treatment, randomly chosen taxpayers must be taken into account (unpredictability). In addition the results of the random activities can identify new risks, new ways of detection or new ways of coverage (knowledge). Importantly, the results can also be used as an indicator of the effectiveness of the risk management process, which is in use.

The weighing (valuing) of the factors mentioned above is an internal process. Context, strategy and fixed objectives will play a leading part in this process. This can take place on a central level, at local level or a combination of both.

2.7.2. Risk ranking

When assessing and ranking risks it is necessary to take into account both the likelihood and the consequence of the risk occurring. This can be done using a compliance risk-rating matrix. Figure 5 is an example of how this can be done.[17]

Fig 5. Compliance risk-rating matrix

Consequence						
	Extreme	High	High	**Severe**	**Severe**	**Severe**
	Very High	High	High	High	**Severe**	**Severe**
	High	Significant	High	High	High	High
	Medium	Moderate	Moderate	Significant	Significant	Significant
	Low	Low	Low	Moderate	Moderate	Significant
		Rare	*Unlikely*	*Possible*	*Likely*	*Almost Certain*
		Likelihood				

The ranking gives a list of risks, some of which will be treated. Another example can be found in chapter 3.

See example 10 The Netherlands (par 3.4.1.): Attention Category

2.7.3. Possible treatment forms

The choice of risks in the prioritisation step will be dependent on the available human and other resources and the most effective treatment forms.

There are three basic treatments that can be applied and there are several options within these treatment forms. As they are described in detail in the next chapter, only the headlines are mentioned here:

1. Risk Transfer - passing the risk to other parties;
2. Risk Reduction - using methods to minimise the frequency and/or the extent of the risk in a coming period;
3. Risk Covering - carrying out activities to neutralise the impact of an occurred risk.

The most effective way, risk transfer, can only be used in some specific areas. Therefore, reduction and covering remain the most important strategies for risk treatment. Again, context, strategy and objectives will play their role in this. The enforcement of the law must meet all requirements of equity but, for reasons of effective and efficient performance of their duties, the tax administration must make choices with

[17] This figure is a copy of figure 3.3 from page 27 of OECD Compliance Risk Management guidance note (Oct 2004) Sample Compliance Risk Rating Matrix.

respect to the degree of examination. This means that the treatment must be business-like and based upon rational arguments instead of arbitrary choices.

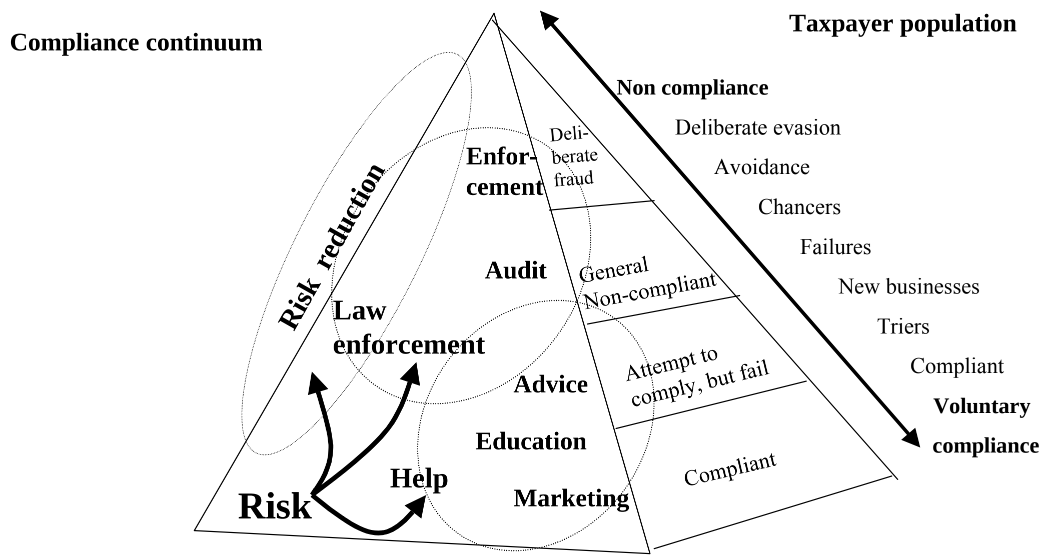
Reducing and preventing activities are, in general, undertaken before, the arrival of the tax return. Risk covering activities follow on. Also, the nature of reducing activities tends to be more general and therefore often not focused on an individual taxpayer. In contrast, risk covering activities are almost always related to an individual taxpayer.

The tax administration is obliged to make the most efficient use of the limited human and other resources and will try to minimise the costs of enforcement. So preference will be given to those forms of treatment, which reach a certain level of effectiveness with minimal use of resources.

This means that, in general, risk-reducing forms of treatment will be used first, followed by forms of risk covering that use minimum capacity and finally by methods using more capacity. Very often an optimum result is gained with a combination of treatment forms. This is the kernel of risk management: knowing how to allocate available resources in the most efficient way to get an optimal result.

The many treatments available can be used on a specific risk, at taxpayer level and also on a general level. The measures to be chosen depend on the specifications of the risk and the taxpayer. They should ideally reflect the location occupied by the taxpayer on the compliance spectrum or pyramid. Clearly, the provision of help and advice is not appropriate to a fraudster, nor is a full investigation for a compliant taxpayer. Where analysis is able to distinguish the relative compliance levels, then this will aid the appropriate decision. However, more often than not, analysis will only point to particular risk areas or relativities and not to where on the scale of compliance a particular taxpayer belongs.

Fig. 6 The compliance spectrum



The compliance continuum, or compliance spectrum, visualises the connection between the degree of compliance, as earlier shown in the 'pyramid', and the optimal effect of the various treatment forms.

All these elements have to be taken into account in assessing the risks that will be treated and the preferred treatment options. The result of the assessment phase is the risk mix, the risks that will be treated in one way or another in a given period. Risk assessment can take place on a central, local, or a combination of both levels. It is often preferable for local level assessment to take place first where added value in the risk analysis phase or in the ranking and prioritisation steps could occur.

2.7.4. Risk prioritisation

A choice of risks, which will be treated given the available resources, is simultaneously a choice of risks, which must be accepted. While additional resources can enable more risks to be treated, this is not necessarily a positive thing. The best approach is one where specific risks are deliberately accepted, because of their low (financial or social) importance or because they can't be detected or covered. Additional resources focused in these areas can give no solution because treatment of these risks is neither efficient nor effective.

2.7.5. The Risk prioritisation output

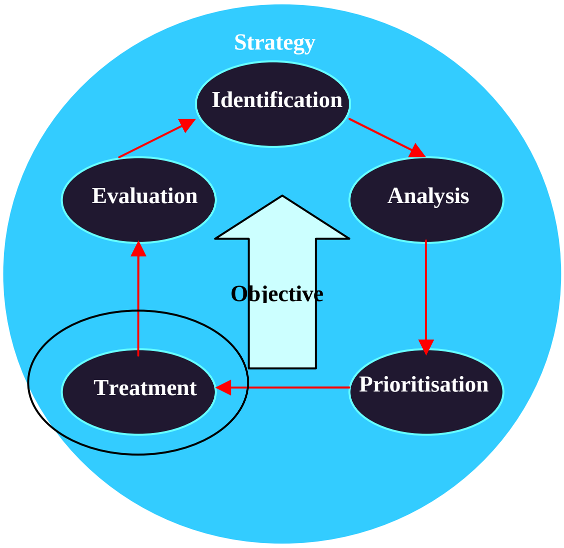
The output of the Risk Prioritisation stage is a *treatment plan* setting out risks to be treated as well as the treatment choices. The treatment plan could be further elaborated in a working plan for specific projects.

In summary, the prioritisation step has the following input-throughput-output schedule:

Input		*Throughput*		*Output*
List of risks, risky taxpayers, including - characteristics - reasons behaviour - selection rules - (cost of) possible treatment options	→	Ranking risks/risky taxpayers Calculating human and other resources Calculating effective treatment options Prioritising	→	Treatment plan

2.8. Treatment

Having established the relevant contexts and performed the required analysis and assessment of risks, the next stage in the compliance risk management process is to apply the right treatment, at the right time and in the right way.



The treatment stage can range from educating the taxpayers of the future, supporting all taxpayers to be compliant and dealing with those that remain non-compliant. Generally speaking, supporting taxpayers to be compliant results in influencing their behaviour in the area of their tax affairs.

The tax administration can influence the compliance behaviour of all taxpayers by cultivating a public image where:

- the tax administration is perceived to be helpful and facilitating in assisting taxpayers to be compliant;
- it is accepted that the great majority of taxpayers are compliant;
- the tax administration is perceived as being very good at identifying and dealing with non-compliance.

The treatment options available can be classified under three general headings:

– Risk Transfer (2.8.1);
– Risk Reduction (2.8.2);
– Risk Covering (2.8.3).

Risk treatment can be defined as ‘the process in which the negative impact of the risk on the administrations objectives is neutralised’. The treatment always has to be carried out in the most efficient and effective way. The way in which the tax administration applies this can be put into a work programme, a business plan that describes the way a group of taxpayers and/or the assessed risks will be treated. This work programme can be made on several organisational levels. The most detailed one will be set up at local level.

2.8.1. Risk Transfer

It may be that another Government department or outside organisation is best placed to deal with the identified risk. An example is the payment risk. Depending on legislation, it may be possible to require a bank guarantee against future tax liabilities. The risk of not paying is therefore transferred from the tax administration to another organisation, in this case a bank. In this way, the passing of risks can be considered as the ultimate form of risk reduction. However, because the risk still exists, despite being on someone else’s plate, it must be considered as a specific form of risk treatment.

2.8.2. Risk Reduction

The more risks that can be reduced in advance, the less effort is needed after the event. Reducing risks can be seen as a specific form of risk coverage. Risk reduction is possible in a number of ways:

- Limiting opportunities (*2.8.2.1.*)
- Reducing unintentional errors (*2.8.2.2.)*
- Reducing intentional errors (*2.8.2.3.)*

2.8.2.1. Limiting opportunities

"Make it impossible to make mistakes". Opportunities to make errors, deliberate or accidental, can be reduced. Reducing to zero means that errors cannot be made anymore and thus a risk no longer exists: it is no longer *possible* to make errors. Here are some measures used by tax administrations:

Legislation

- Amending: High-risk elements of legislation and regulations can be substituted with elements containing less risks and better enforceability;
- Standard allowances: A standard allowance regularises parts of the legislation with legal assumptions. Through a standard allowance, complexity can be reduced.

See example 11 The Netherlands (par 3.5.1.): Consultation in Agricultural Sector

- Thresholds: By introducing a threshold in the legislation or regulation a lot of (mostly small) risks disappear. However a new risk can appear around the level of the threshold;
- Authorisations: The award of the authorisation can be linked to specific conditions, for example that the taxpayers' bookkeeping conforms to specific standards.
- Schemes: in sectors that carry particular risks reverse charge schemes can change the obligation of payment of VAT to the purchaser.

Technical solutions

- Filing: By using an electronic tax return programme errors that arise in transferring data from paper to digital format can be avoided.
- Validity checks: By using electronic tax return programmes validity checks can be built in. This makes it impossible to make certain mistakes.

Consultation and agreements

- With tax consultancy organisations about the interpretation of the law in specific circumstances or in specific sectors.
- With organisations in the relevant economic sectors about the interpretation of the law in specific circumstances or about valuing of specific elements.

See example 11 The Netherlands (par 3.5.1.): Consultation in Agricultural Sector

- With the individual taxpayer to explain fiscal law in specific circumstances.

2.8.2.2. Reducing unintentional errors

"Make it difficult to make mistakes". Not all errors made by taxpayers are deliberate and some of the unintentional errors can be addressed. That is why taxpayers must be educated and helped by the tax administration to overcome unintentional errors. This is where the service side of the administration is visible, offering the helping hand.

The intensity and degree of matching activities of the administration with the individual taxpayer's requirements will increase the costs. It is therefore a matter of efficiency on the tax administration's side to fine tune the diverse information demands to the most appropriate information channels available.

Understandable legislation and tax returns

- Understandable legislation and tax returns with clear guidance notes reduce unintentional errors. It must be easy for taxpayers to comply. The less barriers the better the results will be.
- Consistency: Sometimes the same element has different definitions in legislation or regulations. By ensuring consistent interpretation the chances of making errors is reduced.
- Pre-filled tax returns will help the taxpayer to fulfil his obligation. The tax administration can provide the data held by the tax administration and put it on the tax return in advance. The taxpayer should then be able to make any amendments via the Internet.

Information and guiding

- Accessible and understandable support information: If explanatory notes accompanying returns, public notes and leaflets on specific subjects, are easy to obtain, are accessible and can be understood, the number of unintentional errors should reduce.

  See example 12 Sweden (par 3.5.2): Early Letter Treatment

- Public notices and leaflets can be seen as part of the education process and can also be targeted at specific groups, for example start-up businesses. Target groups can be invited to meetings at the tax office to get information about legislation, tax returns, administrative obligations and any specific bookkeeping requirements. The tax administration can also have a programme of on site visits to new traders that can be tailored to the specific needs of the taxpayer.
- By using mass media – press, radio and television – thousands of taxpayers can be reached and informed about certain tax issues. The nature of the information channels, advertisements on radio or TV, and their costs, will determine what type of messages are directed to taxpayers regarding major changes and ways on how to get more information.

  See example 13 Denmark (par 3.5.3.): Fair Play

- Advance ruling: A specific aspect of giving information is called preliminary consultation. Specific because it is not all one-way traffic, but a communication to and from both sides, a consultation that takes place before the fiscal event occurs. This is a win-win situation: certainty for the taxpayer, reduced risk for the administration. To provide certainty at an early stage for the taxpayer, the tax administration can facilitate a preliminary consultation where its point of view is clarified in respect of the fiscal consequences of a forthcoming major event, for example the sale of the company. Openness and trust are the key words here as the taxpayer must be fully upfront with his intentions. Subject to satisfactory use by both taxpayers and tax administrations, this approach can give an efficient and effective contribution to risk reduction.

Encouragement and support

- Easy contacts; The easier it is to get in contact with the tax administration in a way and at a time that suits the taxpayer, the earlier this will be done

  Internet: The Internet is accessible 24 hours a day, is easy to update and gives opportunities for making general information as well as more specific information available e.g. information for young people starting in their first job.

  Telephone: The telephone is a medium favoured by certain groups of taxpayers. Accessibility at times that suit the taxpayer facilitates the use.

  Client desks: In the tax office, a taxpayer can meet a tax official but access is restricted by the location of the office and the availability of staff. Some tax administrations have special information centres for immigrants who need service in different languages or special service centres in big constructions sites where new subcontractors and foreign employees are working.

- Helping hand

  Electronic tax return programmes can have an 'electronic helping hand' built in. When using online declarations, hyperlinks can guide the taxpayer through his return using specific and related information from the tax administration’s website.

  Physical help can be provided for example with filling in the tax returns. In spite of all the electronic services on offer, for some groups of taxpayers, for example elderly people, it is often impossible for them to fill in their tax returns properly. By physically helping them, errors can be reduced/eliminated. This can be done by social organisations, for example the unions or organisations for elderly people with the support of tax administration.

  A special group are school children, the *future taxpayers*. Education about taxes, their role and function in modern society, the way tax money is used and the effects of fraud can be included in several stages of the school cycle. All the students can also be taught to complete tax forms. Whilst the tax administration is not an education department, it is possible to develop educational support packs for use by schools. Other ways are also possible, such as a tax web site with information and games aimed at children.

  See example 14 Sweden (par 3.5.4.): Taxpayer campaign

  See example 15 Poland etc. (par 3.5.5.): Visiting schools

2.8.2.3. Reducing intentional errors

"Make it risky to make mistakes". The reduction of opportunities for unintentional errors is followed by an approach for reducing intentional mistakes. The factors that can help contribute to the reduction of unintentional errors also apply to the reduction of intentional errors and help support the administration when non-compliance requires to be sanctioned.

Some taxpayers have no inclination at all to cheat, even though they have the opportunity to do so. These are the taxpayers with a high level of compliance, who are well behaved as far as the tax administration is concerned. However, there is another group of taxpayers who are in a position to cheat and actually have some degree of inclination to do so. There is literature that describes various factors and drivers that influence taxpayers' behaviour. Not all of these factors can be reduced or influenced by the administration but understanding compliance behaviour is essential when a tax administration is choosing treatments to reduce risks (see section 2.4, which deals with influencing behaviour).

Increasing perceived probability of detection

Taxpayers who have both the opportunity and the will to cheat may nevertheless not necessarily do so. They also have to dare to do it. Some in this group will not take the opportunity, because they think the risk of being caught is too high, and they are scared of the consequences – the penalties. What these taxpayers are doing is their own risk analysis: the area of the perceived probability of detection. That is the likelihood as the taxpayer sees it, that any infringement will be detected and punished. In combination with the severity of the penalty (fines or imprisonment), the likelihood of being caught is essential in taxpayers' deliberations. It is always a combination of these two factors. Taxpayers deliberate on the basis of what they hear, for example from others, what they observe about how their own tax affairs are dealt with (visibility of controls) and what they absorb from the media. The outcome of their deliberations is a strictly personal matter, because it depends on the taxpayers' personal make-up and situation.

Making sure the actual likelihood of detection is fairly high can increase the perceived probability of detection in the first place. Taxpayers not only must 'feel' it, but also have the perception of it. That is why communicating the strategy, approaches, tactics and results are needed.

Communication in this area is referred to as enforcement communication, which basically means that it is focused on reducing deliberate errors. This communication can take place on a large-scale, for example using national daily newspapers. Key officers of the tax administration can give interviews, and be supplemented by balanced press releases and annual reports. Information can be general and specific, for example, an announcement in advance on which parts of the tax return the tax administration is going to focus on. A more specific application of this is the announcement that there may be an audit, with an advanced warning giving the taxpayer a chance to make the correct entries on the tax return.

See example 16 Poland (par 3.5.6.): Publishing information on areas of tax audit

See example 17 The Netherlands (3.5.7): Increasing perceived probability of detection

Sometimes it is more efficient and effective to combine the treatment of a specific risk or set of risks into a (nation-wide) campaign. Best practice can be consistently applied to the campaign, which can be supported by media and press attention, giving better results in the area of changing behaviour. Whilst campaigns require extra investment in organisation and time, the effect will be higher than the sum of the individual treatments. Campaigns are intended to have a high impact on the risks and the taxpayers concerned.

It has also been shown that a significant effect can be achieved by communicating ‘prescriptive norms’ (‘failing to declare is prohibited’) and ‘descriptive norms’ (‘large numbers of taxpayers have already fallen into line’): a stimulus to join the majority. The communication may target the whole taxpaying population, but also a small group of taxpayers. In the latter case, it is better to use other ways of communication, for example direct mail.

Enforcement communication is still unexplored territory, but it does have prospects in that it allows the tax administration to achieve a significant effect at a relatively low cost. More has to be learned about the relationship between the message and its effect. Only then will it become a usable element in the process of risk management.

Communications that aim to influence perception on the probability of detection shows the other side of the tax administration. There will be times when it is not transparent, it does not show its hand, and it deliberately creates uncertainty. This contrasts with the situation of service provision being characterised by openness, certainty, accessibility and an accommodating attitude.

Creating a third party interest

By creating a third party interest, the tax administration can translate the bilateral relationship between itself and the taxpayer into a tripartite relationship. Therefore, somebody else is involved who is not under the direct influence of the trader and takes, more or less, responsibility for the taxpayer submitting a correct tax return. That third party can be an individual citizen, but also an organisation. The relationship can be ad hoc, - or a structural and institutionalised one.

See example 18 Italy (par 3.5.8.): Sector Studies

- By giving a citizen an interest in a correct invoice, bookkeeping or tax return, in theory an enormous enforcement power can be achieved. The citizens’ interest can be a general or a specific one. In the first case, for example, it can be communicated that the less tax other people pay, the more tax 'you' have to pay. In this way, the citizens’ interest can be created by asking them to ask for an invoice or bill. The objective to be reached lies behind the completeness of the bookkeeping of the salesman. Sometimes there is a more direct interest of the citizen, because the invoice is needed for other purposes, for example to get back money from a health insurer or to get a special deduction based on the invoice.

  See example 19 Poland (par 3.5.9.): Take the bill

- Horizontal supervision is a systematic, non-governmental control aimed at the improvement of the quality of the products and services of taxpayers. Examples are professional codes, certificates, quality marks but also a system of self-regulation within a sector. In the case of strong horizontal supervision, the risks will be (at least in several areas) lower than without such a system. The reasons for horizontal supervision are not always fiscal and can be based, in the first instance, on economic criteria as, for example, market and quality protection.

See example 20 The Netherlands (par 3.5.10.): Horizontal Monitoring

- Demanding a certificate, by an auditor or another authorised professional, can reduce the risk that a return or an account is not reflecting the truth. In this way, the responsibility and the duties are passed onto a professional third party (the auditor) and the costs thereof to the taxpayer.

2.8.3. Risk covering

After all these measures are taken, the tax administration is left with those who are in a position to cheat, consciously wish to do so and deliberately take the risk. Here there is only one option, and that is to use repressive control measures and take action against offenders. The sooner risks are analysed and detected, the sooner they can be covered. Risk covering, tackling the expected non-compliance, results in the rectification of the damage if the risk really has occurred. Rectification can take place in money terms by a new assessment to pay the evaded tax and a penalty. In some cases other penalties are possible such as imprisonment. Carried out in a correct way, repressive activity as risk covering also has a deterrent effect. This can work, not only on the behaviour of the individual taxpayer but also via his social and commercial network, on other taxpayers. A common characteristic of risk covering is that, except in the case of undercover activities, the taxpayer knows that he is being treated. He 'experiences' the tax administration.

However, there are many ways to cover risks and to interact with the taxpayer. Diverse ways, which can differ not only in degree of depth but also in capacity, are needed. Using a risk covering measure doesn't mean that all the risks are covered. Some of them can be accepted, for example because of their small financial consequence. For reasons of efficiency and effectiveness, the measures of risk covering must be in balance with the extent of the risk and/or of the cost to taxpayer. This is called the principle of proportionality. It should be noted that the possible use of the above mentioned measures will always depend on the existing specific legal circumstances or a political imperative.

There are three basic ways to approach the covering of risks:

- request to the taxpayer (*2.8.3.1.)*

- inspection at the desk *(2.8.3.2.*)

- field audit (*2.8.3.3.*)

2.8.3.1. Request to the taxpayer

Written contact

Contact by letter can be made on various occasions and with various intentions. In this chapter contact on paper has to be seen in the context of risk covering. The intention of this contact can be questions of clarification or questions to complete information on the tax return.

Sometimes a standard questionnaire can be developed and used. Depending on the answer the conclusion can be that the supposed risk did not occur or that it still exists. In the latter case, follow-up activity is needed.

A specific form of letter contact is that in which answers, decisions and the like are communicated to the taxpayer. Most of the time this can be seen as the final stage of the risk-covering phase. The way of communicating with the taxpayer is the 'business card' of the tax administration and contributes to its image. Therefore, it cannot be emphasised enough that attention has to be paid to the form and content in terms of speed, quality and comprehension.

Contact by telephone

Compared to written contact, contact by telephone interferes more in the private domain of the taxpayer. Both the moment of contact and the moment of answering are set by the tax administration. The reasons for and results of contact by telephone are identical with those mentioned under contact by paper. Additionally, requirements can be made about the way in which telephone calls are made. Sometimes specific training of staff on this subject is required.

Invitation for voluntary disclosure

When a taxpayer is selected for a more intensive form of risk coverage, like a desk audit, it is possible to invite the taxpayer to make a voluntary adjustment to his tax return. In return for this, the penalty can be reduced or eliminated. In a way it looks like this is a method of risk reduction, but in this case the tax return is already filed and the taxpayer selected for intervention. It is not possible to reduce the risk of fire when the house is already burning! Attention has to be paid to the way in which this measure is implemented, and the words used in the invitation are a key factor for successful results.

An invitation for voluntary disclosure can be addressed to a group of taxpayers, for example taxpayers who are known to have accounts in foreign banks.

2.8.3.2. Inspection at the desk

Partial desk test

A partial desk test is a treatment done in the tax office in which one or more specific risks of the tax return are covered 'from behind the desk'. Contact with the taxpayer is possible during the test. The test is done with available information and interpretation of law and regulations to examine the pointed risk area.

Complete desk test

A complete desk test only differs from the partial one because the tax return as a whole is treated.

Desk audit

In this digital era taxpayers use computers more and more for their bookkeeping. This offers the tax administration opportunities to ask the taxpayer to send an electronic copy of his accounts to the local office. Here the analysis of the records can take place. A desk audit can be followed by a partial or full audit, for example, if access to underlying papers is needed. Also the choice can be made to finish the desk audit in the office by asking the taxpayer to send the selected papers. In that case, some elements of the audit could be carried out by less qualified staff.

2.8.3.3. Field audit

On site visits

On site visits are those made to certain taxpayers during their business hours with the aim of collecting information to use in a future treatment. The object of the visit can be to:

- identify the number of employees working at that moment;
- identify who they are;
- check the cash balance;
- establish the existence of specific parts of administration, for example agenda's;
- ascertain the level of business activity;
- identify the prices actually charged;
- check the dimensions, content and composition of the product(s);
- undertake test purchasing.

An on-site visit can be announced or unannounced, visible or undercover. The choice is a tactical one depending on aspects such as legal powers, safety risks, the image that the tax administration wants to portray, the sort of information to be collected and the extent of the (fiscal) risk(s). The overt nature of announcements of site visits, that 'there is a chance that you may be visited in the next two months', may have a substantial preventive effect and a change in behaviour.

Partial audit

A partial audit is one where, from the beginning, the audit is limited to one or more specific risks. The audit will normally not extend to other areas except when it is obviously necessary. In contrast with the desk test an audit is directed at the administration and bookkeeping of the taxpayer. Normally the audit covers a specific period, often the most current. But when a mistake is found, the audit can also be extended to previous periods. The taxpayer is informed in advance about the limitations of the audits, thus eliminating negative effects from not finding potential errors in areas other than the covered areas.

Normally the audit is carried out on the business premises and not in the tax office. In this way not only is all the required administration and information available but it is also possible to 'hear, feel, see and smell' the taxpayer’s business.

Complete audit

A complete audit only differs from the partial one because in this case the business as a whole is the subject of the audit. Risk assessment supports the tax official in deciding which areas need deeper investigations.

Audits can be started announced or unannounced. Normally audits are announced, but unannounced audits can be necessary due to the risk that an advance announcement will result in crucial parts of the bookkeeping being destroyed.

The tax official has to understand the entity and its environment. He has to determine the components of the assessed risk. For this determination the tax official can make use of statistical techniques and/or IT-support. In complex situations a team containing several specialists, for example on EDP, statistics and legislation, can carry out the audit.

Criminal investigation

The most intensive treatment of a taxpayer is a criminal investigation. In this situation he is no longer a taxpayer but a suspect and will have specific rights and obligations. The aim of the investigation is to collect evidence for a criminal court case. Because of the nature and the specific applicable legislation, specialists will carry out these investigations.

Specific activities

- Multi agency treatment

Sometimes risk sharing is possible as the risk or the (group of) taxpayer(s) have more legal connections than the fiscal one and it is not only a matter of fiscal non-compliance. Also, the combination of several small risks occurring in the different departments can make a huge risk for society. In close cooperation with other Government departments or local councils, the risk(s) can be treated.

- Projects

In the case of the treatment of complex risks a project can be set up to support the tax officials in an efficient way with specialist know how. Projects are internally focussed and not externally communicated.

Another example is a pilot programme which looks at testing alternative approaches to tried and tested means. This can test for benefits that have been missed in the past in terms of more efficient and greater coverage of a population that meets the risk criteria.

Projects can be further sub-divided. Test drilling operations are undertaken to identify the extent to which a particular risk extends into a given group of taxpayers or to identify the risks associated with a specific group of taxpayers. Taxpayers are selected at random from amongst a chosen population so as not to skew the results.

2.8.4. Timing and quality of the intervention

Some tax risks can and should be addressed prior to acceptance of a taxpayer onto the tax system. However, most risks only materialise once registration has occurred so analysis and treatment can only take place post registration.

Not only is the form of treatment important but also the timing. Ideally, the combination of both must be right to get a maximum result. Timing of the treatment of course depends on the timing of the detection of the risk, but proper timing of the treatment after detection is also needed. Depending on the character of the risk, whether it is structural or incidental, action has to be taken at the correct moment. This, especially in the case of incidental risks, is because the longer the delay the higher the risk that the tax has disappeared or cannot be collected.

However, there is another element, the element of education. The longer the time between making an error and its discovery, the less the penalty will lead to a change of behaviour. The taxpayer won't relate his misbehaviour to the penalty anymore. The maximum effect is reached of course with a 'caught in the act', but the fiscal possibilities here are limited. An 'on site visit' is one of them. But the situation of a ' caught in the act' can be approached by an adequate organisation of the risk identification, analysis, assessment and treatment.

Both the timing and the quality of the treatment are contributory to the ultimate effect on the risk chain. It is obvious that the result of a well identified, analysed and assessed but poorly treated risk will be poor as well. Not only is the energy put in at the early stages spoiled, but also the intended effect is not achieved and in some cases the situation made even worse. The taxpayer will persist in non-compliance and there is a big chance that his behaviour will deteriorate: 'after all the taxman fails to notice it anyway'. The quality aspect will be addressed in chapter 2.9 (evaluation).

The outcome of the phase of risk treatment gives an answer to the risk question. The answer can be a lower risk level as a result of the undertaken risk reduction measures. In case of risk covering the answer may be that the risk did not occur. It may also have occurred and non-compliant behaviour had to be redressed with a correction (sometimes including a penalty) on the tax return. These results give rise to the next stage of the process, the evaluation.

However, risk covering also results in notes and conclusions in the files set up during the treatment. These files can be used for quality control purposes and as a part of a learning circle focused on an increasingly better treatment and a treatment which is constantly tuned to changes on the taxpayers' part.

2.8.5. Output of the treatment step

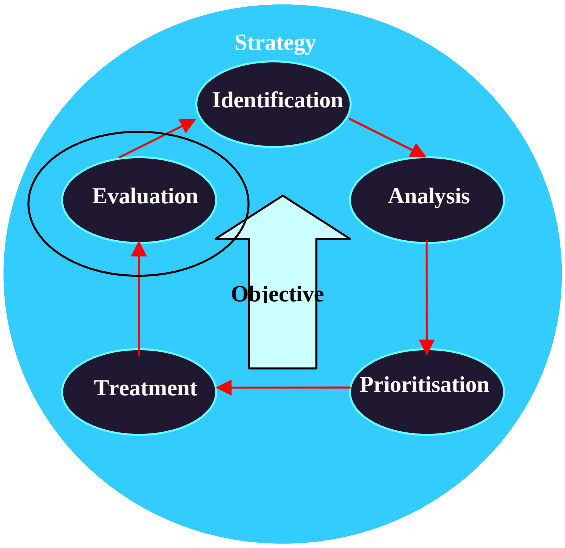
In summary, the treatment step has the following input-throughput-output schedule:

Input	*Throughput*	*Output*
Treatment plan →	Actual Treatment (quality) →	Results

2.9. Evaluation

2.9.1. Introduction to evaluation

The last stage of the Risk Management Process is the evaluation stage. Evaluation can take place at different levels. On a *global level* evaluation can help indicate how the administration is meeting its long-term objectives (e.g. increasing the compliance level and/or reducing the tax gap). On an *activity level* evaluation can help guide activities towards those that work most effectively. It is important to note that risk management is a cyclical process in which evaluation should take place systematically at each stage of the process, to build a learning circle.



2.9.1.1. Objectives and types of evaluation

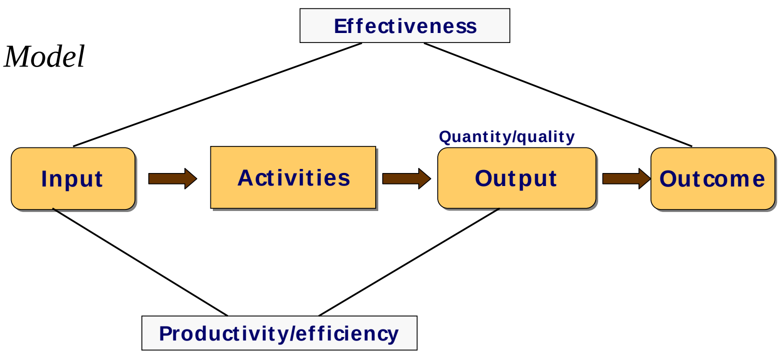
In recent decades governments have focused more on goal oriented rather than detailed management. Similarly for tax administrations, compliance activity evaluations are now moving towards measuring *outcomes* (e.g. a change in compliance level) more than *outputs* (e.g. number of audits performed). There is also an increased demand for outcome measurements within tax administrations.

There are two types of evaluation; impact (effect) and process. An *impact* evaluation estimates how much a programme, policy or intervention has caused an observed outcome or change. In contrast, a *process* evaluation asks how or why it works (or doesn't work).

2.9.1.2. Program theory – a useful tool to plan and carry out evaluations

The starting point for each evaluation can be the basic model below.[18] It is a simplified version of Program Theory, which describes the course of events, from input to outcome, and how these events are linked in a cause and effect chain.

Fig. 7 Evaluation Model



[18] Descriptions of used terms in scheme are provided in glossary of terms.

Input is the resources consumed to produce the outputs. They can be described in financial terms, like costs, or in physical terms, like work hours.

Activities are the basic steps of the process where input is transformed to output (e.g. analyses, defining risk treatment options or every activity undertaken by the tax administration to achieve its objectives).

Output is what is produced (e.g. number and quality of audits, number of assessments or collected revenue, other measures taken to reduce risk). The evaluation should not focus on output alone. A completed audit can be regarded as the output but the future level of improved compliance is regarded as the outcome.

Outcome (Impact or effect) Rather than the direct output (e.g. audits) the typical purpose of activities is to achieve something such as the long-term goal of improved compliance. A time factor could be added to the model to divide the outcome into immediate, intermediate and long term. The outcome is often affected by "frame factors" and external factors. Frame factors (e.g. culture, traditions) are obstacles in the process to reach the desired outcome, whereas external factors (e.g. changes in the economic environment) make it difficult to isolate the effect of the activity (e.g. increased revenue may be from growth in GDP rather than the effect of our activities).

See example 21 Ireland (par 3.6.1.): Construction Industry.

The effectiveness of a program or campaign can be determined by comparing the input to the outcome, while efficiency is input compared to output.

2.9.2. Evaluation in practice

2.9.2.1. Evaluation planning

It is strongly recommended to plan an evaluation well in advance before the start of a campaign (program, etc.). An evaluation plan could include:

- Identification of relevant effect variables/indicators. Indicators chosen should reflect well the effect to be measured and be as objective as possible. Possible indicators might be: number of returns on time, number of correct returns, amount of taxes paid on time, increase of taxes paid, etc.
- The evaluation method or methods.
- The sampling method (i.e. selecting a subset of units or "sample" from a larger population).
- Data collection (e.g. web forms, paper questionnaires, telephone calls etc.).
- Organisation of the evaluation (e.g. project manager, participants, time scales, resources etc.).

2.9.2.2. Evaluation methods

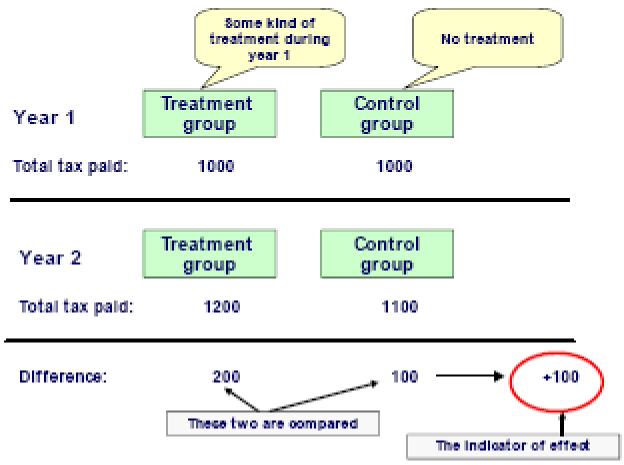
Impact evaluations often use a comparison group to ask the following question: If we did not run this policy, or start this programme, what would have happened anyway? This allows us to compare the counterfactual or control to the treatment group and estimate how much of the observed change was the result of the intervention alone.

Randomised control trials are the gold standard of impact evaluations. Taxpayers are randomly allocated to either the treatment (e.g. receive an audit) or control group (e.g. receive no audit). This ensures that on average the treatment and control group are the same (e.g. they have similar characteristics such as age and turnover) so we can easily estimate the impact of a treatment. Because the characteristics of the treatment and control group are the same any difference we find in the outcome is likely to be due to the treatment.

See example 22 Sweden (par 3.6.2.): Campaign against late payment

Below is a hypothetical example of a randomised control trial:

Fig. 8 Randomised Control Trial



In the example above, two groups of taxpayers have been randomly selected (Year 1). Total tax paid is used as an indicator. Taxpayers from the treatment group were audited during Year 2. In Year 2 the amount of tax paid by the two taxpayer groups is compared with the previous year. Finally the difference in total tax paid between the two taxpayers groups is calculated (200-100). This difference of 100 is the effect of the audit campaign.

However, there may be many reasons why a randomised control trial is not possible, such as limited time, resources or ethical considerations. For this reason there are many other impact methodology methods that can be used known as quasi-experimental or non-experimental. These methods can be used with a reasonable degree of accuracy when, for example, similar groups exist where the comparison group chosen is not affected by the activity or when the impact of the activity is large compared to changes from external factors (e.g. economic or legislation changes). An example of another evaluation method is the difference-in-difference method.

See example 23 United Kingdom (par 3.6.3.): Impact of working Families Tax Credit

2.9.3. Practical considerations

Evaluation can be expensive in terms of resources and it may not be possible to evaluate all compliance activities. The complexity of the environment (e.g. economy, policy changes, or other compliance activities) and availability of data may differ between compliance activities. A challenge is to match the evaluation needs with what is feasible given the methods and resources available. A close co-operation and mutual understanding is therefore needed between management and the analysts within an administration. Generally speaking, the higher the level of certainty the greater the cost (e.g. large random samples or surveys required). Some indicators to help decide whether to run an evaluation of an activity could be:

- Is the activity within a high-risk area?
- Does previous knowledge show that treating the risk is difficult?
- Is prioritisation needed between certain activities?
- Is the activity due to the introduction of new legislation?
- Are large resources used to treat the risk area?
- Would the result of an evaluation help measure the overall performance of the tax administration?
- What are the costs of performing the evaluation compared to the benefits?

A compliance activity could be evaluated either within the activity itself (internally, e.g. within an audit project) or outside the activity (externally, e.g. by an expert function). Performing the evaluation internally can be cost-effective as the knowledge of the activity is high. A drawback is a lack of objectivity and a risk the evaluator wants to show the "right" effects too strongly. By assigning an external team, the cost is higher but expert evaluation knowledge and objectivity is more likely.

Depending on the size of a tax administration, an evaluation can either be part of the risk management team or a separate business function. Evaluation can also be performed centrally (e.g. for large scale compliance activities) and/or regionally (for regional activities). An evaluation function could consider:

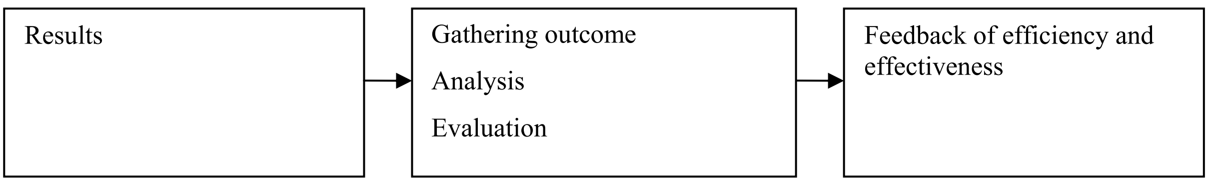
- collaborating with universities (e.g. on methods and design of evaluations)
- outsourcing – either "in-house" (e.g. auditors performing random audits) or with external partners (e.g. for taxpayer surveys)
- the use of evaluation in other government agencies (e.g. for multi-agency programmes).

Many evaluations are experiments that lead to different treatments to different groups of taxpayers purely on a random basis. The tax administration should therefore take into account how taxpayers could perceive being subject to a random audit programme. However, the benefits of such experiments are updated knowledge about compliance that may avoid future interventions with taxpayers who already are compliant.

2.9.4. Output of the evaluation step

In summary, the evaluation step has the following input-throughput-output schedule:

Input *Throughput* *Output*



D. ORGANISATIONAL FACTORS

2.10. Corporate Governance – Addressing Internal Risk

Earlier chapters focused on the risks that taxpayers present to the tax administration in the collection of taxes. This chapter will address *internal risks* faced by the tax administration and also emphasise the importance of integrated risk management, covering both internal and external risks.

Internal or organisational risks may exist in a number of critical areas, such as: human resources, information technology, business processes, governance framework, partnerships, financial control and legislation. Management of internal risks will support the successful implementation of compliance risk management.

See example 24: United Kingdom (par 3.7.1.): Management Assurance

To identify internal risks that can pose a threat to achieving the goals of the tax administration the following examples of questions should be considered:

- Does staff have the skills necessary to perform their functions effectively?
- Are there adequate resources to handle work demands?
- Is staff equipped to do its jobs efficiently?
- Are there clear lines of accountability for all key business processes in the organisation?
- Is the organisational structure adequate to achieve the administration's goals and objectives?
- Is the technology infrastructure adequate? Are the necessary IT systems in place?
- Are the IT systems thoroughly tested to ensure that processing is accurate?
- Are the right business processes in place? Are they effective? Are they efficient?
- Are the processes for identifying compliance risk adequate?
- Does the legislative framework have gaps or allow unintended interpretations?
- Are external partnerships (e.g., industry groups, accountancy and legal boards) used to support the goals of the administration?

The following answers can emerge from the questions posed above:

(1) The risk management process does not work as it should

– Severe risks not identified

– Wrong treatment applied

– Low quality or productivity

(2) Internal organisation and systems are not working

– Failure in IT support

– Internal communications break down

– Bad organisation or leadership

3) Inappropriate behaviour from staff

– Corruption

– Fraud

– Bad attitude towards taxpayers.

The risk management process in itself will not be different if it is used for external risks, internal risks or both. Everything in this Guide is applicable to all three possibilities. The important thing is that all risks or problems are covered in some way and that it is done with a holistic approach. Each tax administration has to decide which tools and mechanisms should be used for different kinds of risks.

A holistic view of risk management is imperative in order to successfully achieve the objectives of the tax administration. Most problems a tax administration experiences are related to both internal and external risks and should be seen from an organisation wide perspective.

At a strategic level, risk management is used to protect the tax administration's reputation, and safeguard accounting for public funds. At an operational level, effective risk management ensures delivery of major projects and programs, provides early warning of potential problems and identifies potential opportunities.

Effective risk management will ensure that it becomes everyone's responsibility. All staff and particularly managers should identify, understand and manage risks to their objectives, and develop an appreciation of which risks can be tolerated and which risks cannot.

The sustainability and full value of risk management is realised when it is practiced in an integrated fashion and when it is tied to other corporate functions such as planning, resource allocation and management of performance. If risk management is practiced as a separate exercise, its true value will not be realised. There is also a close connection with the implementation of Quality Management in an organisation.

See example 25 Italy (par 3.7.2.): Quality Certification

Some will see integrated risk management as something adding to the tax administration's activities and therefore representing an additional burden. Integrated risk management is intertwined with a tax administration's operating activities. It is most effective when built into the tax administration's infrastructure.

2.11. Organisational culture

Organisational culture is one of the critical success factors in the implementation of risk management in an organisation. It reflects a multitude of facets ranging from values, leadership styles, controls, reward mechanisms plus many other aspects. These facets combine to create a set of behaviours that visually define and energise the organisation. Change in culture is a significant challenge and requires determined and ongoing commitment.[19]

[19] What is organisational culture and how can you change it?
http:www.iproconhcm.co.uk/Top_HCM_Papers.htm

Integrated risk management requires a healthy risk culture, leadership, and innovation. It enhances a proactive climate of problem solving, communication, and risk taking that is essential for achieving the organisation's goals. It requires long-term commitment that involves a strategic and functional overhaul of all policies, processes, and systems, followed by management of its impact on the workforce and corporate performance.

Internal and external communication and continuous learning improve risk management understanding and skills at all levels of an organisation. The process provides a common language, guides the decision-making at all levels while at the same time allowing organisations to tailor their activities at the local level.

Generally, compliance or enforcement activities are regarded as the responsibility of audit and collection areas. However, new multi-faceted approaches will distribute this role and responsibility more widely and bring front line 'service' and 'contact' areas into the process.

Where this type of change has been undertaken, extensive communication was a key element in increased understanding and engagement. These communications need to ensure that front line staff is able to establish a line of sight between key strategic goals, aggregated/priority risks and day-to-day activities. Equally, it is important to ensure that periodic measurement and reporting, at various levels, is structured in a way that reinforces this line of sight.

2.12. Human resources

The quality of the treatment is based on an adequate assessment of risks, the choice of the treatment form and the timing of the action. However, the results of the treatment depend even more on the skills and competency of the tax official in undertaking the treatment in an efficient and effective way. Therefore, attention has to be paid to the skills and competency of tax officials.

2.12.1. Recruitment and selection

Every tax administration wants to have proper insight into its workforce composition and personnel structure, and into its short-term and medium-term needs. Therefore, the tax administration needs to have a set of tools to help guide the recruitment and selection process.

Dealing with risk management also means that different kinds of competency are required, for example statistics, IT/EDP, behavioural sciences and communications.

2.12.2. Skills and competency

A competence-based human resources system is rooted in the idea that good performance will result from having the right people, in the right jobs, at the right time, with the right skills and abilities.

More specifically, staff engaged in risk treatment is expected to have competence in the following areas:

- effective interactive communication;
- appropriate level of service-mindedness
- writing and reporting skills;
- appropriate level of confidence;
- (basic) analytical skills;
- knowledge of principles of good governance;
- knowledge of legislation, policies and procedures;
- knowledge of auditing (specially auditors);
- knowledge of office technology; and
- knowledge of supporting Tax Administration values.

Each competence has associated levels of proficiency, or a scale, that generally lays out a behaviour pattern for each level: e.g. expert capability, in-depth knowledge and capability; solid capability and good working knowledge; basic capability; or basic awareness.

Skills and competency are not only the tax administrations' concern but also that of the individual employee. The importance of training should not be underestimated.

2.12.3. Support

Another element, which plays a role in well-treated risks, is the availability of support during the treatment. This makes the treatment more effective. There are a lot of types of support, varying from joint-audits with just-in-time specialist support, to support with (risk related) audit manuals and audit automation.

2.13. Impact on the Administration

Working with a compliance risk management model does not just mean a different relationship with the relevant environment around the tax administration. It also has consequences for the internal work process (organisational structure, working methods, communication, decision making, planning etc), and the people involved in it, the staff.

Staff commitment is an important factor in the successful implementation of risk-oriented working. Several shifts or changes can be identified in the way towards a risk-oriented style of working. Staff may view these shifts as either positive or negative.

Management needs to understand how the staff experience these things. Front-line staff can find changes resulting from new risk priorities and approaches difficult. Vision, good communications, openness and consistent messages are all necessary to build up acceptance of the change process among staff. It is also important for the management to support the changes and reflect that consistently. Consistency requires a vision, not only a vision on risk management but also on its effects, external and internal. The management must carry and articulate this vision.

Some of the areas that will be part of a change to a risk management approach include:

'Shifts' from... to...

- *From directly influencing the risks to be dealt with, to an indirect influence:* Before, intervention staff decided for themselves which taxpayers they would deal with and which areas would be considered. Risk-oriented working means that the risk assessors will play a more central role.
- *From dealing with everything, to dealing with matters decided on in advance:* Before, intervention staff could deal with everything themselves if they thought it was expedient or they enjoyed doing it. Now, the areas they need to look at will be laid down in advance, and could include an estimate of the degree of correction expected and the level of resource to be used.
- *From dealing with both easy and hard jobs, to more hard jobs:* Before, intervention staff worked a mixture of easy and difficult jobs. A difficult job could be followed by a few straightforward jobs. Risk oriented working will result in more concentration on difficult jobs.
- *From operating inside a black box, to working in a transparent environment:* Before, each staff member worked inside a black box; in fact they *were* a black box. What went on inside the black box was not visible to the management. Management was not really concerned with this. Risk-oriented working implies a completely transparent choice process. In this process, the transparency is in the choices (by management) and in the implementation of the choices (by staff) in terms of revenue and time spent.
- *From implicit to explicit:* Before, risk-oriented working did happen, but a lot of things were not made explicit. As a result, it was not always clear afterwards why certain parts of a certain item had been looked at, and how the quality of the work compared to the time spent. Risk-oriented working requires everything to be made explicit. It must be made explicit why a certain item needs to be dealt with, what risks are present in relation to that item, what the financial importance is, and what the estimated time needed to deal with it is. Making things explicit can make some staff vulnerable, because it may be apparent afterwards that their judgment was incorrect. However, making things explicit makes it possible to learn.
- *From freedom to freedom with restraint:* Risk-oriented working can sometimes give a feeling of lost freedom. It is important to emphasise that the freedom is still there, but it takes a different shape. It is still there in the opportunity to highlight risks, in selecting items and weighing up the risks. Yet it also means accepting that other people, colleagues, can make choices. Trusting the judgment of colleagues is often a competency requiring further development.
- *From working your way through the pile, to 'just in time'*: Everyone is familiar with the sight of cupboards bulging with work in progress and the awkward jobs that always get left on the pile. Experience also shows that bulging cupboards make people feel that they are under a lot of pressure at work. Risk-oriented working implies a just-in-time system for delivering new risks. There should not be more work in the in-tray than there is room for.
- *From judging people on numbers to learning from content:* Before, staff were judged on the number of things they dealt with, how many jobs got finished. Risk-

oriented working moves away from this. Numbers are no longer sacred, it's the content:

  - What risks were dealt with,
  - What were the outcomes,
  - Why were certain risks dealt with and others not,
  - How are the risks developing,
  - What choices were made.

  In short, a transparent process that gives an insight into what is going on. Accepting this means adopting a learning culture instead of a judging culture. Instead of judging what happened yesterday, we learn for tomorrow.

- *From drifting to guiding:* Before, as a manager one had little or nothing to do with the specialist content of the work or with substantive guidance on the primary process of levying taxes and auditing. At management level in particular, risk-oriented working makes it possible to guide staff. It sounds good, but it does imply the courage to make choices, to decide *not* to deal with certain risks, and therefore not to generate that additional revenue. The process of choice is also transparent, which makes a manager vulnerable. However, it also allows the manager to take responsibility and account for his actions.
- *From general to specific competencies:* Before, someone was an all-rounder as a staff member – knowing something about everything and deployable anywhere. Working with a compliance risk management model can mean that some competencies are more necessary than others. It makes it clear which risks must be dealt with, and what special knowledge, if any, is needed for this. That knowledge may not be there, or not at a sufficient level, in which case training will be needed on a specific area. There may also be some risks that can only be dealt with by a small number of staff – the specialists.

These ten shifts are a non-exhaustive list and are intended to offer some insight into the ‘soft’ side, the human effects of working with a compliance risk management model. Knowledge of these shifts and the way in which they are welcomed or resisted by staff is essential in making a success of compliance risk management, as managers and as an organisation.

2.14. Managing the process

Risk management is an essential element of good governance. It is often said that the risk management chain is as strong as its weakest link. At the same time the compliance risk management process is not in perpetual motion: is does not start nor does it keep moving on its own. Things have to be organised, resources made available and assurance has to be in place regarding the quality of the component parts of the process. This is the management component of the process. This is a very important component that must be present at all organisational levels.

This component is not only complementary to every phase of the risk management process but also to the relationships between the phases. Differences in the legal, organisational and geographical situation in the various member states make it impossible to outline the management component in detail. It would be outside the remit of this Guide, which is focused on the risk management process.

The management task is to 'get the right things done, at the right time, in the right way' by initiating, organising, controlling and, not least, by communicating. A consistent message, repeated as many times as needed, is essential to achieve the end result. The content of that message can be built around the material from this Guide.

3. EXAMPLES

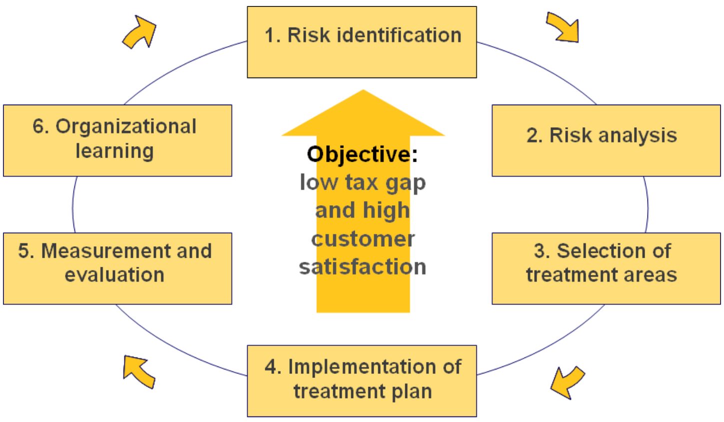
Interesting as the theoretical approaches to Risk Management may be, finally it comes down to how it is applied in practice.

This part will illustrate the theory by examples, gathered from the experiences in the different tax administrations, and categorised according to the theoretical model. In as much as it has been possible, all the examples follow the same outline (background – objective – treatment – measurements – results). It in no way pretends to be complete and the choices for publication here may sometimes be arbitrary. The intention is to have this as a dynamic collection of experiences where the steps of the Compliance Risk Management Model can be seen in the actions of tax administrations.

3.1. Examples for chapter 2.3 – Strategy

3.1.1. Example 1 Denmark: The Danish Compliance Risk Management Model

In 2007 the Danish Tax & Customs Administration started implementing a new compliance strategy designed to strike a balance between traditional enforcement activities and innovative treatments seeking more effective ways to arrive at high levels of compliance and high customer satisfaction. Central to the implementation is a compliance risk management model inspired by recommendations advanced in publications on risk management by the OECD (OECD 2004) and FISCALIS (FISCALIS 2006).



The compliance risk management model (which is applied for taxes, customs and duties) is based on six successive steps forming a compliance risk management cycle. The first two steps relate to risk identification and analysis; the next two to treatment planning and implementation; and the final two to measurement, evaluation and learning. All steps revolve around the goals implied by our mission statement on securing fair and effective financing of the future public sector: low tax gap and high customer satisfaction.

Risk identification is based on a bottom-up exercise involving staff at all levels of the organisation. Staff is asked to fill in risk identification templates on known or suspected risks with as much details and documentation as at all possible. The risk identification process is supported by guidance material describing what is meant by a risk (behaviours that contribute to the tax gap in the broadest possible sense) and what sort of information is required (description and classification of risk, considerations on drivers of risk, estimate of size, documentation). The exercise involves staff in tax centres and specialist units through a network of risk identification co-ordinators.

The identified risks are validated and further analysed in a process that is co-ordinated at the central level, but may involve the staff that originally identified specific risks or other staff with specialist knowledge relevant to the understanding and documentation of specific risks. The output of this process is then subjected to a series of workshops, where panels of experts score the risks relative to each other in relation to relevance (direct and indirect impact on the tax gap) and barriers to treatment (internal and external capabilities), which leads to a risk map showing the risks relative to each other.

This risk map along with qualitative considerations from the workshops forms the basis for management decisions on what risks are to be subjected to treatments and how resources are to be allocated. On the basis of these priorities a treatment plan is developed comprising projects that are designed, implemented and evaluated by local staff (often overlapping with the staff involved in the risk identification exercise) with support from specialist staff at the central level.

The risk identification was conducted for the second time in 2008. The first exercise in 2007 led to the establishment of a risk database that was consolidated with the second exercise in 2008. It is currently being considered how the process (and the organisation relating to it) might be adapted to better reflect this new situation, which calls for more emphasis on risk monitoring and updating than risk identification as such.

3.2. Examples for chapter 2.5 – Risk Identification

3.2.1. Example 2 Italy: Risk Analysis on new VAT identification numbers

Background - Objective

“Risk analysis on new VAT numbers” is an application set up in order to improve the preventive fight against VAT frauds.

Treatment

The software contains and automatically processes personal data, income and property information on taxpayers who, on their own or as legal representatives of a company, obtain a new VAT identification number.

The result of the processing is a “risk profile”.

All VAT numbers are analysed and not only those ones which refer to a risky activity sector.

To each information a risk score is assigned, on the basis of the previous experience and of information provided by the local offices tackling VAT frauds. Some factors refer to new VAT identification numbers (i.e. identity between business place and owner’s/representative’s residence, more then 2 changes of residence in the last 3 years, etc.), some others refer to VAT numbers previously obtained, if any (i.e. VAT refunds, no VAT tax returns and payments in the last 5 years, etc.). Each factor further includes inner specifications.

The final risk score, estimated by the sum of 20 risk factors, is assigned to a taxpayer and represents and important risk indicator.

At the end of the process, the application provides a list of all new VAT numbers by decreasing risk score.

Selections of VAT numbers are possible by using the following variables:

- Territory (country, region, local Office of the Revenue Agency)
- Activity (a specific activity, the whole sector, etc.)
- Period of time (a year, half-year, a quarter, a month)

Software is useful in order to detect suspicious cases that the local Office has to further analyse before carrying on any control on the spot.

The application is an analysis tool for the local Offices of the Revenue Agency.

The regional Offices are charged of the control, the coordination and the evaluation of the results of the analysis.

Measurement – Result

The application improved the effectiveness of preventive controls on new VAT identification numbers. One of the results is closing VAT numbers with reference to business activity that actually do not exist.

3.2.2. Example 3 The Netherlands: National Risk Database

Background

The National Risk Database (RDB) is a computerised method for recording and considering risks in the fiscal process. The RDB application is available for all staff members of the tax administration. In the RDB the whole 'lifecycle' of a risk is recorded.

Objective

Every tax official can record a new risk in the RDB. Details include:

– the name of the risk;
– description of the risk;
– legislation related to the risk;
– the nature of the risk;
– how the official found out about the risk;
– are there any indications that this risk often occurs;
– in which sector is the risk detected; is there any information about likelihood and financial importance of the risk;
– which way is the best to detect the risk;
– which way is the best to cover the risk.

Treatment

The national risk management organisation improves every new risk signal in a way that:

– the description is understandable and complete;
– ensures it really is a new risk and that it isn't already recorded, under another name, in the database;

– the new risk is described in a structured and unambiguous way;
– describes how risk detection can take place, its sources and moment;
– a possible selection rule is developed;

In case preliminary investigations (audits or desk tests) are needed, the participating tax offices are recorded in the RDB just as the results of the investigations in terms of:

– the percentage of returns selected: the tax returns which are identified by the selection rule as a percentage of all the tax returns;
– efficiency: in how many selected tax returns the risk occurred and was corrected;
– effectiveness: which part of the corrected tax returns was covered by the selection rule;
– the financial importance of the risk;
– the needed treatment capacity in hours;
– the definitive selection rule and parameters.

Measurement

After the introduction of the risk, the results of coverage are recorded in RDB in almost the same terms as used during the phase of the preliminary investigations.

Result

Every tax official can consult the RDB at any moment to see if a certain risk is already recorded, as well as which risks are recorded in the base. The information on the preliminary investigations results and those of the risk coverage is classified and only accessible for a few members of the national risk management organisation.

3.2.3. Example 4 Italy: APPLE (Application to fight against tax evasion)

Background - Objective

APPLE (Application to fight against tax evasion) is an IT tool that allows detection of non-compliant taxpayers by crossing information on their taxable capacity and data declared in the tax returns.

Treatment

This application refers to all natural persons (resident or non-resident) over 18 years having the fiscal code who completely evade taxes or do not pay the right amount due. Risky taxpayers, on the basis of specific risk hints, can be identified. APPLE gets information from internal and external sources.

Internal information are as follows:

- tax return if submitted
- taxable income declared
- turnover
- information on each section of the tax return
- payment of taxes
- etc

External information are as follows:

- capital flows by/to foreign Countries for an amount exceeding a specific threshold, interest payable on loan, bank transfers related to real estate rebuilding which allow to claim for tax deduction. Information provided by banks.
- insurance contacts
- ownership of auto vehicles and purchases of luxury auto vehicles
- provided by the Municipalities: authorizations and licenses, supply contracts
- registrations at professional rolls
- social security contributions
- payments at national insurance funds
- utility contracts
- ownership of crafts, aircrafts and real estates

Selections, also with reference to homogeneous groups of taxpayers, are made by matching pieces of internal and external information.

The first step is starting from analysing the taxable capacity indicators (external information) and then compare them with income information (internal information).

APPLE has been developed in order to improve the effectiveness of selecting risky taxpayers compared to two old IT applications:

- ET (Total evaders): database containing information on persons receiving income who completely evade taxes
- BEE (External Bodies Database): database containing information on the taxpayers' taxable capacity provided by external bodies

APPLE replaced ET and BEE in order to take advantage by crossing information coming from different sources.

Measurement – Result

APPLE has improved the quality and the quantity of the tax controls.

3.2.4. Example 5 Sweden: The Swedish Tax Gap Map

In 2007 the Swedish Tax Agency presented new estimates of the tax gap showing that approximately 133 billion SEK in tax revenue is lost each year due to different types of fraud and errors made by taxpayers. This corresponds to roughly 5 percent of GDP and 10 percent of total tax revenues (settled tax). The largest part of the tax gap, 66 billion SEK, consists of black work of which two thirds can be assigned to micro businesses. The tax gap related to international transactions has been estimated to 46 billion SEK with medium sized and large companies representing the larger parts. The remaining tax gap has been estimated to 21 billion SEK.

Definition

The tax gap is defined as the difference between the tax that should have been settled had all taxpayers correctly accounted all their work and transactions and the tax that is actually being settled. In the definition no consideration is given to whether the tax is being paid or not. The definition includes all types of "errors" i.e. both deliberate mistakes and fraud as well as non deliberate mistakes due to carelessness or difficult rules and regulations.

Calculation methods

To calculate the tax gap related to black work a recent study exploring the size of the black economy has been used.[20] In this study the total level of black work has been identified through a macro method using the discrepancy between income and household consumption in the national accounts. This method indicates that black work amounts to approximately 115-120 billion SEK. With the help of various micro methods, such as results from audits, surveys to both buyers and sellers of black work and surveys of different business sectors, the content of the black work has been assigned to different groups of tax payers. In this way most of the content of black work has been explained. The remaining part is defined as "black work not allocated". For the two other areas, "international" and "other", there have been no macro models available. Instead, the estimates build on various micro methods such as the results from random tax controls, the results of targeted tax audits and different risk analyses. If possible, several calculations and sources have been compared to verify the accuracy of the estimates. In a few cases, where no basic data has been available, experts have instead assessed the reasonableness of the estimates.

The underlying data is gathered from different years. The tax gap map is therefore not a snap shot from a specific point in time, but should rather be viewed as the Tax Agency's current knowledge of the tax gap. Since the estimates are based on data from many years it can not be used to follow the development of the tax gap over time.

Uncertainty

It should be noted that the uncertainty in the estimates is large overall. The lowest level of uncertainty can be found in estimates based on results from random controls. The highest level of uncertainty can be found in the international area and in the estimates of the tax gap for large companies. Due to the high level of uncertainty in many areas the tax gap map should be used with caution.

3.3. Examples for chapter 2.6 – Risk Analysis

3.3.1. Example 6 The Netherlands: External sources, Internet (web robot XENON)

Background

Over the past number of years the volume of (taxable) activities taking place on the Internet has increased. Therefore, the development of an automated instrument for the detection of those taxable activities has become necessary. A web robot, XENON, has been developed by the Netherlands tax Administration and is in use since 2004.

Objective

XENON detects unknown taxpayers as well as other probable non-compliant events such as the unauthorised use of brand names or illegal diversion of trade.

XENON has three main parts:

(1) Basic Fiscal Search tool (Trainer). With this tool one or more profiles can be set up.

20 Purchasing and Performing Undeclared Work in Sweden, Part 1: Results from Various Studies, Report 2006:4B, The Swedish Tax Agency.

(2) Web robot (Crawler). The web robot searches the Internet for sites that meet the profile. Parameters can be set to determine how deeply links have to be followed, how many sites have to be found as a maximum and how long XENON has to search the Internet.

(3) Web Identification Tool (WebID). WebID supports the identification of the websites owner.

Treatment

XENON operates as follows:

- with some examples, an expert shows the XENON-'trainer' what to look for;
- based of these examples, XENON creates a profile, which can be refined if necessary;
- after the final profile is created, the Crawler enters the Internet to search for a pre-determined time or a pre-determined number of sites that meet the profile;
- the results are filed and can be analysed;
- with WebID a 'probable site owner' is identified.

Measurement/ Result

The results of the XENON-search are correlated with the databases of the Tax Administration.

3.3.2. Example 7 Ireland: REAP- Risk Evaluation Analysis and Profiling

*Backgroun*d

REAP was developed in order to maximising the value of the data held by Revenue for risk assessment purposes. It is a knowledge based system based on rules and scores and the output is used to guide compliance programmes. It analyses the returns of the main taxes, derived data from internal systems as well as all available third party information that is linked to the taxpayer. The output from the analysis is a holistic risk analysis system that produces a risk ranked view of the business customer base.

Objective

The objective is to improve compliance levels through a better-focused use of compliance resources, by concentrating resources and effort on the higher risk rated cases and minimising contacts with compliant taxpayers.

Treatment/Description

The result of the analysis is made available to District compliance managers, who can extract the cases in their own area for further examination and follow up. A "case select" tool that managers can use to interrogate the results supports the output from the analysis. The manager can assign cases for working directly into an officer's case management application. A "Risk Profile Viewer" tool is also available where the caseworker can view each individual case, the rules that fired, the period in which they fired and the significance of the risks posed. The guiding principle of resources to risk is greatly assisted by this process. The national business plans now require that a minimum of 60% of compliance interventions must be chosen from the top 20% of risky cases. This gives enough scope for local initiatives and a defensible rationale for not intervening in low risk cases. By linking the economic activity code for each case a sectorial approach is also facilitated.

Measurement/Result

2008 was the first year that the business requirement to source 60% of audits from the top 20% of risk. The results are encouraging and a trend of higher yields and less non-yielding cases is emerging. In order to get assurance on the relative risk of the output the results of the Random audit programme are also checked against the risk rank of the case. Again there is evidence of better yields recovered from the high-risk.

3.3.3. Example 8 Germany: Qualified new registrations by using checklists

Background

Since 2005, every taxpayer applying for a VAT registration for the first time is checked using uniform national checklists which are designed to identify high-risk cases as early as possible.

Objective

The chief objective is to identify high-risk cases at the earliest possible stage and to forestall VAT fraud.

Treatment

Checks are first and foremost based on information obtained from the taxpayer by means of a questionnaire for tax registration purposes. This multi-page questionnaire is sent to the prospective taxpayer by the tax authorities with a view to obtaining detailed information about his or her business.

The checklist includes a set of features tailored to the legal form of the business to be examined. Those features have been developed on the basis of national anti-fraud experts' knowledge.

Joint stock companies, for example, are evaluated applying the following criteria:

- whether any partner in the new company has ever acted with intent to defraud before
- whether the legal representative has already been registered for taxation
- the branch of industry the organisation is engaged in
- noticeable features of the bank account
- shareholders' tax compliance record.

There are a number of different internal information systems for use by tax offices. These databases are designed to improve the quality of the checks. The tools include:

- national record of the names of all registered taxpayers (name, address, date of birth, VAT-identification number, bank account plus a number of general tax features)
- national database of VAT fraud cases
- local databases of office/business addresses
- local databases of unpaid taxes.

To get a maximum benefit, every information system available is used. In case of doubt, VAT registration is denied, and the tax offices have to conduct additional checks. As a general rule, these consist of unannounced limited audits to get a real picture of the business enterprise. If there is reasonable suspicion of tax evasion, the tax investigation service has to be informed immediately.

Measurement / Result

VAT fraud cases are detected and input into the database mentioned above.

3.3.4. Example 9 Italy: FALCO

Background - Objective

FALCO is one of the most innovative IT tools the Italian Revenue Agency uses to detect large taxpayers to be audited. The application also allows for monitoring their behaviour also using web sites data.

Treatment

By analysing dossiers of taxpayers having specific dimensional parameters, the Large Taxpayer Unit at central level and the Regional Tax Offices use this tool in order to set up the yearly audit plan. A correct planning of audits depends on the quantity and quality of available data.

FALCO contains both internal and external data:

- Internal data: Internal information refers to VAT number, fiscal code and all fiscal information like: summery of historical trend of specific data from the tax return (VAT and income tax returns) for the last 5 years, data about payments and detailed information about audit activities already carried out. Information on merger and demerger, presence of fiscal losses and data from the tax return are also available. The application also shows if the selected taxpayer applied the domestic consolidation regime with reference to the group. In this case a list of subsidiaries and their tax data is obtained
- External data: News extracted from the web represent an important part of external data. The application is based on semantic logic which automatically performs searching and filtering functions of news and data from the web regarding large taxpayers. It uses an exclusive linguistic platform and it is able to process the knowledge of texts in an intelligent way. By leveraging advanced linguistic technologies the tool recognised all aspect of language: morphology, syntax, vocabulary and semantic.

Most of external information comes from Internet as explained above. The collected data feeds the existing information base, in real time and by subject, aiming to monitoring and analysing repeated phenomena related to selected companies. More than 300 sources (newspaper headings, institutional sites, category associations' website, etc.) have been identified and they are constantly monitored. They give the opportunity to collect significant information and details about companies considered of highest interest.

The application allows selecting pages of interest on the basis of filters, which is the selection criteria fixed by the user, like: "tax heaven", "holding", "evasion", "transfer pricing", "trust", etc.

All information is contained in an electronic dossier (folder) with reference to each large taxpayer allowing effective selections of taxpayers to be audited.

Measurement – Result

FALCO has improved the quality and the quantity of the tax controls on large taxpayers.

3.4. Examples for chapter 2.7 – Prioritisation

3.4.1. Example10 The Netherlands: Attention Category

Background

The attention category is an estimation of the compliance level and importance of an individual company.

Objective

The objective was to create a relatively easy instrument to divide the taxpayers in groups to create a basis for effective compliance risk management.

Treatment

Both elements, fiscal risk and fiscal importance, are divided into 'high', 'medium' and 'low'. The nine categories are completed with two special ones: business start-ups (too little is known about them to place them in the right category) and a special category for traders actually under criminal prosecution (predominance of the fraud element). Eleven different attention categories have been identified on the basis of objective criteria. Every company, except the thousand largest ones, has an attention category.

Measurement

The **fiscal risk** class is based on 13 criteria:

- Business start-up Yes/No
- Sector risk
- Tax complexity related to the number of companies in the entity
- Tax conduct (income and corporation tax). The percentage of the indicated income and corporation tax amount owing is collected via provisional tax assessment in the tax year itself.
- Regularity of returns for all taxes over the last twelve months.
- Official assessments in the last completed year
- Supplementary payment of VAT in the last calendar year.
- Quality of administration
- Substantive material corrections of the tax return in the last five years
- Fiscal-technical corrections in the last five years
- Fraud
- Regularity of payment (irrespective of resource)
- Preliminary consultation

Every criterion results in a score. The sum of the scores qualifies the company for a low, medium or high-risk level rating. The higher the score, the higher the rating.

The fiscal importance is based on the annual declarations made for the four major taxes: Corporation tax, Income Tax, VAT and Wage Tax. The sum of the declarations qualifies the company for a low, medium or high importance rating. The higher the result, the higher the rating.

The determination of the attention category is fully automated. Moreover, almost every question is automatically answered. Twice a year the attention category is updated by answering all the questions with the latest information.

Result

Fiscal importance	High	B	1A	1C	1D	E
	Medium		2A	2C	2D	
	Low		3A	3C	3D	
			A Low	C Medium	D High	**Fiscal risk**

3.5. Examples for chapter 2.8 – Treatment

3.5.1. Example 11 The Netherlands: Consultation in the Agricultural Sector

Background

In the Netherlands a structured consultation exists between the Tax and Customs Administration and businesses. One of the oldest consultations is the one with the agricultural sector. Specialist tax consultants advise the majority of farmers. These consultants are united at a national level in a sector association, with representatives of which the tax administration discusses.

Objective

An agreement about standards (norms) in the agricultural business for the most common farming costs and for particular means of business and stock.

Treatment

The standards are found on many external and free information sources. These sources are also mentioned in the brochure. On the basis of the previous year's standards, actual developments and the study of the sources mentioned above, the new standards are settled in a first draft. The draft proposal is discussed with representatives of the agricultural consultants' association. This consultation results in jointly accepted standards for a one-year period. These standards are for the whole tax administration *and* all farmers.

Deviation is only possible in exceptional cases, but then a clear explanation is needed. Some standards do not have the weight of a norm but are a guideline, for example the private part of the costs of energy and telephone. Deviation from the guidelines is possible if the taxpayer can provide an acceptable argument, usually supported by evidence. Of course, if no agreement can be reached then the normal objection and appeals procedures can be followed.

Measurement

Standards are agreed on the following aspects:

- private use of agricultural goods;
- private element of costs
- assessment of value of cattle,
- assessment of value of corn and grass;
- depreciation standards in horticulture;
- assessment of value of growth on the field;
- assessment of value of bulbs;
- assessment of value of trees;
- depreciation standards of farming machines;
- depreciation standards of production rights.

Result

The result of this consultation is the yearly agreement of standards for the most common farming costs and for particular means of business and stock. These agreements are laid down in an official resolution of the State Secretary of Finance. Afterwards the standards are recorded in a brochure, which is sent free of charge to every fiscal consultant in the country. The content is also available on the tax administration's internet site.

With this procedure, a situation is reached in which there is no longer a need for discussions at taxpayer level about the level of costs and values. This contributes to a higher level of compliance in tax returns and tax payment.

3.5.2. Example 12 Sweden: Early Letter Treatment (antiques)

Background

Private persons who have sold antiquities at auction houses are obliged to declare these incomes. However, many taxpayers do not know this and misunderstand the legislation.

Objective

The Swedish tax administration wanted taxpayers to be more compliant and also wanted the taxpayers to think that it did the effort in a professional way were the tax administration gave the taxpayers a chance to do things right from the start.

Treatment

An informative letter was sent out to the target group before they should file their tax return forms; the tax administration didn't mention anything about audit activities in the letter. It was just a letter were the tax administration wrote that they had information that the taxpayer had sold antiquities at an auction house and an instruction how the taxpayer should declare these kinds of transactions. The enclosure, which is to be used to declare these kinds of incomes, was also sent to the taxpayer. In the letter the tax administration used a kind of "campaign" telephone number; so those who had question about the letter could contact persons who knew this area without being connected to different people before reaching the right one to talk to.

Measurement – Result

From the computer register the tax administration looked at the taxpayers who declared incomes from selling antiquities before the treatment and then they looked after the treatment.

From the evaluation the tax administration could see that the number of taxpayers who declared the income increased by 28 percent when they compared the figures before and after the treatment. The conclusion is that most of the result depended on the information the tax administration sent to the taxpayers.

A positive comment is that the tax administration sometimes underestimates the impact of early targeted information activities and that it is a very cost efficient way to give taxpayers a possibility to comply. In areas, like this one, there are taxpayers who make intentional and unintentional errors. With this kind of treatment everybody in the target group is given a fair chance to do things right from the start; it's not possible for taxpayers to say that they didn't know these transactions should be declared.

3.5.3. Example 13 Denmark: Fair Play (combating the underground economy with visible enforcement and moral messages)

Background

The underground economy is a major risk area that it is difficult to address effectively with traditional enforcement tools. In addition to the direct loss of revenue, a thriving underground economy leads indirectly to further loss of revenue, as it has a negative impact on tax morale. Moreover the more organized aspects of the underground economy are often associated with violations of legislation in other areas such as employment, immigration, social services, food administration and environment. Therefore the Danish Tax & Customs administration has since 2004 cooperated with other authorities within a framework combining aspects of a traditional enforcement approach with visibility and campaigning.

The highly profiled initiative is supported by changes in legislation enhancing the reach of the enforcement activities in such areas as inspection and immediate sanctions.

Objective

The objective – from the point of view of the Danish Tax & Customs Administration – is reduce the underground economy and counter the negative impact of non-compliance on overall tax morale.

Treatment

The treatments under the Fair Play umbrella combine aspects of a traditional enforcement approach with visibility and campaigning.

Between 1.500 and 2.000 companies in risk lines of business (typically businesses that are dealing with private customers and have part of their turnover in cash) are subjected to Fair Play visits each year. These visits are, in accordance with the Danish compliance strategy, designed and carried out in such a manner as to create visibility in order to increase the impact on compliance and tax morale.

Tax morale as a whole is further addressed through campaigns designed to impact on the younger part of the population, as initial surveys indicated that young people were particularly tolerant of black labour. The campaigns have featured the images and voices of sports stars, metaphors from the world of sports and strong moral messages condemning black labour and social fraud.

Measurement

Data on balanced books and staff status (in relation to undeclared income and/or unwarranted social benefits) is inconclusive, which may be explained by increased attention to the problem and increased enforcement capacity that has come along with the Fair Play initiative.

A focus on illegal beverages (with no excise duties paid and no bottle deposits) saw hit rates drop from 80% to 19% of audited companies from 2005 to 2007 – in parallel with an increase in paid excise duties and a decrease in seizures.

Biannual surveys document the impact of the campaign activities: from 2004 to 2006 tax morale has increased among the population as a whole, but especially among young people, who have gone from having significantly lower tax morale than the overall population to having tax morale roughly on par with the overall population.

Result

The Fair Play campaign has had positive impact on compliance and tax morale.

3.5.4. Example 14 Sweden: Taxpayer Campaign

Background

Taxpayer surveys are regularly used in Sweden to assess the attitudes of people in the community towards tax issues. The survey in 2001 revealed that young people had a more positive attitude towards tax evasion than the total population. One item in the survey was: '*I think it is okay to evade tax if I have the opportunity*'. 12 % of the age group 18-24 agreed compared to 7 % of the total population.

Objective

This was considered a risk (especially for the tax revenue in the future). It was therefore decided to run a campaign with the objective of influencing attitudes of young people towards less acceptance of tax evasion.

Treatment

The campaign was designed to run for three years. It started in 2002 with TV-advertising (a short film about how the society would look like if we didn't pay tax), distributed information in schools about how the taxes are spent, and the Director General sent a letter to the target group with some information about taxes. A web site was developed with general tax information. During the second year the campaign continued with additional TV-advertising showing the connection between taxes and benefits like healthcare, libraries, infrastructure, etc. The municipalities also put up small posters (stickers) with the message "Paid for by you" on park benches, waste bins, schools and similar objects.

Measurement – Result

The results show that the campaign has been working. The survey in 2004 showed that the attitudes of young people have changed. Attitudes are now comparable to those of the total population with only 7 % in the age group 18-24 now agreeing with the item mentioned above.

3.5.5. Example 15 Poland, Cyprus, Austria and Sweden: Visiting Schools

Background

The aim for the different tax administrations is to reach the young generation in order to make the young people think about taxes as part of the society. Most administrations see schools as an important arena in order to discuss taxes and meet the target group.

Objective

To increase awareness about taxes in society and to increase voluntary compliance. It is mostly general information about income taxes, but in Cyprus and Austria, the focus is also on VAT. In Sweden the aim were more to change young people's attitude towards illicit work, but also to give general information about taxes.

In Poland, the objective was to answer the question: "Why do we pay taxes?":

- presenting taxes in chosen historical periods and the way taxes influenced the process of establishing and reinforcing state structures at that times,
- presenting the most important social needs being satisfied by the state,
- presenting taxes as the main source of financing tasks realised by the state,
- making students realise results of tax avoidance.

Treatment

The treatment differs a bit between the countries. In Austria, officers visit schools independent of the type of school but the students should have at least 15 years of age. In Cyprus, VAT officers visit secondary schools and undertake presentations in class.

In Poland, the educational action was carried out in cooperation with the Department of National Education. Directors of Tax Chambers and School Superintendents were charged with the organisation aspects related with the action within the territory of individual provinces. The program included training of speakers - workers of tax offices who were assigned to teach school (they were supposed to be relieved of other duties if possible). The following materials were integral part of the educational program:

- posters,
- handbook for the trainers - speakers teaching students (including source texts, instructions concerning the methods of discussing the issues, examples of exercise),
- the film produced during one of the lessons, showing the course of the lesson and executing principles accepted by the trainer

In Sweden, they sent out a black box to schools. In the box there was a film about young people planning a trip to Florida, some instructions to the teacher, a wig, rings etc used by the actors in the film. The film was used to start a discussion and a role playing game in the classroom about illicit work.

Measurement – Result

In Austria, the starting of the evaluation process is planned by the end of spring 2009. Since direct measurement for compliance is hardly possible, the Ministry wants to evaluate the reaction of students and teachers to the presentations held. For instance

- What topics they are especially interested in?

- What additional information they ask for?
- Is the standardised presentation the right approach for all types of school?

In Cyprus, The evaluation of the activity is restricted at level 1 evaluation that measures the immediate reaction of the participating high school students as regards satisfaction with the content and delivery of the presentation.

In Poland, an anonymous questionnaire was distributed among teachers listening to the meetings of workers from tax administration with primary school students of fifth and sixth class. Based on the replies to the questionnaire the report on the educational action results was made. The educational action as a whole was rated in average at 5.27 within 1-6 scale. As it resulted from the publications in local and nationwide newspapers the initiative of Polish Tax Administration was received by media with interest and recognition.

In Sweden, the black box was a part of a wider campaign in order to change young people's opinion about illicit work. Surveys were made before the campaign started and after the ending of the campaign. The result was a positive change. Before the campaign, 42 % of people aged 16-20 disagreed to the statement "It's OK if people work without paying tax", and after the campaign, 55 % disagreed.

3.5.6. Example 16 Poland: Publishing information on areas of tax audit

Background

Based on the information and analyses from local and regional level of tax administration the Ministry of Finance elaborates Annual National Compliance. It contains among others the list of risk areas of national priority and actions that must be taken with regard to each individual risk area. In general National Compliance Plan is aimed at achieving high level and quality of tax obligations fulfillment resulting from the tax system.

Implementing the principles of the External Risk Management Strategy with respect to Annual National Compliance Plan the Ministry of Finance decided to elaborate also complementary annual public information as a kind of both preventive and enforcement communication measure.

Objective

The document published on the internet page of the Ministry of Finance is aimed at ensuring better voluntary tax compliance and decreasing the number of tax mistakes.

Treatment

Since the year 2006 the Ministry of Finance has been publishing on its *internet* page annual information on „*Basic Scope of Tax Audit Areas"* indicating priority course of tasks for tax chambers and tax offices for a given year. The information presents aspects being the source of the most frequently arising irregularities identified by the tax administration.

In fact areas of audit described and published in the document comprise the list of risk areas of national priority included in internal document of the tax administration created with regard to External Risk Management Strategy, called the *Annual National*

Compliance Plan.

The document includes basic areas of audit and so does not restrict scope of tax authorities' actions to other areas of audit.

The way of presenting the document and content of information about audit areas is the example of new approach for work organisation of polish tax administration.

Measurement

As it results from the publications in local and nationwide newspapers the initiative of the Ministry of Finance was received by the public opinion with interest and recognition.

The Ministry of Finance evaluates the results of actions taken within the risk areas with respect to influencing taxpayers behaviour based on the annual reports from the local and regional level of tax administration that is tax offices and tax chambers.

3.5.7. Example 17 The Netherlands: Increasing perceived probability of detection

Background

In the Netherlands a study of the effects of publicity has been carried out. The study was part of a project in which the Tax and Customs Administration was able to cover risks using contra- information on money held by Dutch residents in foreign bank accounts.

Objective

Taxpayers were given the opportunity to make a voluntary disclosure to the tax authorities about their foreign bank account which was not known by the tax administration before. And which contained 'sources of income' that had not previously been declared on their tax returns. In exchange for disclosure they were guaranteed exemption from penalties - although they were still required to pay the tax due, with an interest for late payment, going back up to twelve years.

Treatment

The scheme was publicised by means of press releases. The study showed six aspects to be crucial in influencing compliance.

- Targeted coverage: This principle dictates that the more personally relevant the media coverage is to the target reader, viewer or listener, the greater its impact.
- Arguments for and against: The arguments advanced by the reporter, the journalist, for 'falling into line' (or not) are an important factor. This is firstly because those arguments could be either in favour of or against 'falling into line'. Secondly, the strength of their arguments may vary. Where strong arguments are put forward in favour, or weak arguments against, this will tend to increase the number of taxpayers falling into line (albeit reluctantly).
- Risk of detection: People can be influenced to opt for compliant behaviour if we ensure that the chance of detection (or at least, the taxpayer's perception of it) is high and that the consequences for anyone found failing to comply will be serious (or at least if we give the impression that this is so).
- Standards of behaviour: Standards of behaviour can have a significant effect on compliance. Two different types can be distinguished: prescribed standards, what other people expect from the tax administration (both the implicit and the

explicit rules) and observed standards, what the people in society do. The influence of standards is particularly great when people's attention is specifically drawn to them.

- Legitimacy: Taxpayers are more likely to behave in a compliant way the more they are convinced that the Tax Administration operates in a fair and just way - the most important aspects of which are the justness of procedures, the way in which taxes are levied and the way the tax administration performs its enforcement duties.
- Consequences: Research shows that 'Knowing what the possibilities are' is an important part of influencing people's behaviour. That was why it was essential in this project to tell taxpayers that 'falling into line' was a possibility.

Measurement

The number, moment and content of the press releases, the number of taxpayers who made a voluntary disclosure and the moment this was done, and the relation between both aspects.

Result

Based on the above, a model was developed for effective press releases. This is described below.[21]

3.5.8. Example 18 Italy: Sector studies

Background - Objective

Sector Studies have been introduced by Law no. 427 of 1993 to allow the Italian Tax Administration to check taxpayers' compliance. The law is applied to taxpayers who are self-employed workers and enterprises with the turnover below a specific threshold. This is a method used to make assessment of income. Variables of the assessment tool come from information contained in questionnaires filled in by taxpayers. In this way an accounting and structural database is created.

---

[21] *Large numbers of taxpayers disclose secret foreign savings to tax authorities. Over the past few months' interest in the Dutch Tax and Customs Administration's scheme, which allows taxpayers to declare previously undeclared foreign bank balances (3) has been enormous (2). The Administration's web site (3) (www.belastingdienst.nl) where the 'Declaration of foreign bank account' form can be downloaded has had over 50,000 visitors (2). People who make a voluntary disclosure to the tax authorities can avoid the penalty normally chargeable on back tax (6). In early 2001 the tax authorities secured from various banks in various countries information on Dutch residents who held funds there (5). The information was obtained partly under the provisions of international treaties on the basis of which the Tax and Customs Administration can issue assessments on the account holders (4). Other information came from tip-offs (5). Failure to declare savings held outside the Netherlands to the tax authorities is an offence and costs the Netherlands several billion euros every year (1). Almost a thousand Dutch residents have completed the Internet form so far (2). Others have made their disclosure direct to the tax authorities or through a lawyer (3a).*

(1) Prescribed standard
(2) Observed standard
(3) Possibility
(3a) Possibility for people who do not have Internet access
(4) Legitimacy
(5) Broadening of the target group
(6) Consequences

Treatment

From a technical point of view, Sector Studies are a process of analysis and economic evaluation of small and medium-sized enterprises (SME) with respect to the specific territorial features of each enterprise and how the business is operated. Thanks to a comparative analysis, these Studies were worked out considering the existing relation between accounting and structural variables of each economic branch with respect to the belonging sector, to the production process, to the corporate structure, to the product of the activity, to the location, to the market and to other significant elements referred to each specific business.

As to each economic sector, such an analysis provides for:

- The identification of structural elements, which are characteristic of the business activity in a sector (i.e. products, reference markets, production process and procedures, selling channels and procedures…);
- Identification of the business organisational model of a sector through the Cluster Analysis;
- Taxpayers selection under normal economic conditions using significant economic indicators with respect to the sector activity (i.e. trade: mark-up, inventory turnover, employee productivity);
- When applying Sector Studies, taxpayers are assigned a cluster singled out with respect to the business organisational model of the sector;
- The definition of the revenue functions and territorial analysis: the statistical analysis through Multiple Regression allows the Tax Administration to detect the relation existing between revenues and accounting and structural data derived from questionnaires; as a consequence, each organisational model referred to a sector is assigned its own revenue function. Revenue functions allow to determine a range, between a minimum and a maximum, where to locate subjects operating under similar conditions but also determine a "reference revenue" that the taxpayer may report to avoid tax assessments.

Sector Studies are based on a principle already applying to the tax system, i.e. assessments may be based on an indirect audit when there exist "deep discrepancies between data declared and data derived from characteristics and conditions of the activity carried on".

Considering that Studies are useful to make an estimate of turnover but not the definitive income, amounts derived from the application of the same studies are valid only as an indicator. The application of the study will be enough to shift the burden of proof in favour of the Administration unless the taxpayer can proof to the contrary.

Sector Studies are a tool to improve compliance for various reasons:

- taxpayers, through trade associations, may submit their observations and may participate in the Commission of Experts (which approves the Studies) along with Tax Administration's representatives;
- taxpayer with a revenue lower then the threshold established by the "Revenue Function" may avoid a tax assessment by "adjusting" the revenue declared;
- they allow a study into the evolution of the economic and business context.

Measurement – Result

Analysis showed that Sector Studies increased the spontaneous fulfilment of the tax obligations.

3.5.9. Example 19 Poland: Take the bill

Background

Every person who is buying goods or services should receive a document as a confirmation of closing a deal. If the salesman owns a cash register it would be a bill. Such a bill includes information concerning at least price, due tax and salesman's data. Generally, the bill should be given to the buyer without specifically requesting it. Unfortunately, it is not so obvious for all the salespersons.

The clients buying goods or services should ask for a bill because it is important for many reasons:

- it makes it easier to claim buyer's rights in case the quality of goods or services is not satisfactory.
- it is conducive to honest competition, because the salesman, printing the bill, registers the transaction as part of the turnover, decreasing the "shadow economy".
- indirectly it is favourable to everyone because the tax paid comes in to the national budget so it makes possible for the state/government to provide all taxpayers with proper health care, education, protection etc.
- Taking into consideration all three factors mentioned earlier and the fact that not every salesperson gives the bills, some precautions were taken. One was to educate taxpayers on their rights, obligations and benefits. The Ministry of Finance of Poland started a project called "Take the bill". It was directed at:
    - consumers (also children and teenagers);
    - entrepreneurs who were obliged to register their turnover by means of cash registers;
    - consumer organisations;
    - business representative organisations;
    - the media.

Objective

The objective of the action was to improve public awareness of the role of the bill. The main principle was to explain consumers its role in forming the state budget and proper functioning of market economy. The bill favours honest competition. Consumers requesting the bill oblige the seller to register the transactions and so to pay taxes due to the budget what results in decreasing the "shadow economy".

Treatment

The first stage was the poll aimed to study public awareness of receipt importance for goods and services turnover. Five questions were asked:

- Does a seller having a cash register deliver you with receipt after transaction?
- Do you require being delivered with a receipt?
- Why do you accept receipt?
- Do you know advantages of having/accepting a receipt?
- Do you think it is important to propagate knowledge about the pros of having a receipt?

Polled people could choose from four answers: “always”, “sometimes”, “never”, “I don’t pay attention to that”.

The results of the poll proved that only a part of sellers met their obligations to deliver receipts to their customers. Only few people indicated that receipts were important for budgetary revenues.

After compiling the outcomes of opinion poll the Ministry of Finance organized a press conference to announce the beginning of the “Take the bill” action.

The next step was disseminating information materials (posters, leaflets). Moreover taxpayers had the opportunity to familiarize themselves with guidelines of the action during special so-called “open day” in tax offices, and as for young people during educational action “Where do we get money for all the expenses. We all pay taxes”.

Except tax administration also other institutions took part in the action, such as e.g.: Consumer’s Federation, Polish Chamber of Commerce, Confederation of Polish Employers. Different institutions got involved in the action in order to make consumers realize their importance in limiting “grey economy” and standing up for common business of taxpayers and fair competition. The poll forms were published on their internet pages, mailing campaigns targeted at associated subjects were carried out, etc.

Moreover tax chambers and tax offices cooperated with units of local authorities, agencies of Social Insurance Authority, Agricultural Social Insurance Fund, accounting offices, consumer’s organisations. And leaflets informing about the action were attached to correspondence with taxpayers.

Measurement

By means of specific reporting forms data on actions taken with reference to the risk area: “Taxpayers not compliant with the rules concerning registering sales using cash-registers” is collected by the Ministry of Finance. Thanks to the information from the report the Ministry may indicate the most relevant tax mistakes identified within that individual risk area and to analyze the results of desk audits and field audits.

Based on the reports it is claimed that actions taken within the risk area “Taxpayers not compliant with the rules concerning registering sales using cash-registers” resulted in a considerable preventive effect and “Take the bill” action had a strong impact on the group of taxpayers.

3.5.10. Example 20 The Netherlands: Horizontal Monitoring

Background

The vast majority of Dutchmen pay their tax appropriately, knowing their fellow countrymen do the same. Maintaining this community confidence requires a level playing field for all businesses, so that those who try to avoid their obligations do not have an unfair advantage over honest business people. Where businesses show a reckless disregard for their obligations the community expects the Netherlands Tax and Customs Administration (NTCA) to respond firmly and professionally. In such an environment, the NTCA can differentiate its approach, minimising the intrusiveness of its compliance activities on those who want to comply, while being able to better identify those businesses that represent a higher risk.

Objective

The objective of Horizontal Monitoring – monitoring by non-government organisations – is to encourage self-regulation and voluntary compliance by establishing a positive relationship between the corporate and the NTCA build on trust, transparency and mutual understanding. The focus is on the phase before the tax return is filed, working with real-time data and on cooperation throughout the fiscal chain. By doing so, the quality of tax returns will improve and the taxpayer will have more certainty on his tax position.

Treatment

Horizontal monitoring is custom-tailored to different types of taxpayers. The NTCA enters into individual agreements with large enterprises. With this agreement the parties underwrite that they will base their relationship on trust, transparency and mutual understanding. NTCA expects these Horizontal Monitoring Partners to come forward with possible fiscal discussion points, before the tax return is filed. In return, the NTCA will reach a fast and timely decision, with regard for the current situation the business is in.

To reach the group of small to medium sized companies, the NTCA enters into agreements with the trade and industry organisations. In these agreements relevant tax issues (e.g. joint determination of norms and ratios) are addressed, in addition to an outline of the mutual obligations of trust, transparency and mutual understanding. Individual companies can then apply to join the agreement with their local tax-office, by filling in an application form. With this form, the company states that it wishes to conduct business with the tax office based on the values of horizontal monitoring. Furthermore, to reach the group of small to medium sized companies, the NTCA is entering into agreements with tax practitioners; intermediary parties such as financial and tax advisors and certified auditors / accountants. They play a vital role in the fiscal chain, cooperation with tax practitioners – aligning the working processes - lead to higher quality of tax returns and therefore indirectly to more compliance. The tax intermediaries are responsible for setting up a sufficient internal quality assurance system so that the NTCA can rely on their processes. The NTCA will monitor the performance of the intermediary on a ‘meta-level’.

The NTCA is cooperating with producers of administrative software, offering knowledge on current fiscal issues and making sure the software products meet compliance standards.

For individuals, the NTCA wants to make it as easy as possible to comply, by offering pre-filled tax returns. The NTCA provides the known data and the taxpayer underwrites this tax return or makes changes where necessary. NTCA is also developing a Personal Domain on the internet. In this personal domain data (status information) is recorded and transactions can be conducted, e.g. fiscal relevant changes in the personal situation.

The NTCA is working together with other government administrations to develop whole-of-government solutions to further minimise red tape and compliance costs – for enterprise and government.

Measurement

Horizontal monitoring can be measured by the number of enterprises (small to very large) that have entered into an agreement with the NTCA, directly or through a trade association, or the number of tax returns filed according to the agreements with tax practitioners.

Another means of measurement is on the improvement of quality of the tax returns, filed under the horizontal monitoring protocol. The NTCA carries out a nationwide random check on tax returns. The results of this random check are used to measure the quality of the tax returns that are filed under the conditions of the horizontal monitoring agreements. The results are shared with the partners, and further measures are determined together.

Result

Horizontal Monitoring requires a big initial investment in time and effort of both parties, of the enterprises involved and the NTCA alike. In the end, compliance is believed to improve. Other positive effects of horizontal monitoring are: more cooperation throughout the fiscal chain, higher quality of the filed tax returns and a focus on non-compliant or unknown taxpayers. And in the long run: the administrative burden and compliance costs are foreseen to reduce.

3.6. Examples for chapter 2.9 – Evaluation

3.6.1. Example 21 Ireland: Construction Industry

Background

By 2005 the construction industry was a major contributor to economic activity in Ireland and needed some focussed attention. In 2006 the Irish Revenue Commissioners commenced a National Construction Project.

Objective

To improve compliance levels with construction industry returns and regulations in both filing and payment and regulations.

Treatment

In order to achieve this the project set out to improve understanding of compliance obligations within the construction section through information and awareness programme. This was delivered to taxpayers and tax agents through a multi faceted campaign that included:

- Open Forums, magazine articles, media interviews, mail shots, a dedicated web page on the Revenue website
- Regular email updates to the trade and accountancy representative bodies,
- Regular consultations with the trade representative body, Construction Industry Federation
- Clarity of revenue policy
- Working with the Social partners and other Government Agencies, to ensure compliance with employer obligations.

Measurement/Outcomes

An improvement in both timely filing and payment was recorded as follows:

Filing	by due date	by due date + 6 months
2005	52%	77%
2007	61%	86%

Payment of monthly tax returns by case size improved as follows:

	2005	2007
Big Cases	72%	80%
Medium Cases	77%	83%
Small Case	73%	76%

The Project achieved its objectives as reflected in the improvement measured over the two years.

3.6.2. Example 22 Sweden: Campaign against late tax payment (randomised controlled trial)

Background

Payments of taxes in time is one of the objectives of the Swedish tax administration. In the spring of 2007 the Swedish tax agency conducted a randomised experiment to evaluate if early reminders could improve the payment of tax on time.

Objective

The aim was to find out if a phone call or letter about unpaid taxes results in earlier payment and which was the most cost-effective.

Treatment

651 letters were sent and 400 calls made in one of the tax regions (Mälardalen). In Stockholm 200 letters were sent out.

Measurements and methods

Before random selection taxpayers with outstanding taxes in Stockholm and Mälardalen were identified. They were randomly selected to receive a reminder letter or phone call. A control group was selected who received no contact.

Results

The study found a large impact of both telephone and letter reminders on payment behaviour. For example, payments within 14 days after receiving a reminder in Stockholm were estimated 33.6 percent points higher than the control group who received no reminders. Twenty-eight days after the reminders were made there was a weakening effect of the campaign, though results were still very good (26.9 percent points). There was no evidence that a reminder phone call gave a larger effect than a letter. Though project cost compared to benefit was not examined, early reminders were recommended to be carried out in future.

3.6.3. Example 23 United Kingdom: Impact of Working Families Tax Credit (difference-in-difference method)

Background

In 1999 the government of the United Kingdom has changed tax and benefit system by introducing Working Families Tax Credit (WFTC). WFTC replaced Family Credit which was a type of social benefit.

Objective

The aim of WFTC is to provide financial support for low income families with children. WFTC enables families to receive additional money through wage rather than benefits. This points to one of the advantages of WFTC compared to Family Credit, i.e. higher incentives to work.

Treatment

WFTC can be claimed by one of the family members who work. The amount of credit depends on the family income, number and age of the children, number of working hours, etc. The difference between WFTC and income tax due is refunded to the families that claim. It is paid with the wage by employer or by HM Revenue and Customs. The latter institution administers and assesses WFTC.

Measurements and Methods

The aim of the research was to evaluate the impact of WFTC on the employment rate of parents (potential recipients of WFTC) against adults without children (comparison group). The research used survey data from 1996 to 2002. The evaluation method chosen was “difference-in-differences” because participants could not be randomly allocated to treatment and control groups. Difference-in-difference will attempt to “difference out” any variability between people who take the credit and those who do not. In this way the natural difference between groups from not being able to randomize is less likely to be attributed to the effect of the credit itself.

Results

Though it could not give a clear answer about WFTC effect alone (as there were more tax and benefit reforms during the investigated period) WFTC and other associate reforms were found to increase lone parents’ employment by around 3.6 percentage points in 1999-2002. For couples with children it was found that WFTC and associated reforms had no significant effect on mother’s employment, but was associated with a 0.5 percentage point reduction in fathers’ employment. Overall these changes corresponded to between 25,000 and 59,000 extra workers depending on the data source used.

3.7. Examples for chapter 2.10 – Corporate Governance

3.7.1. Example 24 United Kingdom: Management Assurance

Risk management is central to strategic management. It covers a series of well-defined steps which, when taken in sequence, identify risks and provide insight into options for controlling potential opportunities and threats to delivery of objectives. Effective risk management takes account of probability and/or impact factors, limits exposure to risk, and helps manage, rather than eliminate, the risk of failure in achieving the objectives.

At a strategic level, risk management is used to protect the tax administration's reputation, and safeguard accounting for public funds. At an operational level, effective risk management ensures delivery of major projects and programmes provides early warning of potential problems and/or identifies potential opportunities.

All staff and particularly managers, should identify, understand and manage risks, and develop an appreciation of which risks can be tolerated and which risks cannot.

The following describes potential internal risks and suggested options to test and reduce the risk.

Threat	Countermeasure	Activity
The Central Risk Analysis (or other case selection tool) may not produce the correct risk ranking of taxpayers	Random selection of taxpayers from each segmentation for audit or other intervention.	Audits should preferably be undertaken by experienced staff to fully test the ranking process
Inappropriate tax refunds authorised. a) fraudulent claims submitted by staff b)inappropriate release of funds	a) Random selection parameters determining a mandatory full audit b) Complete listing of all approvals for management consideration	a) Audits should be undertaken by staff not connected with the risk process b) Contacts to be made by managers not connected with the risk process
Custom & practice may not be following central policy	A programme of system reviews planned over a given cycle	A team of "experts" to undertake local and central system reviews
High risk taxpayers not identified as such	Local management to review decisions based upon local risk assessment of their staff	Observations should be fed back to individuals
Taxpayers selected for the wrong intervention	Local management to review decisions based upon local risk assessment of their staff	Feedback from intervention staff encouraged
Poor quality interventions	Local managers to review time undertaken for each audit and undertake a review of activity reported	Managers to a) accompany staff on audits to judge performance b) spend time with staff who undertake other interventions

Collusion by staff with taxpayers	Managers to make follow up approaches to taxpayers based upon a risk assessment of their staff	A programme of "overtaking" and "return" visits or contacts required

Managers are expected to:

- understand the risks they face, their causes, probability and impact;
- prioritise the management of risks - ensuring that risks of highest concern are addressed before effort is directed towards lower-level risks; and
- manage risks in their areas to ensure the tax administration's exposure to risk is aligned with risk appetite/tolerance, and that controls put in place are proportionate to the risk.

This will include a risk assessment of staff under their command. All of this is brought together through Management Assurance Plans.

3.7.2. Example 25 Italy: Quality Certification

Background - Objective

Quality Certification of the local offices of the Italian Revenue Agency is presently being carried on in order to:

ensure and develop fiscal assistance to taxpayers and simplify audit procedures by speeding them up, increasing the fiscal yield and reducing the legal cases;

ensure that the organisation is based on process integration and on multi-purpose teams.

Treatment

The process of Quality Certification consists of several stages:

(1) *Presentation of the project;* The regional responsible explains the project to the responsible of the teams

(2) *Analysis of the management and operational processes*; Evaluation of the existence of the conditions to qualify for Quality Certification.
Confirmation that critical factors were tackled and proper initiatives were set up in order to solve them.

(3) *Implementation of the Quality Management System*; Controls of the internal procedures in order to check if the process is effective.

(4) *Analysis of the results*; The results of the Quality System implementation, the objectives for the immediate future and the suggestions to improve the system are reported.

(5) *Identification of Offices to be checked*; The Central Personnel Directorate is made aware of the Offices that will be controlled by the external body charged of the check.

(6) *Certification*; The external body, after having checked the organisation is in conformity with the standard UNI EN ISO 9001:2000, certifies the Office. The Quality Certificate is valid for a three-year period and subsequently a new one will be issued if this is the case.

Measurement – Result

Quality Certification provides for a periodical monitoring system in order to keep the achieved results in a long time run.

4. DATA, TECHNIQUES AND TOOLING

Data, techniques, tools and (human) capabilities are undoubtedly the basis for executing the compliance risk management process. These elements play a role in all steps of the risk management process, particularly in the identification and analysis stage. It is important that management decisions are based on firm ground; on knowledge of taxpayers (the behaviour) and risks. As the compliance risk management process is a cycle, the output of the process gives input to new risks, more knowledge etc. This can then be used to develop the information position of a tax administration in such a way that management can make decisions faster (real-time) and in a more consistent and more reliable way.

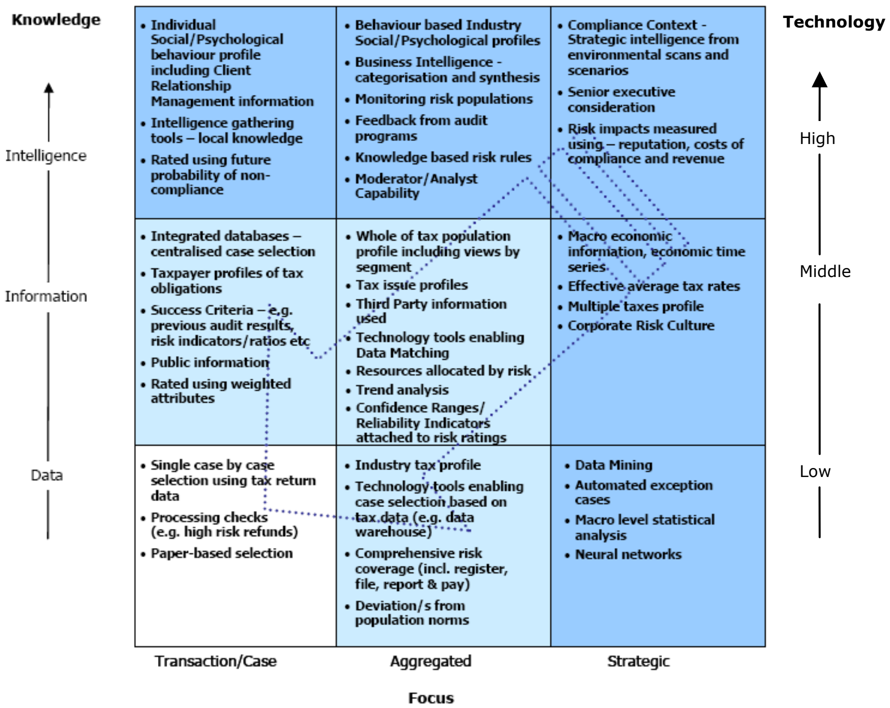
It is important that tax administrations are aware of their level of development both with regard to *knowledge* and *technology*. If a tax administration progresses towards strategic intelligence there will be a demand for sophisticated tools and technologies. An example is e.g. the use of a web robot.

See example 7 The Netherlands (par 3.3.1.): External Sources, Internet (web robot)

With respect to the development of 'knowledge', a tax administration should progress from data towards intelligence. It should be able, not only to describe what happened or is currently happening, but also be able to explain the current situation or even predict what is going to happen. Data tends to be a reflection of past events, information can supply understanding of patterns and trends across data sources, and intelligence can add value by providing insight into the future.

In the *figure* below practical examples of tools and techniques are described that allow a tax administration to identify what level of 'knowledge' and 'technology are present in their current situation.

Fig. 9 Tools and techniques (level of knowledge and technology)



If a tax administration is mainly using case-by-case' selection tools (situation bottom left), attention should also be paid to the more aggregated tactical level and strategic intelligence. This will be necessary to be able to develop the compliance risk management process in the future.

In paragraph 4.1 an overview is given of 'risk tools' used within the EU Member States. Risk tools are described as "product(s) that enable a tax administration to undertake its mandate of applying risk management principles to direct and indirect tax regimes in order to mitigate associated current or emerging risks."

4.1. Catalogue of IT based risk management tools (risk tools)

Within the limitations of the domestic legislation the tax administrations have access to an enormous amount of data. It is used for various tasks and more and more of the risk management efforts are based on the available information. Reducing staff capacity and the new service oriented approach of taxpayer treatment demand an efficient and effective allocation of resources to deliver a good service but tackle all the key non-compliant activities.

Since 2000 the introduction of risk tools in Member States has picked up and the applications have begun to prove their value. Presently, 45 risk tools are reported to be in operation.[22] Before successful utilisation of a risk tool some preliminary work had to be done by the tax administrations; these include, training of the staff working with the tool, the identification of available information and how to convert it and harness the output for risk management purposes.

All kinds of data are used for the identification of risky taxpayers or risky procedures; mostly the taxpayers themselves provide useful information (e.g. registration information, tax declarations, balance sheets and profit and loss calculations). Additionally information from third parties who are legally obliged to produce this kind of data, for example, employees, banks and insurance companies, is the basis for assessment and analysis of risk for the tax administrations.

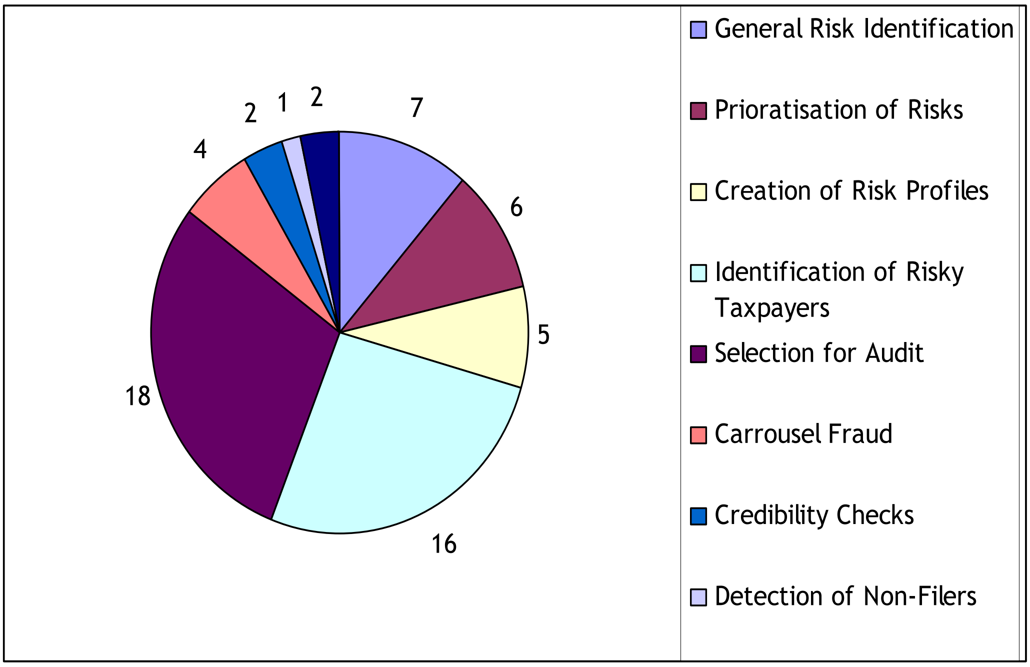
Tax administrations have used both self-developed and customised "off the shelf" software applications in their risk management activities. Both approaches have strengths and weaknesses: for example, independence from any software developers on the one hand but close vicinity to products used by taxpayers on the other hand.

Most of the risk tools are employed in the field of Value Added Tax (VAT) and mainly focus on the selection of taxpayers for audit or investigation. The Member States build on the stronger legal reporting obligations of taxpayers in the field of indirect taxation and perceived the risk tools as an appropriate way to tackle the significant losses caused by the Intra Community VAT fraud.

The catalogue within the document offers a classification of the reported risk tools. It is self-evident that some risk tools are assigned to more than one category if its functionality supports that. Included in the catalogue is an analysis of the Member States responses, which tries to highlight important findings for further consideration. For any inquiries and detailed explanation of the software itself please contact the competent person from the respective Member State.

[22] As at 31 December 2008 based upon questionnaire replies received.

The chart below outlines the general purpose of the risk tools identified. In some cases they can be used for more than one purpose.



4.2. The use of data processing techniques for Intelligence Purposes

Intelligence is the process through which data is made available, furnishing reports and assembled information to decision-makers for analysis of the activities. This process is generally made up of four phases:

1) The extraction of the data from the original sources and its entry into a temporary management area;
2) The transformation of the data into a usable form: The data, drawn from the above mentioned sources, is entered into a temporary area, where it is filtered and cleaned. In particular, the filtering operations consist in the elimination of data that is not coherent in accordance with predefined rules (for example, the coherency between taxpayer's code and personal data for natural persons) or the elimination of data that lacks the fundamental information (for example, it lacks the taxpayer's code);
3) The loading of the data into a dedicated database (data warehouse and data marts);
4) The data analysis and data mining procedures necessary to perform the queries on the data warehouse. One of the most popular data mining exploration techniques for risk identification is a technique known as 'neural network'. This is particularly suitable for so called 'predictive determination' which allows a quick identification of risk related activities. The main terms used for these processes are explained below.

• **Data warehouse**

A data warehouse is a particular database containing historical data. This data is used for analysis at all levels: from strategic planning to decisions on particular information. The quality of the data is an essential factor for the functionality of a data warehouse. In fact if the data stored is inaccurate or contains errors, the resultant analysis can be incorrect or even counter productive. To achieve high levels of data quality it is necessary to use filters that use many data integrity rules and thereafter to carry out checks relating to quality of the data. When designing the data warehouse it is necessary to create tables relating to facts and dimensions and to set indexes with key fields in all the tables.

The fact tables collect the numerical data of the analysis (number of subjects, amounts, etc.) that result from the selection made on the basis of the dimension tables. Often the dimension tables are organised hierarchically (for example, the territorial table: national – regional – provincial – municipal). The most common structure is comprised of one fact table and more than one dimension table (the star structure).

• **Data mart**

It is difficult to construct a data warehouse containing all the data found within a tax administration. Given the volume of data it would be problematic to carry out effective and accurate analyses. For this reason an easier approach is often used, based on the subdivision of all the information into simpler subsets in which the object of the analysis is clearly identified. A data mart is the representation of the data organised in this manner and accordingly it represents a part of the information.

The emphasis of a data mart is on meeting the specific demands of a particular group of users in terms of analysis, content, presentation, and ease-of-use. In practice, the terms data mart and data warehouse each tend to imply the presence of the other in some form. The design of a data mart, however, tends to start from an analysis of user needs where a data warehouse tends to start from an analysis of what data already exists and how it can be collected in such a way that the data can later be used. In general, a data warehouse tends to be a strategic but somewhat unfinished concept; a data mart tends to be tactical and aimed at meeting an immediate need.

• **Data mining**

Data Mining is an analytic process designed to explore data in search of consistent patterns and/or systematic relationships between variables, and then to validate the findings by applying the detected patterns to new subsets of data. The ultimate goal of data mining is to extract useful information from a large volume of information to predict trends and patterns.

• **Neural Networks**

Neural networks is a Data Mining technique and can be defined as an analytical technique modelled after the processes of learning cognitive systems and the neurological functions of the brain and capable of predicting new observations (on specific variables) from other observations (on the same or other variables) after executing a process of so-called learning from existing data. They can be used for any task that requires relations between "fuzzy" patterns to be recognised.

The artificial intelligence thus created makes it possible to identify from a whole series of cases those in which the relevant risks are inherent. Artificial neural networks mimic the capacity of the brain to organise itself through learning processes.

Neural networks can be useful for the following reasons:

a. *Pattern formation*: patterns may be formed from frequent and infinitely complex combinations of indicators. Risk-inherent cases may be precisely recognised as a result of the patterns formed. Patterns relating to VAT could be:

- Founders of fictitious companies
- Missing traders
- Buffers
- Distributors
- Zero-result cases
- Harmless cases.

b. *Forecasts*: forecast can be used in the tax field for example in the pre-emptive prevention of VAT fraud. Not all problems can be solved by the use of artificial neural networks alone. For example, it is not possible to provide the processing official with qualified information as to why the case was identified as being risk-relevant. As a result, neural networks are often used in conjunction with other technologies (e.g. fuzzy logic).

4.3. Rule based systems

It is possible to identify cases with potential tax risks using *a rule based decision system*. A rules based system is an expert system based on knowledge from tax experts obtained over a number of years. It consists of:

- facts,
- defined rules, and
- a controlling system with a rule interpreter.

To be used in a computer system, all facts have to be stored in a uniform database and the evaluated risks have to be described in abstract mathematical rules as simple as possible. A rule consists of one or more facts (preconditions) connected with each other and actions. Rules in the form of IF "x" THEN "y" are particularly suitable. These kinds of rules are the basis for the computer-assisted analysis of risk cases.

A rule interpreter checks all incoming VAT declarations. As a central component, it decides which conclusions from all facts have to be drawn together. All the rules are checked by the expert system, as far as the preconditions are met and these rules worked out. As soon as one of the rules is triggered, the case is reported for a personal check.

Example:

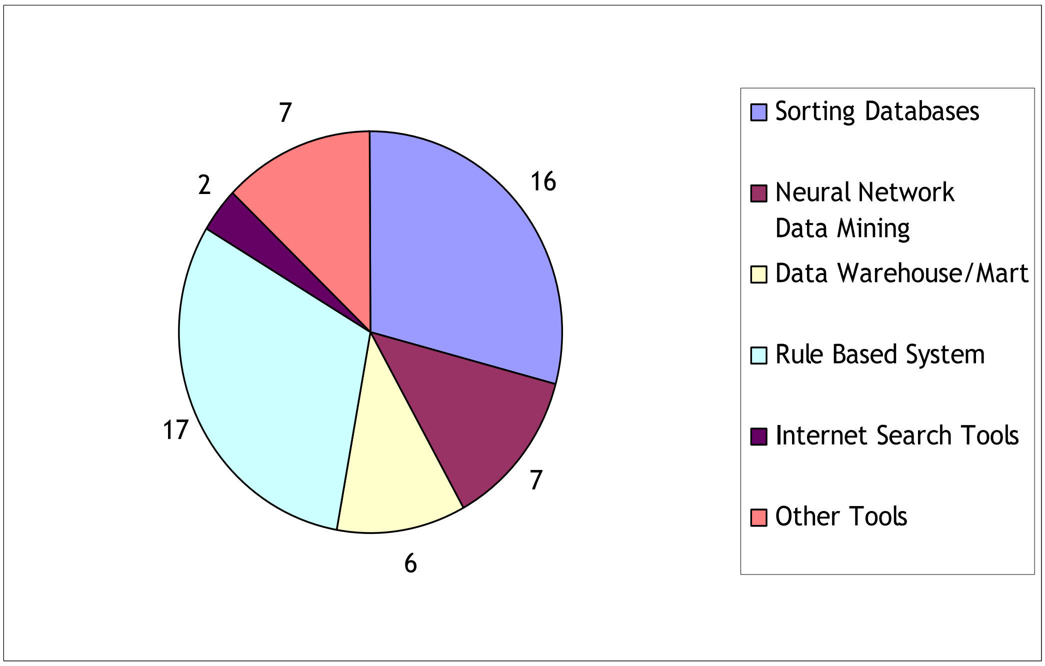
Rule 1: If "Newly set up enterprise" and "immediate turnover- amounting to millions", and "low VAT due". Then "Suspicion of participation in a VAT carousel fraud”

Rule 2: If "Suspicion of participation in a VAT carousel fraud". Then "sales tax audit"

In rule 1 "Newly set up enterprise", "immediate turnover amounting to millions" and "low VAT due" are the connected facts and "suspicion of participation in a VAT carousel fraud" is the action.

Finally an expert system should have the capability to explain to the user its conclusions as "eloquently as possible".

The chart below is an analysis of the type of the risk tools identified in the survey. In some cases tools have more than one attribution and that is reflected.



5. ORGANISATIONAL ASPECTS OF COMPLIANCE RISK MANAGEMENT

This part provides an overview of how Risk Management has been integrated into the work of tax administrations. Compliance Risk Management is part of the organisational structure of every Member State, but tax administrations are at different stages of development. There is no unified model for Compliance Risk Management organisation. There are many different organisational structures of Compliance Risk Management amongst tax administrations and all have validity. While Member States apply Compliance Risk Management at the central as well as at the regional and/or local level, there are many direct linkages made between these levels. The role of central, regional and/or local level differs among Member States.

The description of the organisational aspects of Compliance Risk Management is concentrated on four elements:

- the organisational structure of the Compliance Risk Management organisation;
- the goals of the Compliance Risk Management organisation;
- the areas responsible for Compliance Risk Management;
- the role of central, regional and/or local level in the Compliance Risk Management process.

The nine descriptions included in this chapter have been made and provided by the tax administrations of the relevant Member States.

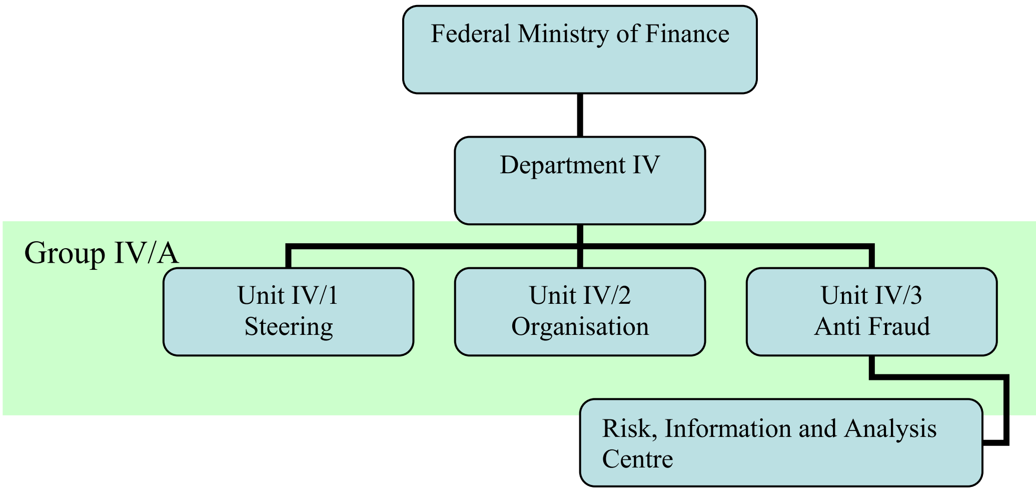
5.1. Risk Management in Austria

Risk Management is an essential part of the permanent fight against fraud in Austria. Risk and Compliance Management is centralised in the Federal Ministry of Finance, group IV/A (3 units), responsible for steering, organisation and the fight against fraud in the areas of taxes and customs. The main objective is to develop strategies to influence taxpayers' behaviour and to reduce tax avoidance.

The risk management is supported by the Risk, Information and Analysis Centre (RIA). It is a nationwide operating unit, only responsible to the Ministry of Finance (Anti Fraud Unit). RIA takes care of operational risk management in the areas of taxes and customs.

RIA's major responsibilities are:

- the risk management process;
- gathering, exchange and analysis of information (including internet monitoring);
- development of audit and control techniques;
- case selection and audit plans;
- international cooperation in the above mentioned areas.

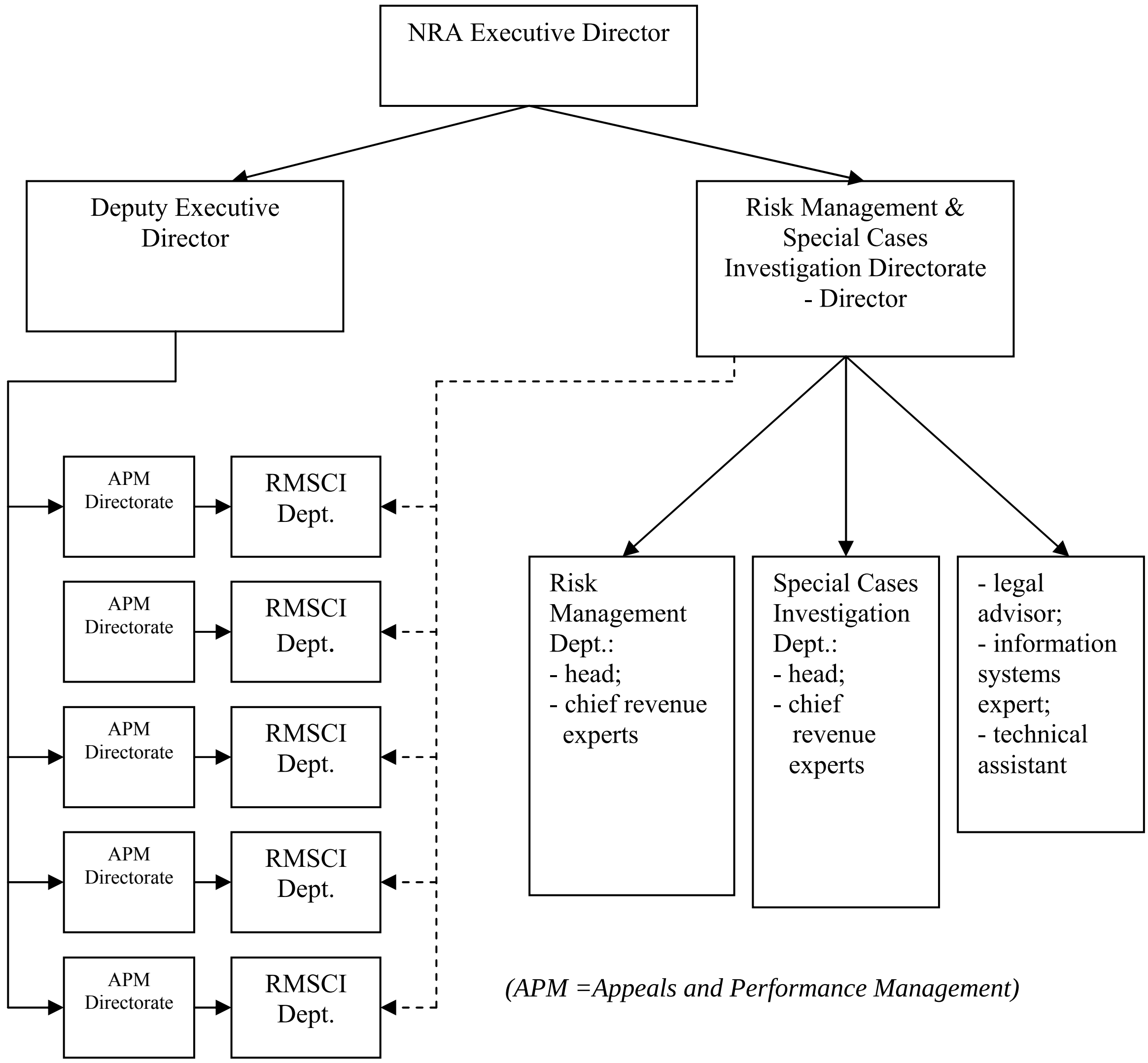


5.2. Risk Management in the Bulgarian revenue administration

Organisational structure

In 2006 the National Revenue Agency (NRA) started working on the "Risk Management at NRA" Project. The aim of the project was to implement into NRA's operation a single system for managing the risks from non-compliance with tax and social security. During the project a Risk Management Concept was developed, and also the main activities required for system implementation were defined and carried out. As a result of the project, since 01.01.2008 a new structural unit is operating at NRA, which is in charge of the risk management processes.

The main organisational structure is positioned at central level and includes two individual departments – Common Risk Management Department and Special Cases Investigation Department. Individual structural units are also established at regional level – Risk Management and Special Cases Investigation departments. At territorial level the structure has no administrative units, but each territorial structure has one official with functions from the special cases investigation process.



(APM =Appeals and Performance Management)

Structure goals

Risk Management & Special Cases Investigation Directorate is aiming at provision of favourable conditions to achieve the following current strategic goals of NRA:

- collecting taxes and social security contributions while constantly increasing the efficiency;
- stimulating the voluntary compliance based on high public credibility.

In this regard the objectives of the structure are to:

- apply a unified approach in risk management that provides efficiency in detecting, analyzing and treating risks from non-compliance with tax and social security legislation;
- provide profound knowledge of main risks;
- support the administrative decisions when selecting tools for risk treatment and allocating the resources available;
- increase the degree of compliance with tax and social security legislation;
- reduce the budgetary losses by limiting the risks from non-compliance with the tax and social security legislation;

- support penal (criminal) investigations of tax frauds in order to detect and divulge persons who have organized, committed and benefited from these frauds.

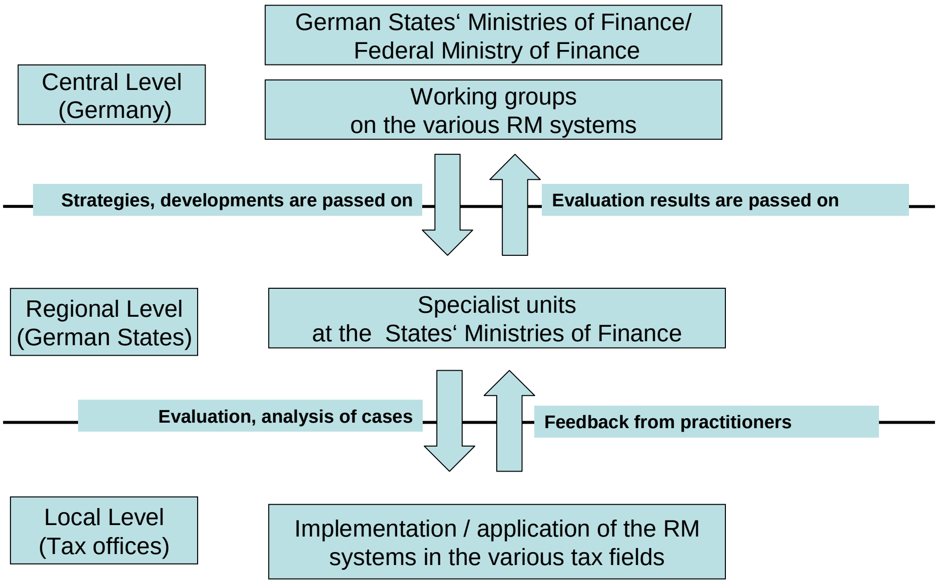
Roles and responsibilities in the risk management process

The newly established structure at central level – Risk Management & Special Cases Investigation Directorate is in charge of the whole process of risk management. The following table presents the roles and responsibilities of the individual officials subject to process stages:

Process phase	Activities	Structure/officials carrying out the activity	Links/Methods of interaction
Detection	Communicating the presence of risk or fraud	All officials – both from the specialized structure and from the territorial ones	By means of special software "Risk Management" – communicating by data entry in the software
	Risks detection	Officials from the specialized structure – at central and regional level	If required – direct contacts with the official who have communicated the risk – meeting, phone call or e-mail
Analysis	Common risks analysis	Officials from the specialized structure – at central and regional level	Interaction between the officials at central and regional level to provide unified approach in analysis
	Frauds analysis	Officials from the specialized structure – at central and regional level	
Prioritization	Risks sorting and prioritizing	Approved by NRA Executive Director	Prepared by RMSCI Directorate at central level and discussed and agreed with the remaining functional directorates
Treatment	Operational actions (e.g. inspections and audits)	Operational officials from territorial structures	When treating frauds the actions are coordinated by the officials from the specialized structure
	Other treatment measures (educational campaigns, business processes optimization)	The respective competent directorate at central level	
Process assessment	Collecting information about treatment results	Officials from the specialized structure – at central and regional level	
	Assessment	The specialized structure at central level	

5.3. Risk Management in Germany

Organisational structure



Goals

Risk management in Germany aims to evaluate, in an automated form using the data available, the risk of tax losses in a given tax case. The risk evaluation approach is designed to

- avoid, or at least detect, fraud in a pinpointed manner;
- optimise handling of tax cases on the basis of a risk-oriented management of work flows including
  - fully automated processing of low-risk cases, and
  - automated selection of cases for external tax audits.

Procedure

Risk management strategies are conceived at the federal level. The technical implementation of those strategies is carried out uniformly for all the 16 German states. Examples include risk management schemes for the assessment of income tax, the disruption/minimisation of VAT fraud, and the selection of cases for external tax audits.

Operation of the risk management systems is co-ordinated at the regional level, i.e. by the states, which are above all responsible for the evaluation of the schemes. The results of the evaluation are used as input for reviewing/revising and developing risk management systems at the federal level.

At the local level, risk management is applied by the tax offices. Their terms of reference for instance include auditing the cases that have been selected for an external tax audit and automated processing of low-risk cases. The federal and state governments' central agencies support and co-ordinate some of the work to be performed by the tax offices. Findings from practical work are input into the optimising process at the federal level.

5.4. Risk Management System in Greece

An integrated system for audit services is currently under development by the Ministry of Finance and Economics. The above-mentioned system, except from the tax audit services, is planned to facilitate other main audit services of the ministry such as customs, service of special audits and inspection service.

The system will be available to all tax audit units of the ministry and except the central audit unit. All auditors will have access to it according to their level of competence.

The architecture of the new system focuses on three pillars. Although those pillars seem to function independently, they are planned to be inter-connected so that the life-cycle of each case will be monitored centrally and the results of the tax audits will be evaluated regularly.

The first pillar focuses on case selection process in accordance with risk analysis criteria and other criteria which are centrally set and come to fulfil the strategic goals of the ministry, while the second pillar is focused on the execution of the tax audits by all tax units.

The third pillar of the system is focused on the management of each case after the completion of the audit performed by the respective audit units and the production of evaluation reports from each case.

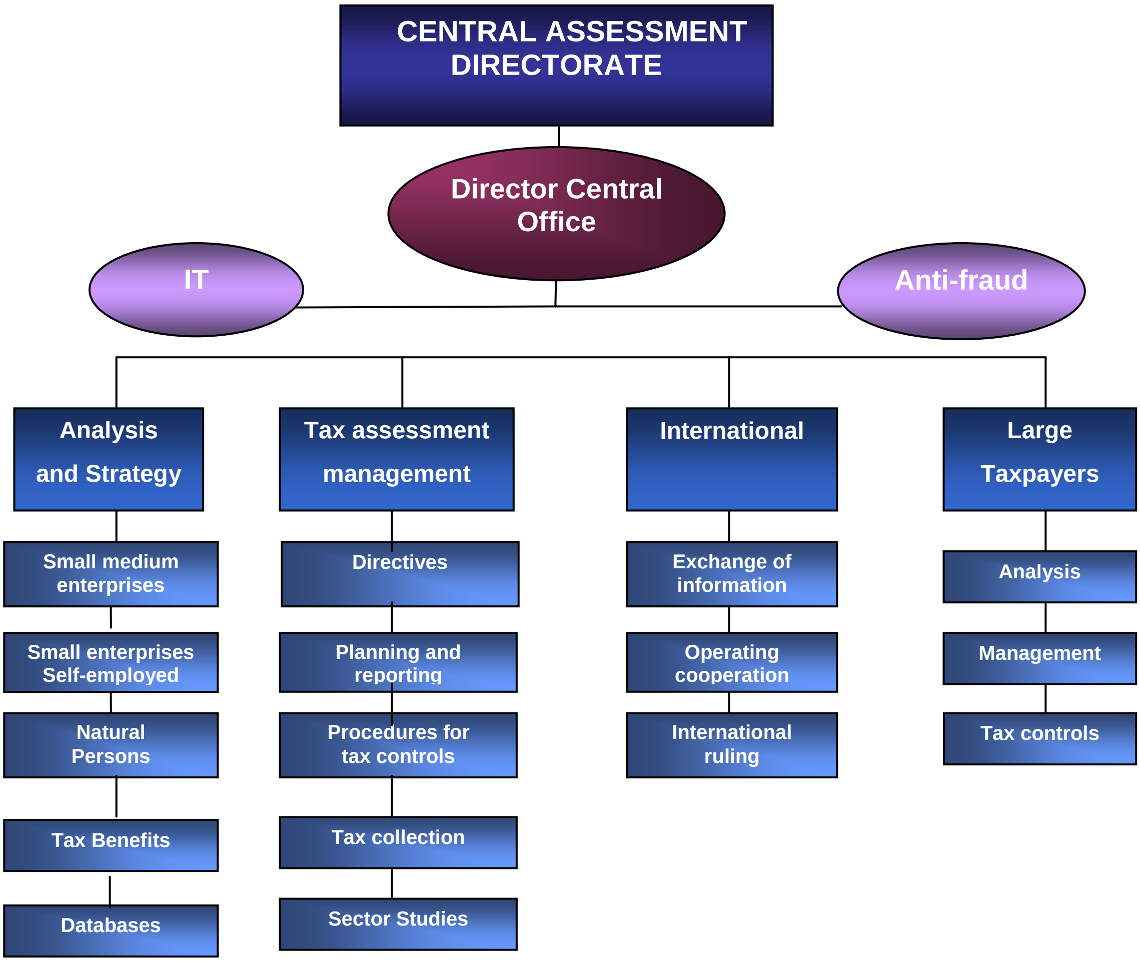
An important aspect of the system is the provision of management information in a comprehensive manner by all audit services, with the aim that any piece of information will be available to the competent user the soonest possible for further action.

In all phases of the process as described above, various electronic tools will be in use so that case selection, case management, reporting and various audit tasks will be organized and performed in a more efficient way.

5.5. Italian Revenue Agency: risk analysis for assessment purposes

Tax assessments and fiscal examinations are dealt with by the Central Assessment Directorate of the Revenue Agency.

The new structure of the Central Assessment Directorate focuses on the typology of taxpayers (large taxpayers, small enterprises, medium enterprises, self-employed workers, natural persons) whereas the previous structure focussed on the processes (audits, tax assessments, etc.).



The structures in the Directorate mainly involved in the risk analysis aimed at the detection of tax evasion and tax fraud are the Analysis and Strategy Division, the Large Taxpayer Division and the Anti-Fraud Office.

Analysis and Strategy Division is charged with:

- the analysis of the main tax avoidance and evasion risks also providing tools to be used at local level to make a risk analysis;
- setting up strategies and methodologies to carry out tax controls;
- coordinating and monitoring specific risk analysis processed at local level;
- monitoring tax control activities and their impact on compliance.

All these activities are carried out with reference to each typology of taxpayers by the three Offices inside the Division: Medium enterprises, Small enterprises and Self-employed Workers and Natural Persons not having a VAT number.

A specific Division is charged with the analysis, coordination and control activities with reference to large taxpayers.

Inside Large Taxpayers Division the Analysis Office has been set up in order to carry out the following activities:

- the analysis of tax avoidance and evasion risks;
- setting up tools to help with risk analysis on the avoidance and evasion phenomena;
- setting up strategies and methodologies to carry out tax controls;

- providing a list of large taxpayers whose turnover exceeds 100 million Euro;
- selecting other relevant taxpayers (taxpayers having the group taxation are also included);
- tutoring constantly carried out on large taxpayers on the basis of specific tax avoidance and evasion risk analysis.

Anti-Fraud Office, also charged with risk analysis, carries out the following activities:

- analysis of fraud phenomena;
- setting up strategies and methodologies to fight against tax fraud;
- coordinating and monitoring tax controls related to tax fraud carried out at central and local level;
- investigations and controls at central level on main risky taxpayers.

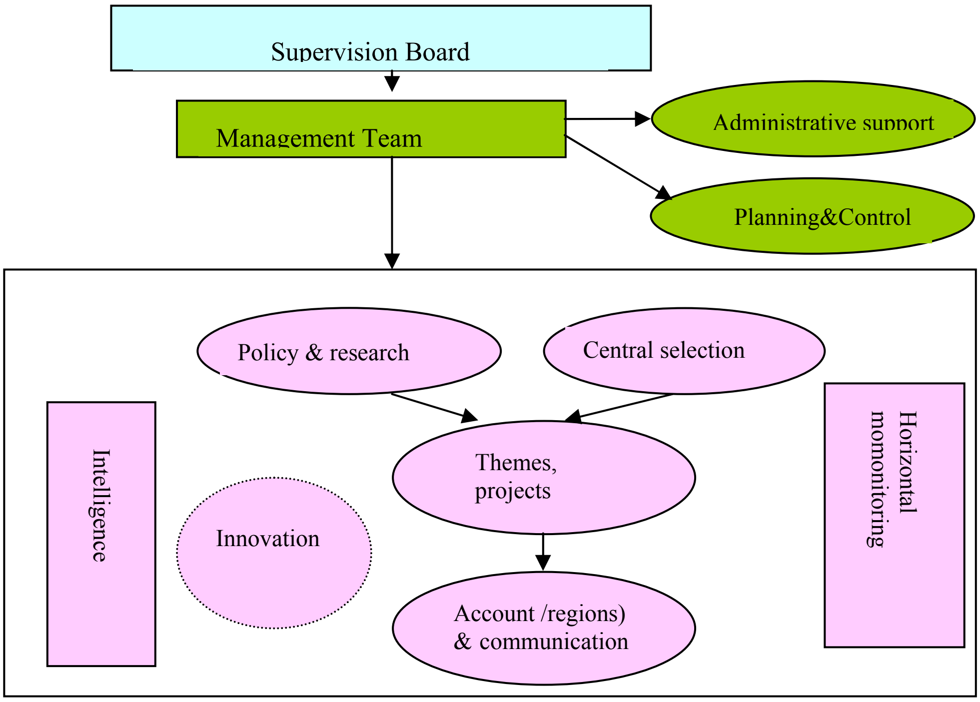
Risk analysis activities are also performed by the Analysis structures at regional and provincial level.

5.6. Compliance Risk Management in the Netherlands

The Tax and Customs Administration is working on tightening up supervision. It wants to enhance the *effect* of its actions and, at the same time, reduce the administrative burden involved in supervision. It is working to accomplish this by pursuing the course developed in the government-broad, framework-setting approach to supervision. The principal challenge over the years ahead is to make supervision more selective and to see where the Tax and Customs Administration shares responsibility with taxpayers. The basis of its actions is trust. And, where trust is justified, the taxpayer's dealings are made as straightforward as possible. In cases where that trust is misplaced, supervision will be stepped up and the Tax and Customs Administration will take effective, decisive measures. In this context the Tax and Customs Administration also seeks an enhanced relationship with tax intermediaries. By deploying a more diversified approach, it is able to keep its increasing – and highly dynamic – client volume at an acceptable compliance level.

Organisational structure of compliance risk management

In the chart underneath, the structure of the compliance risk management organisation in the Netherlands is described:



Goals of the compliance risk management organisation

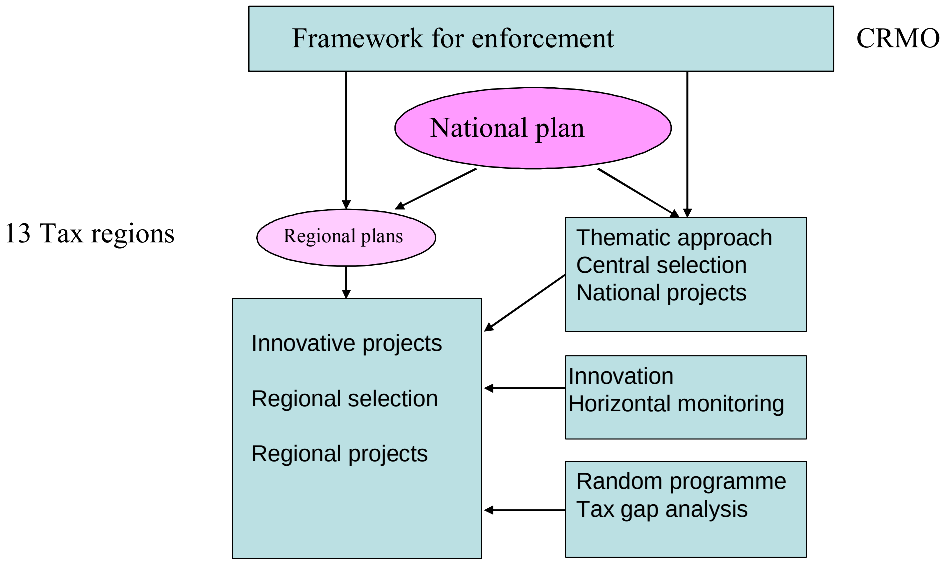
The '*Landelijke Toezicht Organisatie*' (Compliance Risk Management Organisation) is responsible for the implementation of compliance risk management in the Tax and Customs Administration, together with and within the 13 regional tax offices. The compliance risk management organisation monitors the system to identify risks and develops and advises about matching strategies. All (enforcement) activities to be carried out are kept in a nation wide, dynamic plan for supervision and enforcement (or in regional plans), to be carried out by the tax regions. Coherence between all the components of the plan and close co-operation with the other parts of the DTCA that play a role in supervision and enforcement is an essential part of compliance risk management.

The organisation also supports the tax regions and shares experience on several fields, such as intelligence, horizontal monitoring, enforcement communication, measurement of outcome and compliance risk management in general.

Level of compliance risk management

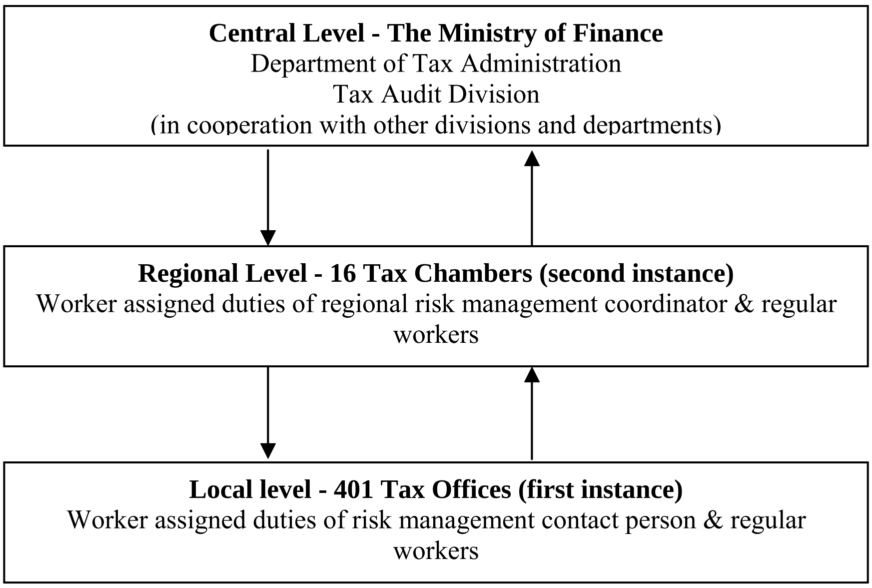
Compliance risk management is designed partly on a national and partly on a regional level. Efficiency and strategic interests determine whether something is steered nationally, or regionally. This differs per segment and sometimes also per enforcement instrument or tax. Some tax risks are best determined centrally, others regionally. Due to their nature, some policy aspects may be better suited to regional management, such as tackling havens and dealing with new businesses. Working with other enforcement agencies is also mainly organised at regional level. An important element in dividing the work to central or regional level is the commitment of the staff to compliance risk management. For an optimal use of the energy and creativity of staff, work has to be organised in their neighbourhood. A percentage of supervision capacity is claimed for audits based on random sampling. This not only increases the unpredictability of checks, but also creates a permanent research database that provides insight into the current risks related to entrepreneurs.

Two-way approach



5.7. Risk Management in Poland

Organisational structure



Goals

The targets of the Risk Management Organisation (according to External Risk Management Strategy) are as follows:

- to minimize the total number of tax errors,
- to use the resources in the tax administration in an efficient way,
- to increase the level of voluntary compliance of the taxpayers.

Role and responsibility

The structure of the Risk Management Organisation in Poland allows a combination of a top-down and bottom-up approaches to apply. Responsibility for risk management is divided between all three levels of tax administration (local, regional and central).

With reference to implementation of External Risk Management Strategy the role and responsibility of Tax Audit Division in the Ministry of Finance encompasses inter alia:

- analysis of information from Tax Offices and Tax Chambers in order to identify risk areas;
- elaboration and monitoring of Annual National Tax Compliance Plan (annex to National Guidelines for Tax Chambers and Tax Offices) comprising description of national risk areas, the plan of actions on the risk areas including information, desk audit and audit at premises, possible criteria of selection;
- evaluation and verification of establishments and course of actions taken in scope of Annual National Compliance Plan.

The role and responsibility of Tax Chamber encompasses inter alia:

- providing with fast and efficient flow of information between Tax Offices and Tax Chamber by organising the regional net of contact persons in charge of external risk management and (if needed) creating task teams on risk analysis;
- if needed, elaboration of Annual Regional Compliance Plan comprising description of specific regional risk areas, the plan of actions on the risk areas including information, desk audit and audit at premises, possible criteria of selection;
- supervision and coordination of actions implemented and cooperation in scope of Annual National and Regional Compliance Plan;
- current analysis and reporting to Tax Audit Division in the Ministry of Finance on actions carried out by Tax Offices in scope of risk areas, most frequent tax errors and newly identified risk areas.

The role and responsibility of Tax Office encompasses inter alia:

- implementing actions indicated in Annual National and Regional Compliance Plan and reporting on that to Tax Chamber;
- identification of new risk areas, exchange of information on risk areas and cases of law infringement and cooperation with other authorities in the course of implementing External Risk Management Strategy;
- improving cooperation of organisation units on tax information analysis for possible tax compliance irregularities.

5.8. How Risk Management is operated in Sweden

Risk Management is fully integrated into the planning process of the Swedish Tax Agency. It is used as the primary decision-making tool for choosing the right treatment methods (e.g. audits, information campaigns) for reaching the objectives of the administration (e.g. reducing the tax gap, increase public confidence). It is made on three different levels:

- *Strategic level* – an environmental scanning is made on global level together with an identification of the most important external and internal risks facing the administration ("Strategic Risk Report"). This input is finalised in March/April each year and forms a platform for the annual strategic planning conference held by management (held in May). It forms the basis for strategic decisions made by the management with a 3 – 5 years horizon.

- *Tactical level* – the strategic risks are broken down in specific risk areas which should be treated in the short run (annual basis). The results forms the base for the annual management plan ("National Compliance plan"), set in September for the following year, and leads into specific compliance activities (which could include audits, trade co-operation, media campaigns etc. For each planning area (e.g. private persons, SMEs, tax evasion, international transactions), several tactical risk analysis reports are made to provide a basis for the treatments.

- *Tax payer level* – a selection team (called "PRIUS") consisting of central and regional experts is used for those compliance activities that are in need of central selection. Each compliance activity identifies the businesses needs according to identified risk criteria. PRIUS then designs the selections using the selection techniques available (e.g. internal and external data, rule based selection programmes, data mining).

A mostly *top-down approach* is taken on risk management where the strategic risks are identified at Head office and broken down at tactical level. Tactical risks are co-ordinated at central level but identified at regional level. The knowledge at tactical and tax payer level could also, especially in the longer run, influence the strategic risks (bottom-up approach).

Risk Management in Sweden is managed centrally but with a heavy regional influence. Each region has designated nationwide responsibilities for certain risk areas (e.g. micro businesses at Northern Region, cash sector at Western Region). Regional representatives are also taking part in reference groups when prioritization and allocation of resources are made. The ambition is to make the risk assessment and the prioritisation a holistic view for the whole country. For risk treatments, each region takes responsibility for leading nationwide compliance projects involving all regions.

Evaluation of compliance activities are carried out at both strategic and tactical level, involving analysts both at central and regional level. Examples of evaluation techniques are surveys and targeted random audit programmes performed by one (1) region with the objective to monitor certain risk areas. Evaluations are also carried out for a limited number of compliance activities, e.g. the treatment of newly registered businesses.

5.9. Risk Management in UK

HM Revenue and Customs (HMRC) has several directorates responsible for the compliance of taxpayers, one of which is the Risk and Intelligence Service (RIS). RIS is at the heart of HMRC's compliance and enforcement activity. The prime role is to enable HMRC to understand and manage the risks to taxation and frontiers in order to contribute to the financial integrity and well-being of the UK. It does this by gathering information and seeking out high quality intelligence from within and outside the UK. It then analyses the data and assess the risks and threats in order to provide comprehensive high-quality risk and intelligence products for HMRC's internal partners. The internal partners are then able to effectively target and deploy their resources. The products Risk & Intelligence Service provide are designed to ensure that HMRC engage most appropriately with any given customer. This approach reduces the burden on compliant customers by focusing HMRC's attentions on the non-compliant and those who deliberately target the tax system. To fulfil this role RIS is divided into three distinct elements:

1. Analysis and Information

Its purpose is to:

- Inform top level decision making across HMRC, and particularly across Enforcement and Compliance directorates, through the supply of evidence based analysis;
- Interface with key strategic partners;
- Horizon scanning and early warning giving over a 0 -10 year forward look of the potential threats to HMRC;
- Co-ordinate the responsibilities of regime based teams and customer/behaviour teams;
- Provide advice and support on the use of data, knowledge and IT systems across RIS.

2. Campaigns

Its purpose is to:

- Design, pilot, manage and evaluate campaigns on the key compliance threats facing HMRC.

3. Operations

Its purpose is to:

- Combine intelligence and risk functions where appropriate;
- Development/standardisation of operational intelligence packages and procedures;
- Delivery of operational intelligence packages to our internal partners;
- Enhance relationships with internal and external partners;
- New and enhanced feedback/debriefing capability.

GLOSSARY OF TERMS

TERM	SHORT DESCRIPTION
Compliance Risk Management	A technique to improve the tax administration's effectiveness in dealing with compliance risks.
Compliance Risk Management Model	A structured approach in which the Compliance Risk Management Process is embedded in context, strategy and organisational objectives.
Compliance Risk Management Process	A structured cycle of steps in which risks are identified, analysed, prioritised, treated and results evaluated.
Compliance	The willingness of a taxpayer to fulfil his/her tax obligations.
Consequence	The impact of an occurred risk.
Context	The environment in which the tax administration operates.
Data	Information relating to taxpayers for use by tax administrations.
Data mart	A subset of the data contained in a data warehouse to carry out effective and accurate analyses.
Data mining	An analytic process designed to explore data in search of consistent patterns and/or systematic relationships between variables, and then to validate the findings by applying the detected patterns to new subsets of data.
Data warehouse	A particular database containing historical data.
Deterrence	The indirect effect of a treatment option on the compliance level of a taxpayer.
Effectiveness	The relationship between the ***input*** and the ***outcome*** of a compliance activity.
Efficiency	The relationship between the ***input*** and the ***output*** of a compliance activity.
Enforcement communication	Systematic communication to improve taxpayer compliance.
Evaluation	Comparison of the planned and realised effectiveness/efficiency and the analyses of the differences between both.
Extent	The tax amount involved in an occurred risk.
External context	The part of the environment outside the tax administration.
Frequency	The number of times the risk will occur.
Horizon scanning	The systematic examination of potential threats, opportunities and likely future developments, including (but not restricted to) those at the margins of current thinking and planning.
Horizontal monitoring	The supervision by non-governmental organisations, institutes or associations.
Input	Resources used in a compliance activity, e.g. human resources, IT-equipment and data.
Integrated Risk Management	A technique to improve the tax administration's effectiveness in dealing with compliance and internal risks.
Intelligence	The process through which data is made available, furnishing reports and assembled information to decision-makers for analysis of the activities.
Internal context	The part of the environment inside the tax administration.

Intermediaries	Third parties that provide services between taxpayers and tax authorities.
Likelihood	Probability that a risk will occur.
Neural Networks	An analytical technique modelled after the process of learning cognitive systems and the neurological functions of the brain and capable of predicting new observations (on specific variables) from other observations (on the same or other variables) after executing a process of so-called learning from existing data.
Objectives	The specifically measurable desired results and outcomes of the organisation.
Outcome	A change due to the compliance activity, which relates to the objectives, e.g. increased voluntary compliance of the tax administration.
Output	Direct results of a compliance activity, e.g. number of audits performed, tax collected, taxpayers informed.
Productivity	The relationship between the input and the output of a compliance activity.
Relational databases	A set of data tables, which are linked together and made up of columns (fields) and rows, in which the data is stored.
Risk	The threat or probability that an action or event, will adversely affect an organisation's ability to achieve its objectives.
Risk analysis	The phase in which identified risks and risky taxpayers are systematically weighed and grouped in relative order.
Risk area	A risk area is a collection of connected risks.
Risk assessment	The determination of the seriousness of the risk based on the likelihood or frequency of the risk and the consequence or impact.
Risk covering	A repressive activity carried out against deliberately non-compliant taxpayers.
Risk identification	The phase in which sources and signals are transferred into a list of potential risks.
Risk indicator	A weighed variable pointing to a potential risk.
Risk picture	A list of areas, groups of taxpayers or sectors where risks are expected.
Risk prioritisation	The choice of risks, which will be treated.
Risk reduction	A form of risk treatment aimed to lessen the extent of exposure to a risk and/or negative consequences associated with occurrence of a risk in the coming period.
Risk tools	Product(s) that enable a tax administration to undertake its mandate of applying risk management principles to direct and indirect tax regimes in order to mitigate associated current or emerging risks.
Risk transfer	Passing the risk to another organisation.
Risk treatment	Process performed to manage the negative effects of risks in order to reduce or neutralise their impact on the objectives.
Rule based system	An expert system based on knowledge from tax experts.
Strategy	A chosen approach to reach an objective.
Tax gap	The potential tax yield minus the actual tax revenues.
Taxpayer behaviour	The level of willingness of a taxpayer to fulfil his/her tax obligations.