

Tax Administration Modernization – Global Trends and Challenges

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How Old is Tax Reform



The *Arthasashtra*, 4th century BC

- ▶ **Kautilya visualized risk management:**

“Just as the flower is not disturbed or hurt by the honeybee when it draws nectar, the king should not disturb the taxpayer when he collect taxes.”

- ▶ **Kautilya, advocated low rates:**

“We must not have rates that are so high that it provides encouragement to evade and disturbs economic activities.”

- ▶ **Kautilya warned against running after revenue targets:**

“Just as a gardener plucks fruits as they ripen, so shall revenue be collected as it becomes due. Just as one does not collect unripe fruits, taking revenue that is not due will make the people angry and spoil the very sources of revenue.”

Why Reform Tax Administration

- ▶ Tax administration is a major interface between the state and its citizens.
- ▶ A good tax administration is an important attribute of good governance.
- ▶ A client-friendly tax administration encourages investment and improves business environment
- ▶ An effective tax administration is important for providing a stable source of revenue for government programs
- ▶ Modern tax administrations do not collect taxes; they
 - Manage compliance
 - Facilitate compliance

Main Focus of Tax Modernization

- Voluntary compliance
- Improved efficiency
- Improved effectiveness in detecting tax frauds
- Simplified and rationalized processes
- Reduced compliance burden on taxpayers
- Competent , client-friendly workforce
- Minimized contact between taxpayers and officials
- Full use of modern technologies
- Credible appeal system

Current Areas of Reform

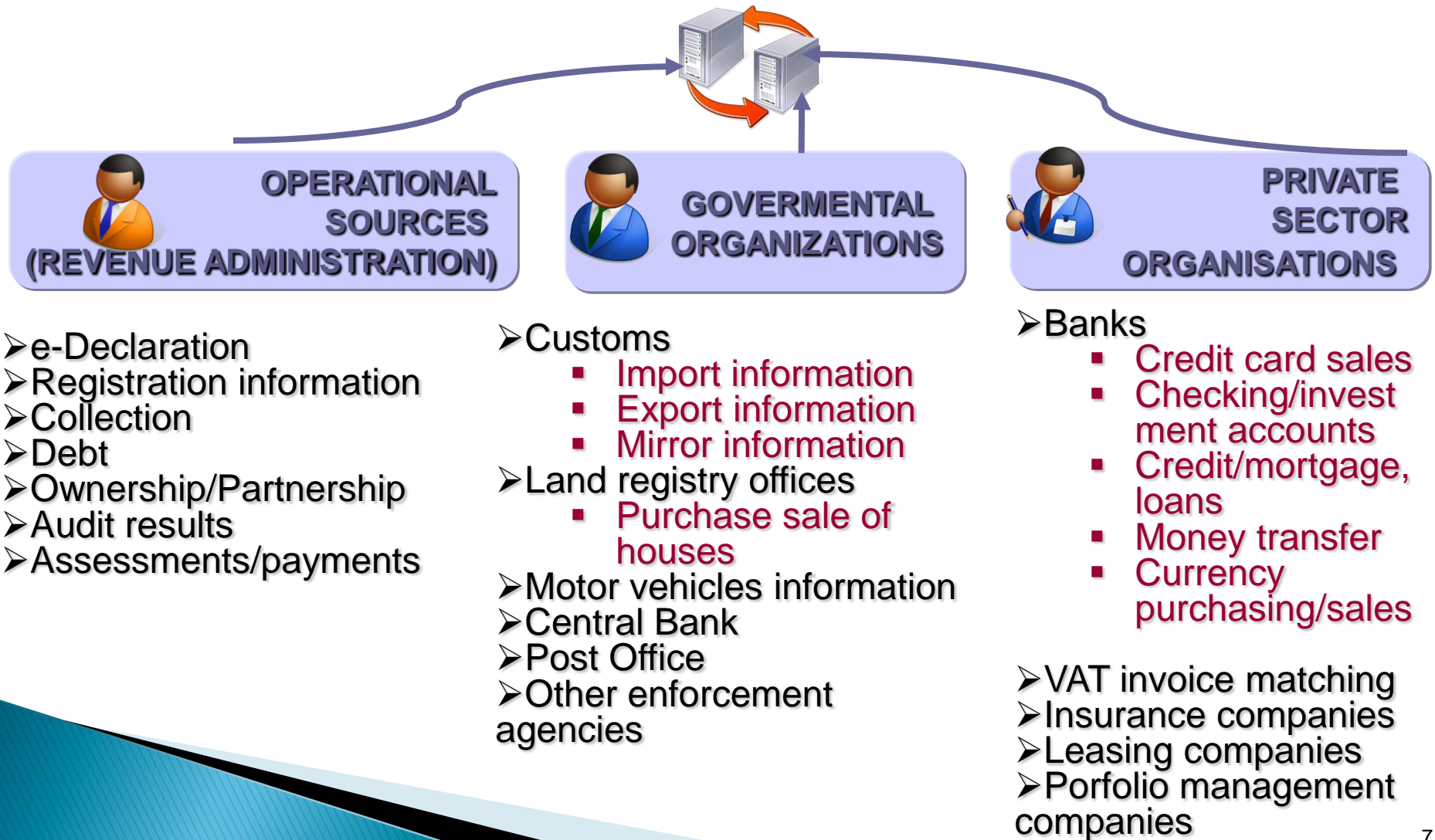
- ▶ Extensive use of third party information
- ▶ Risk management
- ▶ Consolidation
- ▶ Integration
- ▶ Taxpayer segmentation and specialization

Use of Third Party Information

- ▶ Nordic countries have moved towards pre-filled returns
- ▶ 3rd party information constitutes more than 90% of information on tax returns – including buying price of stocks and bonds
- ▶ Enables SKAT to automatically calculating profits and losses and thus taxes due
- ▶ Because of high quality data from third party, they are able to lock fields on the tax return
- ▶ From income year 2011, 10 fields have been locked for individual returns

Source of Third Party Information

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Risk Management – why does it matter

- ▶ Focus attention of audit on non-compliant taxpayers
- ▶ Encourage honest taxpayers and hence voluntary compliance
- ▶ Efficient use of available human resources , budget and technology
- ▶ Equitable treatment for all taxpayers
- ▶ Manage available resources to the level of risks

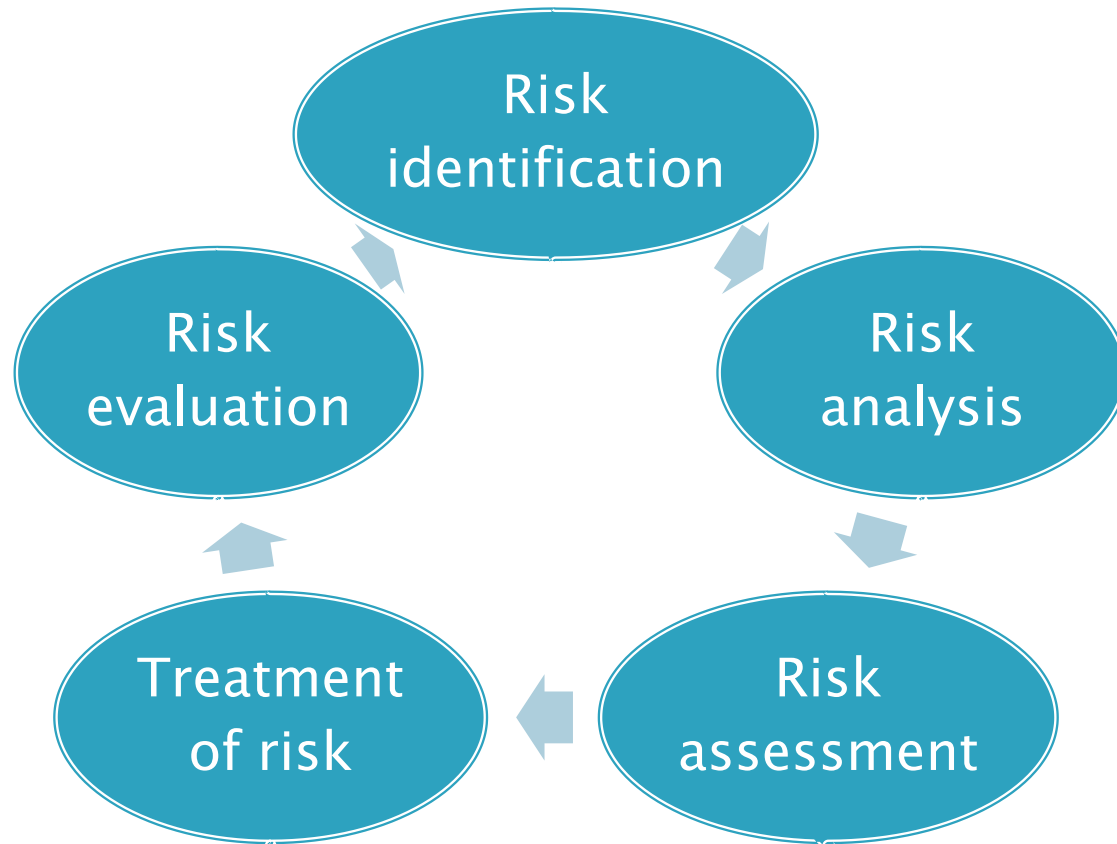
Risk Management – what is forcing the issue

- Pressure from public and political leadership for government to work more efficiently
- Budget constraints and downsizing staff
- Greater emphasis on encouraging voluntary compliance
- Less room to tolerate tax fraud requires targeting the right cases for audit
- Higher demands for accountability and effectiveness in service delivery
- Increased public concern about corruption

Risk Management – what is forcing the issue

- ▶ Massive growth in volume of transactions and number of taxpayers
- ▶ Increasing complexity of modern business operations:
 - global transactions,
 - international ownership,
 - cross-border financing
- ▶ Innovations in businesses
- ▶ New financial products and derivatives
- ▶ E-commerce

Risk Management Cycle



Consolidated Organizational Structure

- ▶ Geographical focus no longer makes sense
- ▶ Focus on functional organization and more rational business processes
- ▶ Centralized processing
- ▶ Risk management helps concentrate key revenue functions in regional rather than local centers
- ▶ Use of technology helps reach taxpayers via web, internet and without physical contact
- ▶ Improves efficiency and effectiveness
- ▶ Reduces avenues for corruption
- ▶ Country examples

Integration –history

- **Canada** and the **United States** always had integrated social security contributions with general revenue collections.
- Traditionally, many **western European states** did not – in these countries social security systems were well-developed before modern revenue administrations.
- After **Sweden** unified the administration of its tax and social contribution systems in the 1980s, a number of central and eastern European countries followed.
- 21 of these 39 OECD countries administer the collection of excises through the main revenue body while the other 18 through customs administrations.

Countries that have integrated

In the past three decades, Argentina, Austria, Bulgaria, Canada, Colombia, Denmark, Hungary, Ireland, Latvia, Mexico, the Netherlands, Romania, South Africa, Spain, Sweden, the United Kingdom and several others underwent such integration

Most of these countries achieved their integration goals through improved revenue collection and services, or reduced administration cost, or both.

Trend and reasons

- Many countries have integrated their revenue administrations, merging tax and customs administration, or unifying collection of tax and social security contributions, or both.
 - to harmonize procedures and
 - minimize the need for citizens to respond to multiple agencies.
- Integrating collection also entails modernizing the revenue administration
 - integration often provides the motivation to modernize revenue administration which could otherwise have been delayed
- Reduced contact between the tax office and the taxpayer
 - no longer physical but virtual, thanks to extensive use of ICT.

Rationale for integrating tax–social contributions

- The key arguments for unifying collections of taxes and social contributions:
 - commonality of core processes,
 - efficient use of resources,
 - core competencies of tax and social organizations, and
 - lowering both government administration costs and taxpayer and contributor compliance costs
- Most have continued with a separate social security organization devoted only to benefit distribution.

Rationale for tax–customs merger

- The rationale for merging tax and customs administrations is generally categorized as:
 - perceived synergies with customs operations which are responsible for the collection of VAT on imports;
 - efforts to obtain economies of scale
 - enhancing effectiveness
 - improves ability to keep track of taxpayer information
 - alleviates the compliance burden on business taxpayers.
 - historical factors associated with the separation of direct and indirect tax administration are no longer seen to be important
 - The evolution of VAT as the principal tax in many countries has given rise to the need for close collaboration between customs and tax administrations

Results of recent customs–tax merger

- Integrating tax and customs potentially raises different and more difficult questions compared to integrating social contribution.
- Although several countries have taken the step of customs tax merger since the 1990s, not all of these experiences worked out well.
- In many recent customs–tax mergers, non–revenue border services have been largely kept separate
- After merger, both Canada and the UK transferred non–revenue border services out of the integrated revenue agency and into a newly established border services body.

Integration scorecard

	Type of integration ^a	Year when integration was initiated ^a	2001	2002	2003	2004	2005	2006	2007	Trend
OECD Countries										
Austria^b	Customs	Before 2003	0.71	0.72	0.91	0.78	0.66	0.65	0.64	Decreasing
Canada	Customs	1992	1.08	1.20	1.33	1.17	1.31	1.35	1.22	Unclear
Denmark^b	Customs	1990	-	-	0.87	0.83	0.74	0.63	0.62	Decreasing
Hungary	Contributions	1992	1.23	1.35	na	1.14	0.99	1.11	1.15	Unclear
Ireland	Customs	1996	0.90	0.95	0.91	0.86	0.82	0.78	0.79	Decreasing
Mexico^c	Customs	1997	na	1.44	1.41	1.29	1.18	1.06	0.95	Decreasing
Netherlands	Customs	1987	1.74	1.76	1.39	1.30	1.35	1.15	1.11	Decreasing
Spain^d	Customs	Before 2004	0.81	0.78	0.83	0.82	0.74	0.68	0.65	Decreasing
Sweden^{b,e}	Contributions	1983	0.55	0.56	0.57	0.59	0.38	0.39	0.41	Unclear
UK^f	Customs	2003	1.06	1.11	1.04	0.97	1.10	1.12	1.10	Constant
Non-OECD Countries										
Argentina^g	Customs	Before 2005	0.88	0.86	0.85	0.83	1.60	1.62	1.84	Not determinable
Bulgaria^h	Contributions	2000	na	1.37	1.48	1.33	1.17	0.82	0.70	Decreasing
Estonia	Contributions	2004					1.03	0.88	0.86	Decreasing
Latvia[*]	Customs	1991	-	-	-	-	1.24	1.19	1.31	Unclear
Romania	Contributions	2002			na	na	0.63	0.72	0.91	Increasing
South Africa	Customs	1998	-	-	1.21	1.25	1.19	1.21	1.02	Constant

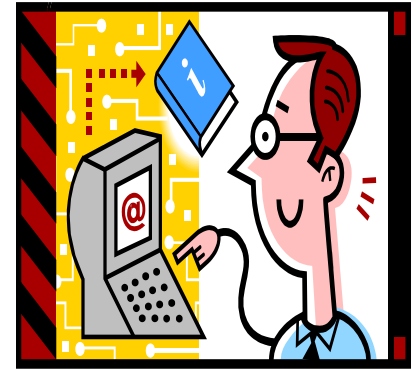
Integration – Key lessons learned

- Integration of revenue collections usually takes many years – requires careful planning and gradual implementation.
- Institutional evolution never stops after the integration goals are largely achieved (e.g., Canada and the UK).
- Swift integration is rare and possible only for a small economy where institutions to be integrated are modern (e.g., Sweden and Denmark).
- Preparation for integration includes understanding the level of “readiness” in existing institutional, organizational and operational conditions
- Among strategic objectives, the first priority is enhancing effectiveness in revenue collection. Only when this priority is secured, does it make sense to emphasize on efficiency.

Segmentation and specialization

- ▶ Needs of large, medium and small taxpayers different
 - Small taxpayers need more attention in taxpayer education and taxpayer service, including simplified procedures
 - Large taxpayers need greater dialogue on nature of transactions and certainty of treatment of complex transfer pricing issues
- ▶ Approach to compliance management also different
 - With large taxpayers – the main challenge is tax avoidance
 - With small and medium taxpayers – the main challenge is tax evasion and underreporting
- ▶ Greater emphasis on horizontal monitoring

And of course



- IT, IT and more IT
- the enabler of most reforms and business process changes



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