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Ambrogio Lorenzetti; The Effects of Good Government on the City Life; Fresco; Palazzo Pubblico, Siena (Italy)

Tax administration options for fiscal sustainability

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Session outline:

- Broad context
 - Fiscal adjustment and where tax admin fits in
 - Revenue possibilities from improved compliance
- Tax administration options
 - Priority actions
 - Medium-term reforms
- Case studies
- Concluding remarks



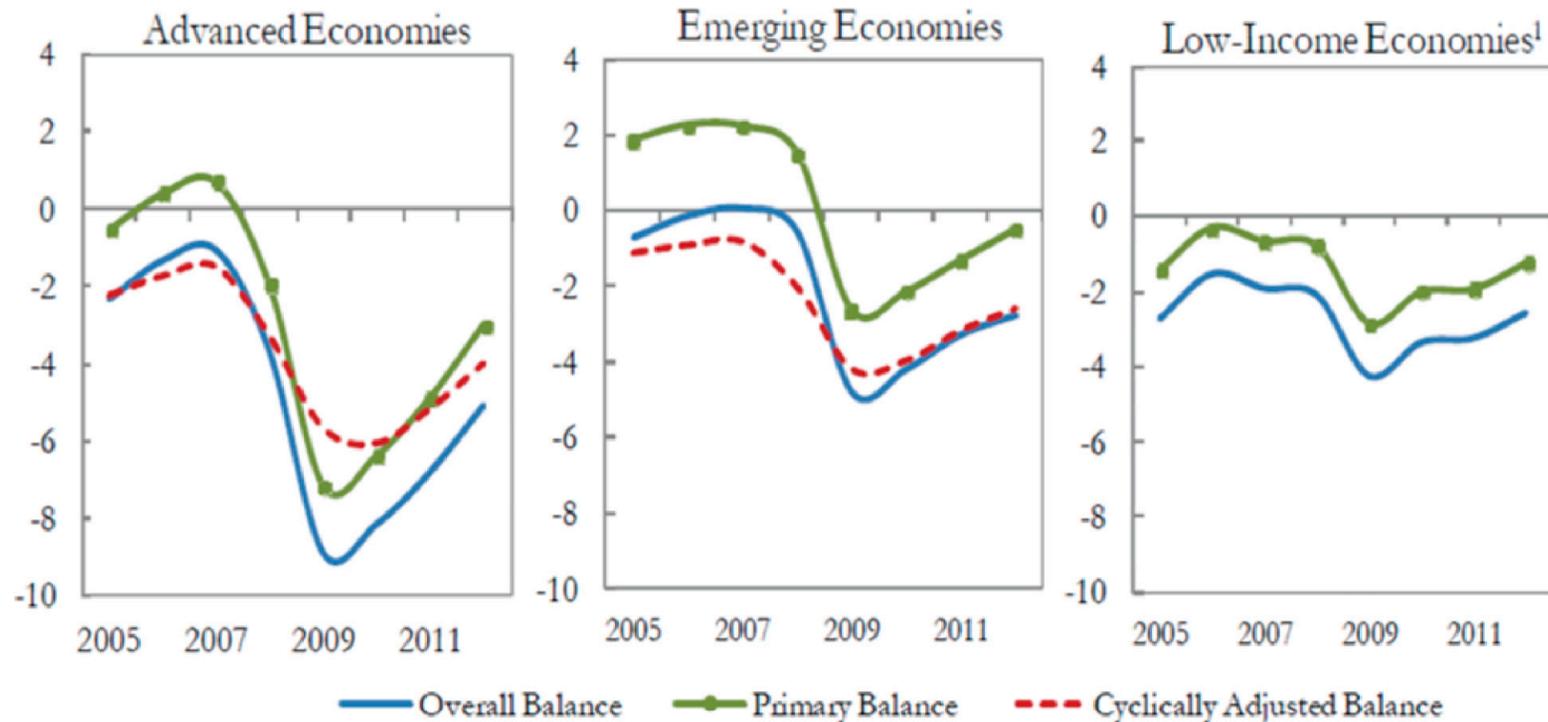
Broad context

Fiscal balances...

Source: IMF Fiscal Monitor, Nov 2010



Figure 1.1. Fiscal Balances, 2005-11
(Percent of GDP)



Source: October 2010 *WEO* and IMF staff calculations.

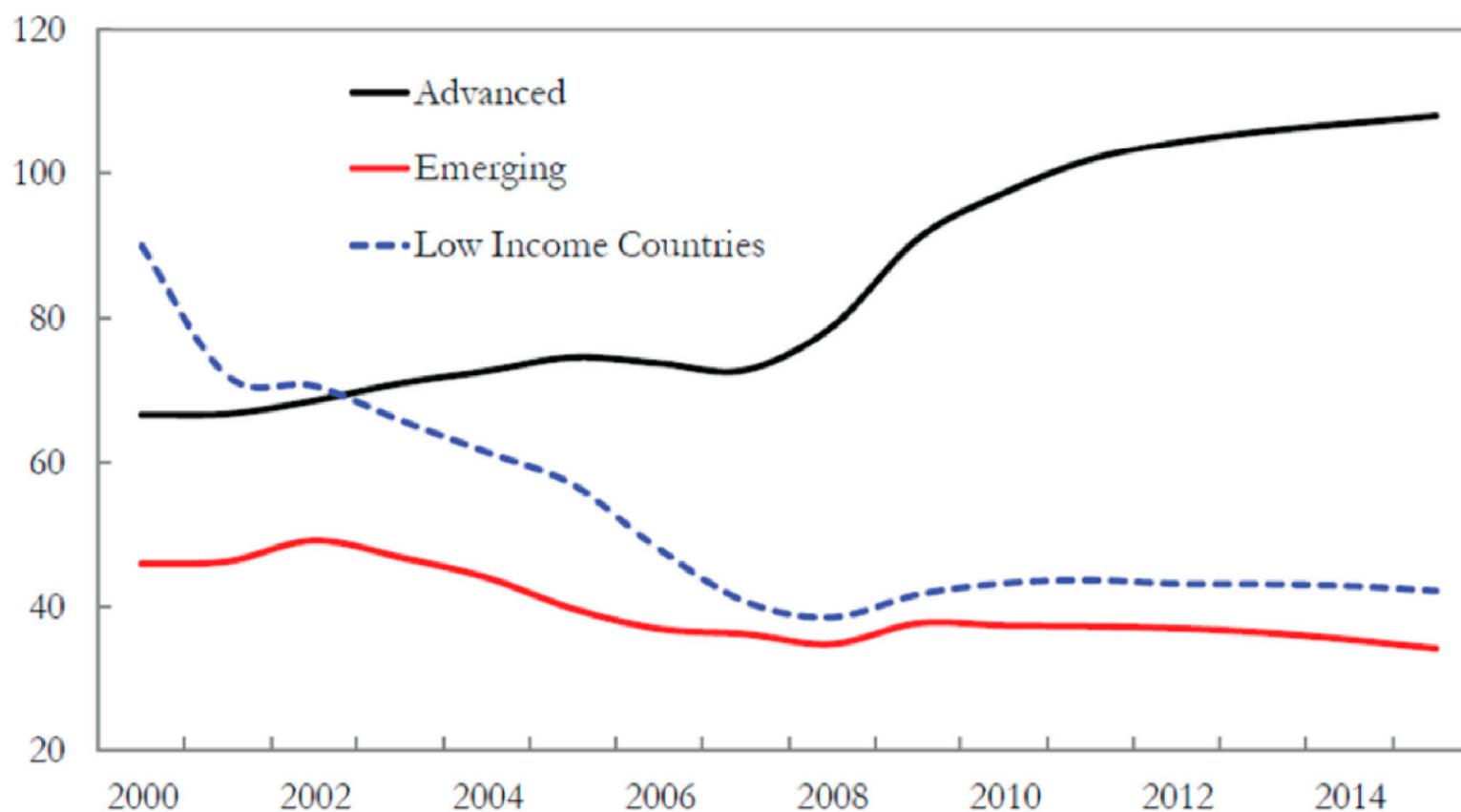
¹ Cyclically adjusted data are not available for several countries.

Government debt...

Source: IMF Fiscal Monitor, Nov 2010



Figure 1.6. General Government Gross Debt Ratios
(Percent of GDP; 2009 PPP-GDP weighted average)



Source: IMF staff estimates based on October 2010 WEO projections.



Composition of adjustment...

- For countries with already high tax-to-GDP ratios, fiscal consolidation plans tend to tilt toward *expenditure* cuts
- Countries with low tax ratios have more scope on the *revenue* side
- Some countries with high adjustment needs will require both *revenue and expenditure* measures—Greece, US, and India, for example, therefore plan a broadly equal mix



Composition of adjustment...

- On the revenue side, fiscal adjustment requires sound tax policy *and* efficient tax administration, especially to improve tax compliance
- The adjustment plans of several countries therefore include admin measures to tackle tax evasion (Greece, India, Italy, Korea, Latvia, Portugal, and UK)
- This is important in terms of both equity and efficiency considerations, and the large existing margins to improve tax compliance



Large tax gaps are widespread...

- VAT compliance gap (*difference between actual and potential VAT revenues*) is 20 percent or more in many countries (e.g. Mexico, Italy, Latvia, Greece)
- Revenue possibilities from closing the VAT gap are greater in emerging and developing economies:
 - Av. gap in emerging economies (21%)
 - Av. gap in advanced economies (13%)

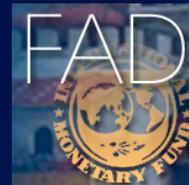
Source: Published data from tax gap studies by EU, US, UK, Sweden, and some Latin American countries



Tax abuse is pervasive...

- *Shadow economy*
 - *OECD country average (18%); Developing countries (38%); Schneider*
- *Evasion, particularly by the self-employed*
 - *Understated business earnings: Sweden 33%; Denmark 40%; US 50%*
- *Aggressive tax planning*
 - *\$1.1 trillion of bank losses presents planning opportunities*
- **Offshore tax abuse**
 - **US Senate estimate of revenue losses \$100bn per year (2008)**
- *Tax fraud*
 - *Estimated EU VAT refund fraud losses > \$100bn (2006)*
- **Unpaid tax debts**
 - **Large debt inventories are common; 28% of GDP in an extreme case**

Impact of crisis on tax compliance...



- The crisis has aggravated compliance problems
- Tax debts have grown—e.g., the UK VAT gap increased by 3 percentage points between 2008 and 2009, mostly due to a rise in unpaid VAT debts
- Filing compliance has deteriorated
- Several revenue agencies have observed a drift towards the shadow economy (Study estimates support this observation... Schneider)
- Concerns of resurgence of contrived tax schemes as the appetite for risk increases and corporations seek to restore financial positions



Priority actions

Priority actions to boost revenues...



- Implement tax policy measures effectively
- Tighten control over the largest taxpayers
- Restore filing and payment discipline
- Strengthen debt management
 - Including removal of collection impediments (esp. legal)
- Target evasion of high risk sectors
 - especially self-employed and high wealth individuals
- Enhance taxpayer assistance



Implement tax policy measures...

- Improved tax policy design can have positive spin-offs for tax administration and tax compliance—e.g. eliminating multiple VAT rates and exemptions removes system complexity and opportunities for abuse, thereby making administration easier
- Implementation is most effective when there is:
 - Coordinated design of policy, legislation, and systems of administration
 - Tight project management of changes to systems and procedures; taxpayer education; monitoring of outcomes etc

Tighter control of large taxpayers...



- In all countries, a handful of large taxpayers contribute most revenue
- Revenue can be safeguarded through:
 - Better understanding the revenue trends and emerging compliance risks of this key group
 - Close monitoring of filing and payment compliance; immediate follow-up where necessary
 - A risk-based audit program tailored to sectors and issues
 - Expanded taxpayer services, including a responsive rulings system



Restore filing discipline...

- Mainstay of compliance management; first step (after registration) in establishing tax liabilities
- Several examples where filing compliance deteriorated during the crisis
- Enforcement should be highly automated
- Some countries have developed profiling tools to predict the type of action most likely to get the desired response from the taxpayer

Strengthen debt management ...



- Debt management is too often the bridesmaid; rarely the bride
- Disparity in performance—OECD survey of 94 countries (pre-crisis):
 - Ratio of year-end tax debt: < 5% (18); 5%-10% (68); 10%-20% (4); > 20% (4)
- Arrears rose sharply during the crisis; more than doubled in some countries
- Collection impediments were exposed, esp. weaknesses in the law and judicial system

Target evasion of high risk groups...



- While compliance is very high (95% +) for taxes withheld at source or subject to regular third-party reporting... for other sources of income it is commonly very low
- US study (2006): More than 80% of income tax gap related to understated business earnings; evasion rates for proprietorship (sole trader) and rental income categories were close to 50%
- Swedish study (2008): understated business earnings estimated to be 33%
- Other tax gap studies (e.g. Denmark, UK)

Target evasion of high risk groups...



- Best practices include:
 - Intensified third-party reporting and data matching
 - Risk-based audit case selection
 - Audit visibility in risky sectors
 - Prosecution of worst offenders
 - Publicizing results and seeking wide community support for anti-evasion efforts

Enhance taxpayer assistance...



- Taxpayers have needed more help during the crisis, especially time payment arrangements
- The challenge now is to manage a smooth exit from the special concessions introduced during the peak of the crisis
- Focus should be on assistance that supports sustainable compliance



Medium-term reforms



Medium-term reforms...

- Five key areas:
 - Building further capacity in core systems
 - Intensifying international collaboration
 - Developing comprehensive compliance programs
 - Strengthening legal frameworks
 - Exploiting new information technology
- These areas will be explored in detail in tomorrow's session



Case studies



Case study A: the situation...

- Developed country with large fiscal adjustment needs
- Revenue efficiency much lower than that of counterparts—(5.5 points of GDP lower)
- Large VAT gap (30 percent) and well above regional average (12 percent)
- Large informal economy (estimated 25% +)
- Income tax evasion high, especially with self-employed professionals
- Very high and growing tax arrears
- Administration fundamentals in need of reform



Case study A: the response...

- A two-pronged strategy, comprising:
 - A *targeted anti-evasion plan* to produce extra revenue during the next 12–18 months from immediate intensified actions to control tax abuse
 - A *structural reform program* aimed at producing extra revenue in the medium-term through fundamental changes in tax administration to secure enduring compliance

Case study A: anti-evasion plan...



- Intensified efforts in five key areas:
 - Centrally managed implementation of policy/legislative package (includes a number of anti-evasion measures)
 - Special collection task force focused on largest tax debts
 - involves coordinated collection of tax and social security debts; removal of legal impediments to collection; and streamlining judicial processes
 - High profile unit established to administer top 1,000 taxpayers
 - Targeted offensive on blatant tax evaders
 - self-employed and wealthy individuals exhibiting high risk of noncompliance
 - Systematic (not *ad hoc*) enforcement of filing and payment

Case study A: medium-term structural reforms...



- Comprehensive modernization of the revenue agency to implement:
 - New organizational structure
 - Modern HRM practices
 - Revamped headquarters
 - Strategic planning and risk management
 - Redeveloped core processes
 - Automated collection systems
 - etc



Case study B: the situation...

- Country in emerging Europe
- Deep recession—real GDP fell by 18% year-on-year in 2009
- Collapse in revenues—tax revenues dropped by 3½% of GDP
- Large fiscal adjustment needs
- Pre-existing VAT gap of 22 percent
- Moderately large shadow economy
- Rapid escalation of tax arrears



Case study B: the situation...

- Relatively sound revenue agency (high level of automation—e-filing around 90 percent; well-qualified staff; modern office facilities) but...

operating budget drastically cut (salaries cut by 30%; staff numbers reduced by 15%; capital works program halted)



Case study B: the response...

- Immediate priority was to redirect resources to:
 - Assist distressed businesses (time payment arrangements for viable businesses with temporary cash-flow problems; timely VAT refunds)
 - Contain the rise in tax debts
 - Expand the large taxpayer unit to increase coverage from 40% to 65% of total domestic tax collections
 - Increase audit presence through use of a wider range of audit types, particularly single-issue and desk audits
- Next step was to develop a comprehensive risk-driven compliance strategy structured around key taxpayer segments



Case study B: the response...

- Medium-term reform effort:
 - Building revenue analysis and risk assessment capability
 - Streamlining operations by reducing the number of local tax offices
 - Centralizing debt collection and taxpayer services functions, and bringing stronger central management to audit operations
 - Revamping key collection processes and systems, especially debt collection and VAT refund processing
 - Simplifying administration of small taxpayers



Concluding remarks



Thank you