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Romania

Improving Compliance Risk Management of Large Taxpayers

Stuart Hamilton

Technical Assistance Report

May 2016

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GLOSSARY

APA	Advance Pricing Arrangement
ATO	Australian Tax Office
BEPS	Base Erosion and Profit Shifting
CoA	Court of Accounts
CRM	Compliance risk management
DG	Director General
FAD	Fiscal Affairs Department
FP	False positive
GDTAC	General Directorate for Tax Audit Coordinator
HWI	High wealth individual
ILO	Industry Liaison Officer
IT	Information technology
KAM	Key Account Manager
LTO	Large Taxpayer Office
NAFA	National Agency for Fiscal Administration
OECD	Organisation for Economic Cooperation and Development
PMS	Planning, Monitoring, and Synthesis
RAMP	Revenue Administration Modernization Project—World Bank
RMU	Risk Management Unit
RO	Risk owner
RON	Romanian Leu (Currency)
TA	Technical assistance
TP	True positive
VAT	Value-added tax

I. INTRODUCTION

This report concerns a visit made by **Mr. Stuart Hamilton** (External Fiscal Affairs Department—FAD—expert) to Bucharest during the period of April 7–20, 2016 to provide technical assistance (TA) to the Romania National Agency for Fiscal Administration (NAFA) on large taxpayer management. The IMF financed this assistance. For the initial few days of the mission Mr. Hamilton was supported by Mr. Allan Jensen and Ms. Lucilla McLaughlin from FAD, who were traveling through Bucharest to another TA task in Europe.

The main purpose of this TA mission was to advise the NAFA Large Taxpayer Office (LTO) on the development and implementation of modern risk-based methods to increase compliance and tax revenues from the most significant taxpayer segment in Romania. The TA mission builds on the recommendations of the July 2015 FAD mission.[1]

II. BACKGROUND

1. **Modernizing the NAFA LTO is an important component of the Romanian government's economic reform program.** Given the limited room for new spending and recent value-added tax (VAT) rate reductions, the authorities have a strong interest in improving the efficiency of revenue collection. The government envisages that NAFA, and in particular its LTO, will deliver improved taxpayer administration and reduce the tax gap to provide additional revenues.

2. **Some progress has been made since 2015, but considerable challenges and scope for improvement in implementing risk-based methods in the LTO remain.** The August 2015 FAD TA mission found that the LTO effectiveness was limited by legislative, procedural, and structural constraints. Initial steps towards improving the LTO structure and client base have been taken (both changed at January 1, 2016), but many of the other recommendations remain unimplemented (see Appendix I). The short timeframe since the August 2015 mission might account for the delays requiring changing the law, but some other changes that appear to be within the remit of NAFA have also been slow in progressing. It is expected that recent organizational changes will allow faster progress in implementing the 2015 recommendations and those of this mission.

3. **The LTO lacks an integrated compliance approach to guide operational activities toward major tax risks and this must be changed as a priority.** The August 2015 mission found that the LTO had an excessive audit focus instead of a considered balance of service and

[1] Jensen, Gillanders, and Cartwright, "Romania—Enabling the Large Taxpayer Office to Reduce the Tax Gap," September 2015, IMF Mission Report.

enforcement to address major compliance risks. Effective risk-based case selection was limited in practice, with many audits directed toward VAT refunds that are a low compliance risk for large taxpayers. Audits were taking far too long to complete compared to good practice. The very unusual practice of the Court of Accounts (CoA) directing NAFA LTO to audit particular taxpayers consumes a considerable amount of the LTO resources for very limited returns. While the number of CoA directed audits for the LTO has declined since the 2015 mission, and those that remain are assessed by NAFA on a risk basis, the risk criteria and processes need to be significantly improved to provide a focus on higher risk matters.

III. FACILITATING INTEGRATED COMPLIANCE RISK MANAGEMENT IN THE NATIONAL AGENCY FOR FISCAL ADMINISTRATION LARGE TAXPAYER OFFICE

A. Improving the Large Taxpayer Office Organization

4. **Despite reorganization, the LTO's ability to implement modern risk-based methods continues to be impeded by its organizational structure.** While the LTO changed to an improved structure on January 1, 2016, its new structure does not align with previous FAD recommendations that would better facilitate the implementation of modern risk-based methods. Key risk roles found in good practice tax administrations, such as Risk Owners (ROs), Industry Liaison Officers (ILOs), and Key Account Managers (KAMs) do not exist in the LTO and this lack of role specialization impedes progress in implementing modern risk-based methods (see Appendix II for draft role statements). Changes in the LTO structure appear to require NAFA management approval, which limits the LTO's ability to act dynamically to match its needs.

5. **The LTO taxpayer service function is limited and needs to be improved so that large taxpayers have the certainty they require.** The LTO does not offer most of the taxpayer services (e.g., advance pricing arrangements (APAs), and binding rulings) that are the norm in good practice LTOs. NAFA Headquarters does provide some of these services to LTO taxpayers, but in a limited manner that is not coordinated with the LTO. Modern risk-based methods make considered use of education, engagement, and enablement activities to prevent compliance problems occurring in the first place. With the LTO's limited focus on, and resourcing of, preventative approaches, opportunities to help large taxpayers to make better tax decisions are being lost and the role of taxpayer services in reducing the tax gap is diluted. (Further information on modern approaches to mitigating compliance risks is included in Appendices III and IV.)

6. **The LTO Risk Management Unit (RMU) needs appropriately skilled staff and good analytic facilities to identify and mitigate risks.** At present, the RMU is essentially a box on the organization chart with just one of nine allocated positions filled. Restrictions on NAFA recruitment impede the employment of the data miners or information analysts needed to identify tax risk and monitor compliance effectiveness. Access to analytic software such as SAS

JMP and data mining software such as R RATTLE is also needed. The RMU has two key roles in implementing modern risk-based methods: (1) risk identification and analysis; and (2) risk mitigation strategy formulation and monitoring. Each role requires different skills sets, but both roles should work closely together and be supported within the RMU. The risk identification and analysis role is responsible for capturing and analyzing data from a wide variety of internal and external databases, and using sophisticated analytics (e.g., data mining technology) to support modern risk-based methods at strategic, tactical, and operational levels. The risk owner and strategy role is responsible for developing a set of integrated strategies to promote compliance and deal with noncompliance. The outputs from both roles provide information for the LTO Risk Committee to make informed decisions regarding what key tax risks exists, who has them, and how best to mitigate them. Encouragingly, there appears to be a strong commitment by NAFA and LTO leadership to improve the capability of the RMU.

7. The lack of adequate industry specialization within the LTO limits the ability to manage key industries. Industry specialization is an important feature in modern risk-based compliance management, as it facilitates risk identification and leverages mitigation effectiveness (see Appendix V. Typical Risk Industry Compliance Approach). As set out in the 2015 report[2] (Figure 3. Romania: Organization Structure Proposal for the Large Taxpayer Office) industry specialization within the LTO should reflect the importance of key industries in the Romanian economy, such as Mining and Oil, Energy Production and Distribution, Manufacturing, Wholesale and Retail Sales, etc. In the current structure, industry specialization is limited to Banking, Finance and Insurance—and this impedes the development of industry knowledge (e.g., understanding the value chain and the key players) crucial for modern risk-based compliance management. It also impedes effective NAFA liaison with the industry sectors that are critical to the Romanian economy.

8. The existing structure has too many people reporting directly to the LTO Director General (DG). The January 1, 2016 restructure of the LTO was a significant improvement, but in the new structure, the DG has over a dozen direct reports. This limits the DG's ability to provide the necessary strategic oversight of current operations and to plan future activities. The structure recommended in the 2015 report was simpler and had just four people directly reporting to the DG. The LTO should move as soon as possible to a structure that better supports modern risk-based methods (see Appendix VI. Large Taxpayer Office Recommended Structure).

9. Staff changes following the restructure present an opportunity to renew and enhance LTO staff capabilities to better support modern risk-based methods. Following the January 1st restructure away from a regional approach there has been a significant disruption to LTO staffing, as LTO staff based in the regions have sought transfer to the eight new regional NAFA Medium Business Offices. While the loss of capable staff from the LTO is of concern, these moves potentially boost the ability of the new Medium Business Offices to deal with more

[2] Jensen, Gillanders, and Cartwright, "Romania—Enabling the Large Taxpayer Office to Reduce the Tax Gap," September 2015, IMF Mission Report.

complex matters. The change of staff also presents a real opportunity to renew, rebuild, and reorganize the capability of the LTO to better deal with compliance risks such as Base Erosion and Profit Shifting (BEPS), and to recruit staff with relevant industry and tax risk knowledge. This change in focus to more complex tax risk matters requires significantly higher skills sets (e.g., ability to do a functional analysis within a transfer pricing audit) and should ideally be accompanied by the targeted recruitment of appropriately skilled people, as well as technical skills development.

B. Improving Autonomy and Transparency

10. Risk decision-making and transparency in the LTO need to be improved to support compliance management. The use of Risk Committees or expert panels at key points in the risk-based decision-making process would improve decision-making quality (by bringing other informed views to the table) and transparency (by having accountable discussions about the decision to be made). In good practice tax administrations, risk committees improve decision-making at the key risk management stage-gates by refining the selection of audit candidates produced by automated case selection approaches, by approving the issues to be audited, and by reviewing proposed audit adjustments. The use of risk committees at such key risk management decision points provides improved integrity assurance and reduces the operational decision load on the DG.

11. The LTO needs improved practical autonomy in order to implement modern risk-based methods. Modern risk-based compliance management methods require dynamic 'real time' taxpayer engagement and decision-making. While the January 1, 2016 changes to the LTO improved its autonomy, it still lacks many of the functional powers and abilities found in good practice tax administrations. For example, based on an existing Ministerial Order, LTO risk criteria must be approved by the NAFA Fiscal Intelligence Unit. This unit has recently allowed for a degree of input from the LTO, but the process limits the ability of the LTO to quickly design and use risk criteria to select audit cases. Similarly, recruitment and budget limitations impede the ability of the LTO to position itself to deal with the most pressing tax risks.

12. The use of 'delegation of powers' by NAFA senior executives to direct audits of LTO taxpayers by Medium Business Offices needs to decrease significantly. The use of 'delegation of powers' to select LTO taxpayers for audit, many of which are carried out by the regional Medium Business Offices rather than the LTO, is not soundly risk-based. One of the main factors used in selection is the time since last audit, which is not a good predictor of tax risk. The output from these audits is consequently lower, and taxpayers thus audited are excluded from further audit on the same tax type for that period. Resource capacity limitations in the LTO should be addressed by moving resources into the LTO, not by moving LTO tax risk mitigation treatments out.

13. LTO staff in the field should be able to use NAFA regional facilities, when needed, to facilitate their compliance management work with LTO taxpayers. It is not optimal to have LTO auditors working from hotel rooms. They should be able to use local NAFA regional facilities when needed, which they are currently not permitted to do.

C. Recommendations

14. These are the recommendations for improving the LTO organizational structure and staffing to support the implementation of modern risk-based compliance management:

- Continue to move towards the implementation of the LTO organizational structure with industry specialization and segmentation as recommended in the FAD September 2015 report.
- Increase the use of preventative compliance management approaches such as taxpayer service via tax rulings, advance pricing agreements, etc., to 'lock in' compliance of the largest corporates.
- Recruit additional skilled staff into the LTO RMU so that it can fulfill its fundamental role in supporting modern risk-based compliance management.
- Reduce the number of direct reports to the DG of the LTO to provide 'space' for strategic planning and engagement.
- Use the opportunity provided by the turnover of LTO staff to rebuild the LTO with staff capable of applying modern risk-based compliance management to a wider variety of tax compliance risks, such as BEPS related matters.
- Use risk committee or panel approaches to improve the quality and of transparency decisions at key points in the risk-based compliance management process.
- Increase the practical autonomy of the LTO to decide on matters such as risk criteria, recruitment and VAT refund audits.
- Reduce the use of 'delegation of powers' to direct the auditing of LTO taxpayers by other parts of NAFA.
- Ensure that LTO staff in the field can access NAFA regional facilities when needed.

IV. ESTABLISHING AN INTEGRATED COMPLIANCE RISK MANAGEMENT APPROACH

A. Improving Large Taxpayer Office Risk Data

15. NAFA needs access to meaningful risk data, which is fundamental to modern risk-based compliance management. To reduce false positives in case selection, good practice tax administrations require large taxpayers to provide certain additional information relevant to key tax risks, for example regarding the extent of related party dealings, the main countries where those related parties are located, and the value of those dealings. At present, even though large taxpayers are required to prepare and hold such transfer pricing documentation (as from February 2016), NAFA/LTO must request this information on a case-by-case basis. This information should be included with filing requirements to enable the RMU to better identify potential cases of concern.

16. **The criteria used to identify LTO taxpayers need to be refined to enable the compliance management of corporate groups**. NAFA's Monitoring and Budget Office populates the LTO taxpayer base by reference to taxpayers' turnover, as recommended by the September 2015 report, but unless affiliates of large taxpayers are included, the LTO cannot administer corporate groups as a unit. In the absence of income tax grouping data, VAT grouping data should be used to identify affiliate members of corporate groups for inclusion in the LTO-administered population. A further adjustment is needed to the LTO taxpayer base to ensure that multinational enterprises with extensive e-commerce activities in Romania are administered by the LTO. In the longer term, LTO taxpayers should, as a matter of course, be required to supply the tax file numbers of all subsidiaries in which they hold more than 50 percent shareholding (either directly or indirectly). The increase in the number of taxpayers administered by the LTO that would follow this recommendation would need to be matched by a corresponding increase in staff resources.

B. Improving Large Taxpayer Office Risk Analysis and Scoring

17. **The LTO RMU risk analysis tools and outputs need to more accurately identify tax risk to add real value to compliance management.** Modern risk analysis adds value by better informing tax administrations about the population they administer, the tax risks that may exist in that population, who may have those risks, and how taxpayers respond to risk mitigation activities. At present the LTO has only nascent risk analysis capabilities with limited output. The RMU Risk Identification and Analysis Team should provide the outputs identified in Appendix VII using tools identified in Appendix VII. The current LTO risk assessment, approved by the NAFA Fiscal Intelligence Unit, uses a threshold scoring approach with weighted additive scores for different risk criteria (such as length of time since last audit). This is a dated selection approach, unlikely to be the best reflection of the amount of potential tax adjustment. Predictive data-mining approaches (e.g., a random forest selection model, overlaid with a single classification and regression tree for explanatory purposes) should be used to construct case selection rules where sufficient parametric data exist. Where parametric data is more limited, such as for a new tax risk or one that has previously had few productive audits, expert rule approaches (such as those currently used by the LTO) should be supplemented with descriptive data mining (e.g., self-organizing maps) and qualitative (field) intelligence, to better identify potential risk candidates. Such changes in case selection need to be coordinated with the World Bank Revenue Administration Modernization Project (RAMP) as it progresses, so that dated selection approaches are not 'built into' the RAMP, limiting its future effectiveness.

C. Improving Law, Regulatory, and Toolkit Support

18. The LTO compliance management toolkit needs to be significantly expanded and improved. NAFA's compliance management toolkit is extensively defined by law and regulation and some elements, while adequate for medium and smaller taxpayers, are poorly suited to large taxpayer needs (see the Compliance Management Toolkit at Appendix III). Improving the LTO ability to address tax risks will require changes to the NAFA toolkit. Compliance management tools (e.g., APAs, transfer pricing audits, binding rulings) that pertain largely to LTO taxpayers, need to be available for the LTO to implement, with appropriate integrity controls. It is inevitable that a large number of false positives will be generated by LTO case selection systems and an efficient means of sorting through these is needed to better focus audits on higher value matters and those that have a much greater probability of producing revenue. The introduction of a quicker 'risk review' step, prior to committing to more resource intensive audit, is needed. The aim should be to 'review more and audit less' for a greater return on overall investment. The requirement for a 30-day completion means that a 'limited scope audit' cannot be effectively used as a 'risk review' for LTO income tax concerns; a better timeframe would be six months. The LTO needs to be able to conduct pre-filing risk reviews on its largest taxpayers.

19. The perceived requirement to perform an audit on the full period since the last audit needs to be clarified. In the LTO, the limitations imposed by the perceived requirement to audit from the date of the last audit (Article 117 (2) of the Tax Procedures Code), together with a widespread fear of personal liability for tax adjustments not identified, currently drives a 'check everything' audit mentality. The LTO needs to take a more considered search for material aspects that produce the greatest return for the investment of scarce compliance resource time. The more appropriate limited scope audit is often not used because of the fear of missing something. While views differ regarding the interpretation of Article 117 (2), its meaning should be put beyond doubt by amending 'shall audit' from the end of the period of the last audit, to a permissive 'may audit if the risk assessment for the period warrants it.'

20. Staff acting in good faith need to be protected from unwarranted claims and associated costs. In good practice tax administrations, public officials performing their duties in good faith are protected from spurious claims. Given the potential size of audit adjustments in the LTO population, unless clearly negligent or deliberately inappropriate behavior is demonstrated, auditors should not be held personally liable for tax amounts not identified during an audit. The same principle should apply to the cost of defending against a spurious action. NAFA should cover costs if taxpayers sue LTO auditors, unless negligent or deliberately inappropriate behavior is demonstrated. The combined result of these two aspects (fear of missing an amount and of being sued and incurring personal costs) drive audit 'paralysis' in the LTO, with much lower rates of productivity than good practice tax administrations, and this needs to change.

21. An ability to negotiate settlements of tax adjustments, with integrity controls, is needed. NAFA needs to be able to settle cases, where appropriate, particularly as the number of profit shifting cases increases. A law court is not the best place to resolve differences of view over the appropriateness of economic rates of return on functions, assets and risks, or the valuation of intellectual property located in different countries. Good practice tax administrations often have a settlement panel composed of internal and external experts (including people with recognized integrity, such as retired senior judges) who make recommendations as to whether a case should be settled by negotiation. This ability to settle matters is integral to moving forward with modern risk-based compliance management. Most transfer pricing cases globally are settled rather than litigated. An alternative and more expensive option for Romania would be to establish and appropriately resource a Tax Court that could adjudicate on transfer pricing matters.

D. Recommendations

22. These are the recommendations for implementing modern risk-based compliance management methods in the LTO:

- Expand the range of data used to assess tax risk, including obtaining, as part of returns filing, supplementary schedules that more meaningfully identify key tax risks.
- Change the allocation criteria used to identify LTO taxpayers to ensure that affiliates of large taxpayers are included.
- Enhance the LTO RMU risk analysis capabilities to include data mining skills, and improve risk scoring by including data mining approaches.
- Significantly expand and improve the LTO compliance management toolkit to include taxpayer service aspects such as APAs and lighter touch risk reviews.
- Urgently clarify the perceived requirement to perform an audit on the full period since the last audit so that audits review only the periods with the higher risks.
- Protect staff acting in good faith from unwarranted claims and costs.
- Develop the ability in the LTO to negotiate, with integrity controls, settlements of tax adjustment.

V. FURTHER TECHNICAL ASSISTANCE

23. Further technical assistance is needed. Implementing modern risk-based methods in the LTO will require follow up FAD technical assistance to progress the advice provided in this report. This technical assistance should include translation of key risk-based compliance management documents to help the broader dissemination and acceptance of the approach. Translation of key documents provided during this TA mission (see Appendix IX) would greatly assist the dissemination of modern risk-based concepts and understanding to a larger group of LTO and NAFA officials.

VI. OTHER ISSUES

24. The expert met with Romanian officials listed in Appendix X. The expert would like to express his thanks to the NAFA and LTO management teams, local IMF staff and the translators for the excellent cooperation and assistance provided during the mission.

Appendix I. Romania: Implementation of the April 2015 Mission's Major Recommendations

Recommendations	Implementation status April 2016
Short term actions (6-12 months)	
Change the criteria for inclusion of taxpayers in the LTO so that it is primarily based on turnover (sales). The criteria would apply for taxpayers throughout Romania and would be the primary mechanism to establish whether a taxpayer is "in or out."	**Implemented.** The criteria have been revised and the LTO caseload reduced to 1,524 [1,418 included solely on entity (not group) turnover, plus a small number (96) of large asset holding entities and some subsidiaries of larger taxpayers]. The effective turnover threshold is about RON 78 million.
Maintain or increase the current number of employees in the LTO, even though the new criteria may significantly reduce the LTO taxpayer population. Although the population will reduce, its importance in terms of revenue that needs to be protected will increase.	**Implemented.** Sanctioned staff numbers have reduced slightly from 642 to 620, all based in Bucharest. Actual staffing as at April 6, 2016 was 506 with 114 vacancies. Many experienced LTO auditors, particularly those who were based in regions, are seeking transfer to the eight regional offices, where medium-sized taxpayer offices have been established. These medium sized taxpayer offices have had transferred to them some 700 taxpayers that were formerly managed by the LTO, based on their former high tax payment criteria.
Commence upgrading the skills of LTO personnel through training, including through exchange programs with advanced tax administrations, and replace personnel as appropriate to upgrade the LTO (it is essential that LTO personnel are highly skilled so that they can match their counterparts in the accounting firms).	**Not yet implemented**. No progress has been made on training and capacity building. There is a restriction limiting recruitment for NAFA to those qualified in law or economics. This significantly limits the ability to recruit experts with skills such as data mining, behavioral change, etc., important in designing and implementing an integrated CRM approach.
Make a government decision to commence the implementation of the compliance risk management model outlined in this report.	**Not yet implemented.** As yet no formal decision has been made by government on implementation.
Change the Tax Procedure Code and relevant regulations and instructions so that sufficient mandate for NAFA is established to enable it to prioritize its compliance efforts to address the major revenue risks.	**Not yet fully implemented**. Some changes have been made to the Tax Procedure Code, regulations and instructions to facilitate modern risk-based compliance management methods, but these have been limited in scope and more needs to be done.
Revise the procedures for VAT refund risk assessment and audit to cut down on the excessive use of audit resources.	**Not yet implemented.** The VAT refund procedures have not been revised, and there has been an increase in the number of VAT refund audits. This aspect is apparently within the control of the

Recommendations	Implementation status April 2016
	LTO to correct by better defining and limiting what a 'high-risk' VAT refund is.
Remove from law and regulations: (1) NAFA's obligation to audit taxpayers for statute of limitation purposes only; (2) the personal liability for the revenue short fall upon auditors and other officials; and (3) auditors obligation to review all tax periods since the last audit.	**Not yet implemented**. Art 117 (1) of the Tax Procedures Code imposes a statute of limitations for a tax audit. Paragraph (2) defines the period subject to audit commencing from the end of the last audit. While an auditor can be personally sued by an aggrieved taxpayer, there is a lack of clarity about personal liability of auditors for undiscovered understatements. This appears to turn on a Prosecutor's view of whether additional amounts of tax should have been raised by the auditor but were not.
Reach a protocol with the Court of Accounts so that it can continue to carry out its important role but in the context of a modern and quality-assured compliance- management framework (essentially, NAFA would be adopting the compliance risk model of the European Union).	**Not yet implemented.** No progress has been made with the CoA for a formal protocol, though it appears that the number of CoA required audits has decreased significantly.
Establish within the LTO a strong risk management unit to facilitate: high-level risk analysis to determine industry sector and other significant risks clusters; prioritizing risks for compliance treatment; coordinating the development of compliance strategies; and facilitating the selection of audit cases.	**Partially implemented**. A risk management unit has been established with nine positions but as at April 6, 2016 only one position had been filled.
Medium term actions (12–36 month)	
Provide the LTO with appropriate accommodation (as already planned); sufficient transport means; and appropriate modern technical tools, including laptops and information technology (IT) software to undertake e-audit.	**Partially implemented**. The LTO is now centralized in a renovated office in Bucharest. It has been established as a separate legal entity with a procurement function but no budget, so that it is still under-resourced with IT hardware and software. The limited number of laptops and printers for the number of LTO staff is an issue affecting productivity. Ten ACL e-audit software licenses are held. LTO staff in the field appear to lack effective access to office accommodation in NAFA regional offices when needed.
Reorganize the LTO organization structure along the lines suggested in this report.	**Not yet implemented**. The LTO was reorganized in January 2016, but not along the lines of the 2015 FAD recommendations.

Recommendations	Implementation status April 2016
	The number of direct reports to the DG of the LTO is excessive and limits the DG's ability to provide strategic oversight and direction.
Provide for industry competitive salaries to LTO managers and key personnel, in particular auditors and legal and IT experts to attract and retain exceptionally skilled personnel.	**Not yet implemented**. No progress has been made on this recommendation. There are legal constraints preventing the recruitment of staff other than lawyers and economists. This is a limitation on the ability of NAFA and its LTO to access the needed skills and experience (e.g., IT, valuers, data miners, etc.) to address material compliance risks.

Appendix II. Example Role Statements for Key Risk-Based Compliance Management Positions

(Provided at the request of the LTO)

Risk owner

For each major compliance risk, a RO is responsible for preparing the proposed risk mitigation strategy, a balanced mix of service and enforcement approaches, for consideration and approval by the risk committee. A RO may be responsible for more than one major risk, depending upon the workload generated.

The risk owner is a member of the Risk Owner and Strategy Unit (a sub unit of the RMU) and works closely with members of the Risk Identification and Analysis Unit (a sub unit of the RMU) to improve the detection criteria used to identify potential cases of noncompliance.

Industry liaison officer

The ILO is responsible for understanding, liaising with, and facilitating service of a major industry grouping. The person needs to be skilled enough to be able to broadly understand the industry value chain, the position of major players, and the major compliance risks that exist with the industry. The ILO is a staff member of the taxpayer service area. An ILO may be responsible for more than one major industry, depending upon the workload generated.

Key account manager

The role of a KAM is to both facilitate service matters with the most important large corporates and to broadly understand the taxpayers' value chain, its position within the market, and the major compliance risks that exist with the taxpayer. The KAM is a member of the taxpayer service area. A KAM may be responsible for more than one major taxpayer, depending upon the workload generated.

Risk committee

The risk committee members should be the relevant heads of LTO compliance and taxpayer service areas, the DG LTO plus external members drawn from Fiscal Intelligence and Central Audit.

ROs, ILOs, and KAMs present to the risk committee regarding 'their' risks, industries, and taxpayers, but are not members of the risk committee. Their role is to improve the information set available to the risk committee for its consideration and decision-making.

The following box outlines the responsibilities of the LTO risk committee:

Large Taxpayer Office Risk Committee Responsibilities

Better harnessing the knowledge of experienced senior staff, the LTO risk committee takes overall responsibility for:

- identifying and prioritizing significant compliance risks according to a structured risk assessment process;
- identifying those compliance risks that represent a sufficient level of threat to warrant the ongoing attention of the senior executive;
- ensuring that an appropriately integrated mitigation strategy managed by a RO is in place for each of these severe compliance risks;
- ensuring that the treatment strategies are adequately resourced (people, finances, skills, business support tools, etc.);
- determining appropriate effectiveness measures; and
- monitoring the implementation and effectiveness of the strategies.

The LTO DG is accountable for the effective functioning of the LTO risk committee.

Appendix III. Typical Tax Administration Approaches to Mitigate Tax Compliance Risks

Enablement via legislation and policy changes	• Changes to existing laws to make compliance easier • Changes to make noncompliance more identifiable, such as improved tax schedules for higher risk issues • Proactive consultation and where appropriate codesign with key taxpayers and industries regarding changes to existing tax laws
Enablement via self-service tools	• Self-service tools • Downloadable software • Internet online services • Electronic filing • On-line help • Taxpayer account access
Education via	• Advisory services • Education for selected high risk groups • Seminars / presentations • Downloadable education material • Publications, booklets and guides
Engagement and Encouragement via	• Private rulings (content public) • Industry Liaison Officers & Key Account Managers • Advance Pricing Agreements & Annual Compliance Agreements • Front line service • Contact centers & help lines • Real time reviews of taxpayer records
Enablement via co-operative arrangement treatments	• Public Rulings relevant to the Industry & Risk • Industry partnerships • With other Government agencies (e.g. Customs) • Industry associations/taxpayer groups • Tax accountants • Other sources of third party information to the Industry
Preventative Enforcement aspects via Pre-obligation reminders	• Risk-based reminders to submit and pay taxes due ✓ Telephone ✓ Email & Letters ✓ Visits ✓ SMS
Detective and Corrective approaches via Review and Audit	• Registration checks • Advisory reviews • Record keeping reviews • Desk audits • Specific reviews /audits • VAT refund audits • Audit projects (specific groups of taxpayers) Prefiling Reviews • Comprehensive audits • Fraud investigations • Penalties that reflect both time and culpability
Correction via Debt collection	• Contact center—outbound • Reminder letters • Offer of installment arrangements • Enforced collection • High integrity settlement approaches
Education and enablement via media engagement	• Communicating areas of tax administration focus in a compliance program (see Appendix IV. Features of a Typical Compliance Program) • Publishing results of compliance campaigns in the compliance program

Appendix IV. Features of a Typical Compliance Program

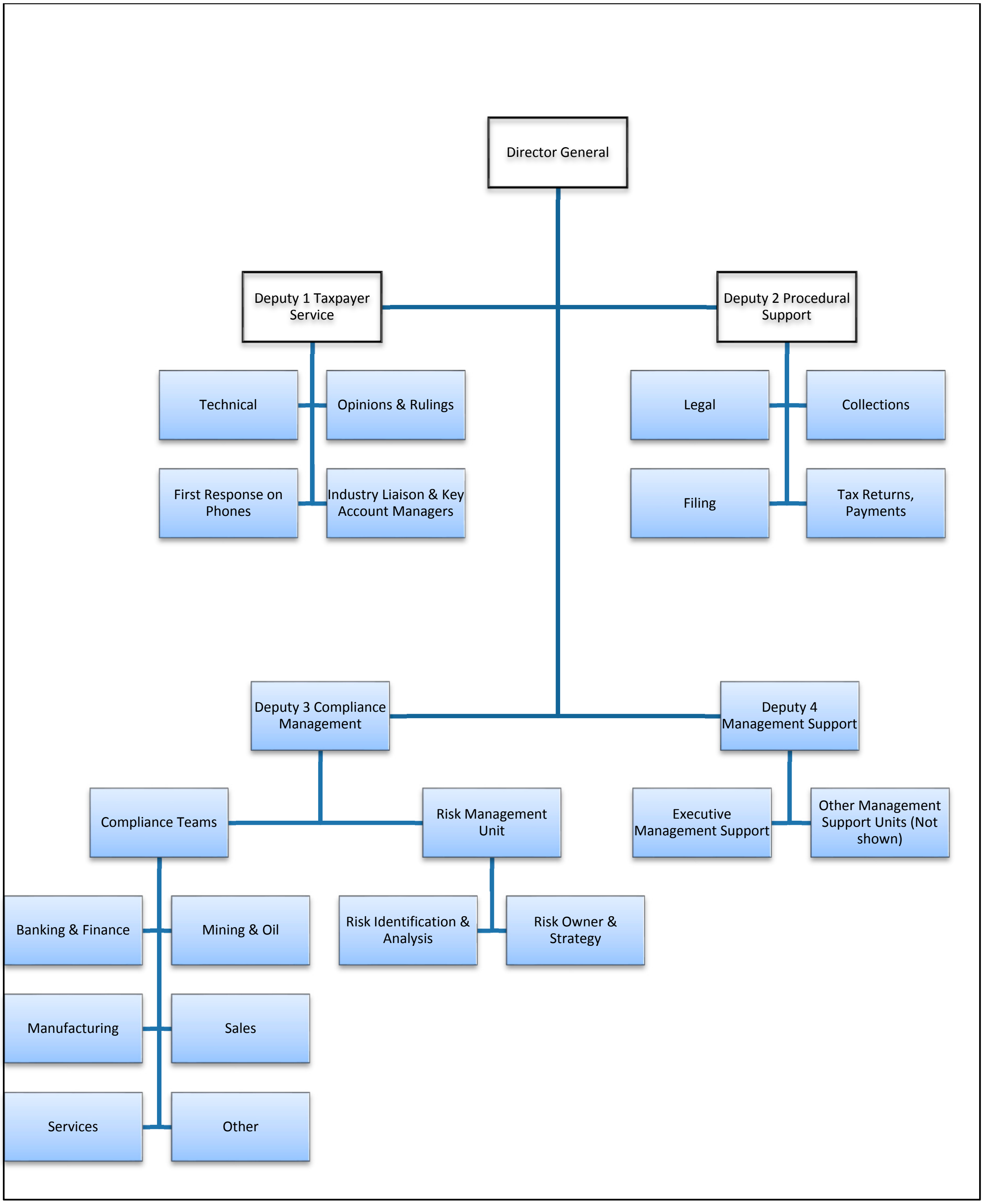
- A compliance program is structured around the major taxpayer segments, typically (1) individuals; (2) micro and small businesses; (3) medium-size businesses; (4) large businesses; (5) nonprofit organizations; and (6) government organizations.
- For each taxpayer segment, the program summarizes the context: economic, revenue, and business environment (e.g., number of taxpayers, nature of entities, total tax contribution, number of persons employed, and structural features).
- The program outlines the major tax issues and risks for each taxpayer segment, and describes how the revenue agency intends to respond to these issues and risks.
- The program records the number and type of different service and control initiatives planned to be undertaken in the coming year within each taxpayer segment by major tax risk.
- The program outlines the results from the prior year's compliance efforts, reporting against commitments. This helps ensure that planned activities are carried out and it builds community confidence in the administration of the tax system.

Appendix V. Typical Risk Industry Compliance Approach

Where an industry or trade is identified by the tax administration as having a higher risk, it should:

- *Engage with the relevant industry or business associations* to explain why it is seen as higher risk and to ensure that the tax administration has an accurate understanding of how the industry operates.
- *Publicize the tax administration's intention to conduct a verification program of the industry* and seek the support of the associations in informing their members.
- *Identify tax advisors* who have a significant client base in the targeted industry, alert them to the issues and request that they inform their clients of the intention to conduct a verification program.
- *Conduct a series of scoping risk reviews* to confirm the most serious areas of noncompliance, the factors associated with increased likelihood and consequence, to better quantify the amount of tax at risk across the industry. Use this to improve the risk filters used to identify potential noncompliance.
- *Engage with the industry association and the tax practitioners* to prepare advice to industry participants on the areas of noncompliance identified through the *scoping risk reviews*.
- *Send letters to taxpayers in the industry* and/or communicate with taxpayers through the industry association and practitioners advising them of the specific areas of noncompliance and requesting that they review their returns and make any necessary self-corrections.
- *Highlight that voluntary disclosures will attract lenient penalties*, and that further audits are planned under which taxpayers who have not self-corrected will be subject to full penalties.
- *Offer free seminars and advisory visits* for taxpayers who are unsure of their obligations (these seminars should ideally be conducted jointly with the industry association).
- *Ensure that tax administration enquiry staff are aware of the compliance improvement program* and has scripted answers for enquiries received from taxpayers about the program, including how to make a voluntary disclosure, attend a seminar or request an advisory visit.
- *Ensure that collection enforcement staff are aware of the program* and applies the reduced penalties and more flexible payment arrangements to taxpayers who voluntarily self-correct.
- *Conduct a follow-up review and audit program* of the industry with wider coverage and targeting taxpayers who have failed to self-correct and are assessed as higher risk; and with prosecutions for the most blatant offenders.
- *Publicize results* of audits and prosecutions highlighting how data matching and other new approaches facilitated detection of higher risk taxpayers, and using representative case studies to show how the risk is being dealt with.
- *Measure the effectiveness of the project* e.g., by tracking the number of voluntary disclosures received and the overall change in tax paid by taxpayers in the target industry, and surveying the industry and practitioners to test for changes in observed compliance behavior.

Appendix VI. Large Taxpayer Office Recommended Structure



Appendix VII. Required Risk Management Unit Outputs

Risk Management Unit Risk Identification and Analysis Team Outputs

Output	Description
1	Contextual and summary data about LTO taxpayers including distribution aspects and trends and revenue projections by tax type.
2	Contextual industry and sectors summaries including identifying who are the key taxpayers in each industry.
3	Strategic tax gap analysis and estimations of the potential amounts associated with key tax risks (albeit with large uncertainties) at a population level, and tactical analysis and estimates at an industry or sector level of these key risks.
4	Operational analysis providing case selection listings providing a ranked view, based on the estimated tax at risk, of which taxpayers are considered to potentially have tax risks, including where practical an estimate of the potential tax amounts involved.
5	Compliance effectiveness analysis reviewing those taxpayers treated against control or untreated groups to estimate changes in tax results and reductions in tax gaps that may be attributable to the treatment.
6	Identification and analysis of outliers and taxpayers exhibiting unusual patterns and trends in the data, such as low effective tax rates, major differences between accounting profits and taxable income, unusual use of losses, variances in major line items affecting tax.
7	Provision of taxpayer profiles, providing LTO staff with summarized information sets regarding particular taxpayers.

Appendix VIII. Analytic Approaches for the Risk Management Unit

Analytic tools such as SAS JMP and the open source data mining package in R called RATTLE, developed by the former Chief Data Miner at the ATO, (See https://journal.r-project.org/archive/2009-2/RJournal_2009-2_Williams.pdf) are needed to provide a suite of data analysis tools. This is critical for the LTO RMU if they are to be able to provide the quantitative intelligence necessary to support a modern compliance management approach.

The following diagram illustrates the kinds of analytic approaches that should be used to inform each step in the compliance management journey.

Understand the customer	Determine right experience	Deliver the right experience

Understand the customer

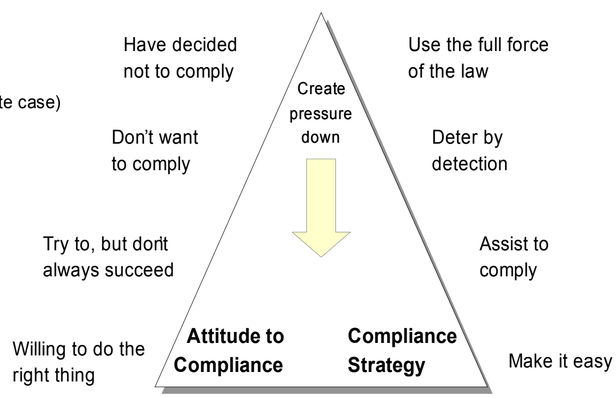
Research:

> Intelligence (Qualitative)
- Strategic (What to look at)
- Operational (Who to look at)
- Tactical (What is needed to complete case)

+

> Analytics (Quantitative)
- Descriptive analytics

Determine right experience



Deliver the right experience

Delivery:

Channel management +
Case Management (mult-activities) +
Work Management (single activities)

Investigate / prosecute

Audit / Penalise

Review / Advise

Educate / Market

System changes
- Simplification
- Prepopulation

• **Optimise understanding of client**
> Descriptive analytics
>> Distibution – mean, median, mode, kurtosis, skewness
> Exploratory data analysis – understand the data
>> Cumulative distributions
>> Analysis of variance
>> Box whisker – Interquartile range & outliers
>> Missing values – data cleaning
>> Transformations / Normalisation
>> Principle components
>> Benfords analysis
>> Dendograms
>> Time series analysis
> Clustering – how do clients naturally group in the data
>> k-means
>> Hierarchical
>> Self organising feature maps

• **Optimise treatments**
> Champion / challenger approach
> Control groups

• **Optimise treatment selection**
> Predictive analytics – risk score modelling
>> Decision tree
>> Random forest
>> Logistic regression
>> Support vector machine
>> Neural networks

• **Optimise delivery**
> Simulation modelling – decision support
> Queuing methodologies
> Linear programming
> Sensitivity modelling of parameters

Appendix IX. Documents Provided

Hamilton 2016 Compliance Risk Management presentation to the LTO
Hamilton 2006 Optimizing Compliance using Analytic Techniques
Risk Filter Outline
ATO Large Market Strategy 2014
ATO Large Market Audit Process 2014
ATO Large Market Risk Review Process 2014
ATO Large Business and Tax Compliance 2010
ATO Compliance Program 2013
ATO Active Compliance Manual 2015
ATO Compliance Results 2014
ATO RDF Fact Sheet 2014
ATO Wealthy and Wise 2008
ATO Your Case Matters 2012

Of these the following are recommended for translation:
Hamilton 2016 Compliance Risk Management presentation to the LTO
ATO Large Business and Tax Compliance 2010
ATO Compliance Program 2013

This set of documents covers risk-based compliance management approaches for large taxpayers. The technical nature of these documents means that translators experienced with tax administration issues should be used in order to ensure that the correct meaning is conveyed.

Appendix X. Romanian Officials Involved in the Mission

Mrs. Anca Dragu, Minister of Public Finance

Mr. Eugen-Dragos Doros, President of National Agency of Fiscal Administration (NAFA)
Mr. Florin Tunaru, Vice President of NAFA
Mr. Adrian Cucu, DG, Planning, Monitoring & Synthesis (PMS), NAFA
Mrs. Carmen Balasoiu, Deputy DG, PMS NAFA
Mr. Constantin Gioga, DG General Directorate for Tax Audit Coordination, (GDTAC), NAFA
Ms. Simona Rouadedeal, Superior Counsillor, DG GDTAC, NAFA
Ms. Luminita Rontescu, International Relations Department, NAFA

Mr. Ionut Misa, Director General of Large Tax Office, NAFA
Mrs. Vasilica Sandu, Deputy DG Revenue Administration, LTO
Mr. Catalin Lojocoru, Deputy DG Tax Audit Activity, LTO
Mr. Radu Dumitru, Head of Office, Risk Analysis, LTO
Mr. Adrian Filip, Head of Office, Monitoring Budgetary Claims, LTO
Mrs. Petruta Catargiu, Head of Office, Selection, Programming and Analysis for Tax Audit, LTO
Mrs. Carmen Patru, Head of Office, VAT Reimbursement, LTO
Mr. Nicolae Gratie, Head of Office, Tax Audit Number 15, LTO

Others assisting/involved:
Interpreters: Corneliu Stefanescu and Valentina Rotaru

IMF Staff Washington: Allan Jensen and Lucilla McLaughlin
IMF Staff Local: Luminita Dragan and Georgia Babici

Appendix XI. Glossary of Technical Terminology Used in the Report

Integrated Compliance Approach
An approach to tax compliance risk management that appropriately brings together (integrates) preventative, detective, and corrective risk mitigation approaches using the compliance toolkit outlined in Appendix III. An outline of the use of the approach is set out in Appendix V.

Risk Owners, Industry Liaison Officers, and Key Account Managers
Particular roles undertaken as part of an Integrated Compliance Approach. Outlined in Appendix II.

Risk committee
A type of expert panel, where relevant personnel sit as a committee to consider and review risk prioritization, risk mitigation strategies and risk monitoring. See Appendix II.

Settlement panel
A type of expert panel that considers proposed tax settlements. Properly constituted, it assists in providing/demonstrating transparency, objectivity, and integrity to decisions regarding possible tax settlements.

Related party dealings
Transactions involving products or services exchanged (transferred) between related parties (members of an economic group/controlled parties).

Transfer pricing
The process of pricing products or services exchanged or transferred between related parties. The mispricing of such transfers of products or services can result in profit shifting and inappropriate tax outcomes between jurisdictions. For additional detail refer to the Organisation for Economic Cooperation and Development (OECD) Transfer Pricing Guidelines.

Functional analysis
A formal process used to identify the functions, assets and risks used in each jurisdiction by related parties. Using information obtained from observation, interviews and questionnaires, a functional analysis determines 'who does what' and 'where and how they do it.' The output from a functional analysis helps considerations regarding the most appropriate approach to transfer pricing and what comparability adjustments might be needed to determine a reasonable 'arms length price'—the price range and conditions at which independent parties would have exchanged the products or services. For additional detail refer to the OECD Transfer Pricing Guidelines.

Base erosion and profit shifting
BEPS refers to the tax planning strategies (e.g., transfer pricing, thin capitalization, use of financial hybrids, avoidance of permanent establishments etc.) that can be used shift profits between related parties to low or no tax jurisdictions where little real economic activity undertaken. A G20 endorsed OECD plan of 15 Actions aims at addressing BEPS activities. For additional detail refer to the OECD BEPS website and documents.

Advance pricing arrangements/agreement
A formal agreement between the tax administration and the taxpayer on the expected price /profit ranges for products or services exchanged or transferred between related parties. Part of the compliance toolkit.

Rulings (public or private binding)
A formal statement setting out the tax administration's view on the operation of the law in a particular context/set of facts. Part of the compliance toolkit.

Data miners/information analysts
A role that uses computer algorithms (machine learning programs) to identify patterns and associations (knowledge discovery) in data. Data mining can be descriptive or predictive. Data mining approaches can be contrasted with subject matter expert approaches, where a person (a subject matter expert) defines (imposes) how taxpayers should be categorized or selected for compliance actions.

- **Descriptive data-mining** approaches use algorithms (e.g., self-organizing maps, etc.) to reveal clusters and other associations in data. Can be used to identify particular taxpayer segments.
- **Predictive data-mining** approaches use algorithms (e.g., classification and regression tree, random forest, support vectors, neural networks etc.) to reveal factors associated with a particular target state (e.g., noncompliance). Can be used for case selection.
- **R RATTLE**
  R is an open source programming language optimized for statistical computing. RATTLE is an open source graphical user interface for R developed specifically for data mining.

- **SAS JMP**
  A exploratory data analysis and visualization program developed by SAS.

Case selection
The process (e.g., via data-mining or subject matter expert rules) used to initially identify a set of taxpayers (positives) that may have compliance risks. Ideally should produce a prioritized listing of taxpayers.

- **Risk Filter**
  A set of rules used to select cases for a particular risk. Can be created by subject matter experts or from predictive data mining.
- **False positives**
  False positive (FP) taxpayers that initially appear to have a tax compliance risk, but on review are found to be compliant. Opposite of true positives (TP)
- **Strike Rate: TP/(TP+FP)**
  The ratio of TPs over the number selected. A function of case selection rationale, efficacy and size, auditor detection capability, and the underlying compliance rate.

Risk review
A process used after case selection to quickly ascertain whether a tax compliance risk may be present or not. Less formal and less resource intensive than an audit, risk reviews are used to 'filter out' false positives prior to committing to a more resource intensive audit.

- **Pre-filing risk review**
  A risk review performed after a transaction but prior to the taxpayer filing the tax return.
- **Specific risk review**
  A risk review limited to a specific risk. (Compared to a comprehensive risk review.)

Audit
A process used to establish whether the correct amount of tax has been assessed. It involves formal evidence gathering to establish the facts and then the application of relevant law to those facts. The time and resources required to appropriately audit a taxpayer depends upon the matter and materiality being audited and one size audit does not fit all. For example, a VAT refund audit generally involves simple fact checking, while at the other extreme an income tax transfer pricing audit may involve information exchanges with other tax jurisdictions, taking several months just to establish the functional analysis facts.

Resolution
The processes used to resolve a tax dispute. Can include settlements, mutual agreement procedure, and litigation.

Delegation of powers
A process used in NAFA to delegate the performance of a task to others. In this report the term refers to a direction to audit LTO taxpayers by the Medium Taxpayer Office.