



Tax Compliance by Design

ACHIEVING IMPROVED SME TAX COMPLIANCE
BY ADOPTING A SYSTEM PERSPECTIVE



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Foreword

Revenue bodies continue to look for ways to improve their relationship with small and mid-sized enterprises (SMEs) and to achieve higher levels of voluntary compliance at lower cost to SMEs and themselves.

This study introduces the concept of “Tax Compliance by design”. It describes how revenue bodies can exploit developments in technology and the ways in which modern SMEs organise themselves to incorporate tax compliance into the systems businesses use to manage their financial affairs.

The study was commissioned by the Forum on Tax Administration and sponsored by the Commissioner of the Swedish Tax Administration, Ingemar Hansson. It has been prepared by a task group of SME Compliance Sub-group delegates with support from the OECD Secretariat. A total of nine countries (Australia, Canada, Denmark, New Zealand, Singapore, South Africa, Sweden, The Netherlands and United Kingdom) participated in the task group. The project team and Secretariat further developed the content of the report with experts of the FTA’s SME Compliance Sub-group, including through detailed discussion at its annual meeting in May 2014.

The Forum on Tax Administration and the SME Compliance Sub-group

The Forum on Tax Administration (FTA) was created by the Committee on Fiscal Affairs in July 2002. Since then the FTA has grown to become a unique forum for co-operation between revenue bodies at Commissioner-level with participation from 46 countries. Our vision is to create a forum through which tax administrators can identify, discuss and influence relevant global trends and develop new ideas to enhance tax administration around the world. The work programme of the Forum is decided and overseen by a Bureau comprised of commissioners from 12 revenue bodies. The FTA vision is to create a forum through which tax administrators can identify, discuss and influence relevant global trends and develop new ideas to enhance tax administration around the world. This vision is underpinned by the FTA’s key aim which is to help revenue bodies increase the efficiency, effectiveness and fairness of tax administration and reduce the costs of compliance.

The FTA is supported by a number of specialist sub-groups and networks to help carry out its mandate: The Taxpayer Services Sub-group, the SME Compliance Sub-group, the Large Business Network, and the High Net Worth Individuals Network, and the Offshore Compliance Network.

The work of the SME Compliance Sub-group focuses on managing and improving tax compliance in the SME segment. The sub-group meets annually to provide oversight of its work programme, to review and discuss major developments, and to provide a platform for exchanging experience.

More information on the FTA, including details on products and publications, can be found at its dedicated website: www.oecd.org/tax/fta

This study is part of the OECD Tax Administration Information and Guidance Series, which extends across a range of areas of key interest to revenue bodies. National revenue bodies differ in a number of important ways, including in respect of their institutional legacies, the tax systems they administer, and the broader context they are part of. The series is therefore intended to inspire and inform revenue bodies rather than promote a standard approach to tax administration, which may be neither practical nor desirable.

Inquiries concerning this study should be directed to the International Co-operation and Tax Administration Division at the OECD Centre for Tax Policy and Administration (fta@oecd.org).

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Preface

Revenue bodies have been successful in constantly improving their compliance strategies and to become more cost-effective, meeting challenging demands from both taxpayers and governments. This has required a willingness to change and to adapt to changed circumstances.

These challenges are not diminishing. On the contrary, we are facing increasing demands for even better performance and to reduce costs for both revenue bodies and taxpayers. It is not unreasonable for governments and the general public to expect public bodies to be constantly improving and adapting to become more effective and to provide better services. This means that revenue bodies have to be good at innovation and to always look into the future for better and smarter ways of working.

The concept of “tax compliance by design” described in this report is a good example of this. It is about adapting to changes in society and especially about building on technological developments that are already taking place in the business environment. Applying a holistic view and seeing tax compliance from the taxpayer’s perspective and utilising existing features in the environment offers a new approach for working with the small and mid-sized business sector.

This Forum on Tax Administration publication describes how high levels of tax compliance can be achieved by making compliance an embedded part of taxpayers’ normal business processes building on digital solutions and co-operation with different participants. It is about designing in compliance into the taxpayer’s environment.

I am convinced that by working according to these principles and treating taxpayers with respect and building trust we can make it easier for them to comply and difficult to not to and thus achieve significantly improved levels of compliance in the SME sector.

I would like to thank everyone that has contributed to this report; the task team, the Compliance Sub-group and the OECD Secretariat.

Ingemar Hansson
Sponsoring Commissioner

Acronyms and abbreviations

ATO	Australian Taxation Office
EC	European Commission
FTA	Forum on Tax Administration
GST	Goods and Services Tax
HMRC	Her Majesty Revenue and Customs (the United Kingdom)
ICT	Information and Communication Technology
IR	Inland Revenue (New Zealand)
IRAS	Inland Revenue Authority of Singapore
IT	Information technology
NFC	Near Field Communication
OECD	Organisation for Economic Co-operation and Development
PAYE	Pay-As-You-Earn
PAYG	Pay-As-You-Go
SAT	Servicio de Administracion Tributaria (Mexico)
SII	Servicio de Impuestos Internos – Internal Revenue Service (Chile)
SKAT	Danish Tax and Customs Administration
SME	Small and Medium-sized Enterprise
SBR	Standard business reporting
VAT	Value Added Tax
XBRL	eXtensible Business Reporting Language

Executive summary

Revenue bodies have long recognised the importance of finding better ways of securing good tax compliance by small and mid-sized enterprises (SME). They spend a large proportion of their limited resources on this taxpayer segment but increasingly cannot afford to deal with SME on a one-to-one basis. However, SMEs matter a great deal economically and they find the costs of complying with tax regulations burdensome. Those costs tend to be higher as a proportion of their total operating costs than they are for larger enterprises and the rules are often perceived to be very complex. This can affect SME's ability to grow, their resilience in a crisis and, of course, their compliance with tax laws. The search for increased economic growth and cost savings in tax administration mean this issue is increasingly urgent.

Revenue bodies are endeavouring to improve the operating environment for SMEs, improve levels of compliance in the segment, while also reducing their own costs. This study discusses an approach to SME taxation that reconciles the apparently conflicted priorities of revenue bodies, without having to trade them off. It is based on a robust theoretical framework and, more importantly, real life practice. Every component of the approach described in the report, termed “*Tax compliance by design*” is in use or under development in one or more countries. The novelty of “tax compliance by design” is that it brings those components together in a comprehensive and systematic way. It offers for the first time an approach that enables SME's to achieve high standards of tax compliance, while reducing their costs and offering revenue bodies real assurance, also at low cost.

“Tax compliance by design” recognises that most SMEs want to be compliant. Historically, poor systems and a poor understanding of the tax system have been major causes of non-compliance. However, technology is changing the way SMEs operate. As the costs of software have fallen and the emergence of the “cloud” has enabled new ways of delivering technology, SMEs have gained access to new and sophisticated systems for managing their businesses. Most SMEs now use technology in some form to help them keep track of their business and to improve effectiveness. Information and payments are increasingly becoming digital. There is rapid growth of new payment systems using mobile devices. The use of electronic invoices is increasing. Electronic cash registers are used for handling cash transactions. A number of cheap and simple-to-use on-line accounting systems are available.

“Tax compliance by design” recognises these fundamental changes in the way SMEs operate and shows how tax compliance can become an integral part of the systems businesses use to carry out their daily transactions with one another and with citizens. Tax compliance can become easy and accurate if it is simply a by-product of the steps a business follows automatically to transact. “Tax compliance by design” assembles the different elements of technology on which modern commerce relies into a system that delivers a seamless and secure flow of accurate tax information and tax payments.

This is a continuation of the FTA’s previous work on “Right from the start”. This work highlighted the importance of adopting an end-to-end perspective, meaning a holistic view of the combined processes of both the taxpayer and the revenue body. The role of the revenue body is shifting from being a passive receiver of tax returns into an active facilitator of compliance. Necessarily, this involves much more collaboration between revenue bodies and SMEs as a group, but also with other key participants in the overall process: tax intermediaries, accountants, banks, industry organisations and software developers.

The study discusses two basic approaches to achieving tax compliance by design – the “secured chain approach” and the “centralised data approach”.

The idea behind the secured chain approach is to create a secured flow of information from the capture of business transactions to the final determination of the correct amount of tax being paid. The role of the revenue body is mainly to act as a facilitator of needed features in the environment in order to make sure that the flow of information from the taxpayer is secure enough. This reduces the need for the revenue body to handle all of the data by itself and it reduces the need for doing post-filing audits.

The idea behind the centralised data approach is to make sure that the revenue body itself can capture as many business transactions from the source as possible in order to determine the right amount of tax to be paid with minimum information from the taxpayer. The role of the revenue body is more about managing the whole process, handling and transforming all information by itself so the need for the taxpayer to provide information on his own transactions is significantly reduced.

Together, both approaches show that there are a range of possibilities to create or support an environment conducive to tax compliance and reduced compliance burden. These two strategies are very different but they can also be combined in various ways depending on the context and desired future environment. The essential similarity is that the flow of data needed to secure good tax compliance is built into processes that fulfil an underlying business purpose. This enables tax compliance to become much more automated and reduces costs for business and the revenue body alike. It also makes it possible for SMEs to offer revenue bodies transparency, in the form of systems for reporting tax data on which the revenue body can rely, in exchange for certainty about their tax position. This will increase the levels of trust between SMEs and revenue bodies, without requiring them to have a close one to one relationship.

This study report outlines “tax compliance by design” in more detail, its background and theoretical underpinnings. Examples of what is already being done and plans for the future in different countries are described. Practical guidance on how to implement the concept is provided.

Recommendation

In the light of this report, revenue bodies are encouraged to consider developing a system of Tax compliance by design that is appropriate for their specific circumstances. It is recommended that they do this by following the key implementation steps described in Chapter 4:

- **The first step:** Assess the current situation and context. The two strategies described, the secured chain strategy and the centralised data strategy, can be helpful tools for this exercise. They and the examples quoted in the report provide some reference points and enable revenue bodies to see which of the capabilities

described already exist, are in the process of being developed, or could be brought into being reasonably quickly. On the basis of this analysis, it will be possible to develop thinking about what the future infrastructure could look like and how tax compliance by design could be implemented.

- ***The second step*** is to use the vision of the desired future, to describe in more detail (but still on an aggregated level) the flow of data, information and knowledge within the system, the participants and the necessary infrastructure. This would also include descriptions of responsibilities and mechanisms for systemic assurance and quality assurance.
- ***The third and final step*** would be to plan how the system could be implemented in practice. This will involve deciding the level of control and/or involvement the revenue body or the government wants to exercise. It can range from high control to a more facilitative approach or a mix of these.

In line with the *Together for Better Outcomes* report, it is recommended that these steps are undertaken by engaging and involving SMEs themselves and the other participants in the system that is being designed.

Chapter 1

Introduction

This chapter explains the background to this study, the methodology used and the countries involved in the task group that undertook the work. It also sets out how the report is structured.

Context and background

When designing the modern personal income tax in the early 20th century policy makers in most countries recognised the enormous challenges to effective tax administration that would arise if their relatively large populations of employee taxpayers were each required to accurately calculate their own employment income for tax assessment purposes and make timely provision for their own payments of income tax. For this reason, they decided to introduce “employer tax withholding and income reporting” requirements as core elements of their systems for the collection of personal income tax, an approach which today has become just about universal practice. With the passage of time, the wisdom of this approach for achieving very high levels of compliance in respect of employment income, an example of what this study terms “*tax compliance by design*”, has become clearly apparent. Research studies from a number of revenue bodies (Swedish Tax Agency, 2008) consistently point to the very high levels of compliance achieved in respect of employment income (and other categories of income subject to similar requirements).

Unfortunately, the same very high compliance outcomes are not enjoyed for income derived from business activities, in particular by the relatively large numbers of small and mid-sized enterprises that are seen in any economy – hereafter referred to as the SME segment. To the present time, it has proved largely impracticable (e.g. owing to compliance costs considerations and technological limitations) to devise equally effective arrangements for collecting income taxes in respect of such incomes. While revenue bodies continue to make progress in refining their risk management processes and educating and supporting SME taxpayers in a variety of ways, there is no evidence to suggest that these approaches alone can lead to levels of compliance comparable to those achieved in respect of employment income. In fact, revenue body research¹ from a number of countries consistently points to relatively large amounts of revenue leakage from within the SME segment, notwithstanding the fact that Governments (through their revenue bodies) continue to invest significant resources in SME tax administration.

Acknowledging these systemic shortcomings while at the same time taking a lead from recent work of the Forum, this study aims to take a fresh look at the emerging SME business landscape and thinking from a few revenue bodies about possible new approaches to achieving improved compliance and reducing taxpayers’ compliance burden.

End to end – Achieving tax compliance “right from the start”

In early 2012, the OECD’s Forum on Tax Administration (FTA) released its report *Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises* that introduced the approach of influencing behaviour by changing conditions in the taxpayers’ environment in co-operation with taxpayers and participants. This approach entails the application of measures “upstream” in the value chain in order to support compliance and prevent non-compliance from arising. The 2012 report alluded to some potential examples (e.g. extended third party reporting, user-friendly e-services, and increased co-operation with tax intermediaries and industry organisations) but did not explore their practical application or overall potential in any detail.

The right from the start approach highlights the need to focus on taxpayers’ and revenue bodies’ combined processes for collecting the right amount of tax. This “end-to-end” process starts with business taxpayers’ taxable business transactions and ends with the final correct tax being paid. Business transactions form the basis for taxation regardless whether it is based on profit, turnover or value added. The taxpayer and the

revenue body both want to know what amount of tax the taxpayer is due to pay. They have a shared interest in knowing the tax consequences of any transaction, with as little administrative burden as possible. This study uses the end-to-end perspective in order to find opportunities to achieve opportunities for “tax compliance by design”.

Purpose of the study

Against the background provided, the purpose of this study is to collect and share knowledge about strategies to improve compliance by seeing the taxpayer’s process and the revenue body’s processes “end to end”. This includes efforts to simplify process design and to build in quality “right from the start”. Of particular relevance and interest are the opportunities presented by modern technologies and the rapid growth in the numbers of businesses deploying these technologies for many aspects of their operations (e.g. accounting, invoicing, payroll, and tax). The study is also required to explore possibilities and ideas about how improved end-to-end processes could be further developed in the future.

Methodology

The project was carried out by a project team from Sweden, and sponsored by the Swedish Tax Agency and supported by the OECD Centre for Tax Policy and Administration, working in close co-operation with members of the FTA’s SME Compliance Sub-group, including a small task group of countries (i.e. Australia, Canada, Denmark, New Zealand, Singapore, South Africa, Sweden, The Netherlands and United Kingdom).

For the purposes of the study a survey instrument was designed and completed by task group countries to provide information concerning: 1) members’ expectations from the study; 2) examples of implemented or planned initiatives relevant to the study’s scope; and 3) ideas on possible new initiatives relevant to the study’s scope. In February 2014, a workshop of officials from task group countries and the OECD was dedicated to exploring and discussing aspects of the subject study in greater detail. The workshop included a presentation by Dr Martin Fransson from the Service Research Center at the University of Karlstad on service dominant logic. The workshop was also informed by the participation of representatives of two Swedish bodies (i.e. Professional Institute for Accountants and the Association of Swedish Accounting Consultants) together representing the views of Swedish tax intermediaries. The project team and Secretariat further developed the content of the report with experts of the FTA’s SME Compliance Sub-group, including through detailed discussion at its annual meeting in May 2014.

Structure of the report

The report begins with a description of some of the main steps in the development and evolution of compliance strategies within the FTA with special attention to the “right from the start” approach. The concept of a service perspective is introduced as an additional perspective to understand tax compliance as a form of public service delivery. Relevant technological developments are described because they are fundamental drivers for these changes. The conclusions from the current directions of strategic developments and the insights added by bringing a service perspective and the technological developments are then combined in order to outline a possible future environment characterised by “tax compliance by design”. (*Readers familiar with this background may wish to go straight to Chapter 3 for the main subject of this report.*)

In Chapter 3, the report describes at a high level what a compliance system for small businesses that has compliance “designed in” might look like and sets provides a number of practical examples reported by participating revenue bodies. To provide practical guidance, Chapter 4 outlines a number of useful components that are needed for implementation of “tax compliance by design” together with some ideas on possible further developments. Chapter 5 concludes with some final observations and a recommendation.

Note

1. See references in bibliography.

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Chapter 2

The current environment and developments

This chapter provides an overview of the current environment and relevant developments and is in four parts. The first part explains how tax compliance strategies have evolved and how the idea of right from the start emerged. The second part describes the “right from the start” approach and the third part introduces the service perspective as a way of further developing the shift in focus from the tax return as the end product to the desired outcome in terms of the right tax being paid at the right time. The last part outlines some of the major technological developments that make this new way of thinking and working possible to implement in practice.

Tax compliance by design builds on previous works of tax compliance strategies and shows it is evolution.

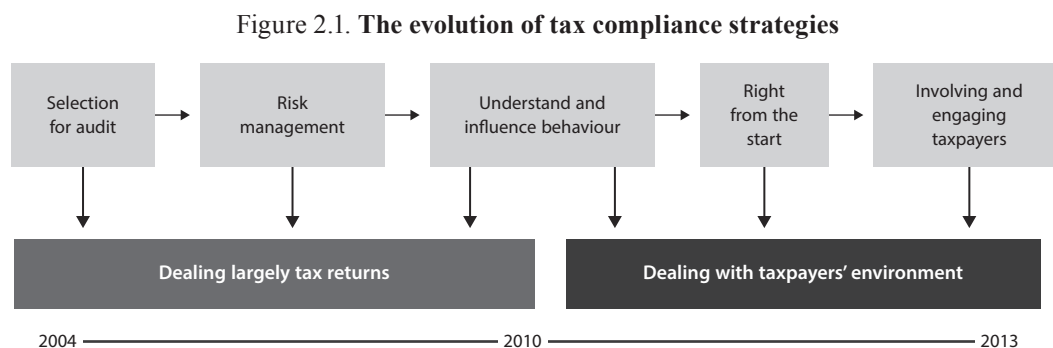
This chapter, drawing on the recent environment and relevant developments and consists of four parts. It relates to the idea, right from the start’ approach and how it creates and develops the shift in focus of compliance process, also service perspective as a way of further developing the shift in focus of the compliance process from the tax return and main aspects of the technological developments that make this new way of thinking and working possible to implement in practice.

Tax compliance by design as a concept builds on previous developments of tax compliance strategies. The ideas about “right from the start” are put into a systemic and holistic approach using features and technological developments already taking place in the SME environment.

This chapter provides an overview of the current environment and relevant developments and consists of four parts. The first part explains how tax compliance strategies have evolved and how the idea of right from the start emerged. The second part describes the “right from the start” approach and how it creates the strategic context for tax compliance by design. The third part introduces the service perspective as a way of further developing the shift in focus of the compliance process from the tax return as such to the environment and the value achieved in form of the right tax paid at the right time. The fourth and last part outlines some of the major technological developments that make this new way of thinking and working possible to implement in practice.

How the “right from the start” approach emerged

Compliance strategies adopted by revenue bodies have undergone a remarkable development over the last decade. By applying new knowledge and adapting to a changing environment, revenue bodies have been able to improve their effectiveness and deliver better outcomes with fewer resources. The strategies have evolved from a singular focus on enforcement to multi-faceted approaches based on a good understanding of taxpayer behaviour and use of technology. The current approach gives emphasis to getting it right from the start partly by involving and engaging taxpayers and participants, which entails more up-front measures in order to support compliance and prevent non-compliance instead of just applying reactive measures. This evolution can be seen in the work of the Forum on Tax Administration and its reports on the subject of small business taxation, and is illustrated in Figure 2.1.



Compliance risk management

The traditional view on the role of a revenue body has been that it is primarily an enforcer of the tax law. The focus of compliance activities has historically been on monitoring the quality of tax returns and addressing non-compliance via audits, especially targeted at high-risk tax returns, and other verification processes. Revenue bodies' success in this context has been measured by how much extra yield all of these verification activities bring in. Proper identification of risks and selection of cases are important in this approach. The strong focus on better selection of audit cases contributed to an increased interest in risk management.

The FTA published the report *Compliance Risk Management: Managing and Improving Tax Compliance* in 2004. It was the first comprehensive guide on compliance risk management for revenue bodies. The guide aimed at providing support for decision-making on compliance issues such as “*What are the major risks?*” “*Which taxpayers do they relate to?*” and “*How ought these risks to be treated to achieve the best possible outcome?*” (OECD, 2004). The desired outcome in the guide was defined as improved compliance that was now perceived as a more relevant goal than “audit yield”. Risk management thus introduced a more holistic approach and made it clear that dealing with risks consists of more than selection and audits. Risk management and its more holistic view required revenue bodies to understand the underlying causes for the risks and to choose the most effective form of treatment. This in turn led to an increased interest in understanding the drivers of taxpayers' compliance behaviour.

Taxpayers' compliance behaviour

The FTA's 2010 report *Understanding and Influencing Taxpayers' Compliance Behaviour* aimed to provide support in this regard. It noted that through a better understanding of taxpayer behaviour revenue bodies could make more effective use of their resources to develop strategies to have a sustainable impact on taxpayer compliance (OECD, 2010). It concluded that a strategy solely based on deterrence can have major drawbacks and does not necessarily result in improved compliance. And it outlined the most important drivers and motivations behind a taxpayer's choice between compliance and non-compliance and grouped the main drivers and motivational factors into five categories: 1) economy; 2) norms; 3) deterrence; 4) opportunity; and 5) fairness.

This was important for the further development of compliance strategies. Most of the drivers behind taxpayer behaviour described in the report are clearly external factors; personal norms are the only factors relating to personal values and beliefs. The focus of revenue bodies therefore started to shift from “changing the taxpayer” to “changing the external factors”. This did not mean that revenue bodies should abandon a clear customer-oriented perspective; rather, it meant that compliance was not primarily about finding as many errors as possible in the tax returns and had more to do with influencing the environment of the taxpayers, together with taxpayers and participants, in order to make it easier to comply and more difficult not to comply. The approach of “right from the start” was therefore a logical next step.

Applying a “right from the start” approach and involving taxpayers and participants

The FTA's report *Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises* published in 2012 clearly marks the shift in compliance strategies towards an increased focus on influencing taxpayers' environment.

The report highlights two insights from research. The first insight is that small changes in a taxpayer's environment can have a big impact on their behaviour. The second finds that human beings tend to overestimate the importance of people's character and underestimate the importance of external factors when they assess other people's behaviour.

It was clear that external factors play a big role and that even small changes in these factors can have a big impact on taxpayer behaviour. The report refers to insights from behavioural economics and the idea of "nudges". Behavioural scientists Richard H. Thaler and Cass R. Sunstein coined the term "nudges" to refer to small changes in the environment (Thaler and Sunstein 2009). One example of a nudge involves changing the order in which cafeteria food is arranged so that the healthy food is placed before unhealthy snacks, which lead to customers making more healthy food choices. The idea is not to remove any choices but to provide support for making better decisions.

The tendency to overestimate the importance of people's character and underestimate the importance of external factors is generally termed "the fundamental attribution error". The phrase originates from a now classic experiment by Edward E. Jones and Victor Harris in 1967. In the experiment, subjects were asked to read essays that expressed opinions for or against Fidel Castro, and were asked to rate the pro-Castro attitudes of the writers. They rated writers who spoke in favour of Castro as having a more positive attitude towards Castro than those who spoke against him. This was the case even when the subjects were told that the writer's positions were determined by a coin toss. This showed that the subjects were unable to fully appreciate the constraints placed upon the writers; they could not refrain from believing that the writers expressed sincere opinions (Gilbert and Malone, 1995; OECD, 2012b).

Revenue bodies are not immune to these behavioural aspects. For example, as an employee, the taxpayer receives and confirms his pre-filled tax return and the revenue body perceives this person to be a compliant taxpayer. When he becomes a self-employed restaurant owner, he starts to under-report taxes because he sees his competitors doing so. Running his business and complying with tax rules turns out to be difficult and the norms in the industry prescribe or allow non-compliance. It is unlikely that the taxpayer's personal character has changed as a result of the transition from employment to self-employment but the tax compliance environment clearly has. However, if non-compliance is primarily attributed to the taxpayer's personal character there will be a preference for compliance strategies that target the individual taxpayer as a person rather than targeting his environment (OECD, 2012b).

Recognising that small changes in the environment can have great impact on behaviour and the fact that there is a tendency to overestimate the importance of character and underestimate the importance of the environment, it follows that tax compliance strategies should focus more on influencing the environment.

The "right from the start" approach aims primarily on supporting an environment that is conducive to compliance and makes it difficult not to comply. As described in the report, the approach concluded that revenue bodies could facilitate and improve compliance by shifting attention:

- From focusing on the past to focusing on the present (shifting attention from the filed tax return to the on-going tax related processes of businesses);
- From focusing mostly on the internal process of the revenue bodies to also considering the external processes of taxpayers and participants; and
- From mostly focusing on the taxpayer to focusing also on factors in a taxpayer's environment that influence compliance behaviour.

The “right from the start” approach is explained as a way of working and thinking that encompasses four different dimensions:

- Acting in real time so that problems are prevented or addressed when they occur;
- Focusing on end-to-end processes rather than just focusing on the revenue body processes;
- Making it easy to comply and difficult not to comply; and
- Actively involving and engaging taxpayers, their representatives and other participants.

These dimensions should not be seen as separate building blocks of a strategy; rather, they are different dimensions of the same approach and therefore all applicable at the same time. This means that even though the end-to-end perspective is used in this study as a starting point, all the other dimensions must be considered as well. Of particular importance is the level of co-operation with taxpayers and other participants because the end-to-end perspective covers both the environment of the taxpayer and the revenue body.

Engaging and involving SME taxpayers and participants

The dimension on actively involving and engaging taxpayers, their representatives and other participants was further explored in a study by the Forum on Tax Administration in 2013 in the report *Together for better outcomes: Engaging and involving SME taxpayers and participants* (OECD, 2013b). The basic idea is that the design of an environment conducive to tax compliance will be better and more effective if it is designed together with those operating within that environment. Involving and engaging taxpayers and other participants will also offer opportunities to strengthening legitimacy and to build trust. This is possible when citizens are not just seen as passive recipients of public services, instead value for citizens is created with citizens. Engaging and involving citizens is in this light a way of tapping into external resources in order to enhance the value of public services.

Further developing the approach by applying a service perspective on tax compliance

The shift from a focus on the tax return to a broader perspective on the taxpayers’ environment including external participants is important for how a revenue body perceives its own work and the value it creates.

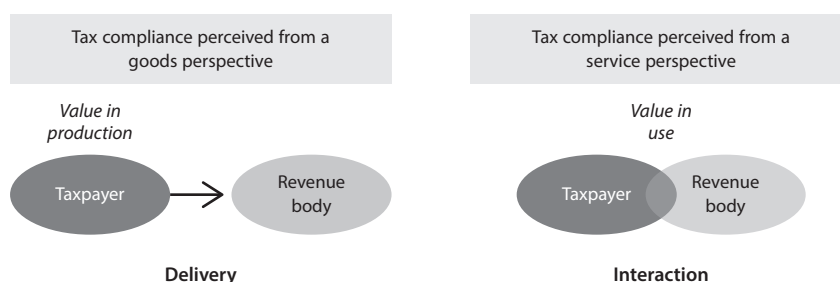
Applying a service perspective on the compliance process can provide benefits in this regard. From this perspective, the tax compliance process is seen primarily as a service process rather than a process for handling physical goods. This helps shift the focus of the compliance process from the tax return to the taxpayers’ environment and to the desired value achieved in form of the right tax paid at the right time.

Traditionally it has been easy to think about the tax return handling process as a production line in a factory consisting of a number of linear steps handling physical goods; tangible things are put into a process, worked on and transformed, and tangible things with added value are delivered as the output. Tax returns are received, registered, checked and processed in order to determine the final amount of tax to be paid. Traditional activities like assessments and audits are all part of the tax return handling process. In a production line model the creation of the final physical products (completed tax returns and assessments) has the appearance of being the purpose for which the process exists.

For this way of perceiving the work the factory is often used as a mental model. This is an inheritance from the age of industrialisation when this made a lot of sense. Over time, production of intangible services has increased but very often the existing logic based on goods is still being applied also in respect of services. A separate logic might be more suitable for services – a logic or a mental model that is based on the specific features of services that distinguish them from goods.

It is clear that there are a number of fundamental differences between “goods” and “services”. “Goods” are physical objects that are typically produced in a factory, stored in a warehouse, sold in a shop and consumed by a customer. Production is separated from consumption and goods represent a value when they are stored. Value is often reduced when the item is used. “Services” on the other hand are often non-tangibles, not produced in a factory and incapable of being stored. They are often produced and consumed at the same time in an interaction with the customer (like healthcare). Value is created during this interaction (value in use). “Service” is a process rather than a delivery of products (Vargo and Lusch 2004). If these two perspectives-goods and services-are applied to the compliance process it can be illustrated as shown in Figure 2.2.

Figure 2.2. Tax compliance perceived from different perspectives



Given the goal of reaching the right amount of tax being paid on time a goods perspective would lead to a focus on the tax return as such (as an item to be delivered), while a service perspective would lead to a focus on the value created through a process and through interactions (Osborne et al. 2012).

The main purpose of handling tax returns is to be able to determine the right amount of tax that should be paid. But the delivery of a tax return does not in itself mean that the right amount of tax will be paid. The value creation process therefore needs to encompass more than the delivery and receiving of tax returns.

The perceived value may be different for different participants in the compliance process. The value for taxpayers would be having certainty about their tax position, and achieved with ease and low cost and knowing that they have paid the right amount (and no more). Also relevant for taxpayers is the need to be reasonably confident that other taxpayers are also paying their fair share. The revenue body shares these interests and also wants to learn about possible weaknesses and flaws in tax processes, as they may affect compliance over time.

When seeking to develop services that support tax compliance it is important to realise that for different participants slightly different value may be at stake. Co-designing these services together with relevant participants should try to optimise the value for all

participants. The key value for all parties involved will be to know with reasonable a level of certainty that the right amount of tax is being paid on time. To achieve this value different participants, such as taxpayers, revenue body and others, combine their resources and exchange information. For instance, taxpayers have information on their transactions and income. Revenue bodies can provide e-services, help to resolve ambiguity in the law, check and enforce the law when necessary and provide support in other ways. The combination of these different skills and competences can add value.

Other participants can contribute also if that adds value by providing additional certainty and/or more cost-effective solutions. This could, for instance, be tax intermediaries, other third parties, software developers, banks or industry organisations. A tax intermediary can transform information on taxable transactions into information on taxable profit and deliver it to the revenue body. Third parties can have information on the taxpayer's transactions that can substitute, or verify, the information from the taxpayer. Software developers can provide an infrastructure for transferring, transforming and storing information in a secure way. Banks can supply information, handle tax payments and provide support services to the taxpayer. Industry organisations can have specialised competences regarding the taxpayer's context that can support both the taxpayer and the revenue body.

Many different participants can bring information and skills to the compliance process in different ways in order to make it more effective and to provide the desired level of certainty. The certainty is thus built into the processes (or system) so the end result is certainty on the right amount of tax being paid on time.

The main benefit of applying a service perspective to the compliance process therefore lies in the focus on achieving value by looking at how information and knowledge is gained, rather than the delivery of tax returns. Tax returns are still useful but they are vessels of information and the value arises from the information, regardless whether it is bound to a tax return or not. Indeed, it may be possible to substitute new automatic processes for the completion and processing of tax returns. It is a shift in focus from the tax return to the process of creating value. "Tax compliance by design" is about facilitating this process.

Building on technology already in place or being developed

Information and communication technologies (ICT) have developed and spread at a rapid pace during the last decades, and the digital landscape has evolved significantly. Businesses, in particular, have taken advantage of this to change the ways they interact with each other and to improve efficiency. Many businesses have also entered into a restructuring process by which they modify internal and external business processes (OECD, 2012a).

SME's are also adapting to these technological changes and increasingly manage their information and payments digitally. Examples are the rapid growth in the online selling of goods and services and the use of electronic payment systems. It is also becoming common to have cash registers connected to the accounting system or to use electronic invoices. A number of cheap and simple-to-use on-line accounting systems are available. More information and payments are becoming digital. But this is often incomplete; some information is still recorded on paper and some payments are made in cash without the use of electronic cash registers.

A holistic view on this, or a systems approach, provides opportunities for both taxpayers and revenue bodies. To move towards a more complete digital chain of information

and payments, where everything fits together, from recording business transactions to bookkeeping and accounting for tax, can improve business processes as well as tax compliance. It is about capturing business transaction digitally and to co-ordinate this with electronic payments and electronic bookkeeping and further on with electronic reporting and payments to the government.

The common way of paying with a credit or debit card by keying in a PIN-code in a terminal makes the payment and the information about the payment digital. New electronic payment models are developing fast and offer consumers easy-to-use payment mechanisms (e.g. mobile payments) that can be linked to a bank account, a credit or pre-paid card or payments charged to bills from mobile operators. Smartphones and mobile apps provide opportunities for users to scan product codes, compare prices and purchase products online. New hardware developments, such as the integration of near field communication (NFC) in phones allow users to pay for items by holding their phone to a reader and confirming the sale. Smartphones are also expanding the reach of point-sale equipment as credit card readers (OECD, 2013a). Where payments are made in cash, transactions can still be captured electronically by the use of electronic cash registers that ideally should have an electronic and automated connection to an accounting system.

Business-to-business transactions are also increasingly being captured electronically, and maybe even more so than business-to-consumer transactions. Companies have progressively increased interaction via the Internet with other firms, for example, for electronic purchases and electronic sales. Firms have been able to link their invoicing and payments systems by using e-invoices (OECD, 2012a). Some countries, especially in Latin America (e.g. Mexico, Brazil, Chile), have made or are in the process of making electronic invoicing mandatory. The purpose is then often to improve tax compliance and the invoices have to be sent to the tax administration (CIAT, 2014; The Economist, 2014). But electronic invoices can help to build a complete chain of digital information even when they are not sent to the tax administration.

Transactions captured digitally should ideally be transferred to an accounting system that as far as possible can handle the bookkeeping automatically. These developments are increasingly becoming affordable and practical also for small businesses. One reason for this is the development of cloud computing. In recent years cloud computing has emerged as one of the most important platforms for innovative new services. Users no longer have to make significant, up-front investments in IT infrastructure and software, but can pay for computing resources via a pay-as-you go model. Providers are able to provision computing resources in a rapid and flexible way allowing adaptation to changing requirements (OECD, 2012a).

Revenue bodies, and other government agencies, also need to rethink their business processes in order to connect to the increased digitalisation of information. Governments globally are developing initiatives to become more digitally oriented. Examples can be seen in the establishment of the UK “Government Digital Service” (Cabinet Office, 2013), the creation of Republic of Korea’s “E-Government Roadmap” (NIA, 2011) and the European Commission’s “Digital Agenda for Europe” (European Commission, 2010). Each of these initiatives is on-going and includes multiple projects to improve the connectedness of governments and citizens (Jackson 2014).

The on-going work on Standard Business Reporting (SBR) will make this transformation easier. The idea underpinning SBR is that information can be more easily shared and processed if common definitions or a common language exist. SBR is such a language or taxonomy that can be used by businesses to report financial information to the government.

The use of eXtensible Business Reporting Language (XBRL), which is a core element of SBR, provides an opportunity to capture the different tax treatments of business transactions in their financial accounts, either at the account or transaction level (OECD, 2009). The Netherlands and Australia are two countries that have a fair deal of experience with the development and application of SBR – for more information readers are directed to www.sbr-nl.nl/wat-is-sbr/international/ and www.sbr.gov.au/.

All of these developments make “tax compliance by design” possible in an SME context. Tax compliance can be designed into the existing systems and information sharing already taking place. It is a matter of adapting to new circumstances and a changed landscape for SME’s.

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Chapter 3

The future tax compliance environment

This chapter describes how tax compliance can become a natural by-product of the day-to-day transactions of businesses as they take place. It describes two different scenarios and strategies and these are illustrated with practical examples from FTA member countries.

In the effort to focus more on shaping the compliance environment, revenue bodies and other government agencies and business parties are utilising technological developments, and are promoting further developments in order to become more effective. Examples of initiatives that build on these developments are certified cash registers, online bookkeeping and filing and e-invoicing arrangements.

“Tax compliance by design” is about how this can be taken one step further by integrating these different initiatives so that tax compliance becomes a natural part the day-to-day transactions as they take place. Revenue bodies are already embarking down this road but there could be benefits in doing this more systematically with a clear strategic vision.

The Forum on Tax Administrations Taxpayer Service Group is in a similar way talking about the future service delivery environment where the service is seamless and part of taxpayers’ systems:

“Revenue bodies leverage taxpayers’ ecosystems to enable citizens and businesses to satisfy their tax obligations as a by-product of their day-to-day activities. The taxpayers’ ecosystems, rather than the taxpayers themselves, are driving the service and fulfilment of tax obligations. Leveraging these natural ecosystems leads to elimination of entire services. The tax system is “in the background” as taxpayers are naturally connected with the tax system through their natural ecosystems (such as business software) and digital capabilities.” (OECD, 2014)

Designing compliance (and service) into the business processes may take many forms. Yet, based on the description so far it is possible to identify a few characteristics. Tax compliance by design is:

- More about getting it right than fixing what has gone wrong.
- About influencing the environment through co-operation with taxpayers and other participants.
- About building compliance into existing business processes.
- More about gaining and handling information rather than handling tax returns.
- Potentially achieved in many different ways; there is no single best solution.

Based on these insights the possibilities of the future compliance environment are described in this chapter. “Tax compliance by design” implies adopting a comprehensive and system based approach, the system perspective is therefore also explored in this chapter. Some of the main benefits and challenges are included at the end of the chapter.

What the environment could look like: Two different scenarios and strategies

The “tax compliance by design” approach does not imply that there is only one design possible. The idea is that tax compliance can be designed into normal business processes but that this can take different forms and shapes depending on the context and the solutions preferred by SME’s and revenue bodies. From the work done in this study it is clear there are a number of different possibilities. However, they share some fundamental features: they rely on the real-time collection of data about business transactions and its use in automated processes that translate that data into information about the taxes due and, where possible, payment of those liabilities.

It is possible to discern two principal strategies for realising the “tax compliance by design” concept. For the purpose of this study, these strategies are described as “*the secured chain approach*” and the second as “*the centralised data approach*”. In the first, much of the focus is on the internal processes of the business and how these are supported by trusted intermediaries. Most of the collection of data and processing that into information about tax liabilities and their payment takes place within the business and the service providers that support it. In the centralised data approach much of the data collection involves third parties directly supplying information to the revenue body and the revenue body will transform this into information about tax liabilities and payment that is fed back to the business. In this section we have used two scenarios that, in a simplified and streamlined form, illustrate the two different strategies. These are supported by a number of country examples, to demonstrate the possibilities. As the examples demonstrate, it is possible to pursue parts of both approaches at the same time; they can be complementary.

The secured chain approach

The central idea underpinning the “secured chain approach” is to create a *secured flow of information* from the capture of business transactions to the final determination of the correct amount of tax being paid. Tax compliance requirements are in this way built into the technology systems and processes used by the taxpayer anyway for the purpose of managing the business. The systems in this scenario are purposely designed to make it impossible or difficult to manipulate or erase information (or make such attempts easy to detect). The different participants that support the taxpayer (e.g. tax advisors or accountants) are subject to quality standards and quality assurance checks or certification schemes. An example of one possible environment of tax compliance by design based on this strategy looks like this:

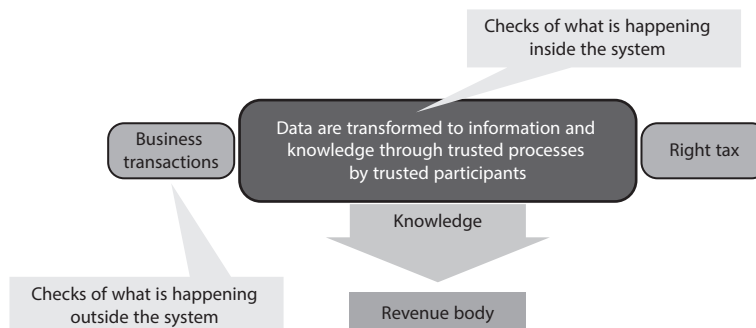
The taxpayer uses a certified cash register that provides certainty. The cash register is connected to an on-line accounting system and all transactions are booked automatically. Other business transactions are captured by linking transactions from a bank account to this automatic accounting system. The accounting system is certified and provided by a trusted software developer, and it contains a number of in-built checks to assure high quality of the information. The system handles all measures necessary in order to compile a complete tax return in line with current legislation, aided with manual work when needed (possible by a certified intermediary). The taxpayer can file the tax return from the same system. Payments are integrated with the reporting.

It is obvious that a number of mechanisms need to be in place in order to achieve the desired level of certainty. It is likewise obvious that other mechanisms need to be in place in order to detect transactions taking place outside the scope of these secured chains. Otherwise it would be an easy task to evade taxes just by avoiding transactions being captured in the first place. These different mechanisms need to be part of the tax compliance by design environment. Figure 3.1 illustrates this scenario.

The objective is to design a system in such a way that the revenue body and taxpayer can both gain the desired certainty about the right amount of tax being determined and paid by making sure that the processes are secure and work together as a complete chain. The revenue body receives knowledge on income and/or on the fact that the right amount has been paid, while the taxpayer also benefits from a reduced compliance burden as their reporting obligations are satisfied with less cost and inconvenience.

The role of the revenue body is mainly to act as a facilitator of needed features in the environment in order to make sure that the flow of information from the taxpayer on his own taxable transactions is secure enough. This reduces the need for the revenue body to handle all of the data by itself and it reduces the need for doing post-filing audits. It is about making sure that the whole chain of information can be trusted.

Figure 3.1. **The secured chain approach**



Practical examples of the “secured chain approach”

A number of revenue bodies are already applying these principles to a lesser or greater extent, or are planning developments along these lines. The survey sent to countries participating in the task group revealed that all respondents had ideas or plans about further integration of the software used by the business taxpayers and the software used by the revenue body. A number of examples are provided in the following part of the report to further explain the “secured chain approach” and its practical (potential) application:

- The Danish revenue body (SKAT’s) has developed a “proof of concept” product known as EasySME to assist small businesses manage their affairs and meet their tax obligations (Box 3.1).
- As part of its strategy *Reinventing the ATO*,¹ the Australian Taxation Office is developing two concepts to streamline the tax system reporting requirements of businesses, known as “Standard Chart of Accounts” and “Single Touch Payroll” (Box 3.2).

Box 3.1. **Danish Tax Administration’s *EasySME* concept**

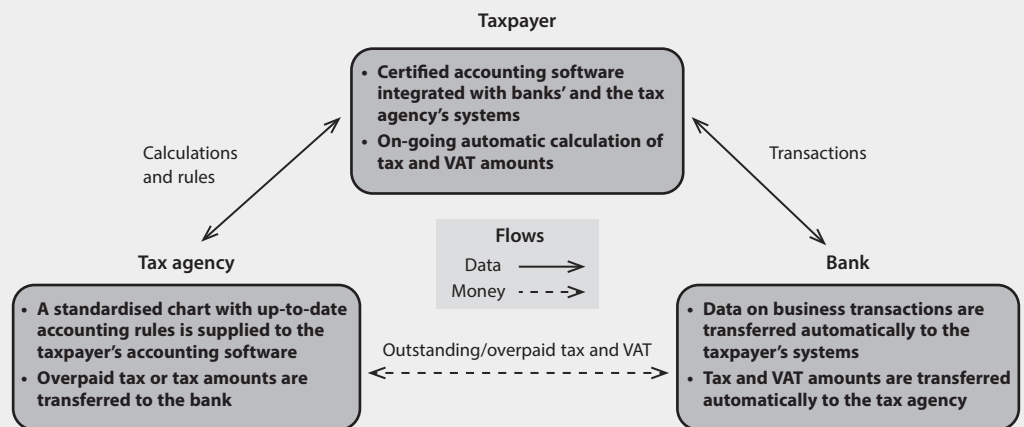
The Danish Tax Administration (SKAT) is developing a concept known as “*EasySME*” in co-operation with accounting software developers in Denmark. The objective is to make it easier for small businesses to get an overview of the situation of their business and at the same time make it easier for them to comply with the tax legislation.

The concept requires that the taxpayer use one bank account for all business transactions. The taxpayer must also choose an accounting system certified to the concept and it is based solely on the use of electronic transactions. The transaction data is imported from the designated bank accounts into the accounting system and this makes it easy to do the book-keeping of the transactions based on a fixed standard accounting plan. The accounting system is providing a contextualised help facility to the accounting process by presenting guidance,

Box 3.1. Danish Tax Administration's *EasySME* concept (continued)

which is supplied (on line and real time updated) by SKAT. The taxpayer reports VAT, estimated profit and personal income online directly from the accounting system to SKAT. Figure 3.2 below depicts the main elements of the concept. To be certified as an *EasySME* accounting system, the system must show real-time up-date of six key economic parameters, which gives the business a realistic and useful overview of the economic status and estimated taxes etc., for the entire fiscal year. After reporting of VAT and income, the Tax Administration recalculates the relevant key economic parameters and return updated figures to the accounting system so that the business can make informed decisions.

Figure 3.2. Denmark: The concept of *EasySME*



The Danish government presented the *Easy SME* concept to its Parliament in May 2014 as part of a general growth plan. While negotiations to find a majority for a political decision are yet to take place the concept is being refined and some of the technical and legal challenges are being explored further in order to prepare implementation should the proposal be accepted.

Source: Danish Tax Administration (SKAT).

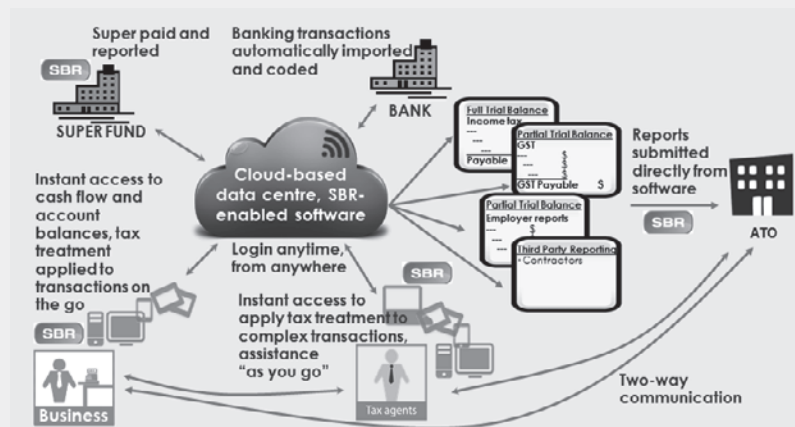
Box 3.2. Australia: Standard chart of accounts and payroll automation

The Australian Taxation Office (ATO) is looking to reposition itself within the Australian taxation system. The emphasis is now on providing contemporary services that will be more streamlined and tailored, based on its knowledge of the tax and superannuation (pension) affairs of taxpayers. The new focus is to apply to all aspects of tax administration and therefore will impact all ATO business processes and taxpayer segments. Building on incremental improvements in the way it collects and uses data, it has developed a vision for the future which it describes as *Reinventing the ATO*. With respect to businesses, especially SMEs, the focus of its strategy is on making better use of business taxpayers' natural systems to make all tax and superannuation reporting automatic by-products of their day-to-day activities. Two specific examples of its thinking are set out in the following part.

Box 3.2. Australia: Standard chart of accounts and payroll automation (continued)

Standard chart of account: The ATO is exploring how tax reporting will work in an environment where financial record keeping is increasingly automated. In this regard, it is proposing to move towards standardised record keeping, capturing the tax treatment of business transactions in a timely manner (real or near time) and simplify tax reporting. To help achieve this outcome, it will extend the Standard Business Reporting (SBR) taxonomy by defining sub-accounts that capture the taxation treatment of underlying transactions. Business transactions will be tagged for appropriate taxation treatment (e.g. income, deduction, GST, etc.). This will make it possible for business taxpayers to automatically extract relevant tax information and enable seamless reporting to the ATO, as depicted in Figure 3.3.

Figure 3.3. ATO vision of the future small business future and enablers



Automating payroll and related tax and superannuation roles: Australia’s personal income tax system imposes obligations on employers to deduct tax withholdings from the wages of their employees and to remit those amounts, along with reporting income, to the ATO. Employers also have significant superannuation (i.e. retirement pensions) obligations under the laws that are also administered by the ATO.

A concept being developed to help business to get it right from the start, and reduce compliance and administration costs is known as “Single Touch Payroll”. Many businesses in Australia already use software to calculate or generate payroll data but they issue paper pay slips to their employees and meet other obligations outside of their software. The ATO is therefore looking at ways to build a system that allows for all relevant payroll functions to be incorporated into a “Single Touch Payroll event”. Under this concept, the software would perform all payroll functions electronically, such as pay employees, produce pay slips, report and pay employee superannuation and report and pay employee pay as you go tax withholdings and employee payment summaries and annual reporting to the ATO.

Source: Australian Tax Office (ATO).

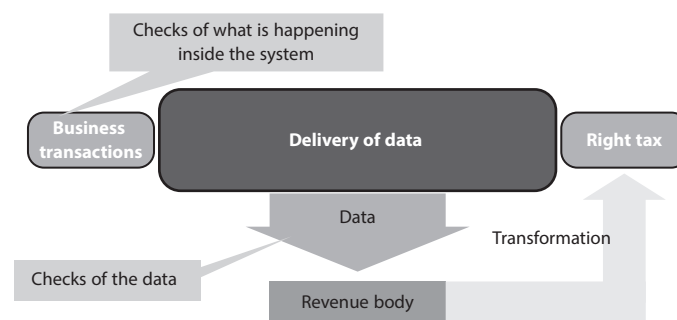
The centralised data approach

The idea underpinning the “centralised data approach” is that the revenue body itself can capture as many business transactions from the source as possible in order to determine the right amount of tax to be paid with minimum information from the taxpayer. Tax compliance requirements are built into the IT systems and processes used by the taxpayer but not in the same way as the “secured chain approach”. The taxpayer mainly reports information related to other taxpayers. The information collected by the revenue body can be presented to those other taxpayers and then used by them for the purpose of managing their business and/or to help meet tax obligations. It can thus support businesses and/or assist in reducing their compliance burden. By collecting information from the source in this way it should be easier to gain the desired level of certainty because the bulk of the data is not delivered by the taxpayer. It is largely delivered by third parties that may not have any incentive to manipulate or hide the information. However, other mechanisms are still needed in order to detect transactions taking place outside the scope of the information that is being captured by these third parties. An example of an environment of tax compliance by design based on this strategy looks like this:

The revenue body receives information from business taxpayers on their transactions with other businesses. The revenue body also receives information from banks, credit card institutions, government and other parties on all transactions related to a business taxpayer. The revenue body then structures and analyses the data and uses it to pre-fill the tax returns as much as possible. The taxpayer verifies the information provided and adds any other information required.

The purpose of this approach is to design the system in such a way that the revenue body receives as much of the underlying transaction data from the third party source as possible. The role of the revenue body is more about managing the whole process, handling and transforming all information by itself so the need for taxpayers to provide information on their own transactions is reduced. Figure 3.4 illustrates this scenario.

Figure 3.4. The centralised data approach



Practical examples of the centralised data approach

Revenue bodies are already applying to these principles in varying ways, using information captured centrally for a variety of administrative purposes (e.g. to assist taxpayers keep more accurate books and records, to prefill tax returns, and to detect fraudulent VAT invoices shortly after their creation). The survey sent to countries participating in the task group, along with other research carried out of revenue bodies’ practices, revealed that a

number of countries had systems in place and/or planned developments along these lines. A number of examples are provided hereunder to further explain “the centralised data” approach and its practical application:

- The Chilean Internal Revenue Service’s (SII) Electronic VAT invoicing system (see Box 3.3); and
- The Korean National Tax Service’s e-Tax Invoice and Cash Receipts Systems (see Box 3.4)

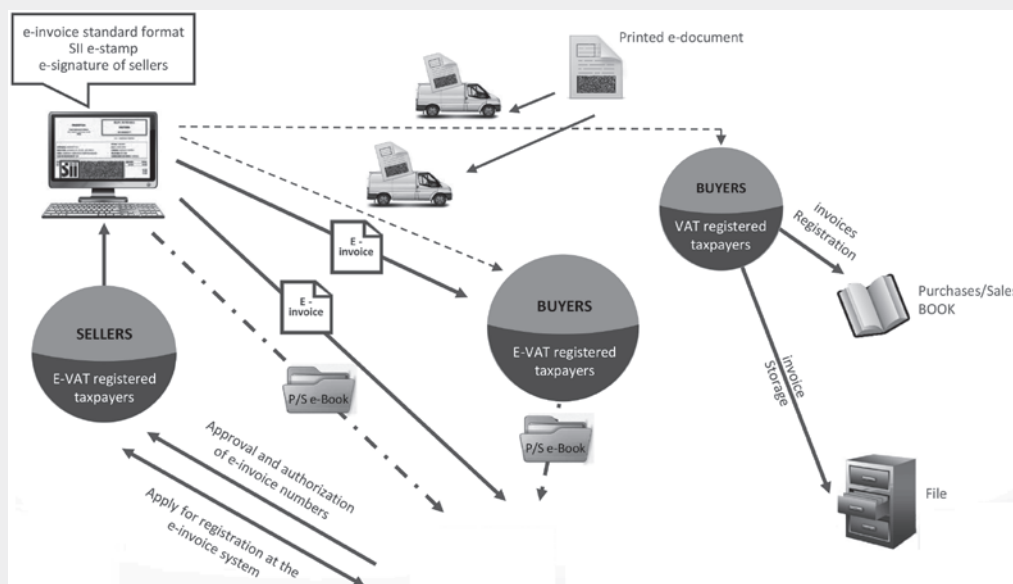
Box 3.3. Chile: Electronic VAT invoicing System

The Electronic Invoicing System, launched in 2002, allows business taxpayers to issue and receive invoices, which are immediately available to the revenue body of Chile (SII). The system is available to all business taxpayers via commercial software products. In addition, for SME’s SII developed a solution in 2005 available via their portal, known as MIPYME. The portal also provides both a simplified and complete accounting system for business. The simplified accounting system is for businesses that choose to belong to a special simplified taxation category and have sales under USD 400 000 per annum.

The simplified system enables businesses to keep records of sales, purchases and other business expenses, such as salaries and wages, to calculate taxable income, to generate prefilled tax returns and to produce a standard financial report. The complete accounting system provides enhanced functionality for businesses including generation of complete financial statements on a monthly basis across the financial year and generation of prefilled monthly and annual tax returns, as well as other mandatory forms that are required to be submitted. (A more detailed account of these systems can be found in the source document identified at the foot of this box – see www.ciat.org/index.php/en/international-cooperation/international-activities/technical-conferences/3240.html.)

In January 2014, the Government approved legislation that mandated the use of the Electronic Invoicing System by all businesses. A phased roll-out is underway, with all businesses scheduled to be using the system by early 2017.

Figure 3.5. Chile’s Electronic VAT Invoicing System



Source: *Electronic Documents: Solutions for Small and Medium Businesses*, Chile Internal Revenue Service (SII) CIAT (2014), 48th General Assembly 2014.

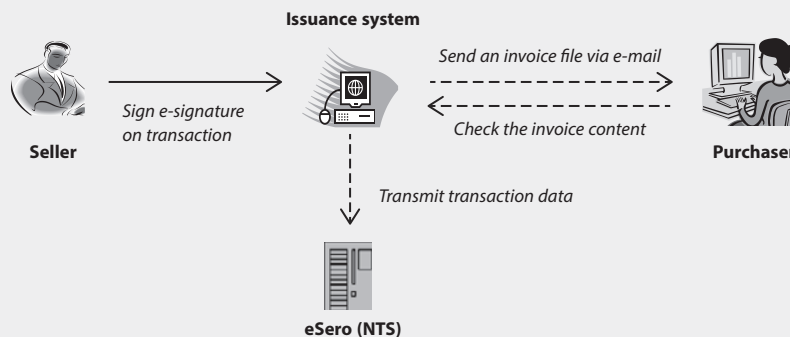
Box 3.4. Korea: e-Tax Invoice System

The e-Tax Invoice System is an online tax invoice system which enables online issuance and distribution of a tax invoice and transmission to the NTS, and which supports other aspects of tax administration.

Issue and transmission of e-Tax invoices: There are a number of methods possible for issuing an e-Tax Invoice: 1) **eSero:** this is a free online system administered by the NTS for the issuance and distribution of the tax invoice; the user logs into www.esero.go.kr using the Accredited Certificate and after making the tax invoice can e-mail it to the customer; 2) **ASP:** A supplier can use ASP (i.e. a business which provides the tax invoice issuing system) to issue and transmit tax invoices; 3) **ERP:** A large corporation with its own in-house ERP system may use its own system to issue and transmit tax invoices; and 4) **Telephone or tax office:** Those with no access to the internet can use the AVRS service to issue an e-Tax Invoice, or visit a District Tax Office to issue one.

A tax invoice is issued when goods or services are provided to a customer (as for paper tax invoices). After the issuance and distribution of an e-Tax Invoice, it can be revised only in special cases as prescribed in law. The issuance of a tax invoice is completed when a tax invoice file is e-mailed to the purchaser's inbox. If the purchaser does not have an e-mail account, issuance of a tax invoice is completed when it is input and transmitted to eSero. A tax invoice should be transmitted immediately after the tax invoice is distributed. However, suppliers can transmit the e-Tax Invoice to the NTS by the 10th date of the following month. The supplier needs an Accredited Certificate in order to use the online tax invoice system (e.g. eSero, ASP and ERP). The supplier needs to obtain either an individual or a business e-mail account of the purchaser to distribute the tax invoice.

Figure 3.6. Issuance and transmission of an e-Tax invoice



e-Tax Invoice Early Warning & Early Verification Systems: To enhance transparency in transactions, the “e-Tax Invoice Early Warning System” was adopted in October 2010. The system constantly monitors transactions before (i.e. “Pre-filing Early Warning System (PFEWS)”) and after (i.e. “Post-filing Early Verification System (PFEVS)”) VAT filing. The PFEWS monitors invoices immediately after each e-Tax Invoice is issued/transmitted and detects invoice fraud real-time. The PFEVS can detect those who claimed false input VAT credit by analysing various data (e.g. purchase and sales records) immediately after VAT returns are filed.

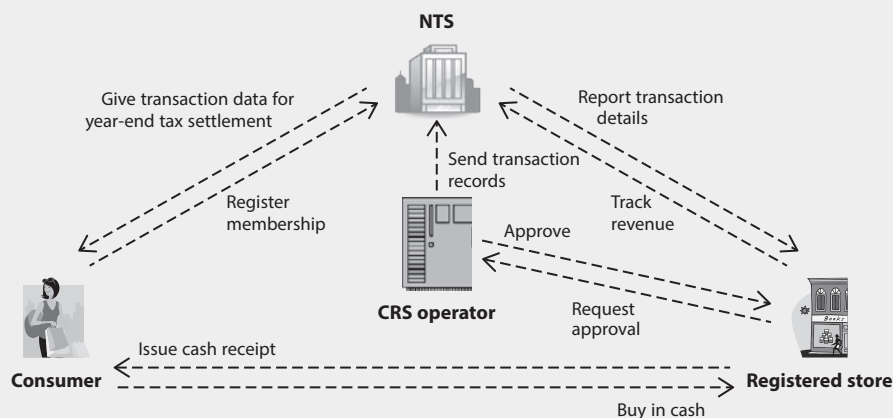
Key outcomes: The NTS reports that the e-Tax Invoice System enables faster and more convenient bookkeeping and electronic preparation/storing/filing of tax invoices, thereby reducing compliance costs significantly. SMEs use the system to review their income and expenditure history and file the VAT return. To help SMEs file returns without difficulty, the

Box 3.4. Korea: e-Tax Invoice System (continued)

eSero system provides taxpayers with a sum table in the same form of the VAT return during the VAT filing period. According to research conducted by the Korean Institute of Public Finance in 2011, the system saved about 900 billion won in compliance costs. In April 2012, a survey was conducted on the e-Tax Invoice website. Of the 63 000 people surveyed, 74% of the respondents thought the e-Tax Invoice System was convenient, and 75% said it is necessary to make the e-Tax Invoice mandatory to all sole proprietorships.

Source: NTS Annual Report 2013 and information supplied by Korean NTS officials.

Figure 3.7. The Cash Receipt System



Benefits: The system benefits both consumers and business owners. For *consumers*, the income deduction applied to transactions on cash receipts is probably the biggest benefit. Only wage and salary earners are eligible for income deduction. In other words, a certain proportion of aggregate cash and credit/debit card transactions made by the wage and salary earner and his/her family member is deducted. Although currently discontinued, the Cash Receipt Lottery used to be held monthly to promote the Cash Receipt System. The lottery was to encourage non-wage and salary earners who do not receive income deduction benefits (e.g. students) to request Cash Receipt issuance more frequently. The lottery was drawn once a month on the national TV with prize money ranging from 50 thousand won (5th place) to 100 million won (1st place). *Business owners* can enjoy benefits both by issuing and receiving Cash Receipts. When a business owner issues Cash Receipts, he/she can claim 1.3% VAT credit of the corresponding transaction. In addition, issuers can receive a 20 won tax credit for transactions at less than 5 thousand won. When business owners receive Cash Receipts for expense deduction, they can enjoy input VAT credit benefits. In its first year of operation, 450 million Cash Receipts were issued for an aggregate value of 18 trillion won. By the eighth year, the number of Cash Receipts issued had increased to 5.34 billion (an increase of 1200%) and the aggregate value had grown to 82 trillion won. At end-2012, there were 2.52 million merchants that issue Cash Receipts. The number of persons registered on the Cash Receipt website grew to 17.86 million, equivalent to one third of the entire Korean population.

Source: NTS Annual Report 2013.

Two different scenarios showing two different strategies

The main difference between the two strategies lies in how information and knowledge on business transactions is collected. In both cases the purpose is to be able to know, for both the taxpayer and the revenue body, with reasonable certainty that all relevant business transactions are included in the calculation of the tax amount. These are two different strategies adapted for different environments.

The “secured chain approach” is about revenue bodies collecting aggregated information from the taxpayer combined with measures that make it reasonably certain that all business transactions are included. This strategy is more apt for an environment where the taxpayer uses, as far as possible, an automated accounting system and also has support (either by software or by an intermediary) for compiling the information required by the revenue body. But this strategy does not depend on all taxpayers having these capabilities; the strategy can be used for sub-sets of taxpayers.

The “centralised data approach” is about revenue bodies collecting all information at the business transaction level but mainly from sources other than the taxpayer. This strategy is more apt for an environment where the taxpayer has possibilities to deliver all business-to-business transactions to the revenue body. This requires that the information is available in electronic format; comprehensive electronic invoicing schemes are therefore desirable. If pre-filing of tax return is the aim then all business taxpayers should be subject to these reporting requirements. This therefore put demands on all taxpayers regarding technical infrastructure.

A summary outlining the characteristics and main differences of the two strategies is provided in Table 3.1.

This description clearly shows that the two strategies are different and require, or is suitable for, different features in the environment. However, the two strategies are complementary at a tactical level and revenue bodies could probably benefit from considering various degrees of integration of the two.

Table 3.1. **Main characteristics of “Secured chain” and “centralised data” approaches**

Characteristics	Secured chain of information	Centralised data
Main source for information on taxpayers' income	Taxpayer	Third parties
Level of data/information used by revenue body	Aggregated data (= information)	Transaction or aggregated data
Scope regarding number of taxpayers involved	Ideally all but sub-segments possible	Preferably all taxpayers
Scope regarding type of transaction data	All transactions for involved taxpayers	Preferably all but limited scope possible
Preferred environment for the taxpayers	Extensive use of accounting software	Extensive use of third party reporting and VAT e-invoicing
Main focus of revenue body	Detecting evasion outside secured chain	Structure and analyse data
Demand for third party data	Limited but still a necessity	Extensive
Pre-filing of tax returns	None or limited	Complete or almost complete

A centralised data approach will probably not include possibilities to collect all relevant data from third parties and will therefore rely on taxpayer reporting at least some information. The third party data also need to be delivered in a secure way which can be done through secured chains of information. A centralised data approach can therefore gain by using some features from the secured chain approach.

A secured chain approach will probably not include possibilities to make everything secured and will therefore rely on third party data to some extent. Third party data will be needed to verify that the system is working and in order to detect transactions taking place outside the scope of the secure chains. Third party data might be needed more for specific groups of taxpayers. A secured chain approach can therefore gain by using some features from the centralised data approach.

Both strategies require third party data to gain the desired level of certainty. The difference between the two strategies lies in the main purpose (verification or pre-filling) of collection third party data and in the amount of data needed. The choice between the two strategies and the combination of different elements needs to be based on the context and wishes of each country and revenue body.

The centralised data approach puts a lot of demands on the availability of data and its quality. It also requires a lot from the revenue body in order to handle and transform vast amounts of data. This in turn raises issues on trust and “big brother society” (elaborated on below).

The secured chain approach on the other hand requires conditions for co-operation with competent participants and an infrastructure that is reasonable well developed. The secured chain approach also provides an opportunity for the revenue body to collect less data and information if it so wishes.

Another consideration is what kind of information the revenue body and government need from the taxpayers for purposes other than to collect the right amount of tax at the right time. The revenue body and the government may, for instance, need information and statistics in order to continue improve the tax system and to be able to modify policies and legislation based upon empirical evidence. Such ancillary issues may need to be considered when designing a tax compliance by design system.

Therefore, it is not possible to advocate one of the strategies as the best one and the other one as inferior. It also means that there a number of possibilities to create or support an environment conducive to tax compliance. There is not just a matter of a choice between two different strategies; it is also a number of tactical choices on how to combine different elements from the two strategies that fits the existing environment or the envisaged future environment. Taxpayer preferences are also an important aspect that should influence the choices made in order to secure buy-in and thus increased effectiveness.

The two strategies will affect the taxpayers’ environment in different ways but both strategies have the potential of supporting the taxpayer and reduce compliance costs.

Tax compliance by design perceived as a system

The description above shows clearly that there is not just one process that is the best one or the right one; there are several processes possible. Completely different processes can also co-exist because different solutions have been chosen for different groups of taxpayers or for different types of business transactions. Different solutions might be appropriate depending

on the size of the business. Even if not all transactional data is collected some data referring to a specific type of transactions or industry might be collected.

One example of this is *the third party reporting regime for the construction industry in Australia*. The building and construction industry are required to report details of payments they make for building and construction services. Reports are filed annually and co-operation with software developers has resulted in adjusted accounting packages to encourage electronic lodgement. The information received is being used to assist individual contractors meet their obligations by making it available as a pre-fill item to tax agents through the electronic lodgement system.

The end-to-end perspective adopted in this study combines the taxpayer's process with the process of the revenue body. The common factors of these processes are the starting point of taxable transaction and the end point of knowing that the right amount of tax has been paid on time. All possible different steps between these points cannot be described as one single process. There are a number of different processes.

“Tax compliance by design” is therefore not best understood as a single process; rather, it is probably best understood as a system. A system consists of several processes interacting with each other in different ways often with a clear goal or function. A process consists of a number of linear steps but in a system a number of parallel actions can take place at the same time. A system is therefore more dynamic but also more complex. The system as described in this report encompasses the flow and transformation of information and knowledge. This is carried out by a number of different participants supported by a technical infrastructure regulated by laws and regulations.

The “tax compliance by design” system can therefore be said to contain the following parts; 1) flow of data/information and knowledge; 2) participants; 3) infrastructure; and 4) rules. The parts are explained further in the following part of this report.

1) Flow and transformation of data, information and knowledge

The purpose of the system is to get knowledge (certainty) about the right amount of tax paid on time. This is the desired end result. The starting point is the taxable business transactions. This starting point of a big pile of transactions is not knowledge; it is data. The compliance process is therefore about transforming this data into knowledge.

Data can be seen as the smallest units being handled (often numbers, e.g. data about one individual business transaction), information is aggregated and structured data (e.g. profit or income) and when the information is used and understood knowledge is gained. Another example to illustrate the differences is to use the jigsaw puzzle as an analogy. Each of the different pieces can be seen as data, when the pieces are put together information exists and when the emerged picture is understood in relation to a relevant context, knowledge is gained. The distinction between information and knowledge is that information can be memorised while knowledge is learnt. Knowledge therefore requires that the information is analysed or put into the context of already existing knowledge.²

The tax compliance process needs to transform data, about taxable transactions, into knowledge about the right amount of tax to be determined and paid. Structured and aggregated data gives information but this is not enough. To really know with reasonable level of certainty, information about the process itself is needed. Besides having information on for instance taxable income, information is needed on how the underlying data has been structured and on how difficult it would be to manipulate the data. This means that knowledge about the right amount of tax being paid on time can be gained by combining

information **from the processes in the system** (like the computation of income) with information **about the functioning of the system** (how reliable is the information in the processes).

2) Participants

In the process of building compliance many participants are involved. Apart from the taxpayer and the revenue body other parties such as tax intermediaries, accountants, software developers, industry organisations, banks and others can play a role. These are all organisations who deliver services that are more or less directly related to the process of bookkeeping and reporting. A broader perspective on the participants who may influence the quality of the tax return increases the group. In business to consumer situations customers may influence behaviour just by simply demanding a cash receipt. Real estate agents could, for instance, play a role in supporting their clients in dealing with the tax consequences of buying or selling property.

“Tax compliance by design” is to a great extent built on the idea that existing participants, already providing value for taxpayers, can be more involved in tax compliance processes. New potential participants introduced into the system should also meet the criteria of providing value for the taxpayers:

3) Infrastructure

Different types of infrastructure are needed to support participants and the flow of data, information and knowledge. Infrastructure refers to technology, structures regarding responsibility for data and information and structures regarding governance. Technology is necessary infrastructure that makes it possible to store, transport and structure data and information. It therefore refers both to hardware and software.

Infrastructure also refers to the possibilities to manage the data and information which require clear structures and transparency on responsibilities, usage and flow or storage of data and information (further elaborated on in Chapter 4).

Structures are also needed for governance. These can take the form of certification schemes, quality assurance methods, monitoring procedures or other similar kind of standards or procedures.

4) Rules

Rules are instructions that regulate behaviour including legislation, agreements and other policies. The rules influence how the infrastructures should be constructed and the behaviour of the participants.

One benefit of perceiving “tax compliance by design” as a system is to realise the many different possibilities that exist. This means that the system should be possible to adapt to the existing rules as far as possible. “Tax compliance by design” as a concept is not intended to require changes of legislation; ideally it should be flexible enough to fit with any kind of tax legislation. But this depends on the preferred solution and the country context. In some cases, changes of legislation might not be needed but some adjustments could perhaps make the system work more effective. Other rules like standards and policies might need to be introduced.

Benefits and challenges

“Tax compliance by design” perceived as system builds on findings and strategies previously outlined by the FTA. The further developments should therefore contribute by harnessing the benefits already identified and by finding opportunities for further improvements. For example, the FTA’s 2012 report noted that:

A “right from the start” approach will support compliant behaviour, drive out error and at the same time reduce the possibilities of non-compliant behaviour. The purpose is not just to reduce unintentional mistakes; the purpose is also to reduce intentional evasion and to strengthen the overall willingness to comply. There is consequently a strong business case for a “Right from the Start” approach. (OECD, 2012).

The FTA’s report 2013 report noted that:

Engaging and involving taxpayers and participants offers the opportunity to harness knowledge and resources residing outside the revenue body. Leveraging on the knowledge, reach, credibility and efforts of others may contribute significantly to improved compliance outcomes, cost reductions, increased levels of customer satisfaction, and a range of other benefits. (OECD, 2013).

To be added to this is a key feature of the “tax compliance by design” system. This is the idea that tax compliance should be part of businesses’ normal processes, utilising the technology and other support already in place in a systematic way. This can reduce the compliance burden put on the taxpayer and reduce the need for the revenue body to provide all necessary infrastructure.

Pro and cons with the different strategies

The benefits and challenges will also depend on which main strategy the revenue body prefers; the secured chain strategy or the centralised data strategy.

A comprehensive and successful implementation of the secured chain strategy has the potential of providing substantial benefits for both taxpayer and revenue body because it reduces uncertainty and to a great extent the need to do post-filing audits. Most taxpayers are mostly compliant most of the time and the commonest causes of non-compliance are inadvertent error and poor record keeping. By tackling these common causes of non-compliance at source, this approach helps taxpayers and reduces the need for revenue bodies to focus on the vast majority of taxpayers on an on-to-one basis. Focus can instead be directed towards more narrow areas of non-compliance and on monitoring the system.

However adopting a secured chain strategy will depend on the maturity of technical infrastructure and financial processes in the business society and will also depend on the willingness of the parties to be involved. A clear business case is needed to make it attractive for other parties to be involved.

The centralised data strategy on the other hand requires a different kind of technical infrastructure. It can potentially support taxpayers and reduce failures and evasion substantially but it also brings a number of risks that are not to the same degree associated with the secured chain strategy.

One such risk is increased cost for the revenue body for handling the data. Storage of data is seldom the problem but the data needs to be extracted from different sources, cleaned in order to increase quality of the data and it needs to be transformed into a data

format the revenue body can use for analysis and selection for audits.³ This is work that needs to be done before the data is used for pre-filing, selection or other purposes and it can be substantial. Furthermore, when using analytical tools or data mining models on the data in order to detect evasion or risks it can still be difficult to separate suspected evasion from anomalies that occur by natural causes or due to faulty data.

Another risk with the centralised data strategy is the cost in term of reduced trust. This can be a result of public discussions on taxpayers' integrity and big brother society. This risk might not materialise but a revenue body needs to carefully assess this risk because reduced trust can lead to a reduced willingness to comply and makes it more difficult to successfully implement a "tax compliance by design" system.

The system approach can contribute to improved effectiveness

The system perspective can be of particular importance in order to gain overall effectiveness. Tax compliance by design perceived as a system brings additional benefits by combining different parts into an effective working whole. Tax compliance becomes an embedded feature of the system and not a separate add-on component that brings additional costs.

"Tax compliance by design" perceived as a system, however, also presents its own challenges for revenue bodies. It relies on co-operation with other parties and on technology. Cooperation, while having the potential of providing substantial benefits, can be difficult and time consuming. Trust helps but competing interests and short-term thinking can create obstacles. Technology can in a similar way provide many benefits but it can also add complexity and unexpected costs. The system perspective is helpful but it can also be difficult to apply in practice. There is a risk that details and sub-parts are improved on the expense of the whole system. These risks can be overcome but they do need to be recognised and managed.

A cost-effective approach for SME taxpayers

Revenue bodies need effective strategies for supporting SME's and for achieving high level of compliance in that sector. These strategies are different from large taxpayers and private individuals. For large taxpayers a one-to-one relationship can be effective, it is not for SME's. For private individuals pre-filing of tax returns is possible but it has so far been difficult to do the same for the SME sector.

Any strategy adopted for the SME sector need, besides increasing compliance, also to contribute to reduced compliance costs and to increased certainty for the taxpayers. It is likely that the most successful strategies are based on a clear taxpayer perspective aiming at making it easy for the taxpayer to be compliant.

The concept outlined in this report builds on the idea that a comprehensive and systematic approach on tax compliance can be very effective in this regard. "Tax compliance by design" offers an approach that, when implemented successfully, enables SME's to achieve high standards of tax compliance, while reducing their costs and offering revenue bodies real assurance, also at low cost.

Notes

1. For a detailed description of “*Reinventing the ATO*” see: https://www.ato.gov.au/uploadedFiles/Content/CR/downloads/js31949%20Corporate%20Plan%20Strategic%20Intent_w.pdf.
2. There exist several definitions of data, information and knowledge, many built on Russell Ackoff’s hierarchy of data, information, knowledge and wisdom. For the purpose of this study it is enough to use simplified definitions of data, information and knowledge.
3. This refers to the common Extract-Clean-Transform processes often used in data warehousing.

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Chapter 4

Practical implementation and further opportunities

This chapter provides practical guidance on how to implement the concept of tax compliance by design. It offers some general guiding principles for revenue bodies to follow.

The previous chapter described what an environment characterised by “tax compliance by design” could look like and the benefits of applying a system perspective. This chapter provides further practical guidance on how such a system could be implemented by pointing towards a number of components or features of such a system together with guidance on the practical implementation.

Components useful for the practical implementation

“Tax compliance by design”, regardless of the strategies chosen, needs some common components in order to functioning properly. The components outlined here together with some practical examples are:

1. Trust and transparency
2. Enforcement strategies adapted to new circumstances
3. Systemic assurance and feedback from detected failures
4. Structures and responsibilities for information
5. A technical infrastructure

1. Trust based on transparency and fair procedures

“Tax compliance by design” and co-operating with taxpayers and participants that comes with it can only function when there is a basis of trust between all parties involved. At the same time working in such a more collaborative way will also feed trust.

The FTA’s 2008 report *Study into the Role of Tax Intermediaries* explored the scope for establishing a more co-operative relationship between revenue bodies, taxpayers and tax intermediaries. The key finding of that study is that co-operation based on trust and mutual understanding offers significant benefits to all parties involved (OECD, 2008).

Trust between system participants is easier to establish if it is clear that all have shared interests and common goals. As discussed in Chapter 2, many participants share the goal of trying to determine the right amount of tax to be paid on time with minimum costs, like the revenue body and most taxpayers and intermediaries. All participants do not need to have completely identical goals; it is sufficient if they have overlapping goals. The idea is to find common ground on which co-operation can be built.

However, trusting participants should not be about exercising blind faith. It is also necessary for all to have ways to verify or monitor that others do what is expected and agreed. This means that an appropriate level of transparency (i.e. openness) and systemic assurance is needed (see below).

The FTA’s 2010 information note *Understanding and Influencing Taxpayers’ Compliance Behaviour* points to ample evidence of a correlation between fair and correct treatment of taxpayers and trust in the revenue body. If regulators are seen to be acting fairly, people will trust the motives of that authority. Fair and correct treatment refers to the concept of procedural fairness. It relates to perceptions about the procedures; that is, how the authority handles the information and makes decision. Procedures are considered as fair if they are perceived to be consistent, accurate, representative, ethical, and correctable. What is also important, as observed by Professor Valerie Braithwaite, is that:

Authorities develop trust and build their legitimacy, not through giving people the outcomes they want, which is often impossible, but rather through observing their right to a fair hearing and respectful treatment. (OECD, 2010).

Perceived fairness leads to trust in the procedures and trust in the procedures leads to perceptions of fairness. The opposite is equally relevant; lack of fairness leads to distrust and distrust leads to perceptions of injustice that in turn leads to non-compliance. Trust must therefore be earned continuously.

An environment conducive to tax compliance should ideally be designed in such a way that it contributes to increased trust; it can thus contribute to an increased willingness to comply besides making it easy to be compliant (and difficult to be non-compliant).

It is reasonable to assume that the “secured chain approach” requires a higher level of trust to start with because it is based on more co-operation with other participants. But it also has the potential, for the same reason, of being able to increase trust more. The “centralised data approach” might not need the same level of trust (though trust is still helpful) but, as pointed out in the previous chapter, it also carries the risk of further reducing the trust if the procedures are not perceived to be fair.

2. Enforcement that supports “tax compliance by design”

The idea underpinning both “right from the start” and “tax compliance by design” is to implement measures that will ensure that reported information from taxpayers is correct when filed and/or when used to pre-fill tax returns. This will reduce the need to carry out post-filing checks, including audits. This is also part of the rationale for such an approach because it provides opportunities for cost-savings.

However, it would be a mistake to assume that enforcement no longer is necessary in this environment. Some taxpayers will try to evade taxes by finding ways of “cheating the system”, probably by trying to prevent their business transactions from being captured by their official accounting system or by a third party that delivers information to the revenue body. Another way of evading taxes is to manipulate the software, for instance by using sales suppression techniques which are reported to be fairly common (OECD, 2013). Enforcement activities to detect attempts of this kind of evasion are therefore necessary. And, of course, with increased reliance on the timely reporting and accuracy of data from third parties there will be a need for quality assurance/enforcement strategies.

An important aspect is also that the effectiveness of enforcement measures can be increased compared to a traditional approach that relies primarily on enforcement. This does, however, require that enforcement strategies are adapted to the new circumstances tax compliance by design entails.

Enforcement in a “tax compliance by design” system context contributes to compliance through two different approaches. The first approach is about doing checks and audits pre-filing. The purpose of the checks and audits are then not to investigate the content of the tax return (because it has not yet been filed) but to investigate if the necessary conditions are in place for a correct tax return to be filed or for other information to be reported. These kinds of checks can be seen as part of the systemic assurance (see below).

The second approach is about detecting and investigating suspected cases of non-compliance taking place outside the scope of the system of “tax compliance by design”. Enforcement resources can thus be directed towards more targeted areas that can actually increase the risk of detection for non-compliance even if the resources spent on enforcement do not increase.

However, this does not mean that all post-filing checks of tax returns should be abolished. Some checks will always be necessary in order to prove that the approach is working as intended and to handle cases when it is not. There can also be events or type of transactions

(e.g. complex and/or rare business activities) not sufficiently covered by the system solutions that could be relevant to audit. There will also be some taxpayer not using electronic accounting systems. All of this needs to be handled in the normal risk assessment processes. But “tax compliance by design” does provide potential opportunities for substantially reducing the numbers of post-filing checks of tax returns.

3. *Systemic assurance and feedback on failures*

The “right from the start” approach does not necessarily mean that all information is accurate at the time of filing. Mistakes happen, knowledge might be lacking or intentional misinformation might take place. The system is not always working as intended. The revenue body and other actors need to know how well the system is performing.

To be able to know how the system is working an appropriate level of systemic assurance is needed. Systemic assurance or system integrity checks refers to checks that have the purpose to monitor the capability of the processes to deliver accurate information. Feedback loops of information are ideally implemented to make sure that the knowledge received from the system integrity checks is used for improving the system and not just for reporting of performance.

One example of this is the Netherlands Tax and Customs Administration (NTCA) that works with software developers to develop quality standards and integrate tax quality issues into their IT systems based on a certification scheme. The NTCA is also currently running a pilot where appointed tax officers or account managers are assigned to tax intermediaries to discuss performance and operation of the tax intermediary. The tax intermediaries receive information on mistakes and risk areas. The tax administration receives feedback on its own performance.

The ideal situation would be to have structures and mechanisms in place that more or less automatically transfers knowledge of discovered failures to the actor that can improve the system so that a particular failure will not re-occur. This is not always possible or practical but feedback loops with information from a latter step of a specific process to an earlier step can be established when perceived as efficient.

Software developers could gain from knowing what mistakes users often make. Similarly, tax intermediaries could benefit from knowing if they should improve any quality assurance mechanism or other working methods. Feedback loops can thus relate to different aspects of a process like technology, working methods or knowledge of different users. This is also valid for feedback to the revenue body and not just feedback from the revenue body. By incorporating these feedback loops of information into the “tax compliance by design” system it will become a system that continuously learns and adapts. This can make it both more flexible and stable at the same time.

Certification schemes or quality assurance and quality checks do not have to be handled by the revenue body. Trusted third parties can also play a role. ***An example of this is the agreement the Swedish Tax Agency has with tax intermediaries’ organisations.*** The intermediaries’ organisations have a number of mechanisms in place in order to assure that their members perform their work with a quality in line with laws and regulations. The tax intermediaries will also receive information from the revenue body about common mistakes in order to improve their quality assurance procedures. The tax agency gets information on which tax returns they have prepared. If these tax returns have a higher quality than other comparable tax return the risk assessment will be adjusted resulting in changed selection criteria for audits. Higher quality therefore pays off for the taxpayer in lower compliance burden and greater certainty.

4. Clear responsibilities and structures for information

Tax compliance by design relies on technology to be effective. But it would be a mistake to perceive this development as solely a technical issue. The real value lies in the transformation of data. This requires attention to information management which can be described as mechanisms and structures for maintaining and processing information (OECD, 2003).

Revenue bodies need to work together with both other government bodies and with the private sector in order to achieve the holistic approach described in this report. Besides collaboration on technical infrastructure it also requires clear responsibilities for storing, transferring and transforming of data and information.

The value of data and information arises when it is used. Many different participants might want to use the data and it can be transferred from one user to another. But this cannot be done without taking a number of restrictions and considerations into account. The availability and use of data can be restricted due to secrecy acts and considerations of integrity or because of incompatible data formats. Data and information cannot therefore be shared and used freely.

Clear structures and responsibilities regarding information management are needed. It should be clear who have the right to use what data and information. It should furthermore be clear who is accountable for the data or information. A government body can for instance collect financial information from businesses, store it in a database and then share it with other government bodies (within the framework of the law). The information needs to be updated and maintained in order to be of high quality. It would not be efficient if all users of the information perform their own updates, only resulting in that the same piece of information for one business will differ from register to register. The structure should be clear so one party is responsible for the data or information and other parties can use it but not change it. The receiving part can of course use data from different sources to construct new pieces of information and thus assume accountability for the accuracy of that aggregated information. That adds a responsibility for that new aggregated information but it does not change the responsibility for the underlying data.

The Inland Revenue in New Zealand is currently moving from a framework of secrecy with restricted and limited exceptions, to more open sharing with other Government agencies with appropriate privacy safeguards. Sharing earnings-related information regularly with the Ministry of Social Development is one example of this that has been put into practice. This has enabled better service to New Zealanders for their social policy payments and easier detection of fraudulent activities.

5. A technical infrastructure

“Tax compliance by design” builds on and uses opportunities provided by general developments of technology in society. Of special importance is the increased use of on-line services and digital storage and transfer of data. This development can be supported by working together with software providers and adopting whole of government standards and promote software integration technologies and other infrastructure (OECD, 2003).

Digital solutions for accounting, filing and other purposes can be of advantage for the SME taxpayer if they provide support and reduce the need for manual work. But revenue bodies still might want to further promote the use of digital services. This can be done by making sure that the software solutions are user-friendly and adapted to the need of the taxpayers or by providing different incentives.

The *Inland Revenue Authority of Singapore (IRAS)* encourage businesses to improve their record keeping standards with the adoption of approved accounting software by providing subsidies in co-operation with another government agency, the Infocomm Development Authority of Singapore.

The *South African Revenue Service (SARS)* provides free software for employers called *e@syFile™*. The software can be downloaded onto the employer's computer and all work can be done offline. Employers only need to go online when they are ready to submit their declarations, reconciliations, tax certificates or other documents.

Getting started – some general guidance

As explained in the previous chapters a revenue body that wants to adopt a “tax compliance by design” strategy needs to involve all participants in the fiscal chain: in the SME context these could be tax intermediaries, providers for online bookkeeping services, banks, software providers and many other.

One example of this is the co-operation that the Netherlands Tax and Customs Administration (NTCA) have developed with the providers of online bookkeeping services. This collaboration started in 2010 at a time when the NTCA was looking for ways to improve bookkeeping by especially smaller SME's. The fast growing market of online bookkeeping was well suited for this purpose, as online solutions combined low cost and quality, induced by automated booking entries provided by the system. The main driver for the market to seek co-operation with the NTCA and other participants was the need to signal to the customers that these online cloud solutions provided the necessary quality and were trustworthy. In 2012 a quality mark “Secure online” was introduced and to date the first certificates are issued. This initiative is owned by the industry but the NTCA is actively involved in developing the standards that underpin the quality mark and also helped to get this initiative started.

The joint responsibility in building systems that support taxpayers tax compliance should ideally also be reflected in the governance of such initiatives, especially when these are based on a private-public co-operation. The revenue body needs to be mindful that traditionally they have operated and been seen as regulators and that a more co-operative approach requires them to create an environment of trust to develop partnerships. For the revenue body it is important to have a clear role and not assume responsibilities it does not formally have. But the active involvement of the revenue body (and other government agencies) in initiatives such as quality marks and standards can add considerably to the trustworthiness and success of these initiatives.

In the example from the Netherlands above on co-operation with providers of online bookkeeping services the Netherlands Tax and Customs Administration is taking part in a supervisory board that overlooks the different initiatives for trusted software and supervises the quality standards that are adopted. The supervisory board consists otherwise of independent members from the academic and professional world, which have no direct connection to the service providers.

Tax compliance by design is an idea or a concept best understood as a system. As pointed out earlier, this means that there are numerous possibilities. Each revenue body needs to find its own preferred system based on the mentioned considerations and components and to find appropriate co-operative arrangements. It is possible, however, to offer some general guiding principles on how to implement a “tax compliance by design” system.

The first step could be, based on the revenue body’s current situation and context, to describe a desired future environment. The two strategies described – the secured chain strategy and the centralised data strategy – can be helpful tools for this exercise. An appropriate mix of the strategies can be described based on what information and knowledge that needs to be collected and how the future infrastructure is expected to look like.

The second step could be, based on the description of the desired future, to more in detail (but still on an aggregated level) describe the flow of data, information and knowledge and the participants and infrastructure that is needed. This would also include descriptions of responsibilities and mechanisms for systemic assurance and quality assurance.

The third and final step could be about deciding on how this would be implemented in practice. This refers to the level of control and/or involvement the revenue body or the government wants to exercise. It can range from high control to a more facilitative approach or a mix of these. The following paths can be combined in an appropriate way:

- *Enabling*: Utilise the strength of the market and provide standards, norms, and guidance as appropriate.
- *Co-designing*: Actively work with other parties in order to build infrastructure or to provide quality assurance or certification schemes.
- *Prescribing*: Take a more directive approach through legislation.

The choices between these different paths will have an impact on how the revenue body perceive and work with important aspects of the implementation like trust, transparency, monitoring and learning.

By going through these steps it is possible to establish a holistic view and to see the whole system. Different solutions can be combined in different ways but to start with the big picture makes it easier to make sure that the different solutions works together to create improved outcomes in cost-effective ways for both taxpayers and the revenue body.

Even if an idea or picture exist on how a complete system would look like the whole concept does not need to be implemented at the same time. The implementation can be done gradually building on what is already in place and then add different features according to what is appropriate and cost-effective. The plans in New Zealand to further develop their system for filing employers schedules is a good example of this.

New Zealand IR currently administers a system where all employers and intermediaries are required to file an Employer Monthly Schedule (EMS) each month. The EMS provides a wealth of information that is imperative in determining the tax status of salary and wage earners. There are some challenges with the current system regarding timeliness and accuracy which require interventions by the employers or the Inland Revenue (IR) before the information can be used. The system will be further developed by integrating the PAYE (Pay As You Earn) into existing business systems (e.g. payroll systems) to make EMS part of the process rather than an additional process and to allow business systems to talk directly to IR systems and vice versa. Near real-time and upfront verification of information will be possible. The plan is to shift focus from prescriptive filing of returns to near real-time transfer of data, probably on a payday-basis. Cooperation with other parties is, therefore, critical as success is contingent on private sector innovation.

Further opportunities

“Tax compliance by design” perceived as a system does not only require some components for its practical implementation but does also provide opportunities for additional components that can be useful. This also points to possible future developments. The following examples are described:

- Open data and open services.
- Transfer revenue workload to external participants.

Open data and open services

Open data refers to the idea that certain data should be freely available to everyone to use and republish as they wish. This is also an approach increasingly adopted by governments (Ubaldi, 2013). Open data is often defined as data that can be freely used, re-used and distributed by anyone, only subject to the requirement that users make their work available to be shared as well. This concept is very much in-line with the ideas described in this study. In this context the relevant data refers for example to business rules (like some selection criteria) or other types of data that external participants can use with the purpose of offering better services to customers.

Assume, for instance, that a private business might want to offer an on-line service to a special target group like restaurants or farmers. The purpose of the service could be to make business dealings with the government simpler and more efficient. Information about legislation, e-services and other areas can then be customised to a special target group. The services offered does not need to fit everyone, they can be limited to what the target group mostly need. This is a kind of service that is difficult for the government to offer due to the great number of possible target groups and requirements of equal treatment.

This means that a revenue body or other government body could consider, within the scope of secrecy acts and other legislation, to release machine-readable data and encourage third party applications, built on application programming interfaces (API), that can deliver innovative and more personalised public services, and at the same time improving the quality of interactions between the governments and the users (Ubaldi, 2013).

This provides innovators from outside the government with the opportunity to develop flexible services that are more targeted to users’ needs than those developed in-house by governments.

One example is the Danish Agricultural Consultancy, owned by Danish farmers, which offers an online accounting system to the agricultural sector. The system also supports data exchange with the revenue body (SKAT).

Transfer revenue workload to external participants

The task group discussed during the workshop together with representatives from Swedish organisations of tax intermediaries possibilities of taking the systems perspective further.

A “tax compliance by design” system can be perceived as a system that delivers information and knowledge to different participants. A tax return needs to be filed at a specific moment and that moment represents the transfer of the responsibilities for that information. This is the case even if a number of checks have already been performed

on the tax return; possible based on revenue body's business rules as open data, by a tax intermediary or a software application. Similarly, an application for the registration of a business needs to be filed to the revenue body even if it is well prepared by a competent intermediary.

But, what if an intermediary could go one step further and not just send in an application but also complete the whole registration of that business? The purpose of this would not be to transfer the formal authority of making decisions to another party, that responsibility must stay with the revenue body, only to transfer some of the work that is needed in order to complete a registration of a business (or another task).

A trusted or certified intermediary could be given the possibility to finalise certain tasks like registration of businesses or extended time for filing of tax return or similar work. These intermediaries would then need to do the same work otherwise done by the revenue body. They would complete all the necessary work and update the registers at the revenue body but the revenue body would make the final decision and always maintain the right to make changes or carry out checks.

This is an issue on how far a revenue body is willing, and has legal possibilities, to let other participants into its own processes. Such considerations can provide opportunities for enhanced effectiveness. The taxpayer can potentially gain convenience, speed and certainty. The revenue body can gain improved efficiency by doing less work on individual cases and put more focus on making sure that the process is adhering to high quality standards.

This is not suitable for all processes or for all cases in possible processes. This kind of arrangement can serve as supplements to existing services the revenue body offers. The potential benefits needs to be explored further by any revenue body embarking on such a path.

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Chapter 5

Conclusions and recommendations

This chapter concludes the report by recommending that revenue bodies consider developing a system of Tax compliance by design that is appropriate for their specific circumstances.

The concept of “tax compliance by design” is a continuation of previous work by revenue bodies to develop effective compliance strategies adapted to changed circumstances. Compliance strategies are increasingly based on a better understanding of taxpayer behaviour and focus today more on early measures, or more up-stream activities, in order to make it right from the start and easy to comply. Relevant circumstances are primarily technological developments that provides new opportunities but also the demand for achieving higher levels of compliance, providing better service to taxpayers while at the same time reduce costs.

The combination of a good understanding of taxpayer behaviour, a clear focus on making compliance less burdensome and new technology provide opportunities to implement a holistic and systemic approach for facilitating compliance for the SME sector. “Tax compliance by design” is a concept that aims at making compliance an embedded part of normal business processes utilising existing technical infrastructure and support from participants such as intermediaries, banks, industry organisations and others. It is about perceiving tax compliance as a system where all different parts work together intentionally designed to make the compliance process smooth and correct.

This is not a utopian view. Most, if not all, of the building blocks already exists and are used by taxpayers and revenue bodies to varying degrees as the examples in this report demonstrate. Electronic payments are being used, as are electronic cash registers and electronic invoicing for VAT administration. There are a number of cheap and simple to use on-line accounting systems available on the market. Some of these systems use automated bookkeeping and can connect with the banking system (i.e. the user’s bank account). Revenue bodies have electronic services for filing tax returns and other information. A number of revenue bodies work with tax intermediaries, software developers and other parties in order to provide standards for quality and reporting. The next step, expressed as “tax compliance by design”, is therefore to connect all relevant building blocks into a working whole.

The further development of compliance strategies adopted by revenue bodies for the SME sector therefore lies in supporting, structuring and organising such a system that effectively utilise different components already in place and adding others as needed that fits with the context and the preferred way of administering the tax system.

This accentuates the on-going change of the focus for the revenue body; from just being an enforcer to also be a facilitator of compliance by supporting and creating changes in the environment of the taxpayer. This changes the role of the revenue body and how it works with enforcement activities.

Enforcement activities like inspections and audits will continue to be important. But the nature of these interventions will change. It will be necessary to work with system integrity checks in order to monitor and to make sure that the system of tax compliance by design works as intended. This can be done through auditing based on random selection and also by checking quality standards and quality assurance mechanism. But most of the enforcement resources should ideally be spent on identifying transactions taking place outside the scope of the system. Unreported business transactions not captured by the system and therefore not subject to a secured chain handling or a centralised data strategy needs to be detected and dealt with.

When implemented this makes it possible, for the first time, to cover a big population of SME with a whole range of different compliance issues without having to rely on extensive use of one-to-one interventions. Such interventions can be directed towards more serious non-compliance with greater accuracy improving overall effectiveness considerably. Tax compliance by design therefore offers great potential for cost savings and increased effectiveness for both taxpayers and revenue bodies.

To achieve this, a number of components need to be in place as outlined in this report. This does not only refer to technical infrastructure and information management. Trust and taxpayer integrity are important as well as co-operation with other parties. Tax compliance by design is by definition not anything a revenue body can accomplish on its own. It depends on co-operation with a number of relevant participants.

This highlights the insight that “tax compliance by design” is more than an instrumental technique; it is an approach based on working together with taxpayers and participants in order to create “win-win” situations. It is not sufficient that the driving forces behind these changes are improved compliance and reduced costs for the revenue body only. To achieve acceptance and a willingness to adopt this approach it is also essential that businesses at large make considerable gains in terms of more efficient business processes and considerably lower compliance costs.

Recommendation

In the light of this report, revenue bodies are encouraged to consider developing a system of Tax compliance by design that is appropriate for their specific circumstances. It is recommended that they do this by following the key implementation steps described in Chapter 4:

- ***The first step:*** Assess the current situation and context. The two strategies described, the secured chain strategy and the centralised data strategy, can be helpful tools for this exercise. They and the examples quoted in the report provide some reference points and enable revenue bodies to see which of the capabilities described already exist, are in the process of being developed, or could be brought into being reasonably quickly. On the basis of this analysis, it will be possible to develop thinking about what the future infrastructure could look like and how tax compliance by design could be implemented.
- ***The second step*** is to use the vision of the desired future, to describe in more detail (but still on an aggregated level) the flow of data, information and knowledge within the system, the participants and the necessary infrastructure. This would also include descriptions of responsibilities and mechanisms for systemic assurance and quality assurance.
- ***The third and final step*** would be to plan how the system could be implemented in practice. This will involve deciding the level of control and/or involvement the revenue body or the government wants to exercise. It can range from high control to a more facilitative approach or a mix of these.

In line with the *Together for Better Outcomes* report, it is recommended that these steps are undertaken by engaging and involving SMEs themselves and the other participants in the system that is being designed.

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Tax Compliance by Design

ACHIEVING IMPROVED SME TAX COMPLIANCE BY ADOPTING A SYSTEM PERSPECTIVE

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