



ORGANISATION FOR ECONOMIC  
CO-OPERATION AND DEVELOPMENT



## **FORUM ON TAX ADMINISTRATION: COMPLIANCE SUB-GROUP**

### **Information Note**

# **Withholding & Information Reporting Regimes for Small/Medium-sized Businesses & Self-employed Taxpayers**

**August 2009**



CENTRE FOR TAX POLICY AND ADMINISTRATION

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## **ABOUT THIS DOCUMENT**

### ***Purpose***

This information note has been prepared to assist revenue bodies advance their thinking on the use of legislated withholding and information reporting regimes for obtaining improved compliance in respect of business income derived by SME/ self-employed taxpayers.

### ***Background to the Forum on Tax Administration***

The Forum on Tax Administration (FTA) was created by the Committee on Fiscal Affairs (CFA) in July 2002. Since then the FTA has grown to become a unique forum on tax administration for the heads of revenue bodies and their teams from OECD and selected non-OECD countries.

In 2009 participating countries developed the *FTA vision* setting out that... *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...*improve taxpayer services and tax compliance – by helping revenue bodies increase the efficiency, effectiveness and fairness of tax administration and reduce the costs of compliance.*

In carrying out this mandate, the FTA's work is directly supported by two specialist Sub-groups—Compliance and Taxpayer Services—that each carry out a program of work agreed by member countries, and a number of more focused task groups.

To help carry out its mandate, in broad terms, is to provide a forum for members to:

- periodically monitor and report on trends in compliance approaches, strategies and activities;
- consider and compare member compliance objectives, the strategies to achieve those objectives and the underlying behavioural compliance models and assumptions being used;
- consider and compare member compliance structures, systems and management, and staff skills and training; and
- develop and maintain papers describing good country practices as well as develop discussion papers on emerging trends and innovative approaches.

Since its inception, the Sub-group has focused its work on issues associated with improving the tax compliance of SME taxpayers. The Sub-group meets annually to review and discuss developments, to provide oversight and direction of its work program, and to provide a forum where members can exchange experiences and approaches for improving taxpayers' compliance.

### ***Caveat***

National revenue bodies face a varied environment within which to administer their taxation system. Jurisdictions differ in respect of their policy and legislative environment and their administrative practices and culture. As such, a standard approach to tax administration may be neither practical nor desirable in a particular instance.

The documents forming the OECD tax guidance series need to be interpreted with this in mind. Care should always be taken when considering a country's practices to fully appreciate the complex factors that have shaped a particular approach.

### ***Inquiries and further information***

Inquiries concerning any matters raised in this information note should be directed to Richard Highfield (CTPA Tax Administration and Consumption Taxes Division) at e-mail (Richard.highfield@oecd.org).

## Withholding and Information Reporting Regimes for Small/Medium Business and Self-employed Taxpayers

### Summary

OECD countries rely substantially on income-related taxes for the major share of their overall tax revenue. For 2006, income-related taxes across member countries accounted for almost 62% of total tax revenue; of this amount, taxes and social contributions in relation to personal income represented over 82%. Given this significant degree of reliance on income-related taxes, and taxes on personal income in particular, it is critical that a very high degree of compliance is achieved for the proper reporting of income and payment of associated taxes by all taxpayers.

Governments have evolved a number of instruments to ensure a high degree of compliance is achieved in relation to income-related taxes. The key instruments are: 1) *withholding of tax at source obligations* of payers; and 2) *systematic reporting* to revenue bodies by payers of *income paid to payees*, hereafter referred to as ‘information reporting obligations’. In practice, these instruments are deployed almost universally for employment and/or investment income. Research findings from a number of countries indicate that, subject to effective administration, these instruments result in very high levels of voluntary compliance in practice, often well over 95%.

For categories of income where these instruments are not used widely (e.g. income from business/self-employment activities), revenue bodies must rely on a range of administrative tools (e.g. education, service, enforcement, and audit-type interventions) to improve compliance. While there is evidence to demonstrate that a program of carefully crafted and delivered set of interventions can have a very positive impact on compliance, both in terms of additional tax collected and wider deterrent impacts (perhaps, at best, to a level of around 90% compliance), further improvements to the traditional mix of interventions (short of any massive expansion of audit resources, which is highly unrealistic) is likely to have only a marginal impact by way of improved voluntary compliance. In other words, some other radically different strategy is needed to achieve substantial improvements in voluntary compliance, to the levels observed for other categories of income.

Building on other work recently carried out by the Forum, this note explores the approaches and experiences of selected countries (i.e. Canada, Ireland, Japan, New Zealand, Norway, UK, and USA) that administer withholding and/or information reporting regimes to varying degrees for prescribed categories of the income of SMEs and self-employed taxpayers. It complements this research with brief reference to the use of these instruments by other OECD and selected countries. The key findings and conclusions are as follows;

- A number of revenue bodies administer extensive withholding and/or reporting regimes in respect of the incomes of SME/ self-employed taxpayers and for some countries, particularly the USA, there are indications of further significant expansion.
- The survey data reflect a preference of governments and policy makers for reporting-only regimes, although some reporting regimes provide for a withholding component as a sanction for inadequate taxpayer identification or poor compliance history, as opposed to a universally-applied withholding regime of the kind seen in almost all countries for employment income.
- There is a lack of quantitative information on the actual compliance impacts of the regimes in the SME/self-employed sector; however, the regimes were generally rated by revenue bodies as highly effective, while more compliance-related research findings provide evidence of the relatively high levels of compliance being achieved with withholding and reporting regimes for other income categories (e.g. employment and investment);
- Compliance cost considerations, which are explored in detail in the note, are a critical issue to be addressed when formulating proposals for new or expanded withholding and

reporting regimes and dictate the need for close and early collaboration with affected parties.

- There are a number of critical design and operational features that bear on the efficiency and effectiveness of such regimes:
  - 1) information reports should include a high integrity taxpayer identifier;
  - 2) an annual reporting regime appears adequate for tax administration purposes;
  - 3) a high degree of information reporting via electronic means, mandated if needed, is essential, and may necessitate tailored arrangements for smaller payers;
  - 4) reporting obligations need to be systematically enforced by the revenue body; and
  - 5) comprehensive case actioning capabilities are needed within the revenue body to deal with the high volume of discrepant reports produced by matching programs;
- From a payer perspective, the increasing computerisation of businesses' accounting systems should facilitate the operation of new information reporting regimes that to the present time have been deemed in some countries to be too burdensome on business.

Taking a longer term perspective and drawing broadly on the existing approaches and plans of a few revenue bodies, the note anticipates moves by more member countries to establish comprehensive reporting arrangements that could significantly impact future administration for this segment of taxpayers. Such arrangements could entail:

- A generalised annual information reporting requirement on business, government bodies, marketing agents, and card payment processing organisations in respect of payments and distributions made to/by businesses;
- If deemed appropriate, such reporting regime could include a withholding component as a sanction for inadequate taxpayer identification or, possibly, poor compliance history;
- Mandated use of electronic reporting by larger businesses and Government bodies and user-friendly web-based reporting facilities for smaller businesses.
- Innovative uses of such third party reporting to assist taxpayers correctly prepare their tax returns—***get it right from the start!***— to reduce the need for post-assessment verification action.

## Recommendations

- Ministries of finance and revenue bodies seeking to achieve significant improvements in voluntary compliance by SME/ self-employed taxpayers are strongly encouraged to explore the potential benefits and costs of withholding and reporting regimes where such arrangements are currently not being used, drawing on the approaches and experiences of countries as described in this note.
- Revenue bodies administering withholding/reporting regimes, or planning to do so, are encouraged to put in place an appropriate set of performance measures to enable them to periodically evaluate their regimes' operation and compliance impacts; among other things, the findings of such evaluation efforts may well provide support for extension of the arrangements to other categories of SME/ self-employed income.

## I. Withholding and Information Reporting Regimes for Small/Medium Business and Self-employed Taxpayers

### Background

1. At the April 2008 meeting of the Forum's Compliance Subgroup, delegates discussed a draft report<sup>1</sup> describing the preliminary findings of work carried out to identify country developments with their risk treatment strategies for taxpayers in the small-medium enterprise (SME) sector.<sup>2</sup> Among other things, it was noted that this work had reported that a few countries (e.g. Canada, Ireland and the UK) administered withholding and/or information reporting regimes that had been introduced to improve the compliance of SME taxpayers (including the self-employed) in selected industries. At the meeting, the OECD Secretariat also noted that its limited research had indicated that a number of other countries (i.e. USA, New Zealand, Norway and Japan) were also making use (to varying degrees) of such arrangements and that one country (i.e. the USA) was proposing further relatively significant reforms to its system of mandated information reporting requirements that were targeted, in part, at SME/ self-employed taxpayers.
2. Given the potential contribution of such regimes to achieving very high levels of taxpayers' compliance, the draft report observed that more in-depth research to identify the features, practical uses and benefits of these arrangements might assist member countries better appraise how these regimes work in practice and their overall value to improving taxpayers' compliance. Members accordingly agreed that a study should be carried out to explore the features, practical uses and benefits of withholding and/or third party reporting regimes for SME taxpayers, in selected countries where such arrangements have been established.
3. In order to provide a report relatively quickly and to minimise the work of members, it was agreed that the study would entail a survey of selected countries that were prepared to participate in the initial round of research.<sup>3</sup> The findings of this initial survey were to be captured in a draft report that would be circulated to all member countries for any additional input, leading to a final report for all members and the Forum's Bureau and the Committee on Fiscal Affairs (CFA). The objective was to complete a draft report of findings by end-2008, ideally in time for the January 2009 FTA Bureau and CFA meetings. This report is the product of the work carried out and has benefited greatly from the substantial contribution of participating revenue bodies.

### Introduction

4. This information note has been prepared to assist national revenue bodies better understand the features, practical uses, and benefits of withholding and reporting regimes implemented by a small number of countries to improve SME taxpayer compliance, thereby enhancing overall revenue collections. <sup>4</sup> For the purposes of this note, the term 'SME/self-employed' taxpayers includes all types legal entities and self-employed individuals conducting business activities, within prescribed size categories (by turnover level) as decided by individual revenue bodies.

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<sup>1</sup> See report '*Update on Innovative Risk Treatment Strategies and Measuring and Evaluating their Effectiveness*', (dated 11 April 2008) sent to all Compliance Sub-group members.

<sup>2</sup> Improving the tax compliance of SME taxpayers is the primary focus of the Compliance Sub-group's work.

<sup>3</sup> Countries agreeing to be involved in the initial work were Canada, Ireland, Japan, New Zealand, Norway, United Kingdom (UK), and United States (US).

<sup>4</sup> For the purpose of this note, the term 'SME' taxpayers refers to both self-employed persons and businesses, incorporated and unincorporated, meeting size criteria identified by individual revenue bodies.



*The significance of income-related taxes to Government revenues*

5. OECD countries rely substantially on income-related taxes (i.e. personal income tax, social contributions, and corporate income tax) for the major share of their overall tax take. In surveyed countries, direct taxes for 2006 as a proportion of total taxes were in the range of 53-72% (see Table 1). Of this amount, taxes on personal income (including ‘social contributions’) were the major element representing, on average, around 82% of all direct taxes. Given this high degree of reliance on income-related taxes, it is critically important that taxpayers accurately report their income for tax assessment purposes.

**Table 1. Significance of income-related taxes in surveyed countries (2006)**

Country	Income-related taxes (% of GDP)				2006 total tax burden %	Total income tax burden/ total tax burden (%)
	PIT	SSC	CIT	Total		
Canada	12.9	4.9	3.7	20.7	33.3	62.2
Ireland	8.9	4.3	3.8	17.0	31.9	53.3
Japan	5.1	10.2	4.7	20.0	27.9	71.7
N. Zealand	14.9	n.a.	5.8	20.7	36.7	56.4
Norway	9.1	8.7	12.9	30.7	43.9	70.0
UK	10.6	6.9	3.9	21.4	37.1	57.7
USA	10.2	6.7	3.3	20.2	28.0	72.1
OECD-aver.	9.2	9.1	3.9	22.2	35.9	61.8

Source: OECD Revenue Statistics (2008).

6. Governments and revenue bodies have evolved a number of instruments over time to ensure a high degree of compliance is achieved in relation to the reporting, assessment, and payment of income-related taxes. The key instruments are: 1) the *withholding of tax at source* by payers; and 2) the *systematic reporting* to the revenue body by payers of income paid to payees, hereafter referred to as ‘information reporting obligations’.
7. For categories of income where these instruments are not available, revenue bodies must resort to a range of education, service, and enforcement-oriented strategies to assist achieve compliance with the law. The most common of these strategies, and also the most costly, is the audit-related verification process.

*Withholding at source obligations*

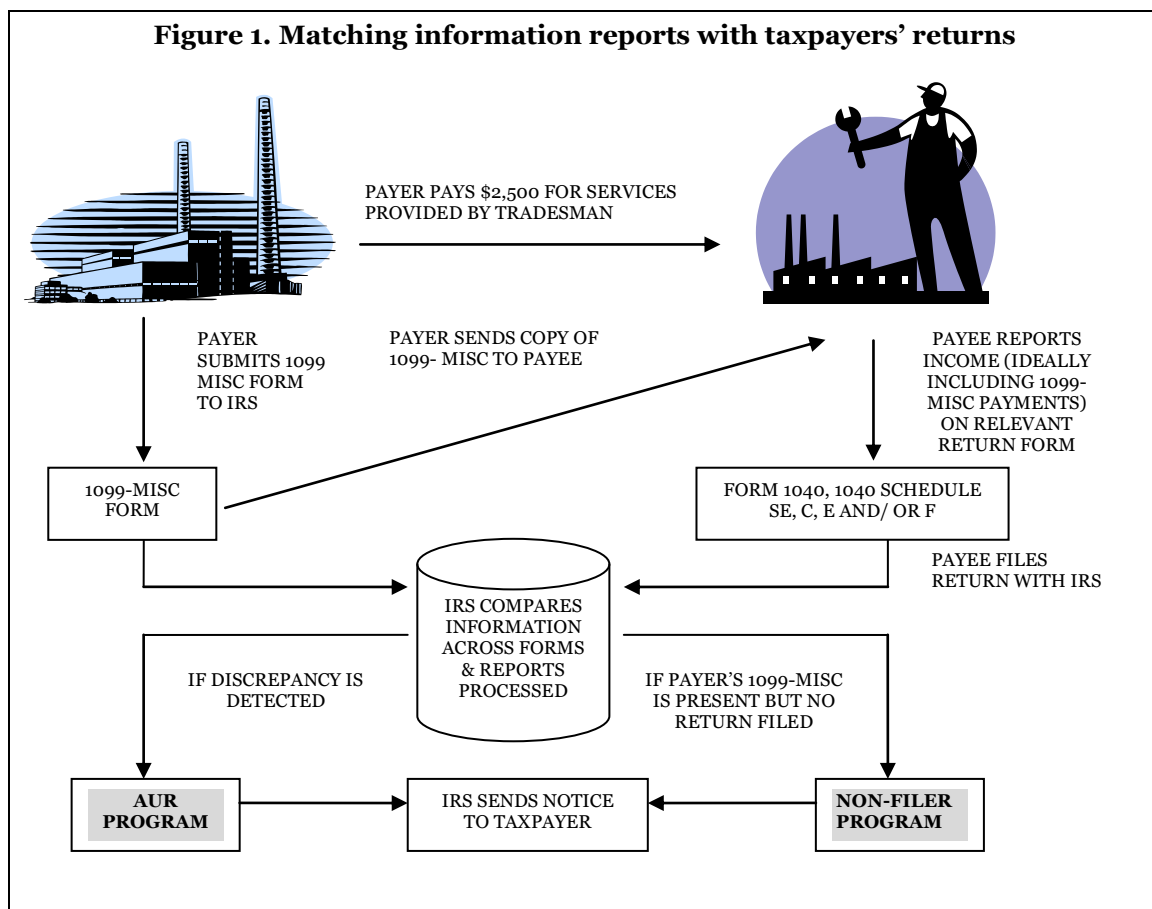
8. Withholding at source arrangements are generally regarded as the cornerstone of an effective income tax system. Imposing the obligation on independent third parties such as employers and financial institutions to withhold an amount of tax from payments of income made to taxpayers significantly reduces, if not eliminates, their ability to understate such income for tax assessment purposes, is a more cost efficient way for both taxpayers and the revenue body to transact the payment of taxes, and reduces the incidence of unpaid taxes that might otherwise arise where taxpayers properly report their income but are unable to pay some/ all of the tax assessed. Furthermore, the regular remittance by payers of amounts withheld to the revenue ensures a good flow of revenue to Government accounts and assists budgetary management.
9. As reported in the Forum’s publication *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series 2008*, use of withholding is well-entrenched in the administration of personal income taxes in OECD and other countries:
- 28 of 30 OECD countries apply ‘withholding’ requirements to the collection of taxes on employment income, the major source of personal income in all countries;
  - 23 of 30 OECD countries routinely apply ‘withholding’ requirements—either on a final or creditable basis—to payments of dividend and interest income to investors.

10. However, the application of withholding requirements in relation to other categories of income, in particular to income derived from business and/or self-employment activities is considerably more limited. As described later in this note five of the surveyed countries (i.e. Ireland, Japan, New Zealand, Norway and United Kingdom) impose withholding obligations to varying degrees to prescribed categories of self-employment/ business-related income. The USA applies a system of “backup” withholding where payees are not properly identified.

*Information reporting obligations*

11. ‘Information reporting obligations’ refer to a legislated requirement on the payers of income to report periodically to the revenue body relevant information (e.g. name and identification number of payee and amount and date of payment), either as an integral component of a withholding regime or as a separate ‘stand-alone’ requirement in relation to a prescribed category of payments. Such reports, where they are systematically matched with tax records, enable the revenue body to verify the amount of income reported by taxpayers in their returns, to identify potential discrepancies, and to identify non-filers (in receipt of assessable income).

Figure 1 below shows the automated process the IRS uses to detect mismatches between non-employee compensation reports (filed electronically or on Form 1099-MISC and covering a variety of business-related income payments) and corresponding line item information in payees’ income tax returns. This process is broadly similar to the systems used by other revenue bodies. The Automated Underreporter (AUR) program handles cases where a payee filed a tax return but, based on the automated matching process, appears to have under-reported 1099-MISC payments. The non-filer program handles cases where no income tax return was filed by a 1099- MISC payee. More details are provided later in this note.



Source: Adapted from figure provided in USGAO report ‘Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements’ (January 2009).

12. A more recent development, especially in Scandinavian countries, has seen the use of information reports (and other taxpayer-related information) held by revenue bodies to prepare tax returns applying a concept of ‘pre-filing’.<sup>5</sup> In their most advanced form, pre-filled tax returns eliminate most of the effort required of taxpayers—principally employees and investors—to prepare their annual tax return, thus considerably easing their compliance burden (see later parts for further commentary on this development).
13. Concerning business-related income, application of information reporting obligations extends more broadly (than withholding) across OECD countries but not to a significant degree. As reported in the Forum’s publication *‘Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series 2006’*, some 14 of 29 countries impose some third party reporting requirements in relation to payments for ‘independent personal services’ but the full extent of these requirements is not disclosed. As described later in this note, all of the surveyed countries impose systematic information reporting obligations to varying degrees in relation to prescribed categories of self-employment/ business-related income.

*The extent of non-compliance of SME taxpayers— what revenue bodies and others have reported*

14. Generally speaking, there is a paucity of information available across member countries concerning the overall incidence of reporting non-compliance by SME/self-employed taxpayers. This is hardly surprising given the difficulty and costs associated with deriving accurate and comprehensive measures of taxpayers’ compliance. However, a number of revenue bodies have implemented special efforts to derive estimates of aggregate evasion (and its key components) to improve their understanding of the magnitude and nature of taxpayers’ non-compliance, to gather critical data items for risk profiling purposes, and to derive benchmarks against which future progress can be gauged. Insights obtained from examination of various published reports by them and other bodies (e.g. National Audit bodies) give a fairly disturbing picture of non-compliance generally among SME/ self-employed taxpayers, and seemingly provide a case for new approaches (some of which are elaborated later in this note):
  - *United States*<sup>6</sup>: The IRS National Research Program (NRP) results for 2001 indicated that net misreporting percentages for non-farm proprietor and farm proprietor incomes in 2001 were estimated at 57% and 72% respectively; in addition, SME taxpayers accounted for just on 70% of the estimated aggregate tax gap for all taxes and taxpayers, with just over 82% of this gap attributable to income under-reporting.
  - *Sweden*<sup>7</sup>: The Swedish Tax Agency’s Tax Gap Map report published in late 2007 provided detailed estimates of the extent of non-compliance/ revenue leakage, classified by various factors (e.g. tax type, taxpayer segment). For the period examined, the aggregate amount of revenue leakage (for all taxes) for micro-businesses and SMEs was estimated at SEK 78 billion, representing around 18% of their estimated total tax liability and just over 58% of Sweden’s aggregate tax gap.
  - *United Kingdom*<sup>8</sup>: In October 2007 and November 2008, Her Majesty’s Revenue and Customs (HMRC) published the results of its work to derive estimates of direct tax losses arising from non-compliance. In its latest report, estimates for SME companies derived from its random enquiry program indicated overall non-compliance with corporate tax

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<sup>5</sup> See FTA documents on OECD’s website— ‘Using Third Party Information Reports to Assist Taxpayers Meet their Return Filing Obligations— Country Experiences With the Use of Pre-populated Personal Tax Returns’ and ‘Third Party Reporting Arrangements and Pre-filled Tax Returns: The Danish and Swedish Approaches’.

<sup>6</sup> See ‘Reducing the Federal Tax Gap—A Report on Improving Voluntary Compliance’, IRS (August 2007).

<sup>7</sup> See ‘Tax Gap Map for Sweden—How it was created and how it can be used’ Swedish Tax Agency (2008).

<sup>8</sup> See ‘Developing Methodologies for Measuring Direct Tax Losses’ HMRC (October 2007).

obligations at 15% (2001), 18% (2002), 15% (2003), and 9% for 2004; for self-assessed individuals, the majority being SME/ self-employed taxpayers, aggregate non-compliance was estimated at 11% (2000), 12% (2001), 14% (2002), 15% (2003) and 14% (2004).

- *Canada*: The CRA's core audit program selects a random sample of unincorporated SMEs for audit to estimate a reliable compliance rate. Different segments of the SME population are selected each year. In its 2008 annual report, the CRA reported an estimate derived from the random audit program of 14.6% in 2008 (in respect of non-compliance greater than \$5,000 in net federal tax).

15. These rates of compliance, while varying widely in their magnitude across countries, are considerably higher than estimates of non-compliance for the reporting of wage income reported by a few countries (e.g. United States—1%, Sweden—3/4%, and the United Kingdom — 1.1% (2004) and 1.0% (2005) (SME employers only)).<sup>9</sup>

#### *The 'compliance' rationale for withholding and/or information reporting regimes*

16. While the imposition of withholding and/or reporting obligations on third parties such as employers clearly imposes a burden (i.e. 'compliance costs') on them, these costs are generally considered to be far outweighed by the benefits they engender to the overall performance of the tax system, particularly in terms of the substantially higher levels of voluntary compliance that can be achieved with the tax laws. A clear illustration of this can be found in the findings of compliance research conducted by the IRS that are described in Box 1. These findings are broadly borne out by similar research conducted by the UK and Swedish revenue bodies that is referred to in the Forum publication '*Monitoring Taxpayers' Compliance: A Practical Guide Based on Revenue Body Experience*' (July 2008).

17. In brief, the findings from the observed research provide evidence that very high levels of compliance can be (and are being) achieved in respect of income that is subject to both withholding and information reporting requirements, while lesser (but still reasonably high) levels of compliance can be achieved in respect of income that is subject to substantial information reporting (that is used systematically by the revenue body). Compliance is likely to be considerably less in respect of income from SME/ self-employment activities that is neither subject to withholding nor information reporting requirements.

#### *The compliance and administrative costs of withholding and reporting regimes*

18. An important consideration in the design and operation of withholding and reporting regimes is the costs associated with their administration. These costs occur at two levels. First, taxpayers who are required under the law to either withhold taxes from payments and/ or report payment information to the revenue body incur a variety of costs in fully complying with their obligations – referred to in this note as '*taxpayers' administrative costs*'. With administrative cost reduction being high on the agenda of many governments at this time, this note gives special attention to the topic, and provides a number of practical ideas for easing/reducing the burden resulting from these regimes. Second, revenue bodies incur their own costs—referred to in this note as '*revenue bodies' administrative costs*'— in administering such regimes. It is likely that the existence and perceived magnitude of all these costs has discouraged some governments and revenue bodies from contemplating measures of this kind described in this note.
19. In the following parts of this note, a detailed account is given of the withholding and reporting regimes in respect of SME/ self-employed incomes administered by the revenue bodies surveyed for this study. Ideas for further and broader application of withholding and reporting are also discussed in later parts given their potential for achieved increased effectiveness.

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<sup>9</sup> As reported in the references cited at footnotes 7, 8 and 9 respectively.

**Box 1. IRS: Compliance rates & the visibility of taxpayers' incomes**

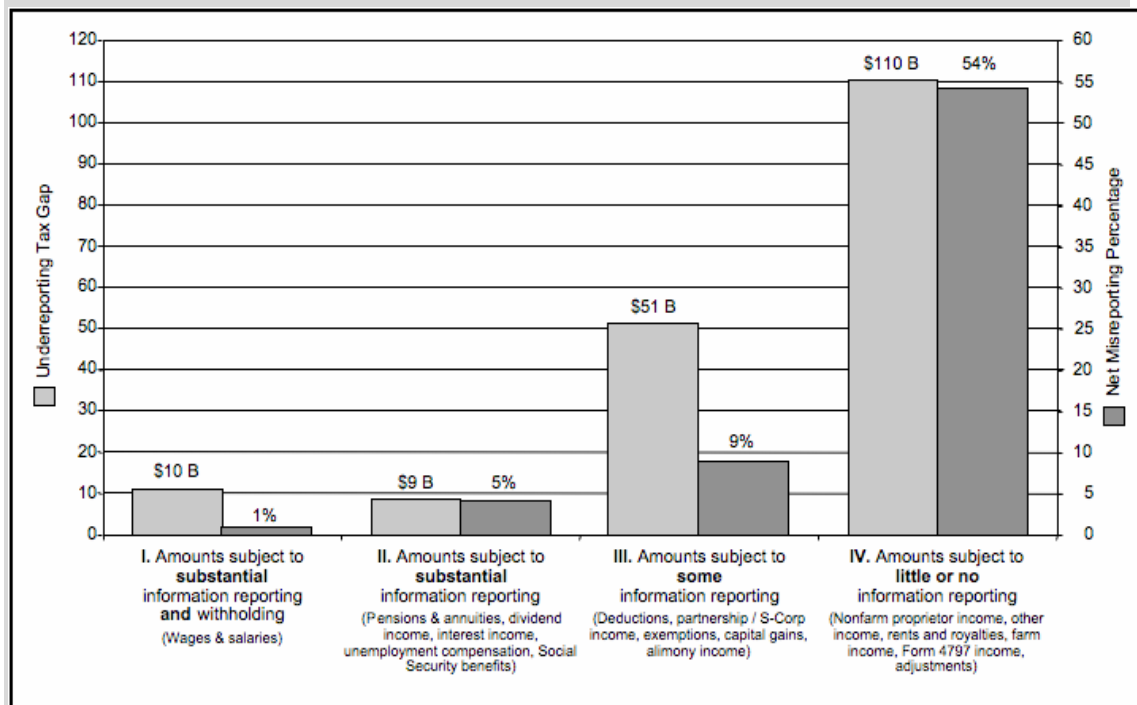
“Figure 6 presents the same (return) line items grouped by the degree to which the items are “visible” to the IRS — that is, the extent to which they are subject to information reporting and withholding. The conclusion is striking: reporting compliance is strongest in the presence of substantial information reporting and withholding. This is illustrated graphically in Figure 6. Although the contribution to the underreporting gap depends on the dollars of income or offset at stake, the net misreporting percentage is clearly inversely related to the degree of visibility.

It appears that compliance rates for sections of the Form 1040 where the most non-compliance occurs have not changed dramatically since the last compliance study for TY 1988. The amounts least likely to be misreported on tax returns are subject to both third-party information reporting and withholding and are, therefore, the most visible (e.g., wages and salaries). The net misreporting percentage for wages and salaries is only 1.2 %.

Amounts subject to third-party information reporting, but not to withholding (e.g., interest and dividend income), exhibit a somewhat higher misreporting percentage. For example, there is about a 4.5 net misreporting percentage rate for items subject to substantial information reporting, such as interest, dividends, pensions, and social security benefits. Amounts subject to partial reporting by third parties (e.g., capital gains) have a still higher net misreporting percentage rate of 8.6%. As expected, amounts not subject to withholding or third-party information reporting (e.g., sole proprietor income and the “other income” line on Form 1040) are the least visible and, therefore, are most likely to be misreported. The net misreporting percentage for this group of line items is 53.9%.

With transactions that are less visible to the IRS, and with very low audit rates by historical standards, some sole proprietors may have become emboldened to cut corners on their taxes. Other small business owners may fail to comply fully because they are overwhelmed by the cost and complexity of meeting their tax obligations and their business requirements. Whatever the reasons, there is a serious problem with underreporting for those items not subject to information reporting.”

**Figure 2. Tax Year 2001 Individual Income Tax Underreporting Gap**  
(Misreporting of Income and Offsets by “Visibility” Categories)



Based on updated estimates derived from the TY01 National Research Program study of individual income tax reporting compliance.

Source: Reducing the Federal Tax Gap—A Report on Improving Voluntary Compliance, IRS (08/ 2007).

## II. Description of withholding and information reporting regimes operating in selected countries

20. The information in this part is drawn from survey data from the 7 revenue bodies that agreed to assist in the initial information gathering stage of this work, along with relevant explanatory material obtained from their websites. The survey focused on gathering detailed information on the design features and operation of withholding and information reporting regimes administered in respect of the incomes of SME taxpayers. A snapshot of the key features of each regime, as reported by surveyed revenue bodies, is set out in Annexes 1, 2 and 3.
21. In this part, the note provides a summary of the key design features of the regimes surveyed and commentary on their practical operation, including issues identified that impede their operation, and the benefits derived from their use.

### Overview of regimes surveyed

22. The revenue bodies participating in this survey identified 10 withholding and/or reporting regimes targeting SME taxpayers. These regimes are summarised in Table 2 and elaborated more fully in Annexes 1 and 2.

**Table 2. Overview of surveyed regimes**

Country	Name of regime /1	Nature of regime	Industries targeted	Year begun
Canada	Contract Payments Reporting System (CPRS)	Reporting only	Construction & all goods & services provided on a contractual basis to Federal Government Bodies	1999
Ireland	Relevant Contracts Tax (RCT)	Reporting (withholding sanction)	Construction, meat processing & forestry	1970
	Professional Services Withholding Tax (PSWT)	Withholding & reporting	Professional services (as defined)	1987
	Third Party Returns (TPR)	Reporting only	Very broad coverage prescribed in law (see Annex 2)	1992
Japan	Statutory With-holding & Reporting (SWR)	Withholding & reporting	Specific categories of remuneration & fees prescribed in laws (not captured by 'employment income')	1899
NZ	Schedular payments (SCH)	Withholding & reporting	Very broad coverage prescribed in law (see Annex 2)	1979
Norway	Withholding tax-fishermen (WTF)	Withholding & reporting	Fishing	1956
Norway	Contracts with foreign enterprises or self-employed (FCR)	Reporting	Building and construction, other services as caught by definition	2008
UK	Construction Industry Scheme (CIS)	Withholding & reporting	Construction	1972
USA	Information Returns Program (IRP) and backup withholding	Reporting & withholding	Very broad coverage prescribed in law (see Annex 2)	1954, 1984, 2011

/1. For ease of presentation, acronyms for each regime will be used in all subsequent tables.

23. As will be apparent from the information provided:
- Withholding at source obligations for prescribed categories of payments to SME taxpayers apply in five of the surveyed countries.

- Information reporting obligations for prescribed categories of payments to SME taxpayers apply in all 9 surveyed countries; in a number of these countries, there is a ‘withholding obligation’ applied to act as an incentive for payees to correctly identify themselves as taxpayers.
- The industries targeted for either withholding and/or reporting vary across countries but ‘construction’, ‘professional services’, and the ‘agricultural sector (including fishing)’ are fairly common.
- A number of the surveyed countries have designed their regimes to ensure that contract payments made by Government bodies (including local government and quasi-government agencies) for many services are brought within the obligations of the respective regime.

### ***Purpose of the regime (as reported by surveyed revenue bodies)***

24. Revenue bodies were asked to indicate the primary purpose of the regimes that had been introduced. Their specific responses are contained in the individual annexes attached but can be summarised in the following terms:

- *Improved compliance and risk detection:* A number of bodies reported that the primary purpose was to deter non-compliance, in particular in areas of the economy open to cash dealings and/or which had been found to exhibit considerable non-compliance, and/or to provide knowledge of dealings that may present compliance risks.
- *Equity/ alignment between taxpayers:* One revenue body reported that the regime aimed to bring the treatment of self-employed persons, in terms of their tax payment and collection, into line with arrangements for employees who performed similar tasks, albeit under different legal guises (i.e. as an ‘employee’ or ‘independent contractor’).
- *Budgetary management:* A number reported that a constant flow of revenue and timely tax payment were important considerations.
- *Alleviate compliance burden:* One body reported that its withholding regime was intended to ease taxpayers’ end-year tax payment burden that would otherwise arise in its absence.
- *Law clarification:* One revenue body noted that its regime enabled it to, among other things, target payments for services not readily encompassed within its employee withholding regime (e.g. payments for services not performed by ‘employees’ as such).

25. All of these stated purposes point to a rich array of benefits that are potentially available from effective withholding and reporting regimes.

### ***Legislated design features***

#### *1) Categories of SME income targeted*

26. Revenue bodies were asked to identify the specific categories of SME/ self-employment income that were subject to withholding and/or reporting. Their responses fall into two categories:

- *Broad generic groupings:* These are essentially payments by government bodies for goods and services (Canada and USA), and business to business payments for goods and or services (Ireland and USA).
- *Specific industry/ economic sectors:* These are primarily building and construction- related payments both by contractors and designated non-building businesses (e.g. Canada, Ireland, Norway, UK, and USA) and other industries (e.g. professional services, meat processing, fishing (share of catch), forestry and commission agents. Specific information

concerning payments in the building and construction industry that are targeted by the various regimes is set in Table 3.

**Table 3. Requirements on building and construction industry**

Country	Regime	Building/construction industry target contractors
Canada	CPRS	Any entity or individual whose primary income earning activities (i.e. >50% of a business' income earning activities) is derived from construction.
Ireland	PSWT	Services covered by the regime include construction-related activities such as architects, engineering, surveying and geological. Accountable persons who must withhold include Government bodies
	RCT	Regime applies only where the principal contractor and subcontractor operate in the same industry; however, the regime extends 'principal contractor' status to virtually all government bodies /1 & certain undertakings (i.e. Gas, water, electricity, power, dock, canal and railway)
	TPR	Excludes reporting of payments covered by RCT
NZ	SCH	Contracts wholly or substantially for labour only in the building industry
Norway	FCR	Contracts with foreign enterprises of self-employed persons
UK	CIS	Any business concern that pays sub-contractors for construction work. It includes all construction businesses, government departments & local authorities & any non-construction business where their average annual expenditure on construction operations over a 3 year period exceeds £1 million.
USA	IRP	General reporting requirement currently applies to all payments (over \$600) for services performed for a trade or business by persons not treated as employees
	BUW	New proposals, effective from 2011, will require all federal and state government agencies to withhold 3% from payments for property and services (including contracts), and certain local government payments.

/1. 'Principal contractors are defined as including local authorities, public utilities, minister of Government, board established under a statute'.

## 2) Exemption from withholding but subject to reporting

27. A number of revenue bodies reported the existence of provisions that exempt certain payees from relevant withholding requirements—see Table 4 below. In the case of New Zealand's SCH regime, the provisions also exempt the payee from payers' reporting obligations. In all cases where there is a provision for exemption, payees must satisfy a "good compliance record" criteria, the precise terms of which are published by the revenue bodies concerned.

**Table 4. Arrangements for exemption from withholding**

Country	Regime	Circumstances for 'reduced' or 'nil' withholding (but with reporting)
Ireland	PSWT	Nil
	RCT	Subcontractors can seek to be paid 'gross' (i.e. free of any withholding) by applying for a 'C2' certificate of authorisation. See Annex 1. To qualify, they must have a fixed place of business, keep proper & accurate records & have a satisfactory tax record (as defined by the revenue body).
Japan	SWR	Nil
NZ	SCH	Provision for exemption from withholding where taxpayer can demonstrate they have a good compliance record and amount of withholdings would be excessive.
UK	CIS	Contractors must verify the status of their subcontractors with HMRC. Subcontractors are paid 'gross' (i.e. no withholding) where registered and certain conditions (including a good compliance history) are satisfied), net of 20% withholding (where registered with HMRC), or net of 30% withholding (where no tax record with HMRC).



## 2) Payer withholding, remittance and reporting obligations

28. Information on the specific withholding and reporting obligations of the surveyed regimes is set out in Table 5. The key and more common features of the regimes are as follows:

- *Rates of withholding:* Where applicable, the rates of withholding are variable and in some cases based on the nature of the service provided.
- *Timing of tax withholding payments:* With minor exceptions, amounts withheld must be remitted to revenue bodies on a monthly basis.
- *Reporting frequency and criteria:* Reporting frequency is a mix of monthly (NZ and UK), immediate (Norway), and annual requirements. A number of revenue bodies administer thresholds to avoid large volumes of small value payments.
- *Electronic reporting:* With minor exception, all revenue bodies offer electronic reporting capabilities for the transmission of information reports. In a number of countries, use of electronic reporting is mandatory for larger payers. Three revenue bodies indicated that initiatives were in course of development aimed at achieving wider use of electronic facilities by smaller businesses with relatively small numbers of payees.

**Table 5. Payer withholding, payment & reporting obligations**

Country	Regime	Withholding rate(s) %	Payment frequency	Reporting thresholds and frequency	Electronic reporting required
Canada	CPRS	n.a.	n.a.	Amounts > \$500/payee. /1 Annual reports 6 months after end of reporting period /1.	Yes (all gov't & payers with > 50 reports)
Ireland	PSWT	20	Monthly	Annual reports by 15 February	Yes (phased from 2009)
	RCT	35 (sanction)	Monthly	Annual reports by 10 January	No
	TPR	n.a.	n.a	€6,000 per annum /payee. Annual reports by 30/09 (companies & 31/10 (others))	Yes (phased from 2009)
Japan	SWR	10 to 20	Monthly	Annual reports	No
NZ	WT	15 to 33	Monthly /2	Monthly reports	Yes (> 50 payees)
Norway	WTF	Vary	Immediate	Annual reports	Yes
UK	CIS	30 and 20	Monthly /3	Monthly	No
USA	IRP	(sanction)	Monthly /2	Amounts > \$600. Annual reports	Yes (> 250 reports)

/1. Payers can choose calendar or fiscal year reporting period; reporting to include the fair market value of any goods and services paid via bartering; Federal Government Bodies have 3 months to report.

/2. Twice a month for large payers.

/3. Quarterly for very small payers.

## 3) Payee identification

29. Information reporting regimes, to be effective, require the use of high integrity taxpayer identifiers so that the information reports can be readily and accurately matched with taxpayers' records. For this reason, most of the regimes surveyed incorporate features designed to ensure the accurate quotation of taxpayer identification numbers by payees. These features, which include additional withholding sanctions and the use of official photo-ID certificates, are summarised in Table 6. Ireland's photo-ID requirements are described in Annex 4.

**Table 6. Payee identification requirements**

Country	Regime	Payee identification requirements	Incentive for proper payee identification
Canada	CPRS	Payee must provide relevant business or social insurance number	Contractors must make reasonable efforts to get TIN
Ireland	PSWT	Payee must provide relevant identifying number	Threat of follow up action by revenue body
	RCT	Payee must provide C2 certificate. See Annex 4	Withholding at 35%
	TPR	Payee must provide relevant identifying number as per VAT invoice	?
Japan	SWR	Payer is required to obtain payee's name & address	Fine up to Y200,000 or conviction
NZ	WT	Payee must provide relevant TIN to avoid additional withholding	Additional withholding of 15%
Norway	WTF	Payee must provide relevant tax deduction card (issued by revenue body) with TIN	50% withholding
UK	CIS	The general rule is that a contractor must verify each of their sub-contractors directly with HMRC, unless they have included the sub-contractor on a return in the last 2 years.	Maximum withholding of 30%
USA	IRP	Payer required to obtain valid TIN	Backup withholding of 28%

#### 4) Sanctions for non-compliance with withholding and reporting obligations

30. Information on the specific sanctions for non-withholding and late filing of information reports is set out in Table 7. A number of revenue bodies indicated that penalties were not being applied routinely although one signalled an intention to intensify enforcement of its requirements.

**Table 7. Sanctions for failure to pay on time and failure to report**

Country	Regime	Failure to pay tax withheld on time	Failure to report on time
Canada	CPRS	Not applicable	New regime from 2009 /1
Ireland	PSWT	Contractor can be held liable for any amount not withheld plus interest	Fine of up to €1,265
	RCT	1% interest per month	
	TPR	Not applicable	Penalty of €125/ report, up to €126,970
Japan	SWR	Additional withholding of 5 or 10%	Fine up to Y1 million or conviction
NZ	WT	Shortfall penalties can be imposed based on degree of culpability or fine	Late filing penalty of \$250 (except first time offenders)
Norway	WTF	Interest for late payment	Fine
UK	CIS	Contractor can be held liable for any amount not withheld	£100 (where > 50 payees), repeated each subsequent month if still remiss
USA	IRP/ BUW		Penalty of \$50 for every return not filed, higher if found to be deliberate

/1. Greater of \$100 and following amounts 1) \$10 per day - for less than 51 returns; 2) \$15 per day - for more than 50 but less than 501 returns; 3) \$25 per day - for more than 500 but less than 2,501 returns; 4) \$50 per day - for more than 2,500 but less than 10,001 returns; and 5) \$75 per day - for more than 10,000 returns. Total penalty limited to 100 days (meaning is capped at between \$1,000 and \$7,500).

## 5) Interaction with VAT/ GST system

31. An important consideration in the operation of withholding regimes is the interaction with VAT/ GST laws. In other words, are amounts to be withheld by payers based on the gross payments to payees, or a net amount exclusive of any VAT charged on the goods and or services concerned Information on how the reporting of payments interacts with the country's GST systems is set out in Table 8.

**Table 8. Interaction with VAT/GST systems**

Country	Regime	Interaction with VAT/ GST system
Canada	CPRS	Payments reported by contractors on T5018 slips may include any GST or provincial sales tax charged by payees; the T1204 slips reported by government bodies do not include this.
Ireland	PSWT	Contractors are obliged to deduct tax from the payment of income to be made <u>exclusive of any VAT charged by the recipient subcontractor.</u>
	RCT	Contractors must deduct tax on the gross amount (inclusive of any VAT charged by the sub-contractor).
	TPR	Report of individual payments must state whether inclusive/ exclusive of VAT
Japan	SWR	The amount including VAT is subject to withholding. However, when bills clearly distinguish remuneration from VAT, it is permissible to withhold on remuneration only
Norway	WTF	No specific rules
UK	CIS	Contractors <u>must deduct any VAT charged</u> by the subcontractor to work out the gross amount subject to any withholding and reporting
USA	IRP	Not applicable

**Administration of withholding and reporting obligations**

## 1) Withholding revenue and reporting obligations

32. Information on aggregate withholdings and the number of taxpayers subject to these regimes are set out in Table 9. While the data provided are incomplete, the information reported by Canada, Ireland, UK and USA indicate that relatively wide coverage of the SME population is achieved via the reporting obligations. In the case of the USA, the volume of reporting and coverage achieved can be expected to grow significantly once new reporting requirements come into operation (effective from 2011).

**Table 9. Withholding revenue collections & taxpayer coverage of regimes**

Country	Regime	Annual withholding revenues (millions)	Income covered by withholding / reporting regime (millions approx.)	Taxpayers covered by reporting	
				Number (millions)	% of SME population
Canada	CPRS	Not applicable	n.avail.	1.45	66
Ireland	PSWT	EUR 527	Around EUR 3,000	??	??
	RCT	EUR 920	n.avail.	0.118	57
	TPR	Not applicable	n.avail.	n.avail.	n.avail.
Japan	SWR	JPY 1,340,000	n.avail.	n.avail.	n.avail.
NZ	WT	NZD 3, 890	n.avail.	n.avail.	20-25
Norway	WTF	Not available	n.avail.	n.avail.	n.avail.
UK	CIS	GBP 4,000	GBP 20,000	1	22
USA	IRP	USD 1,278	n.avail.	23.4	42

2) Processing of information reports

33. Information reporting regimes, especially those intended to operate on any significant scale, rely on the use of electronic reporting and information processing systems to ensure that the vast bulk of data can be quickly captured and matched with taxpayers' records and actioned systematically, all at minimal cost. Information concerning these requirements extracted from survey responses is set out in Table 10. As will be apparent, a number of revenue bodies undertake comprehensive data capture of the reports received although, with the exception of the USA, the vast majority of this information must still be captured manually. Three revenue bodies reported that work was underway to increase the use of electronic reporting.

**Table 10. Processing of information reports**

Country	Regime	Information reports in last fiscal year		
		Total received	Electronic %	Total captured
Canada	CPR	1.45 million	18	1.23 m (approx. 85 %)
Ireland	PSWT	749 (covering multiple payees)	9	None
	RCT	41,400 (covering 118,000 payees)	30	All
	TPR	20,000 (covering multiple payees)	15	Not known
Japan	SWR	9.2 million /1	50 (estimate)	n.avail
NZ	WT	2.14 million	22	2.03 m (around 95%)
Norway	WTF	n.avail	n.avail	n.avail
UK	CIS	2.1 million monthly returns (covering multiple payees)	30	All (for 1 million payees)
USA	IRP	66.2 million	61	All- 66.2 million

/1. Data covers fees and remuneration category for 2005 (out of a total of 125 million reports).

34. From the information in Table 10 it will be apparent that the USA IRS administers by far the largest information reporting program covering SME/self-employed taxpayers. Additional data provided in a recent USA GAO report gives some useful insights as to the scale and composition of the program and the nature and extent of reporting arrangements—see Box 2.

**Box 2. IRS Information reporting metrics- Form 1099-MISC**

In aggregate, the IRS receives around 1.8 billion information reports each year covering a wide variety of taxpayer incomes. Payers are required to submit Form 1099-MISC for a variety of payments made in the course of a trade or business (but not including wage income which is reported separately). The types of payments included on a 1099-MISC include payments to non-employees for services provided of at least \$600 (called non-employee compensation), rental payments, royalty payments of \$10 or more, and medical and health care payments made to physicians or other suppliers (including payments by insurers) of \$600. The data hereunder give a sense of the scale and nature of the reporting undertaken.

**Nature and amounts of income reported:** For tax year 2006, over 5 million payers submitted 82 million reports 1099-MISCs to the IRS, reporting over \$6,000 billion of payments. Of these payments:

- \$2,329 billion were non-employee compensation for services;
- \$ 1,186 were medical and health care payments & \$878 billion were gross attorney fees;
- \$762 billion were non-qualified deferred compensation plans and \$230 billion were rents.

**Volume of reports and use of electronic media:** Payers submitting more than 250 reports are required to report electronically. For tax year 2006:

- 22,000 payers submitted > 250 reports (42 million reports), virtually all on electronic media;
- 103,000 payers submitted 50-249 reports (10 million reports), 25% on electronic media;
- 770, 000 payers submitted 10- 49 reports (14.5 million reports), 10% on electronic media;
- 930,000 payers submitted 5-9 reports (6.1 million reports), 10% on electronic media; and
- 3.2 million payers submitted 1-4 reports (6.2 million reports), 10% on electronic media.

Source: USA GAO report 'Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements' (January 2009).

35. The operation of information reporting regimes, particularly using electronic media, does present issues concerning data security and the need to ensure that personal taxpayer information is properly protected both in the course of transmission to the revenue body and when in the revenue body's possession. While not the subject of detailed study for this note there are well-established practices for data transmission and security within revenue bodies in respect of other large scale categories of information that they already receive (e.g. employers' reports of employee incomes etc, reports by financial institutions of interest payments).
36. A number of revenue bodies (i.e. Canada, Ireland, NZ, UK and USA) also provided a detailed description of the arrangements they apply in practice to deal with large numbers of cases reported by the matching systems after processing information reports. The key points are as follows.
- The matching process, centrally conducted, typically produces a large inventory of cases requiring some form of follow-up attention.
  - Cases tend to be "scored/ risk rated" using various criteria; the extent to which understatements of reported income can be accurately identified and quantified depends on whether corresponding income items are separately identified in taxpayers' returns (which is not always the case in the countries cited).
  - Automated systems are used to deliver cases to revenue officials for review; follow up action is either by adjustment action where an error has clearly been made by the taxpayer or by written correspondence to taxpayers where further information is needed.
  - Linkages exist to non-filer/ late filer programs, enabling use of the reports to determine potentially productive cases for follow up action.
  - Reports are also generally available to audit staff to assist with their examinations.

3) *Administrative uses of information reports*

37. Data on the enforcement outputs resulting from use of the reporting provided by the various regimes are set out in Table 11. Unfortunately, many revenue bodies could not provide any separate results, in some cases because the reports are not systematically matched with tax records. However, the information provided by Canada, Ireland and USA provide clear evidence of the substantial assistance given to verification and late/ non-filer detection of the respective revenue bodies.

**Table 11. Administrative uses of information reports**

Country	Regime	Enforcement uses in latest full fiscal year (2007)			
		Cases of unreported income (no.)	Tax and penalty	No. of late/non-filers detected	Tax and penalty
Canada	CPR	1,1035	CAD 10 m	42,058	CAD 297 m
Ireland	RCT	3,807 audits & 41,161 assurance checks	EUR 167m	4,600	n.avail
UK	CIS	8,978	GBP 15.9m	n.avail	n.avail
USA	IRP	1.926 million	USD 2.1 billion	Not available for SME taxpayers but aggregate data for <u>all</u> taxpayers reported at over 1.356 million contacts in 2007 resulting in \$14 billion in assessments.	

4) Other uses of information reporting regimes

38. A number of revenue bodies reported that the operation of the reporting regimes assists in the administration of other responsibilities carried out by the revenue body. These included: 1) identifying businesses (not registered for VAT) whose turnover exceeded the registration threshold; 2) identifying businesses treating workers as “independent contractors” where it appeared they were likely to be employees (and subject to tax withholding at source); 3) validating welfare entitlements and establishing Child Support liabilities; 4) providing additional intelligence for audit inquiries; and 5) for withholding regimes, the possibility of excess tax payments for some taxpayers providing a source of revenue against which other government debts could be offset.

5) Operational/ practical issues arising in the administration of regimes

39. Revenue bodies were asked to identify problems that arise in practice that hinder or complicate the operation of the regimes. Examples cited by some or identified from other sources are set out below:

- **Correct taxpayer identification:** A number of revenue bodies highlighted issues with obtaining correct TINs and associated identity information concerning payees (e.g. quotation of wrong numbers, incomplete payee identity detail, and identity theft).
- **Paper reports:** Large volumes of paper reports sometimes mean that this work receives low priority and as a result some of the reports received are not captured for matching. The failure to capture all of the reports available inevitably reduces the ability of the computerised matching system to detect potential omissions of income and/or late filers (deriving business income) and to rank cases based on their tax revenue potential.
- **Confusion or lack of awareness by taxpayers and others concerning reporting obligations:** Large scale reporting regimes require a significant effort by the revenue body to ensure that payers are aware of and understand their obligations, and that there is follow up action where payer reporting non-compliance occurs. For example, the recent GAO study <sup>10</sup> that examined the IRS’s administration of its miscellaneous reporting requirements encouraged it to: 1) strengthen activities aimed at better educating payers, especially newly-commenced businesses, of their obligations and to improve associated instructional materials and return forms; 2) clarify reporting obligations, particularly concerning the application of thresholds and where distinctions are made, for reporting purposes, between individuals and incorporated entities; 3) increase outreach to paid tax preparers and tax software vendors to promote awareness of reporting obligations; 4) provide for payers an Internet-based fillable form for reporting purposes (enabling them to avoid burdensome paper-based reporting arrangements or the costs of purchasing software); 5) standardise reporting due dates for all information categories; and 6) waive late reporting penalties for first-time payers.
- **Tax return form design:** Large scale computer-based matching systems used by revenue bodies to validate taxpayers’ reporting compliance are most effective when the income category being reported can be matched with corresponding information in tax returns (e.g. all reported payments of interest are matched with an aggregated amount of interest income reported by taxpayers in their returns). However, for categories of SME/ self-employment income such matching can be complicated because many of the taxpayers concerned derive some of their income from sources that are not subject to reporting and only report aggregated information in their returns. Unless, there is a unique label in return forms where taxpayers are expected to disclose the amount of income subject reporting practical difficulties can arise in the detection of cases involving unreported income.

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<sup>10</sup> See GAO report ‘Tax Gap: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements’ (January 2009).

- **Overall regime design:** UK HMRC reported that its regime had been recently redesigned to streamline and simplify its operation for both business and the revenue body—see case study example at Annex 6.
40. An additional issue presented with information reporting regimes concerns data security and the confidentiality of taxpayers' information. The transmission of large volumes of taxpayer information by payers and its internal processing within a revenue body must be supported by effective data security safeguards to avoid improper release of taxpayer information. For revenue bodies that currently administer extensive information reporting regimes (e.g. for employment income) such arrangements should already be in place. However, where this is not the case, the provision of data security safeguards is an essential consideration.

6) Views and reactions of external parties on the introduction and operation of these regimes

41. The operation of withholding /reporting regimes in respect of SME income presents additional compliance costs for the businesses that are expected to administer aspects of their operation. Revenue bodies were asked to provide any insights as to businesses' views and reactions concerning the introduction and operation of the studied regimes. Responses concerning their experiences basically fell into two categories:
- The introduction of such regimes is often associated with considerable resistance but this tends to soften over time as the regime becomes entrenched and the benefits become more obvious—see Box 3 which gives an illustration of the sorts of issues and concerns that can arise in practice.

**Box 3. Example—Issues arising with the implementation of new regimes**

The following comments are drawn from the IRS's survey response concerning new regimes in course of development for implementation in 2011 and 2012:

*"We are aware of concerns with the withholding and reporting requirements related to certain government payments. The concerns are being raised by both the government entities who will be required to WH and report as well as taxpayers who do business with the government entities who will be the subject of the requirements. They include concerns on whether the 3% rate is higher than the profit margin of the transaction, whether taxpayers will be able to receive a refund of the WH during the year or will be required to wait until they file their income tax returns, as well as the costs for both to create new processes and programming to be in compliance.*

*There is a concern by impacted taxpayers and reporting parties that merchant card reporting will create burden for them. In developing the proposal, we sought information and insight from the industry to understand the burdens and developed the proposal around trying to mitigate concerns. There will be costs to the reporting agents to develop the records and necessary reporting mechanisms to comply. There will be costs to the IRS in ensuring our systems can properly receive the reports and process them to appropriately use in our compliance programs. We will also have to build our compliance programs, developing procedures for use of the reports, once the information is available. The procedures will be critical to ensure we do not burden taxpayer compliant taxpayers unnecessarily based on the information we receive."*

- Some elements of business appreciate compliance improvement initiatives that aim to "level the playing field" for industry participants, reducing the use of tax evasion by some operators in order to gain a competitive advantage over their business rivals.
- Generally speaking, revenue bodies indicated that there were no major issues with businesses' compliance with the withholding and reporting regimes in place. However, some specific compliance issues were mentioned. NZ IRD observed that it was quite common for small businesses in the building and construction industry appearing to be unaware of their withholding responsibilities in respect of 'labour only' contractors. The CRA noted that because payers were not required under the CPRS to issue information slips directly to recipients, some recipients argued that they did not know what to return as income in their tax return.

42. A lesson from experience, and evident from the insights captured in Box 3, appears to be that business groups should be consulted widely in the design of new regimes well in advance of their implementation so that their impacts on business can be minimised. Furthermore, implementation should be closely monitored to ensure that “irritants” are quickly identified and remedied.

*Revenue bodies’ views on the effectiveness of these regimes and future plans*

43. Generally speaking, the regimes studied for this report were introduced with the objective of preventing non-compliance with tax laws and, in the event of non-compliance, to provide information that would facilitate its detection. With minor exception, revenue bodies commented favourably on the effectiveness of these regimes, with the USA IRS pointing to the very positive findings of its compliance research efforts. A number of bodies provided evidence of their significant contribution to verification and non-filer enforcement programs. On the other hand, some comments suggested that there was potential for greater benefits by making better use of data and with some regime redesign :

- **Canada:** *“CRA managers and staff involved in the CPRS program fully support it..... Program results achieved to date are significant and strongly support continuing the program. The program has resulted in over \$650 million in tax assessments over the preceding four years (ending March 31, 2005). Results have been especially notable in the identification of sub-contractors who failed to file tax returns. However, results to date in the audit program suggest a need for a review of the CPRS audit program to ensure that it is achieving acceptable results in addressing the underground economy..... Notwithstanding the positive results that have been achieved to date, changes to the design and administration of the program would improve its overall effectiveness. Design concessions made to minimize administrative burden on the industry, in order to gain the support of the industry have, in fact, adversely impacted the administration and effectiveness of the program. Optional filing periods make it more difficult and less efficient for the Agency to identify non-compliant behaviour with respect to the filing of tax returns and the reporting of income. The provision of information slips to taxpayers is a key feature of third-party reporting systems designed to promote voluntary compliance. This requirement is missing from CPRS and is likely detracting from the strength of the program in this area. Finally, the exclusion from the program of the retail home renovation sector within the industry, which has grown significantly since the introduction of CPRS, is creating perceptions of inequity within the industry and is potentially resulting in significant tax leakage.*
- **Ireland:** Concerning the PSWT ..... *“Arrangements are generally regarded as contributing to improved compliance over time.”* Concerning its TPR program.... *“Reporting regimes are currently minimally effective. The move to mandatory electronic filing should bring about substantial improvement.”*
- **Japan, New Zealand, Norway, United Kingdom and United States:** All these revenue bodies described their respective regimes as highly effective. The IRS also offered the following comment.....

*“Third-party reporting requirements greatly increase compliance. Only 1.2% of wages reported on Forms W-2 are under-reported. But 54% of income not subject to information reporting is under-reported. Third-party reporting is critical for ensuring voluntary compliance. Without reliable third-party data, the IRS cannot easily detect errors in the absence of expensive and intrusive audits. The IRS receives over 1.5 billion information returns a year, reporting income from employers, financial institutions, third-party payers, and state and federal governments. However, the IRS still lacked reliable information on certain types of income, most notably income earned by small businesses & the self-employed.”*



44. An indication of the value of these regimes can also be gleaned from revenue bodies' plans to expand their scope. In this respect, the following advice was received from a number of surveyed revenue bodies:

- **Canada:** The CRA is seeking to have the CPRS expanded to encompass the retail construction sector thereby capturing those sub-contractors used by retail businesses to undertake renovation work for their customers (e.g. installing new kitchens purchased through retail outlets). (As of February 2009, a legislative proposal was being drafted for submission.)
- **New Zealand:** The IRD is currently examining the inclusion of the vegetable growing industry in its regime.
- **United States:** Legislation has been enacted that will substantially expand the capture of payments made to SME taxpayers when the new requirements come into operation:
  - Payments made by payment settlement entities (e.g. credit card companies and banks) to merchants in respect of card purchases (annual reporting from 2012).
  - Payments by federal and state government bodies to business for property and services (including contracts) and certain local government payments (subject to 3% withholding and reporting beginning in 2011).

Also under consideration are certain payments to corporations in the course of a trade or business (that would complement existing reporting obligations where such payments are made to individuals).<sup>11</sup>

### **Costs of administration for business and revenue bodies**

#### *Costs for business and other third parties*

45. As noted at the outset, the imposition of withholding and/ or reporting regimes presents additional costs for business (and other bodies that assume such obligations) and revenue bodies. While the survey for this study did not seek to obtain detailed information on the nature and incidence of such costs they are clearly an important consideration in considering the feasibility of such a regime and, if it is decided to proceed, how it should be designed to minimise the burden on business. This will be especially the case in those countries where there is a clearly stated government policy and emphasis to reducing the administrative burden on business and citizens resulting from government (including tax) regulations.<sup>12</sup>

46. Drawing on exchanges with members and knowledge obtained from general experience with these regimes, it is possible to present a generic framework of the costs incurred by the various parties involved with administering withholding and information reporting regimes. Such a framework is set out in Table 12, along with an outline of factors that can/may influence the incidence of such costs in practice.

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<sup>11</sup> In February 2008, Treasury's proposals for increased information reporting were estimated to produce additional revenue of around \$9 billion in the period 2009-2013. (See 'General Explanations of the Administration's Fiscal Year 2009 Revenue Proposals' Department of Treasury).

<sup>12</sup> For related Forum work on administrative burden reduction, see 'Programs to Reduce the Administrative Burden Resulting from Tax Regulations', FTA, January 2008.

**Table 12. Generic framework: Administrative costs to business of withholding/ information reporting regimes**

<b>Parties impacted</b>	<b>Nature of costs typically incurred with withholding and reporting regimes</b>	<b>Factors influencing (+/-) the overall level of these costs</b>
Business operators (i.e. payers)	Costs associated with: 1) Taking steps to become aware of obligations. 2) Obtaining information required from payees. 3) Costs of adjusting payroll/ accounting system. 4) Accounting for any taxes that must be withheld from payments made. 5) Preparing information returns for revenue body. 6) If required, preparing payees' information slips. 7) Dealing with inquiries by revenue body. 8) Dealing with inspections by revenue body. 9) Keeping records related to regime's administration. 10) Personnel costs for 1) to 9) above.	Scope of regimes in terms of numbers of businesses impacted.  Extent of withholding applied.  Nature/ sophistication of payee identification regime in place.  Frequency of payers' reporting obligations to revenue body.  The existence, if any, of special incentives to offset taxpayers' cost burden. <sup>13</sup>
Business operators (as payees)	Costs associated with: 1) Providing information required to payers. 2) If needed, obtaining certificate etc from revenue body. 3) If needed, assembling information for tax returns.	Extent of payers' automation for producing information returns & sending to revenue body.

47. Research conducted as part of this study brought to light one example of a particular regime that had been the subject of detailed study to establish the scale and nature of costs incurred by businesses in its operation. This regime was the UK's Construction Industry Scheme which was subject to a detailed costing in 2005/06, as part of a comprehensive 'whole of government' study of the administrative burden on business of all government regulations (including taxes).<sup>14</sup> Selected findings from the published details of this research are set out by way of a 'case study' at Annex 6, along with a brief description of measures subsequently implemented from April 2007 to streamline the CIS's obligations on business and thereby reduce its administrative burden on them. While the findings of this work to quantify administrative burden are peculiar to the specific design features of the CIS existing at the time, they and the reforms subsequently implemented give some insights as to the kinds of issues that can arise in practice and how they can be resolved.

48. Research also revealed some relevant experience from other countries that may assist in consideration of this issue:

- **United States:** The costs and uses of third party information returns were the subject of a study conducted in 2007 by the United States General Accountability Office (USGAO) <sup>15</sup>.

<sup>13</sup> Other work conducted by the Forum reported that two countries (i.e. New Zealand and UK) administered monetary incentives to encourage employers to report employees' information reports using electronic means. In the case of New Zealand, certain employers were encouraged to use (free of charge) designated payroll agencies, while the United Kingdom administered a scheme of monetary payments over a mandated period of time for returns filed electronically by designated employers.

<sup>14</sup> See 'Administrative Burdens—HMRC Measurement Project (Report by Tax Area: Construction Industry)' (March 2006)—see HMRC's website.

<sup>15</sup> See 'Tax Administration: The Costs and Uses of Third-party Information Returns' (Report to the Committee on Finance, US Senate), USGAO, November 2007.

The purpose of this study, which revenue bodies are encouraged to examine if considering new reporting regimes, was to identify the compliance costs associated with existing information reporting requirements as reported by selected case study payer organisations and other bodies involved with information reporting, to determine the kinds of third party compliance costs that may result from two new information reporting proposals—merchant payment card re-imbursements and payments to corporations (as noted in para. 44)—and any options for mitigating the costs, and to determine the IRS’s ability to process and use additional information returns. The key findings, albeit from a very small sample, in relation to existing and future administrative costs to business are set out in Box 4 and, as will be apparent, while a relevant consideration do not appear to present a major obstacle in the USA context.

**Box 4. Key findings from USGAO study on the costs of information reporting**

The following summary is a verbatim extract from the referenced report (pages 3-4).

“In our nine case studies, filers of information returns told us that existing information return costs, both in-house and for external payments, were relatively low. In-house compliance costs included the costs of getting taxpayer identification numbers (TIN), buying software, tracking reportable payments, filing returns with IRS, and mailing copies to taxpayers. One small business employing under five people told us of possibly spending 3 to 5 hours per year filing Form 1099 information returns manually, using an accounting package to gather the information. An organization with more than 10,000 employees estimated spending less than .005 percent of its yearly staff time on preparing and filing Forms 1099, including recordkeeping. Two external parties reported prices for preparing and filing Forms 1099 with IRS of about \$10 per form for 5 forms to about \$2 per form for 100 forms, with one of them charging about \$.80 per form for 100,000 forms. As expected, unit prices for services provided to payers by selected software vendors, service bureaus, and return preparers decreased as the number of forms handled increased.

New information reporting requirements for payment card reimbursements and payments to corporations would impose new compliance costs, some of which could be mitigated. For payment card reimbursements, compliance costs would include (1) merging separately stored TINs and merchant identification numbers, especially in the case of multiple locations or franchises; and (2) more generally, new systems and added service requirements. Mitigations could include (1) having the reporting party be as close as possible to the merchant in a payment or reporting chain and (2) extending current systems and procedures that, for instance, might already generate and report related data for other purposes.

For payments to corporations for services, payer compliance costs would include, for example, additional bookkeeping and postage, as well as the need for TIN collection and distinguishing between payments for goods or for services. Mitigations could include using or extending current systems, limiting information return recipients to only some corporations, and grandfathering ongoing relationships for TIN collection and other purposes or specifying a lead time for collecting information on them.”

The report also noted that..... “These nine case studies provide examples of costs but are not to be generalized to the entire population; however, they do provide insights from the perspective of organizations of different sizes and from different industries and of organizations filing their own information returns and those filing on behalf of others”.

Source: *The Costs and Uses of Third-party Information Returns* (Report to the Committee on Finance, US Senate), USGAO, November 2007.

- **Ireland:** A small scale study <sup>16</sup> conducted in 2008 by the Irish Commissioners brought to light two concerns of businesses required to make third party returns. The first related to the requirement on business to review all payments made during each reporting period to determine if the totals to any third party exceeded the legislated threshold (i.e. €6,000). The need for such a task highlights the potential value of accounting software packages in the

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<sup>16</sup> See *Key Administrative Burdens Faced by Revenue’s Small and Medium-sized Business Customers* (Revenue, March 2008)

annual reporting process. The second concern reflected a basic lack of understanding by the business involved of how the information was to be used. This caused the Revenue to consider further education initiatives in this area on the basis that people can be expected to respond more readily if they understand why a request is being made (and presumably, when they see evidence that the information supplied is being used for the stated purpose.

- **Canada:** The CRA reported that the compliance cost issue was explored as part of a public opinion survey completed in March 2004. This survey reported industry participant’s estimated time figures ranging from around one-half hour to one week/ year, with most saying that the time was a day or less. For those giving cost figures, estimates ranged from \$150 to \$3,000, with most saying \$600 or less. The survey also noted a fair degree of opposition to the CPRS on the grounds that it was effective in countering the underground economy, the costs incurred in its administration by business, and the fact that some participants were unaware of how the information was being used and the results obtained.

Concerning the ease of meeting the reporting obligation, the survey report noted a wide range of opinion as to the ease of completing and filing third party returns. Participants noted, however, that where the reporting requirement was pre-programmed into accounting software it could be significantly simplified and sped up. The CRA reported in 2008 that consideration was being given to the creation of a special on-line e-filing system for small contractors.

*Administrative costs of revenue bodies*

49. The survey did not seek detailed information on the cost to revenue bodies of administering withholding and reporting regimes for SME/self-employed taxpayers, given perceived difficulties in their quantification. However, it is possible to provide a generic framework of the costs typically incurred that may be of use to members—see Table 13.

**Table 13. Generic framework: Administrative costs to revenue bodies of withholding/ information reporting regimes**

Nature of costs typically incurred with withholding and reporting regimes	Factors (+/-) influencing the overall level of these costs
Costs associated with: 1) Preparing & distributing explanatory material to parties concerned. 2) Design of internal systems (incl. IT systems). 3) Processing payments of taxes withheld. 4) Dealing with taxpayers’ inquiries. 5) Processing information reports to taxpayer records. 6) Enforcing regimes’ obligations with payers/ payees. 7) Following up reported discrepancies.	The extent to which established information reporting arrangements (including e-reporting) within the revenue body (e.g. for wage and investment income) can be used to absorb new information streams.  Extent of revenue bodies’ automation capabilities (e.g., for data capture, validation, matching).  <b>To be explored!</b> Can business income- related data be used to assist taxpayers complete annual return filing, applying the concept of pre-filing.

50. A factor to be borne in mind is that for those revenue bodies that already have well established systems of information reporting and matching (e.g. those revenue bodies where pre-filing approaches or post-assessment checking systems are already well established using already existing information streams), there may not be significant additional costs of an ongoing nature for a new regime covering some categories of SME/self-employed taxpayers.

### III. Withholding and information reporting regimes in other countries

51. In order to ensure that the study report fully reflected the extent to which withholding and/or reporting regimes for SME/ self-employed income were used across all member countries, limited inquiries, augmented by research, were made of members not covered by the detailed survey. The summary results of these inquiries are set out in Table 14, and elaborated more fully in Annex 8.

**Table 14. Use of withholding and reporting regimes in respect of SME/ self-employed taxpayers in other OECD and non-OECD countries**

Country	Perceived degree of coverage of SME/ self-employed taxpayers /1	Nature of income-related payments caught by regime	Regime type /2
Australia	Very limited	Specifically prescribed individuals in industry groups and exception situations	W&R
Austria	Limited (for self-employed individuals only)	Payments by business to unincorporated self-employed taxpayers for services supplied	R
Belgium	Limited	Payments by government	R
Chile	Limited	Minor prescribed categories (mainly individuals)	W&R
Denmark	Nil	None identified	-
Finland	Extremely limited	Self-employed & SMEs that are <u>not registered</u> : and other minor categories	W&R
France	Nil	None identified	-
Hungary	Nil	None identified	-
Germany	Broad (but building only)	Payments for construction work	W&R
Greece	Fair degree of coverage	Payments by government and for construction	W&R
Italy	Limited (mainly self-employed)	Limited number of minor prescribed categories	W&R
Korea	Very limited	Prescribed professions	W&R
Mexico	Broad	Multiple payment categories	W&R, R
Netherlands	Limited (individuals only)	Persons (other than employees) providing services	R
Poland	Nil	None identified	-
Portugal	Nil	None identified	-
Singapore	Limited (non-residents only)	Prescribed payments to non-resident taxpayers	W&R
Spain	Broad	Business to business payments and prescribed payment categories	W&R, R
Sweden	Limited	Government subsidies	R
Switzerland	Nil	None identified	-
Turkey	Broad	Multiple payment categories across major sectors	W&R, R

Sources: Revenue bodies and IBFD

/1. Adjudged having regard to the scope of payments subject to withholding/ reporting compared with wider population.

/2. W- withholding; R- reporting

52. These inquiries indicate that in addition to some of the surveyed countries, a few other countries (i.e. Greece, Mexico, Spain and Turkey) appear to have quite substantial withholding and reporting regimes in respect of the business income of SMEs and self-employed taxpayers. On the other hand, a number of countries reported minor or no regimes at all.

#### IV. Reducing the systemic non-compliance of SME taxpayers—the potential of withholding and reporting regimes

53. Much of the work of the Compliance Sub-group over the last 5/6 years has focused on revenue bodies' efforts to develop more effective risk treatment strategies using a mix of administrative interventions (e.g. education, service, publicity, verification, and penalties) to achieve improved compliance in targeted risk areas in the SME-self-employed segment of taxpayers. While there is evidence to demonstrate that a program of carefully crafted and delivered set of interventions can have quite a positive impact on compliance, both in terms of additional tax collected and wider deterrent impacts (perhaps, at best, to an overall level of around 90% compliance), further improvements to this traditional mix of interventions (short of any massive expansion of audit resources, which is highly unrealistic) is likely to have only a marginal impact by way of improved overall voluntary compliance. In other words, a different treatment strategy is needed to achieve further improvements in voluntary compliance, of the order experienced for, say, employment income.
54. Compliance-related research findings from a few revenue bodies (e.g. Swedish Tax Agency, UK HMRC, and USA IRS) provide evidence of the relative effectiveness of withholding and/ or reporting programs (where the latter are systemically enforced and applied) in achieving high levels of compliance by taxpayers.<sup>17</sup> In line with this observation, the information in this note provides support for the likely benefits of such regimes in respect of categories of SME incomes and there are indications of a trend to make greater use of these tools for compliance improvement objectives. However, in taking this idea further there are also a number of challenges and risks to be confronted.

“Now, you and I know that when it comes to closing the tax gap, there’s no easy solution or silver bullet. As I have said on numerous occasions, we cannot audit our way to full compliance. But we can enhance our enforcement presence through greater use of innovation and new tools.

**Information reporting will be one key to our future success** and recent bills passed by Congress.....will be important to our enforcement efforts”

*(Douglas Shulman, IRS Commissioner, Tax Executives Institute (October 21, 2008).*

#### **Possible future directions**

55. As noted in paragraph 54 and evident from the information in Table 14, withholding and reporting regimes targeting income from SME and self-employment activities are used to widely varying degrees across member countries. Where such regimes are used, surveyed revenue bodies commented very favourably on their effectiveness in a tax compliance context. However, they also acknowledged that a fair administrative effort is required on their part for such regimes to be fully effective. Furthermore, comprehensive and sustained efforts are needed to ensure that the administrative burden placed on business from such regimes is minimised. These same sentiments apply equally to withholding/ reporting regimes in respect of employment income that, with few exceptions, are used by all member countries.
56. Drawing on the: 1) the experience and plans of surveyed bodies (as described in this note); 2) the increased opportunities presented for cheaper reporting by business with growing use of technology; 3) the likely increased demands on revenue bodies over the medium term for

<sup>17</sup> In response to the findings of its own study into the non-compliance of sole proprietors and concern for the size of the tax gap, the US GAO in 2007 reported on the need for a strategy to reduce the tax gap that should include a comprehensive set of options to addresses sole proprietor non-compliance and provided its own detailed range of ideas. Significantly, most of the ideas advanced by the US GAO involved information reporting, including: 1) introducing new B2B income-related information streams; 2) plugging gaps in existing reporting regimes; 3) enhancing the web-based reporting mechanism for small businesses; 4) improving forms and instructions; 5) extend reporting to prescribed consumer to business transactions; 6) consider universal withholding (and accompanying reporting) for prescribed payments; 7) improving tax return form design to enhance matching and detection of actual discrepancies; 8) expand reporting on business related deductions; and 9) improve the use of third party reports in the audit case selection process.

greater effectiveness; and 4) the recognised overall benefits to compliance from effectively-administered withholding and reporting regimes, it seems reasonable to conclude that new or expanded information reporting requirements targeting prescribed categories of SME/ self-employed income represent an important and potentially valuable option for consideration by Governments and revenue bodies in a revenue mobilisation context, where such regimes are not currently in place.

57. Drawing on all of the information and practical advice provided by members, it is possible to outline the elements and features of a reporting regime (that could be either limited or comprehensive in scope depending on the nature of the third party reporting options chosen) for guidance purposes:

- It could encompass one or more of the following examples of business income-related payments:
  - 1) Business to business payments in targeted sectors for services and goods provided;
  - 2) Payments by national/sub-national governments to business for goods & services;
  - 3) Payments to agricultural producers by marketing bodies for products sold by them;
  - 4) Payments to business by national/sub-national governments of taxable grants; and
  - 5) Payments by card processing/ settlement bodies to merchants in respect of sales made via debit and credit cards;
  - 6) Rental payments received by managing agents on behalf of property owners.

Where it was decided to choose a number of reporting options and there is limited experience with this type of regime, a phased implementation of the reporting options chosen is likely to represent the most prudent approach.

- It could incorporate a withholding sanction for payee's failure to provide a proper taxpayer identifier to the relevant payer; if deemed appropriate, withholding could be applied for prescribed categories of "difficult to tax" payments because of historically poor compliance (e.g. fishing industry/ crew share of catch, building industry).
- To minimise the reporting burden, it would require the reporting of payments for individual payees on an annual basis (perhaps including a reporting threshold to eliminate very small payments), reflecting an aggregation of payments made to each payee over a fiscal year; there would also be an obligation on payers to provide a corresponding report to individual payees (although the revenue body could assume this responsibility).
- There would be mandatory e-reporting obligations for larger payers and user-friendly web-based reporting arrangements for smaller businesses; to facilitate the development of e-reporting, revenue bodies would need to work closely with accounting/tax software providers.
- There would be a range of penalties for various offences to encourage compliance;
- Tax returns could be designed to uniquely identify the SME/ self-employment income subject third party reporting requirements to facilitate income verification (although experience suggests that this is difficult to achieve in practice with a high degree of precision for some of the taxpayers that are the subject of reporting).
- With appropriate systems of data processing, revenue bodies would use the information to detect potential/ actual unreported income, including late and non-filers; the information could also be used in a systematic way to support other administrative processes (e.g. to detect of potential VAT registrants and to validate entitlements to government benefits);
- Reporting compliance by payers would be the subject of systematic follow up checks by the revenue body to ensure timely and accurate/ complete reporting.

- Depending on individual revenue body’s policy and approaches and having regard to the circumstances of individual taxpayers, there may be potential for innovative uses of third party information to inform and remind certain categories of taxpayer (e.g. dependent contractors)<sup>18</sup> of their reported incomes prior to the preparation of their annual tax returns.
58. For the purposes of considering possible reforms, such a framework should be regarded as aspirational in nature, acknowledging that there are many challenges to its realisation (e.g. compliance costs, privacy and data security concerns, notions of “big brother”) which may impact in different ways and to varying degrees across OECD member countries. However, these challenges need not be considered insurmountable if approached carefully and on a phased/ step by step basis .
59. It is inevitable that any proposal for expanded reporting, especially where large numbers of taxpayers are potentially impacted, would be strongly opposed by business and their representatives in many countries, being regarded as overly burdensome and/or constituting a “big brother” approach to government that was undesirable and risky and therefore to be resisted. On the other hand, there is a range of factors that, at the very least, warrant consideration being given to such a proposal, for example:
- **Administrative burden:** New withholding/ reporting regimes inevitably introduce additional administrative burden for the parties impacted. However, in viewing the income-related information streams identified it is important to bear in mind who would bear the bulk of costs involved and their likely magnitude. The information provided in Table 15 reflects some intuitive judgments in respect of where the bulk of additional costs could be expected to arise:

**Table 15. Who would bear the additional costs from new reporting regimes?**

Information obligation	Costs of administration incurred by		
	Small no. of big businesses & governments	Large no. of SMEs	Revenue bodies
1. Payments by national and sub-national governments to businesses for services and goods provided	Yes	No	Yes
2. Payments to business by national and sub-national governments of taxable benefits/grants	Yes	No	Yes
3. Business to business payments for services and goods provided (broadly-based)	Yes	Yes (significant)	Yes (maybe significant)
4. Business to business payments for services and goods provided (prescribed industry sectors)	Yes	(Would depend on the sectors targeted)	
5. Payments to agricultural producers by marketing bodies in respect of products sold / distributed	Yes	No	Yes
6. Payments by card processing / settlement bodies to merchants in respect of sales made via debit and credit cards	Yes	No	Yes
7. Rental payments received by managing agents on behalf of property owners	No	Yes	Yes

<sup>18</sup> ‘Dependant contractors’ are contracting entities or self-employed persons who derive a large proportion of their income from relatively few sources over the course of a fiscal year. Examples include IT professionals and consultants working in the public or private sector.



The information in Table 15 suggests that government itself and relatively few larger businesses would be impacted most by categories 1, 2, 5 and 6, while it is only categories 3 and 7, and 4 (depending on the sectors targeted) that potentially present significant compliance cost concerns for large numbers of SMEs. For these categories, the use of accounting software and user-friendly reporting facilities provided by the revenue body, along with reasonable reporting thresholds, could ameliorate compliance costs.

- **Data availability:** VAT systems (that are widely used across member countries) already operate on the basis of an invoice between contracting parties containing all of the information required for an information reporting regime, and would represent the majority of transactions conducted by business. Accounting software packages that are increasingly being used by business should be capable of generating aggregated invoice payment data and adaptable at relatively little cost to support a legislated annual reporting application. (USA findings noted elsewhere in this report point to the benefits of computerised accounting systems in an information reporting context.)
- **Equity and revenue:** Business and governments in all member countries are already required to report payments for the services provided by their employees, who typically constitute the majority of personal taxpayers. Similarly, financial institutions and incorporated bodies are also obligated in most countries to report details of interest and dividend payments made to their investors. If reporting can be justified for these categories of income, it seems reasonably arguable to justify similar reporting for other major income categories, given equity considerations and the potentially significant tax revenue at stake.
- **Helping taxpayers:** Experience shows that some taxpayers need help to manage their cash flows and are “comfortable” where withholding mechanisms (set at “realistic” rates of tax) are applied to their incomes. (The UK reported its own positive experiences in this respect regarding the fishing industry.)
- **Opportunities to limit compliance burden impacts:** Based on observed practices already seen in some countries, the burden associated with a reporting obligation can be limited by reliance on annual reporting and ensuring that optimal facilities are available for electronic reporting to the revenue body for both large and small businesses. Furthermore, the proposition in this note does not envisage some form of “big-bang” implementation; rather, a phased approach to implementation is clearly preferable, enabling issues peculiar to specific categories of payments to be properly addressed prior to implementation, while at the same time learning from experience as new information streams are introduced.
- **Possible opportunities to reduce compliance costs for some taxpayers:** Revenue bodies are increasingly using third party information reports to prepare tax returns for taxpayers (applying a concept of pre-filing). In their most advanced form, these approaches are significantly reducing the compliance burden of personal taxpayers (e.g. in Nordic region countries) and assisting taxpayers correctly report their incomes.

Spain reported that as part of its practice of sending fiscal information to *individual taxpayers* to assist them with return filing obligations it already provides information related to income from rents and from economic activities. In Australia, where a ‘pre-filing capability’ has been incorporated into the system of electronic filing, tax professionals have expressed strong support for the help it gives them in providing information to assist complete tax returns, particularly for taxpayers who do not have well-organised records of their financial and business affairs.

It is not beyond the realms of possibility that with optimal use of technology revenue bodies may be able to provide some form of assistance to large numbers of SME/self-employed taxpayers—for example, a summary of reported business income and related payments—that could be used by taxpayers to assist them complete their tax returns. This may lead to reductions in some taxpayers’ compliance burden.

60. There is one other factor that might be given consideration.
61. The Sub-group's taxpayer behaviour work has found that there are four main factors that affect compliance decisions: 1) economic deterrence; 2) norms and tax morale; 3) fairness and trust; and 4) opportunity. Withholding and information reporting requirements clearly affect deterrence and opportunity. It could be argued that they might have positive effects on norms and fairness and trust as well. But they might also have negative effects on these factors, particularly if they are perceived by some taxpayers as procedurally unfair and/or they are being introduced because non-compliance is out of control. The UK HMRC has suggested that on the basis of some of its research, care would need to be taken in how such measures are sold to the business community and implemented. These considerations reinforce the need for a well thought out strategy and a phased approach to the implementation of agreed measures.

## **V. Key issues, conclusions and recommendation arising from the study**

### **Issues and conclusions**

62. Drawing on the survey data and related research, there are a number of important observations and conclusions to be made:

- A number of revenue bodies administer extensive withholding and/or reporting regimes in respect of the incomes of SME/ self-employed taxpayers and for some countries, particularly the USA, there are indications of further expansion to improve compliance.
- The survey data reflect a preference of governments and policy makers for reporting-only regimes, although some reporting regimes provide for a withholding component as a sanction for inadequate taxpayer identification or poor compliance history, as opposed to a universally-applied withholding regime of the kind seen in almost all countries for employment income.
- There is a lack of quantitative information on the actual compliance impacts of the regimes in the SME/self-employed sector; however, the regimes were generally rated by revenue bodies as highly effective, while more compliance-related research findings provide evidence of the relatively high levels of compliance being achieved with withholding and reporting regimes for other income categories (e.g. employment and investment);
- Compliance cost considerations, which are explored in detail in the note, are a critical issue to be addressed when formulating proposals for new or expanded withholding and reporting regimes and dictate the need for close and early collaboration with affected parties.
- There are a number of critical design and operational features that bear on the efficiency and effectiveness of such regimes:
  - 1) information reports should include a high integrity taxpayer identifier;
  - 2) an annual reporting regime appears adequate for tax administration purposes;
  - 3) a high degree of information reporting via electronic means, mandated if needed, is essential, and may necessitate tailored/special arrangements for smaller payers;
  - 4) reporting obligations need to be systematically enforced by the revenue body; and
  - 5) comprehensive case actioning capabilities are needed within the revenue body to deal with the high volume of discrepant reports produced by matching programs;
- From a payer perspective, the increasing computerisation of businesses' accounting systems should facilitate the operation of new information reporting regimes which, to the present time, have been deemed in some countries to be too burdensome on business.

Taking a longer term perspective and drawing broadly on the existing approaches and plans of a few revenue bodies, the note anticipates moves by more member countries to establish expanded reporting arrangements that could significantly impact future administration for this segment of taxpayers. Such arrangements could entail:

- An annual information reporting regime covering one or more of a number of specific third party reporting requirements on business, government bodies, marketing agents, and others involved in respect of payments and distributions made to/by businesses;
- If deemed appropriate, such reporting regime could include a withholding component as a sanction for inadequate taxpayer identification or, possibly, poor compliance history;
- Mandated use of electronic reporting by larger businesses and Government bodies and user-friendly web-based reporting facilities for smaller businesses.

- Innovative uses of such third party reporting to assist taxpayers correctly prepare their tax returns—***get it right from the start!***— to reduce the need for post-assessment verification action.

### **Recommendations**

- Ministries of finance and revenue bodies seeking to achieve significant improvements in voluntary compliance by SME/ self-employed taxpayers are strongly encouraged to explore the potential benefits and costs of withholding and reporting regimes where such arrangements are currently not being used, drawing on the approaches and experiences of countries described in this note.
- Revenue bodies administering withholding/reporting regimes, or planning to do so, are encouraged to put in place an appropriate set of performance measures to enable them to periodically evaluate their regimes' operation and compliance impacts; among other things, the findings of such evaluation efforts may well provide support for extension of the arrangements to other categories of SME/ self-employed income.

## Annex 1

## Withholding/ Information Reporting Regimes for Small/ Medium Business Taxpayers

## 1) Canada— Contract payments reporting system

<b>Stated purpose of regime and year of introduction</b>	<p>There was a general perception in the early 1990's that the growth of the underground economy (UE) was a threat to the Treasury. Of particular concern were those sectors of the economy most open to dealing in cash payments, such as hospitality and construction. The willingness to deal in cash was exacerbated by the general backlash to the Goods and Services Tax (GST) which had been introduced in 1990; by way of protest, many consumers were prepared to pay cash to avoid the GST.</p> <p>The broad target was construction. There was a general sense that non-compliance was high. Also, sub-contracting in the construction industry had grown in response to business requirements for greater flexibility and control over projects. This led to a move away from employer-employee relationships and consequently the employer system of reporting and withholdings. CRA also received appeals from business groups, unions and workers to take decisive action to address UE activity found in the construction industry. The system was introduced in 1999.</p>
<b>Categories of payments subject to reporting</b>	<p>The regime applies to payments in the construction and home renovation sector (i.e. by entities which derive more than 50% of income from construction activities) and payments made by federal government bodies for goods and services provided by business. In both cases, this applies when total payments in the year &gt;\$500.</p>
<b>Key design features</b> 1) Frequency of reporting 2) Payers' electronic reporting 3) Payee identification requirements 4) Penalties for non-timely reports	<p>Reporting is done annually: construction sector—six months after the end of the fiscal or calendar year, as selected by the payer; government sector by 31 March each year in respect of the preceding calendar year.</p> <p>It is mandatory for all federal government bodies and is required by regulation for others with &gt; than 50 slips; CRA is currently looking at the introduction of an on-line filing capability for smaller filers (i.e. 1-10 slips) in the construction industry.</p> <p>The relevant legislation requires only that a <u>reasonable</u> effort be made to obtain the identifier, either a SIN (Social Insurance Number) for individuals or BN (Business Number) for businesses (i.e. proprietorships, partnerships or corporations).</p> <p>The penalty for late filing provided under the law as a result of changes made in March 2009 are the greater of \$100 and following amounts 1) \$10 per day - for less than 51 returns; 2) \$15 per day - for 50 to 501 returns; 3) \$25 per day - for 500-2,501 returns; 4) \$50 per day -for 2,500 to 10,001 returns; and 5) \$75 per day - for &gt; 10,000 returns. Total penalty limited to 100 days (meaning it is capped at between \$1,000 and \$7,500).</p> <p>These are penalties for non-filing and late-filing as well as failure to comply with a request to file and relate to the forms submitted by payers, not the actual revenue to be reported by the recipients. In the initial phase of the introduction of the program, an administrative position was taken to waive the applicable late/non-filing penalties. As of 1 April 2006, the CRA has been applying penalties for a failure to comply with a request to file the returns. As of now, we do not routinely assess late/non-filing penalties.</p>
<b>Main administrative uses</b>	<ol style="list-style-type: none"> <li>1. To encourage voluntary correct reporting of income.</li> <li>2. To assist in the detection of unreported income (of filers and non-filers) for income tax and GST/harmonised sales tax, and to detect businesses not registered for the GST/ harmonised sales tax.</li> </ol>
<b>Features of matching activities</b>	<p>All of the data fields filled in by the reporter on the forms submitted to CRA are captured by our data-entry system. Where there is incomplete or incorrect data, such forms are segregated and worked on separately until the issue has been resolved. All data as it relates to reporters with valid SINS and BNs is captured and processed through the CRA's data entry system. Where there is no valid SIN or BN (e.g. for those proprietorships earning less than \$30,000 and therefore not required to be GST registrants), data are keyed into a stand-alone spreadsheet.</p> <p>Once the data are entered, the CRAs' risk assessment system "sweeps" the</p>

	<p>mainframe database twice a year (roughly June and November) and it becomes part of the overall database. The individual files are then “scored” using a number of algorithms to evaluate the relative risk of understating income. One of these compares the amount reported by a taxpayer on filing to the amount actually received as determined by the number of slips posted within the mainframe to that taxpayer. Where the taxpayer reports no business income or an amount less than the total received as per the system, it is considered high risk. (NB: Tax returns are not designed to require taxpayers to separately report such payments.) Where the amount reported is greater than the value of the slips received, it is considered low risk. The system matches the amount reported by the filer to that reported by the recipient. Where there is a mismatch, the audit issue is triggered and the risk for that particular file is assessed in a range from low to high. CRA workload development staff use this ranking when selecting files for audit in order to target compliance efforts on those cases with the most potential.</p>
<b>Other uses of information reports</b>	<p>Reports are used to identify non-registrants for GST where the income exceeds the GST threshold of \$30,000. There are also some referrals to government agencies, where permitted by memoranda of understanding (e.g. welfare recipients found to be in receipt of business income).</p>
<b>Major compliance issues with regime’s operation</b>	<p>There is no requirement to issue the information slip directly to the recipient. This allows recipients to argue that they never received the slip and therefore did not know what to include in income. Currently, large retailers are not required to file slips for payments to sub-contractors. They are not subject to the 50% rule because most of their revenue is derived from retail sales. However, they do make significant payments to sub-contractors. The CRA is considering the appropriate legislative amendment for each issue.</p>
<b>Major operational issues with regime’s administration</b>	<p>Around 45% of reportees are sole proprietorships. These reportees tend to provide the reporter with their business number (BN) instead of their social insurance number (SIN)—it is optional. As a result, it becomes difficult for CRA systems to match the income to the reportee, as it is reported under their SIN account for income tax purposes. Manual matching is required which is time consuming. Consideration is being given to the creation of a separate, automated system dealing only with CPRS. However, this is dependent on funding and would take some years to implement. Also, the reporter will use whatever name is given by the reportee and, as a proportion of these contractors are transient by nature, it is often very difficult to track them down subsequent to the filing.</p>
<b>Planned enhancements of regime’s administration</b>	<p>A formal review conducted in 2005 (available on the CRA website at <a href="http://www.cra-arc.gc.ca/gncy/ntrnl/2005/cprs-eng.html">http://www.cra-arc.gc.ca/gncy/ntrnl/2005/cprs-eng.html</a>) made a range of recommendations that are in the course of being implemented.</p>
<b>Views of revenue body on efficacy of regime</b>	<p>The CPRS is, for the most part, fully operational and is supporting operations to address tax compliance issues in the construction and home renovation industry. CRA managers and staff involved in the CPRS program fully support it. Construction companies and construction associations are less supportive but this is largely attributable to their perception that the program is not effective in addressing the underground economy in their sector, a perception not supported by performance statistics.</p> <p>Program results achieved to date are significant and strongly support continuing the program. The program resulted in over \$650 million in tax assessments in the four years ending March 2005. Results have been especially notable in the identification of sub-contractors who failed to file returns. However, results to date in the CPRS audit program suggest a need for its review to ensure that it is achieving acceptable results in addressing the underground economy.</p> <p>The most significant benefit of CPRS was expected to be its impact on voluntary compliance. This impact has not yet been measured and effort is required to determine levels of voluntary compliance and the impact of CPRS on taxpayer behaviour. CPRS is useful in addressing underground economy activity where recorded transactions and audit trails exist in contractors' books and records. There is general agreement within the industry and the CRA, however, that it is not effective in that segment of the underground economy where transactions are purposefully hidden by both the contractor and sub-contractor to circumvent tax laws and other legal obligations (the so-called 'cash' economy). This segment is addressed by other elements of the CRA's underground economy strategy.</p>

	<p>Notwithstanding the positive results that have been achieved to date, changes to the design and administration of the program would improve its overall effectiveness. Design concessions made to minimize administrative burden on the industry, in order to gain the support of the industry have, in fact, adversely impacted the administration and effectiveness of the program. Optional filing periods make it more difficult and less efficient for the Agency to identify non-compliant behaviour with respect to the filing of tax returns and the reporting of income. The provision of information slips to taxpayers is a key feature of third-party reporting systems designed to promote voluntary compliance. This requirement is missing from CPRS and is likely detracting from the strength of the program in this area. Finally, the exclusion from the program of the retail home renovation sector within the industry, which has grown significantly since the introduction of CPRS, is creating perceptions of inequity within the industry and is potentially resulting in significant tax leakage.</p> <p>Administratively, the program was implemented with limited automated support resulting in process inefficiencies. Performance measurement and compliance research supporting the program are underdeveloped and are required to ensure that CPRS results are monitored and that administration of the program is modified as required. The CRA does not yet have a program in place to verify the accuracy of the CPRS information returns that have been filed and as a result there is no assurance that contractors are fully and accurately reporting payments made to sub-contractors. As well, the CRA has not adequately employed the penalty provisions with respect to the timely filing of CPRS returns, which is serving as a disincentive for contractors to file returns on time or at all. Finally, the industry's lack of knowledge of the results of the program detracts from their support for the program and is a disincentive to their voluntary compliance with its requirements.</p>
<b>Views of other stakeholders</b>	<p>The CRA feels that the status quo has been maintained. There is some resistance from certain parties who have been against the CPRS since inception. Other parties have supported the CRA all along. With continued effort in publicizing the benefits of third party reporting, both from the perspective of the taxation system and from that of protecting the consumer, we hope that all participants see this as a well intentioned measure in dealing with the underground economy.</p>
<b>Proposals/ plans to extend scope of regime</b>	<p>The CRA intends to expand the program to the retail construction sector to encompass the sub-contractors used by these businesses to install the materials purchased by customers. It may be expanded to the insurance industry which also hires subcontractors to do repairs for its clients. A draft proposal for a legislative change has been submitted which is awaiting approval but this may take some time. The expected benefits are that a significant number of construction entities not currently subject to CPRS reporting will be included once the legislative change is made. This will also increase the perception of a "level playing field" for all participants and that no sector is being excluded. It should be noted that any expansion of the program's scope would result in additional workload for all program areas. As stated earlier, additional funding would also be required to address the growth in the program.</p>

**Key metrics (for the period 1 April 2006 to 31 March 2007)\***

<b>Item</b>	<b>Number/ value</b>
1) Businesses required to withhold/ report (no.)	1.5m
2) Tax withheld last fiscal year	n/a.
3) Information reports per annum (no.)	1) Building industry: 1.2 m; 2) Government: 0.25m
4) Information reports received electronically (%)	1) 1%; and 2) 100%
5) Reports captured for matching in latest year (no.)	1) and 2) : 85%
6) SME taxpayers covered by reporting (no.)	1) 1.2 million; and 2) 250,000
7) SME population covered by this regime (%)	66%
8) Cases actioned to include income: number & value	1,035 , CAD 10 m
9) Non-filers detected: number & value	42,058, CAD 297 m

## 2) Ireland— Relevant Contracts Tax

<b>Stated purpose of regime and year of introduction</b>	The primary purpose of the introduction of RCT was to improve the tax compliance of principal and subcontractors within the construction sector, which constitutes 95% of the type of operations covered by RCT. This regime secures the payment of tax by subcontractors who otherwise may not pay. The scheme was introduced in 1970.
<b>Payment categories subject to withholding/reporting</b>	The regime applies to payments by principal contractors for construction, forestry and meat processing operations. It is essentially an annual reporting regime with a withholding sanction (35%) for sub-contractors who do not hold a relevant payments card.
<b>Key design features:</b>	
1) Requirement for withholding	There is a standard 35% withholding tax rate from applied by principals on payments to sub-contractors for whom he/she does not hold a relevant payments card (Form RCT 47). The principal also maintains a record of payments to all sub-contractors regardless of whether he/she holds a relevant payments card for them.  A principal can apply for a relevant payments card, which will permit them to make payments to the subcontractor without the deduction of RCT. Before a relevant payments card can be issued, the subcontractor must hold a certificate of authorisation (C2 card) (see Annex xx). To qualify for a C2, the subcontractor must satisfy strict criteria in relation to his/her bona fides as a subcontractor; that business records are kept properly and accurately; that he/she or any connected partners, companies or shareholders have met their requirements in relation to the payment of taxes, the delivery of returns or other information over a period of more than 3 years prior to the date of application; and that there is good reason to believe that they will continue to meet their tax obligations in the future. A payments card is issued for each contract and may have a monetary limit on it if Revenue deems it appropriate
2) Frequency of withholding & reporting	Withheld amounts must be remitted monthly to the revenue body. There is an annual reporting requirement covering all payments
3) Payee identification requirements	Sub-contractors must hold a certificate of authorisation (C2 card). The C2 is a personalised card similar to a credit card. It has a full face photo and signature of the sub-contractor or nominated user i.e. person authorised by a partnership, company or individual. A nominated user is generally a director of a company, a partner in a partnership or an employee of a business. In the absence of a C2 card and a relevant payments card, the principal must withhold RCT at 35% on any payments under a relevant contract. Contractors are given clear instructions as to what to check for to validate the C2 card etc.  The C2 certificate includes details of the taxpayers identifying number. It is a pre condition of many contracts that the subcontractor holds a C2 and it is a requirement for all government-related work.
4) Payers' electronic reporting to revenue body	No mandatory requirements. Planning is underway on the introduction of eRCT. This development will simplify and streamline the operation of RCT by providing online facilities for the submission of many forms. The project envisages the simplification of many of the commonly used forms and changes in the frequency of forms submitted by customers thus reducing the administrative burden on customers. The expected completion date is 2010.
5) Penalties for non-timely reports	Principal Contractors are obliged to submit monthly returns and an annual return, and any person who fails to deliver declarations to Revenue is guilty of an offence and is liable on summary conviction to a fine of €1,265. Penalties are not currently routinely applied. However, Revenue is increasing its focus on this area and intends to increase the number of cases where penalties will be applied.
6) Penalties for failure to withhold	Except in exceptional circumstances, the Principal Contractor will be held liable for the tax that should have been deducted (in accordance with Section 531(1) Taxes Consolidation Act 1997) from the payments to the subcontractor. This is normally dealt with in a Revenue audit and penalties and interest will be applied in accordance with the Code of Practice for Revenue Auditors, and will depend on the level of cooperation received from the taxpayer and the category of tax default that the failure to deduct lies in. Failure to deduct in



	<p>accordance with Section 531(1) is also a Revenue Offence under Section 1078 TCA 1997, and a person convicted is liable on: 1) Summary conviction to a fine of €3,000 or 12 months imprisonment or both, or 2) Conviction on indictment to a fine of €126,970 or 5 years imprisonment or both.</p>
<b>Main administrative uses</b>	
<b>Features of matching activities</b>	<p>Data from the annual listings are cross-referenced to both the principal and sub contractors' files and are available for officers on a case by case basis. There is an automated non-filer compliance programme for both the monthly and the annual return with a new prosecution programme recently for the annual return. In addition our risk analysis system (Reap) gathers information from all tax returns together with data from outside agencies. The RCT data is included and RCT specific rules have been written to target some of the areas at risk. [Revenue plans more work in this area.]</p> <p>A C2 monitoring group maintains a database of suspected risky principal contractors and their subcontractors. These cases have a marker on them and all their activities are pushed out to the tax offices for monitoring.</p> <p>Officers also have access to an email based "Community of Practice" where issues and trends identified can be notified speedily. We also use local information from newspaper, planning applications etc.</p>
<b>Major compliance issues with regime's operation</b>	<p>Two issues have arisen. Some principal contractors continue to make gross payments with a relevant payments card for the sub-contractor or make payments in excess of the monetary limit imposed. In 2006. Revenue announced some concessions to regularise this and have commenced a clamp down in 2007/2008.</p> <p>There was minimal use of the Form RCT1 procedure (NB: This form is used to attest that the sub-contractor is not an 'employee'). Significant changes were introduced and brought into effect in April 2008 to improve this situation. The focus at present is on awareness and education around the revised procedures.</p>
<b>Major operational issues with regime's administration</b>	<p>The key practical difficulty identified is that some entries on the annual returns are incomplete i.e. incorrect, bogus or no personal identity number for the sub contractor. This issue is being addressed through the twin approach of educating and creating awareness amongst taxpayers of the requirements of the RCT regime and of their obligations, whilst at the same time putting considerable resources in to audit and compliance activities in this sector.</p>
<b>Planned enhancements of regime's administration</b>	<p>In late 2005, Revenue launched a national project on the construction industry. The construction sector was at the time experiencing phenomenal growth with a large number of non-nationals engaged in the sector.</p> <p>There were a significant number of taxation, compliance and customer service issues for those engaged in construction. The key elements of the project were 1) 25% of the audit and compliance resources in 2006 would be devoted to the sector; 2) The setting up of a national C2 monitoring group; 3) All non-resident contractors have been centralised in a single location; 4) Improved technological advances to support all our activities; 5) A number of changes to the legislation governing the administration of Relevant Contracts Tax; 6) More site visits were to be carried out by Revenue and many of these will be in conjunction with other state agencies or Government Departments and Regulatory bodies; 7) A global focus on the construction industry; and 8) Suitable cases would be identified for investigation with a view to prosecution particularly in the areas of cases using false documentation.</p>
<b>Views of revenue body on regime's efficacy</b>	<p>A Risk Evaluation Report on RCT was carried out in 2004/05 primarily to look at fraud issues arising within the sector. A number of information technology changes were introduced as a priority and additional monitoring. Ultimately the recommendations in the report were considered under the national construction project that commenced in late 2005. The system is regarded by Revenue as moderately effective.</p>
<b>Views of other stakeholders</b>	<p>Within the industry, attitude to the system has softened. There is recognition that there are issues with non-compliance by some customers in the sector and</p>

	that the current national focus plays a key role in helping to ensure that the compliant customer is not at an economic disadvantage when competing with non-compliant customers. Tax practitioner bodies are also fully aware that Revenue will no longer tolerate non-compliance with the RCT Regulations.
<b>Proposals to extend scope of regime</b>	None at this stage

### Key metrics

Item	Number/ value
1) Businesses required to withhold/ report (no.)	46,000
2) Tax withheld last fiscal year	EUR 920 m
3) Information reports per annum (no.)	41,400 (covering multiple payees)
4) Information reports received electronically (%)	30%
5) Reports captured for matching in latest year (no.)	41,400
6) SME taxpayers covered by reporting (no.)	118,000
7) SME population covered by this regime (%)	Around 57%
8) Cases actioned to include income: number & value	3,807 audits and 40,161 assurance checks- €167m
9) Late filers detected: number & value	4,600 (value data not yet available)

### 3) Ireland— Professional Services Withholding Tax

<b>Stated purpose of regime and year of introduction</b>	PSWT was introduced in 1987, at a time when government revenues were not buoyant. Tax filing/payment compliance for the professional services sector in particular was particularly poor. The rationale for the introduction of the withholding tax arose because substantial sums were paid annually from State sources in fees and similar payments for professional services. These included payments for medical, legal, financial, training, engineering and similar services. It was considered that tax should be deducted from such payments at source because employees were subject to an immediate deduction system under PAYE (Pay as You Earn). The scheme was implemented in 1987.
<b>Payment categories subject to withholding/ reporting</b>	The regime applies to payments for the following prescribed <b>professional</b> services: 1) medical, dental, pharmaceutical, optical, veterinary; 2) architectural, engineering, surveying and related services; 3) accounting, auditing, finance, advertising, and marketing; 4) legal services; and 5) geological services; and 6) training services on behalf of FAS.
<b>Key design features</b>	
1) Requirement for withholding	Tax must be held from prescribed payments at a standard rate of 20%.
2) Frequency of withholding and information reporting	Withheld amounts must be paid monthly, by 14 <sup>th</sup> of the following month. Reports of income paid and amounts withheld for individual payees must be made annually (on Form F35)
2) Payee identification requirements	In most cases, payee will be known to payer as a contract will exist for the provision of the service involved. In many cases the payer will not have been in a position to enter into a contract unless the payee produced a tax clearance certificate. Payers are required to capture in tax reference number on relevant forms.
3) Payers' electronic reporting to revenue body	Up to 2008, reporting on electronic media is not mandatory. From January 2009, mandatory electronic reporting is required on a phased basis (as per the recently enacted Tax Returns & Payments (Mandatory Electronic Filing & Payment of Tax) Regulations 2008.

4) Penalties for non-timely reports	There is no specific penalty in relation to late submission of the annual return (F35). With regard to the monthly return (F30), which is accompanied by any tax due, interest on late payments can be considered in accordance with the Taxes Consolidation Act 1997.
<b>Main administrative uses</b>	Survey response indicates that Revenue appears satisfied with the withholding/ collection mechanism of the arrangements & no additional actioning is needed.
<b>Features of matching activities &amp; their effectiveness</b>	Reports are currently not matched with tax records and there are no plans to do so in the next 2-3 years
<b>Other uses made of information reports</b>	Reports are made available to audit staff on request
<b>Major compliance issues with regime's operation</b>	None identified
<b>Major operational issues with regime's administration</b>	None identified
<b>Planned enhancements of regime's administration</b>	None at this time
<b>Views of revenue body on regime's efficacy</b>	Arrangements are generally regarded as contributing to improved compliance over time.
<b>Views of other stakeholders</b>	Attitude has improved over time.
<b>Proposals to extend scope of regime</b>	None at this time

#### Key metrics

Item	Number/ value
1) Businesses required to withhold/ report (no.)	752
2) Tax withheld last fiscal year	EUR 527 m (represents income of over EUR 3 billion)
3) Information reports per annum (no.)	749 (each covering multiple payees)
4) Information reports received electronically (%)	9%
5) Reports captured for matching in latest year (no.)	None
6) SME taxpayers covered by reporting (no.)	Not available
7) SME population covered by this regime (%)	Not available
8) Cases actioned to include income: number & value	Not available
9) Late filers detected: number & value	Not available

#### 4) Ireland— Return of certain information by third parties

<b>Stated purpose of regime's introduction and year of introduction</b>	To provide a cross check on payments from payer to payee records and improve voluntary compliance. The scheme was implemented in 1992.
<b>Categories of payments subject to reporting</b>	<p>This regime requires traders (including farmers), professionals and other persons carrying on a business to automatically make third party returns in respect of the following payment categories: 1) payments for services rendered in connection with the trade, profession, business etc., whether paid on your own behalf or on behalf of someone else; 2) payments for services rendered in connection with the formation, acquisition, development or disposal of the trade or business; and 3) periodical or lump sum payments made in respect of any copyright.</p> <p>There is a prescribed list of exclusions to these requirements (e.g. payments subject to PAYE, RCT, or withholding tax, or where goods constitute more than 2/3 of total charge) and a monetary value limit</p>

	(€6,000) per payee for reporting purposes.
<b>Key design features</b>	
1) Frequency of reporting	Annual
2) Payers' electronic reporting	Revenue is in the process of implementing mandatory filing.
3) Payee identification requirements	Reporting bodies must report TIN of payees
4) Penalties for non-timely reports	Penalty of €125, up to a maximum of €126,970.
<b>Main administrative uses</b>	1. To encourage voluntary correct reporting of income. 2. To assist in the detection unreported income (including by non-filers) by matching reports received with tax records.
<b>Features of matching activities &amp; their effectiveness</b>	Response indicates that there has been very limited processing of these data as most of the reports were paper based
<b>Other uses of information reports</b>	Where used, only for revenue body purposes.
<b>Major compliance issues with regime's operation</b>	Relatively low usage over the years has meant that monitoring the compliance of reporting bodies has received limited attention. With the introduction of mandatory reporting, a central team will be responsible for systematic monitoring.
<b>Major operational issues with regime's administration</b>	Paper-based reporting
<b>Planned enhancements of regime's administration</b>	Mandatory e-filing from 2009 will permit systematic matching and incorporation into Revenue's risk-based scoring system.
<b>Views of revenue body on efficacy of regime</b>	Reporting regimes currently minimally effective. Move to mandatory electronic filing should bring about substantial improvement.
<b>Views of other stakeholders</b>	Specific views not known but the move to electronic reporting is generally welcomed.
<b>Proposals/ plans to extend scope of regime</b>	None at present

**Key metrics\***

<b>Item</b>	<b>Number/ value</b>
1) Businesses required to withhold/ report (no.)	40,000
2) Tax withheld last fiscal year	Not applicable
3) Information reports per annum (no.)	20,000 (covering multiple payees)
4) Information reports received electronically (%)	15%
5) Reports captured for matching in latest year (no.)	Not known
6) SME taxpayers covered by reporting (no.)	Estimated at around 200,000
7) SME population covered by this regime (%)	Around 40%
8) Cases actioned to include income: number & value	Not available
9) Late filers detected: number & value	Not available

## Withholding/ Information Reporting Regimes for Small/ Medium Business Taxpayers

### 5) Japan—Statutory withholding and information reporting

<b>Stated purpose of regime and year of introduction</b>	The purpose of withholding regime introduction for government is to get revenue constantly and that for taxpayer is to alleviate their burden. The scheme has operated for many decades.
<b>Payment categories subject to withholding &amp; reporting</b>	Regime requires withholding in respect of the SME/ self-employed income of resident individuals for a prescribed range of payment/ remuneration categories. There is a very narrow set of payments prescribed for reporting only (see Annex 2).
<b>Key design features</b>	
1) Frequency of withholding remittances	Monthly (by 10 <sup>th</sup> of following month). However, special provision exists enabling certain smaller payers to remit twice a year.
2) Rates of withholding applied	Varies (from 10 to 20%)
3) Frequency of reporting information	Annually
4) Payee identification requirements	Nil
5) Payers' electronic reporting to revenue body	Nil
6) Payer's obligation to report year's income paid & tax withheld to payee	Yes, to be done annually (one month after end of fiscal year)
7) Penalties for non-timely reports	Fine up to JPY 200,000 or imprisonment of not more than a year. However, penalties are not routinely applied.
8) Penalties for non-withholding	Additional tax of 10% and body can be punished by imprisonment for up to 3 years or fine up to JPY 1 million.
<b>Main administrative uses</b>	1. To encourage voluntary correct reporting of income. 2. To assist in the detection unreported income (including by non-filers) by matching reports received with tax records.
<b>Features of matching activities</b>	Collected information is fed into the NTA's data investigation system and sorted by names and addresses. Information stored in this way can then be made available systematically for audit officials in their examinations of taxpayers' affairs. Tax returns are designed to identify the reporting of subject payments.
<b>Other uses made of information reports</b>	Income reports are used for the administration of VAT
<b>Major compliance and operational issues with regime's administration</b>	
<b>Planned enhancements of regime's administration or proposals to extend</b>	None identified
<b>Views of revenue body on efficacy of regime; views of other stakeholders</b>	Highly effective

#### Key metrics\*

Item	Number/ value
1) Businesses required to withhold/ report	7 million (2006)
2) Tax withheld last fiscal year	JPY 16, 029,600 million in 2006 (for all forms of withholding); JPY 1,340,600 million for remuneration/ fees category in 2005 (as per 2007 annual report)
3) Information reports per annum (no.)	125 million (2006) for all payees; 9.2 million in 2005 for remuneration/ fees category in 2005 as per 2007 annual

	report)
4) Other metrics on regimes operation	n.avail.

(\* These data relate to a broader set of payment categories, not just payees receiving SME/ self employed income.)

## Withholding/ Information Reporting Regimes for Small/ Medium Business Taxpayers

### 6) New Zealand— Schedular payments

<b>Stated purpose of regime and year of introduction</b>	There was considered to be considerable risk of non-compliance (failure to file and under-reporting of income) for many of the industries/businesses receiving the payments specified. The schedular regime also enabled specific activities to be included (for example mayors and councillors) where they did not fall under the PAYE deduction regime for employees. The scheme was introduced in 1979.
<b>Payment categories subject to withholding/ reporting</b>	Businesses must deduct withholding tax (prescribed at varying rates) from payments made to prescribed self-employed contractors, and to companies operating in the horticultural and viticultural industries unless the contractor holds a current certificate of exemption from withholding tax (see Annex 2)
<b>Key design features</b> 1) Requirement for withholding  2) Frequency of withholding and information reporting  3) Payee identification requirements  4) Payers' electronic reporting to revenue body  5) Penalties for non-withholding and non-timely reports.	<p>Payers must deduct tax on schedular payments from payments made to self-employed contractors and to companies operating in the horticultural and viticultural industries - unless the contractor holds a current certificate of exemption from tax on schedular payments. There is a range of activities that are liable for tax on schedular payments (see Annex 2). The withholding tax rate ranges from 15 to 33 cents in the \$ depending on the nature of the service being provided or goods being sold.</p> <p>Tax need not be withheld from payments made to contractors who hold a current certificate of exemption from withholding tax. New certificates of exemption were introduced with effect from 1 April 2007 which are now issued in a convenient credit card size and have additional security features. Certificates of exemption can be issued for variable periods of exemption ranging from one year to five years, depending on the taxpayer's compliance history.</p> <p>Tax withheld must be remitted monthly (on the 20<sup>th</sup> of the following month). However, if monthly withholdings exceed 100,000, the amounts withheld must be remitted twice a month (by the 5<sup>th</sup> and 20<sup>th</sup> days).</p> <p>Withholding bodies are required to obtain a tax code declaration specifying the name, address and IRD number of the contractor/recipient of the payment. A declaration is required regarding the recipients entitlement to work on the basis, for example, of residency or work permit.</p> <p>Where a payee does not provide an IRD number the withholding body is required to deduct withholding tax at the “no declaration rate”. The no declaration rate is 15 cents in the dollar in addition to the withholding tax deduction required.</p> <p>As applies generally to employers, payers must report monthly using electronic media where there are more than 50 payees</p> <p><b>1) Failure to withhold:</b> On conviction for failing to withhold tax at source a payer can be sentenced to imprisonment for a period of up to 5 years, or a fine of up to \$50,000, or both. Where the obligation to deduct rests with a corporate body, officers of the corporate body can be charged with an offence of aiding or abetting. Instead of or in addition to any term of imprisonment or fine, Inland Revenue can impose “shortfall penalties” at varying rates reflecting the degree of culpability of the payer.</p> <p>Where the obligation to deduct rests with a corporate body, shortfall penalties can be apportioned to officers of the body.</p> <p><b>2) Failure to report on time:</b> A late filing penalty of \$250 can be imposed where an employer monthly schedule is not filed on time. A late filing penalty will not automatically be charged if it is the first time the taxpayer has filed late or if they have filed all their schedules on time for the previous 12 months, in these circumstances a letter will be issued first reminding the taxpayer to file their schedule.</p>
<b>Main administrative uses</b>	Collection of tax as income is derived and detection of returns with un-reported income  Information from the fortnightly/monthly employer monthly schedules is also

	currently used to pre-fill “summary of earnings” forms and “personal tax summary” forms that are provided to taxpayers.
<b>Features of matching activities</b>	<p>The matching process is regarded as highly effective— over 95% of reports are readily matched.</p> <p>Return form design assists the detection of understatements— Income tax returns for individuals include provision for the taxpayers to separately identify withholding income and tax deducted; returns furnished have separate key points to enable withholding payments to be separately recorded and matched to information supplied by payers</p> <p>Risk and Intelligence* (a relatively new operational unit) use data mining techniques to select “high risk” cases arising from computer matching activity. These cases are “risk scored” to reflect the level and extent of risk and also receive an indicative priority for assignment. These cases are held pending assignment to Investigations units within a centralised “job bank”.</p>
<b>Other uses made of information reports</b>	Reports aid in the determination of Child Support liability, GST/VAT thresholds, and social policy entitlements.
<b>Major compliance issues with regime’s operation</b>	<p>Non-compliance within the horticultural and viticultural industries has been an issue over several years particularly in relation to seasonal (local transient and immigrant) workers targeting NZ for tax evasion. This has commonly included using false identities to establish and operate companies within the industry and issuing false invoices to others in the industry to allow them to minimise GST/VAT and PAYE obligations.</p> <p>The withholding regime was amended in 2006 to include companies operating within these industries having to have 15% withheld and paid to revenue authority unless a certificate of exemption is held.</p> <p>It is quite common to find that small businesses in the building/construction industry appear unaware of their responsibilities regarding withholding payment deductions in respect of labour only contractors or due to the high turnover of payees/difficulties in obtaining labour only contractors choose to ignore their obligations to deduct.</p>
<b>Major operational issues with regime’s administration</b>	<p>The major issue was the ease of obtaining a Tax Identification Number in NZ and the ease of incorporating a company over the internet. This has been partially addressed by the introduction of a new Evidence of Identity Framework.</p> <p>A secondary issue is that the current reporting system records situations where withholding has been deducted but <u>no record is required when no withholding has been deducted.</u> (This was considered as part of the legislative review. However, in considering the compliance costs of SMEs - they would all need to be registered as employers and file monthly returns even if not employing during that period – it was not progressed.</p>
<b>Planned enhancements of regime’s administration</b>	Progressive improvements to the website have been made for those filing electronically to make the service consistent with the look of other online services on the website. Information posted by IR on the internet is periodically tested with SME focus groups and tax agents to ensure it is meeting information needs. Enhancements based on user comments are evaluated and made where appropriate.
<b>Views of revenue body on regime’s efficacy</b>	The withholding tax regime is largely effective. By placing an obligation on those making payments to provide the recipient’s TIL number, gross payments received and tax withheld there is a secondary source of information available to identify taxpayers that are not otherwise in the system.
<b>Views of other stakeholders</b>	Representative industry groups have displayed a wiliness to support compliance initiatives in order to promote a “level playing field” for industry participants, those failing to comply being seen as obtaining an unfair advantage over those complying.
<b>Proposals to extend scope of regime/ recent changes to regime’s scope</b>	From September 2003 payments made to independent contractors engaged in the film production industry were subject to withholding payment tax deductions. While payments made to non-resident entertainers were already subject to withholding tax, having those involved in television, video or film productions or presentations also subject to withholding tax enabled simplification and consistency of tax practices within the screen production industry. Further, industry feedback



	<p>indicated that most contractors preferred to have deductions made at source to avoid a large tax bill at year end.</p> <p>From 1 April 2006 withholding payments to companies or other contractors for agricultural, horticultural or viticultural work done in relation to the pruning and/or thinning of fruit trees or vines, or the picking and/or packing of fruit or grapes were made subject to withholding payment tax deductions. This class of payment was included due to the risk of non-compliance by the recipients of this income.</p> <p>From 1 April 2008, payments made under the Injury Prevention, Rehabilitation, and Compensation Act 2001 to an injured person to enable personal care to be provided to that person became liable to withholding tax. This class of payment was included due to the widespread non-compliance by the recipients of this income.</p> <p>Extension to the vegetable growing industry is currently being examined, for possible inclusion in 2009.</p>
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**Key metrics**

Item	Number/ value
1) Businesses required to withhold/ report (no.)	n.avail
2) Tax withheld last fiscal year	NZD 3.89 billion
3) Information reports per annum (no.)	2.14 m
4) Information reports received electronically (%)	22.0
5) Reports captured for matching in latest year (no.)	2.03 m
6) SME taxpayers covered by reporting (no.)	20-25%
7) SME population covered by this regime (%)	n.avail
8) Cases actioned to include income: number & value	n.avail
9) Late filers detected: number & value	n.avail

**Withholding/ Information Reporting Regimes for Small/ Medium Business Taxpayers**

**7) Norway—Withholding tax on fishermen’s catch**

<b>Stated purpose of regime and year of introduction</b>	To secure tax revenue from fishermen. The scheme was introduced in 1956.
<b>Categories of payments subject to withholding and/or reporting</b>	Payments made by captain of a boat to fishermen for share of catch
<b>Key design features</b>	
1) Requirement for withholding	Captain must withhold amount of tax according to the rate indicated in each fisherman’s tax deduction card
2) Frequency of withholding payments and information reporting	Amounts withheld must be paid immediately to the revenue body—there is no normal frequency. Details of income paid and tax withheld for each fisherman required annually
3) Payee identification requirements	Captain has each fisherman’s tax deduction card which shows their tax identification number. Where no deduction card available, captain must withhold 50% of payment
4) Payers’ electronic reporting to revenue body	Electronic reporting is available but not mandatory
5) Penalties for non-timely reports and non-withholding	Fines for late filing of reports. For non-withholding, the withholding body is liable for the amount concerned and can be fined or subject to imprisonment
<b>Main administrative uses</b>	Reports are not currently computer matched but can be accessed for audit purposes
<b>Features of matching activities &amp; their effectiveness</b>	Not appl.
<b>Other uses of information reports</b>	Nil
<b>Major compliance issues with regime’s operation</b>	No major issues have arisen
<b>Major operational issues with regime’s administration</b>	No major issues have arisen
<b>Planned enhancements of regime’s administration</b>	-
<b>Views of revenue body on efficacy of regime</b>	Regime is regarded as highly effective
<b>Views of other stakeholders</b>	Nothing specific but businesses do not like the burden of reporting
<b>Proposals/ plans to extend scope of regime</b>	-

**Key metrics**

<b>Item</b>	<b>Number/ value</b>
1) Businesses required to withhold/ report (no.)	n.avail
2) Tax withheld last fiscal year	n.avail
3) Information reports per annum (no.)	n.avail
4) Information reports received electronically (%)	n.avail
5) Reports captured for matching in latest year (no.)	n.avail
6) SME taxpayers covered by reporting (no.)	n.avail
7) SME population covered by this regime (%)	n.avail
8) Cases actioned to include income: number & value	n.avail
9) Late filers detected: number & value	n.avail

**8) Norway— Reporting obligations**

<b>Name of regime &amp; year commenced</b>	<b>Regime 1:</b> Reporting obligation on work commissioned from foreign entrepreneurs or employees (September 2008) <b>Regime 2:</b> Reporting obligation re sales of certain agricultural and wild-life products.
<b>Stated purpose of regime's introduction</b>	<b>Regime 1:</b> In order to be able to receive the required information about foreign enterprises and employees operating in Norway, it was decided that The Central Office – Foreign Tax Affairs (COFTA) should be informed about all contracts and any subcontracts involving foreign businesses or foreign self-employed persons. <b>Regime 2:</b> Use as a compliance checking tool.
<b>Categories of payments subject to reporting</b>	<b>Regime 1:</b> All businesses and public bodies must provide information regarding contracts or sub-contracts carried out on their behalf: a) on sites for building and assembly work in Norway; b) a site that is under the client's control in Norway; or c) on the Norwegian Continental Shelf. <u>when the contractor is an enterprise domiciled abroad or a person domiciled abroad.</u>  It is not necessary to give information when the client is not a company or a self-employed person. Where there is an obligation to give information about a contract, there is also an obligation to give information about persons working on the contract. Information is not required for contracts less than NOK 10,000.  <b>Regime 2:</b> Tradesmen that buy and sell live animals, carcase (including poultry), hides and skins, wool, fur, milk, egg, potatoes, cereals, seeds, beans, fruit, berries, vegetables and timber should in their annual report provide certain information, including quantity and sales value.
<b>Key design features</b>	
1) Frequency of reporting	<b>Regime 1:</b> The information should be provided as soon as possible and at the latest 14 days after construction or other work has started. This applies both to the reporting of the work project and the persons involved. When the payee's work contract has ended this should be reported as soon as possible and not later than 14 days after the termination of the contract. The same reporting requirements apply for changes in the work project. <b>Regime 2:</b> Annually
2) Payers' electronic reporting	No mandatory requirements for regime 1 but these exist for regime 2. Reporting can be made via the ALTINN government portal
3) Payee identification requirements	Payees must supply a valid TIN
4) Penalties for non-timely reports	<b>Regime 1:</b> Should the third parties concerned fail to comply, the revenue body may impose a fine. In order to force third parties to provide information which they refuse to give, the revenue body may also impose a fine for each day the information is not provided. <b>Regime 2:</b> A small daily fine per report missing.
<b>Main administrative uses</b>	Monitor compliance with laws
<b>Major compliance issues with regime's operation</b>	None identified
<b>Major operational issues</b>	None identified
<b>Relevant documentation</b>	Regime 1: See 'Skatteetaten - Guide for foreign employers and employees' on revenue body website

**Key metrics\***

<b>Item</b>	<b>Number/ value</b>
Items 1) to 5)	None available. Regime 1 only commenced in September 2008.

**Withholding/ Information Reporting Regimes for Small/ Medium Business Taxpayers****9) United Kingdom—Construction industry scheme (CIS)**

<b>Stated purpose of regime and year of introduction</b>	Prevent loss of tax revenue from sub-contractors in the construction industry. The scheme was introduced in 1972.
<b>Payment categories subject to withholding/ reporting</b>	<p>The CIS is a <u>monthly</u> withholding and reporting regime, for contractors in the construction industry. A contractor may be a construction company and building firm, as well as a Government department or local authority and other businesses known in the industry as ‘clients’. Non-construction businesses or other concerns are treated as contractors if their average annual expenditure on construction operations over a period of 3 years is £1 million or more.</p> <p>Sub-contractors who can pass a business test, a turnover test, and a good compliance test administered by HMRC can be paid without deduction at source, but this entitlement is reviewed automatically each year and adjusted where the taxpayer’s compliance has dropped below an acceptable level (see Annex xx). HMRC estimates that 10-15% of self-employed/ SMEs are paid “gross” at any time.</p>
<b>Key design features</b>	
1) Frequency of withholding and information reporting	Generally monthly, quarterly for small remitters (<£1500 /month). Reporting of payments made, or a nil return where there are no payments, is also required on a monthly basis, regardless of whether the sub-contractor is paid gross, net of the standard deduction or paid net of the higher deduction.
2) Payee identification requirements	<p>Payers must contact HMRC to establish the basis on which each payee can be paid- the process of verification. (As a general rule, the contractor does not have to contact HMRC re verification if they last included that contractor on a return in the current or two prior years.)</p> <p>Payee sub-contractors who do not have a TIN or who can’t be verified by HMRC are subject to withholding at a rate of 30%. Other sub-contractors are subject to 20% withholding unless specifically exempted.</p>
3) Payers’ electronic reporting to revenue body	No mandatory requirements. Payers can report electronically via the Internet or using electronic data interchange (EDI).
4) Penalty for non-withholding	Contractor can be held liable for any amount not withheld
5) Penalties for non-timely reports	An automated penalty of £100 (more where more than 50 payees should appear on the return) is charged if the return is not made by the 19 <sup>th</sup> of the month. A further £ 100 penalty is charged on every succeeding 19 <sup>th</sup> of the month, if the return is still not received, with a final penalty of up to £3,000 if the return is still outstanding at month 13.
<b>Main administrative uses</b>	Collection of revenue and compliance checking
<b>Features of matching activities &amp; their effectiveness</b>	Following the central data matching, lists of discrepancy cases are supplied to a central national risk team. Potential cases are reviewed and any with a significant tax discrepancy are packaged and sent to the appropriate compliance team for enquiry at which point any verification issues are also resolved. Cases with smaller discrepancies are written to and invited to explain or self-amend the return to correct any discrepancy. There are no unique features built into the design of tax returns to facilitate the identification of 3 <sup>rd</sup> party reports included by taxpayers.
<b>Other uses made of information reports</b>	Ad hoc projects and various areas of tax administration
<b>Major compliance issues with regime’s operation</b>	None reported
<b>Major operational issues with regime’s administration</b>	A report of the admin burden of the old scheme was published at <a href="http://www.hmrc.gov.uk/better-regulation/part6.pdf">http://www.hmrc.gov.uk/better-regulation/part6.pdf</a> . Work is being undertaken to verify the reductions in the compliance burden from the new scheme, initially estimated at 50-60%. From April 2007, the previous scheme which relied on plastic cards and paper vouchers was replaced by

	less burdensome arrangements, including a facility to operate the scheme electronically or by telephone.
<b>Planned enhancements of regime's administration</b>	None identified beyond changes implemented from April 2007.
<b>Views of revenue body on regime's efficacy</b>	Regarded as <u>highly effective</u> , although there have been no detailed studies of this issue.
<b>Views of other stakeholders</b>	Views have softened over time.
<b>Proposals to extend scope of regime</b>	None at the moment.
<b>Documents available concerning this scheme</b>	Construction Industry Scheme: Guide for Contractors and Sub-contractors (April 2007) (HMRC website)

**Key metrics**

<b>Item</b>	<b>Number/ value</b>
1) Businesses required to withhold/ report (no.)	170,000
2) Tax withheld last fiscal year	BGP 4 billion
3) Information reports per annum (no.)	2.1 m (monthly reports covering multiple payees)
4) Information reports received electronically (%)	30%
5) Reports captured for matching in latest year (no.)	2.1 m
6) SME taxpayers covered by reporting (no.)	1.0 m
7) SME population covered by this regime (%)	22% (approx)
8) Cases actioned to include income: number & value	8,978 cases, tax and penalty of £15.9 m
9) Late filers detected: number & value	n.avail.

**Withholding/ Information Reporting Regimes for Small/ Medium Business Taxpayers****10) USA—Information returns program and backup withholding**

<b>Stated purpose of regime and year of introduction</b>	To ensure amounts owed were received in a timely manner by Government. The scheme was originally introduced in 1954, and the backup withholding component in 1984.
<b>Categories of payments subject to reporting</b>	This regime requires the reporting of a prescribed range of payment categories (refer Annex 2).
<b>Key design features</b>	
1) Withholding obligations	For <u>backup withholding</u> , the withholding body's obligation to withhold is tied, in part, to the failure to obtain a valid Taxpayer Identification Number (TIN) for the payee. The Form W-9, Request for Taxpayer Identification Number and Certification, is used to secure the identification number from the taxpayer. (New withholding obligations to be introduced are discussed later in this summary.)
2) Frequency of payment and/or reporting	There are two deposit schedules, monthly and semi-weekly. The deposit schedule for a calendar year is determined from the total taxes paid (as defined) in a 4-quarter look-back period. The look-back period begins July 1 and ends June 30. If an entity reported \$50,000 or less of taxes for the look-back period, it is a monthly depositor; if it reported more than \$50,000, it is a semi-weekly depositor.  Reports of income paid are required to be given to payees no later than January 31 of the year following the calendar year in which the payment was made.
3) Payers' electronic reporting	Payers who are required to file more than 250 returns are required to report electronically.
4) Payee identification requirements	The backup withholding rules require the payer to validate the TIN of the payee. An individual required to file a Form 1099 series return is required to obtain a Taxpayer Identification Number (TIN).
5) Penalties for non-timely reports	The penalty starts at \$50.00 for every return not filed, and is higher if the return is intentionally not filed.
<b>Main administrative uses</b>	1. To encourage voluntary correct reporting of income. 2. To assist in the detection unreported income (including by non-filers) by matching reports received with tax records.
<b>Features of matching activities</b>	Most information returns submitted to the IRS are matched to tax returns. Discrepancies are assigned to the Automated Under Reported system (AUR). Technicians review and match the filed tax return to the information submitted by payers. For those selected for audit, unresolved discrepancies are made known to the taxpayer through the issuance of a notice detailing the income type and an explanation of why the agency feels the income is subject to reporting. In the instances where there is no income tax return to match to the information returns, the agency will file a return on behalf of the taxpayer and issue a notice detailing the income type. In addition, the Combined Annual Wage Reporting (CAWR) program matches reported withholding between information returns and employment tax returns to detect business non-filing/underreporting.  There are schedules available used by individuals filing tax returns which are designed to report business income payments reported by payers. The Schedule C, Profit or Loss from Business (Sole Proprietorship), Schedule E, Supplemental Income, and Schedule F, Profit or Loss from Fishing are the vehicles used by individual tax payers reporting business income payments. The IRS does not have systemic matching as yet for non-individual returns.  These reports are also available to the audit staff for use during examinations. During the classification process of returns being reviewed for audit selection, these reports are reconciled to the return. Any income discrepancies are noted as an issue for the auditor/examiner to address. Both classifiers and examiners will review the information on the reports for indications of self-employment tax requirements, related party transactions,

	<p>and any other items of inconsistency that is questionable.</p> <p>The overall effectiveness of the process for matching reports with revenue body records is regarded as highly effective.</p>
<b>Other uses of information reports</b>	<p>The Employment Tax Examination Program (ETEP) uses the database of filed Forms 1099 Miscellaneous to assist in inventory selection to identify employers who are potentially treating their workers as ‘independent contractors’ rather than ‘employees’. Selection criteria are used to select taxpayers for examination to make this determination. Taxpayers can also initiate the process to determine workers’ status by filing a Form SS-8. This may be done after an IRS audit or denial of Workers’ Compensation Benefits.</p> <p>Changes to a taxpayer’s income tax return are tracked through the Examination Operational Automation Database (EOAD) by issue and related cause. The data are sent to state and local tax agencies for state tax administration. Other government agencies, such as Social Services, are given access by both the IRS and Social Security Administration of certain wage information; however, reports are not generated and sent. Other federal agencies are also assisted by IRS posting assessments from the other agencies’ non-tax federal debts and collecting the amounts due against any federal tax refunds.</p> <p>Besides income tax, the United States administers taxation in the area of employment taxes, estate and gift taxes, and excise taxes. Information, which is gathered in the process of administering income taxes, is routinely referred to specialists in the other areas of taxation.</p>
<b>Major compliance issues with regime’s operation</b>	<p>No major compliance issues. Success of existing system has provided grounds for extending scope of reporting requirements to new categories (see later comments).</p>
<b>Major operational issues with regime’s administration</b>	<p>The IRS has issues with ensuring the taxpayer identification numbers listed on information returns are correct and belong to the proper taxpayer. We go through a vigorous perfection regime to ensure the correct identification numbers are being used in matching programs. It also works with the Social Security Administration on perfection of social security numbers. There are some systemic tools payers can use to assist them in ensuring they have correct identification numbers. The IRS has established an office to address identity theft and it has put into place procedures to assist taxpayers that are the subject of identity theft. Penalties, notification to the payer, and requirements for backup withholding are used to deter misreporting.</p>
<b>Views of revenue body on efficacy of regime</b>	<p>Generally, the withholding/reporting regimes are highly effective. Notices issued to taxpayers not only identify discrepancies but also assist the taxpayer in becoming more compliant.</p> <p>Third-party reporting requirements greatly increase compliance. Only 1.2% of wages reported on Forms W-2 are under-reported. But 54% of income not subject to information reporting is under-reported. Third-party reporting is critical for ensuring voluntary compliance. Without reliable third-party data, the IRS cannot easily detect errors in the absence of expensive and intrusive audits. The IRS receives over 1.5 billion information returns a year, reporting income from employers, financial institutions, third-party payers, and state and federal governments. However, the IRS still lacked reliable information on certain types of income, most notably income earned by small businesses and the self-employed.</p>
<b>Views of other stakeholders</b>	<p>Anecdotal evidence indicates that practitioners support withholding and reporting regimes since they improve compliance. Practitioners have agreed that the IRS should elevate a request to gather feedback from the financial industry regarding mortgage balance reporting. This will alert preparers to the limitations provided by law on mortgage deductions, thus decreasing subsequent audit assessments in this area.</p> <p>The IRS is aware of some resistance from stakeholders representing industry regarding legislative proposals requiring merchant payment card reporting and withholding on certain government payments. In regard to</p>

	foreign reporting, the field has made efforts to revise Form 1042, Annual Withholding Tax Return for US Source Income of Foreign Persons, in order to reduce burden on individuals who pay rent to a foreign person in accordance with Reg 1.1441-7(a).
<b>Proposals/ plans to extend scope of regime</b>	<p>On August 2, 2007, the IRS and Treasury issued a report on Reducing the Federal Tax Gap that included a number of legislative proposals designed to improve tax compliance including new information reporting requirements related to the reporting of business income:</p> <ol style="list-style-type: none"> <li>1) certain payments to corporations in the course of a trade or business;</li> <li>2) payments to merchants by card agencies in respect of debit and credit card transactions (enacted in Housing Act, 30 July 2008, and reporting will begin in 2012);</li> <li>3) certain government payments for property and services (certain government payment reporting will be required under TIPRA- effective for payments made after 31 December 2010);</li> <li>4) Increased broker information reporting</li> <li>5) Require basis reporting on security sales.</li> </ol> <p>On July 30, 2008, P.L. 110-289 (H.R. 3221), the <i>Housing and Economic Recovery Act of 2008</i> (Act), was signed into law by the President. The Act includes a provision that requires returns relating to payments made in settlement of payment card and third party network transactions. Under new Code section 6050W(a), each payment settlement entity shall make a return for each calendar year setting forth (1) the name, address, and TIN of each participating payee to whom one or more payments in settlement of reportable transactions are made, and (2) the gross amount of the reportable transactions with respect to each such participating payee. Such return shall be made at such time and in such form and manner as the Secretary may require by regulations. The provision applies to amounts paid after 31 December 2011.</p> <p>IRC § 3402(t) was added to the Code by § 511(a) of the Tax Increase Prevention and Reconciliation Act of 2005, effective for payments made after December 31, 2010. <u>New §3402(t) requires withholding on certain payments made by government entities in an amount equal to 3 % of such payment. It is a new withholding requirement on business payments - all federal and state government payments for property and services (including contracts) and certain local government payments will be subject to 3% WH beginning in 2011.</u></p>

**Key metrics (covering both regimes)**

<b>Item</b>	<b>Number/ value</b>
1) Businesses required to withhold/ report (no.)	4.5 million
2) Tax withheld last fiscal year	USD1.278 billion
3) Information reports per annum (no.)	66.2 million
4) Information reports received electronically (%)	61%
5) Reports captured for matching in latest year (no.)	66.2 million
6) SME taxpayers covered by reporting (no.)	23.4 million
7) SME population covered by this regime (%)	Around 42% (23.4 million of 55.1 million overall)
8) Cases actioned to include income: number & value	1.926 million cases for \$2.1 billion tax & penalty
9) Late filers detected: number & value	Not available but appear quite significant. (The IRS's 2007 data book reported that its information returns program covering <u>all</u> taxpayers reported over 1.356 million contacts in 2007 resulting in USD14 billion in assessments.



## Annex 2

**Prescribed Payment Categories for Withholding and/ or Reporting Regimes**  
(to be read in conjunction with country data in Annex 1)

Country	Description of prescribed payment categories
Japan	<p><b><i>Withholding and reporting</i></b></p> <ol style="list-style-type: none"> <li>1) Remuneration for manuscripts, designs, lectures and broadcasting; royalties for industrial properties, etc.</li> <li>2) Remuneration and fees for lawyers, certified public accountants and certified public tax accountants, etc.</li> <li>3) Fees for medical care paid from Medical Treatment Fee Payment Fund under social insurance</li> <li>4) Remuneration or fees paid to salespeople, bill collectors, voltmeter readers, professional baseball players, etc.</li> <li>5) Remuneration or fees for performance or production of entertainment broadcast on radio or television; and remuneration or fees received by persons whose business consists of offering those services by entertainers for arranging those services</li> <li>6) Remuneration or fees paid to hostesses at bars or nightclubs, etc.</li> <li>7) Hiring bonuses and other contract money paid for the engagement of employees; and</li> <li>8) Prize money from corporate promotions and those on horse racing paid to horse owners.</li> </ol> <p><b><i>Reporting only</i></b></p> <ol style="list-style-type: none"> <li>1) Payments of remuneration, fees, contract payments and prizes.</li> <li>2) Payments to insurance agents.</li> <li>3) Payments for partnership contracts based profit, personal services, royalties on industrial property, and rental of machines made to non-residents.</li> </ol>
New Zealand	<p>Payers must deduct tax on schedular payments (formerly withholding payments) from payments made to self-employed contractors and to companies operating in the horticultural and viticultural industries - unless the contractor holds a current certificate of exemption from tax on schedular payments.</p> <p>There is a range of activities that are liable for tax on schedular payments. The tax rate differs according to the activity. These include:</p> <ul style="list-style-type: none"> <li>○ Agricultural contracts for maintenance, development, or other work on farming or agricultural land</li> <li>○ Agricultural, horticultural or viticultural contracts by companies and other contractors, including supply of labour, for pruning and/or thinning of fruit trees or vines, and picking and/or packing of fruit or grapes</li> <li>○ Apprentice jockeys or drivers</li> <li>○ Cleaning office, business, institution, or other premises (except residential) or cleaning or laundering plant, vehicles, furniture etc</li> <li>○ Commissions to insurance agents and sub-agents, and salespeople</li> <li>○ Company directors' (fees)</li> <li>○ Contracts wholly or substantially for labour only in the building industry</li> <li>○ Demonstrating goods or appliances</li> <li>○ Entertainers (New Zealand resident only) such as lecturers, presenters, participants in sporting events, and radio, television, stage and film performers</li> <li>○ Examiners (fees payable)</li> </ul>

	<ul style="list-style-type: none"> <li>○ Forestry or bush work of all kinds, planting, sowing or gathering vegetables, or flax planting or cutting</li> <li>○ Freelance contributions to newspapers, journals etc (articles, photographs, cartoons etc) or for radio, television or stage productions</li> <li>○ Gardening, grass or hedge cutting, or weed or vermin destruction (for an office, business or institution)</li> <li>○ Honoraria (including payments to mayors, chairpersons and members of councils, boards of trustees, boards, committees and official clubs or societies)</li> <li>○ Modelling</li> <li>○ Non-resident contractor companies</li> <li>○ Non-resident entertainers and professional sportspeople visiting New Zealand</li> <li>○ Payments for caretaking or acting as a watchman, mail contracting, milk delivery, refuse removal, street or road cleaning, and transport of school children</li> <li>○ Proceeds from sales of eels (not retail sales), greenstone (not retail sales), sphagnum moss (not retail sales), whitebait (not retail sales) and wild deer, pigs or goats or parts of these animals.</li> <li>○ Sharefishing (on contract for the supply of labour only)</li> <li>○ Shearing or droving</li> <li>○ Television, video or film: on-set and off-set production processes (New Zealand residents only)</li> <li>○ A personal service rehabilitation payment for a person under the Injury Prevention, Rehabilitation, and Compensation Act 2001</li> </ul> <p>Self-employed contractors and companies operating in the horticultural and viticultural industries are usually liable to pay tax on schedular payments (formerly withholding payments). Payers must deduct tax at a flat rate from payments made to contractors. Contractors are responsible for their own ACC earner's levy and student loan repayments.</p>
<p>United States of America</p>	<p>Business income-related transactions that must be reported include:</p> <ol style="list-style-type: none"> <li>1) Payments (over \$600) for services performed for a trade or business by persons not treated as its employees.</li> <li>2) Payments of \$5,000 or more of consumer products to a person on a buy-sell, deposit-commission, or other commission basis for resale (by the buyer or any other person) anywhere other than in a permanent retail establishment.</li> <li>3) Payments (over \$600) to a physician, physician's corporation, or other supplier of health or medical services. Issued mainly by medical assistance programs or health and accident insurance plans.</li> <li>4) Payments to crew-members by owners or operators of fishing boats including payments of proceed from sale of catch.</li> <li>5) Crop insurance proceeds of \$600 or more paid to farmers by insurance companies.</li> <li>6) Gross proceeds paid to an attorney in connection with legal services (regardless of whether the services are performed for the payer).</li> </ol> <p>The IRS's FY 2009 budget proposal includes a number of legislative proposals to improve tax compliance, including new information reporting requirements related to the reporting of business income: 1) certain payments to corporations in the course of a trade or business; 2) payments to merchants by card agencies in respect of debit and credit card transactions; 3) certain government payments for property and services.</p>

## Annex 3

### United States of America Information Returns Program: Backup Withholding Rates

Persons (payers) making certain types of payments must withhold and pay to IRS a specified percentage of those payments under certain conditions. Related to sole proprietors, for example, both (1) the commissions, fees, or other payments for work as an independent contractor and (2) payments by fishing boat operators, but only the part that is in money and that represents a share of the proceeds of the catch, are reported on Form 1099-MISC. Other payments are not subject to backup withholding, including wages, real estate transactions, foreclosures and abandonments, and cancelled debts. Also corporations, governmental entities, and foreign governments generally are exempt from backup withholding.

For backup withholding to be initiated on payments to sole proprietors, a payment must be reportable and the payee must fail to furnish a correct TIN.<sup>19</sup> If an incorrect TIN is provided, IRS is to notify the payer regarding the missing, incorrect, or not currently issued payee TIN. At that time the payer is required to compare the listing with his or her records and send a notice to the payee, asking for the correct TIN. Under tax rules, if the payee refuses to provide a TIN, the payer is required to immediately begin withholding 28 percent of the amount of the payment and remit that amount to IRS. IRS procedures describe how the payer is to verify the TIN and request that the payee provide a correct TIN. The payer must make up to three solicitations for the TIN (initial, first annual, and second annual) to avoid a penalty for failing to include a TIN on the information return. If the payer files an information return with a missing TIN or with an incorrect name and TIN combination, or does not follow the procedure to correct the TIN, the payer may be subject to a \$50 penalty for each incorrect return filed.

Source: *'Tax Gap: A Strategy for Reducing the Gap Should Include Options for Addressing Sole Proprietor Noncompliance'*, General Accounting Office (July 2007)

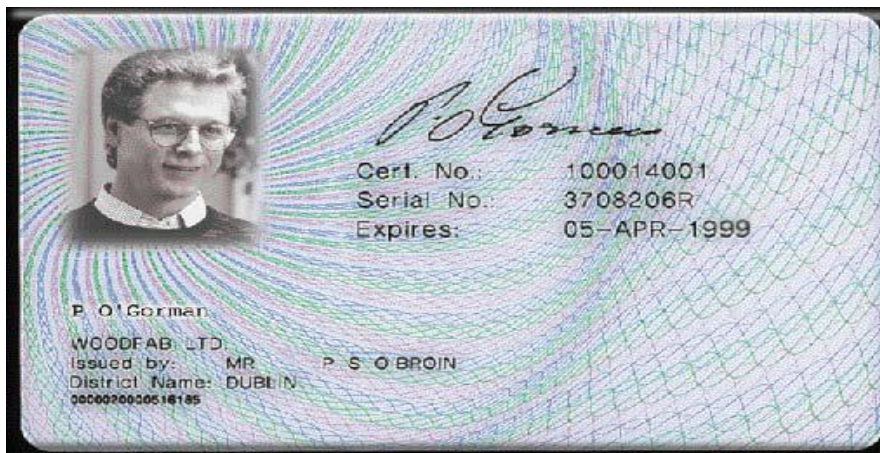
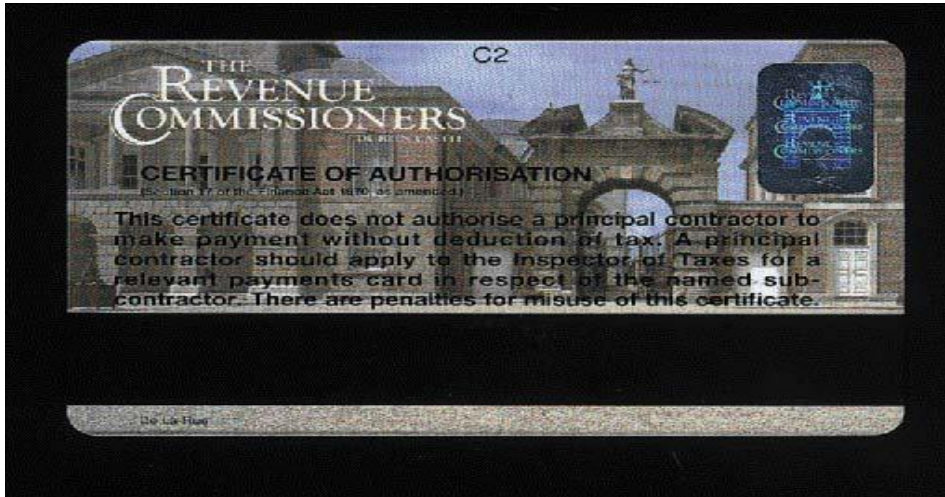
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<sup>19</sup> Backup withholding also applies when the payee fails to certify, under penalties of perjury, that the TIN provided is correct for interest, dividend, and broker and barter exchange accounts opened or instruments acquired after 1983.

**Ensuring Correct Payee Identification:  
Ireland's Relevant Contract Tax**

**What is a C2?**

A C2 is a certificate of authorisation issued by the tax office to a sub-contractor who applies for and qualifies for one. C2s generally are valid for one tax year. An individual, partnership or company may qualify for a C2. It is a personalised card similar to a credit card. It has a full face photo and signature of the sub-contractor or nominated user i.e. person authorised by a partnership or company. A nominated user is generally a director of a company or a partner in a partnership.



**How do principal contractors tax sub-contractors?**

When a principal contractor (PC) engages a sub-contractor there are two possible circumstances: 1) a sub-contractor who holds a C2; and 2) a sub-contractor who does not hold a C2.

**• Sub-contractor who holds a C2**

The sub-contractor or nominated user must give the PC the C2 in person. You must examine the **original** C2 (certificate of authorisation), a photocopy will not suffice, and be satisfied that the photograph thereon is that of the sub-contractor or nominated user who has given you the C2. If you are satisfied you should apply immediately to your tax office on Form RCT 46 for a relevant payments card for the sub-contractor. Form RCT 46 must be signed by both of you. The C2 should be returned immediately to the sub-contractor.

The tax office will send the relevant payments card directly to you. After you receive it you can, in the period to which it relates, make payments without deduction of RCT to the sub-contractor. You must record such

payments on this card at the time of payment. **You must not, in any circumstances, make a payment gross to a sub-contractor without first having received a relevant payments card from the tax office. You are liable for all RCT which you should have deducted but didn't.**

**Principal contractor's check list regarding C2**

- Does the C2 bear the photograph of the person presenting it?
- Does the signature on the RCT 46 match that on the C2?
- Is the sub-contractor's name on the RCT 46 the same as that on the C2?
- Is the C2 still in date?

If the answer to each question is yes, please apply to the tax office for a relevant payments card.

**Sub-contractor who does not hold a C2**

If the sub-contractor does not hold a C2 you cannot apply for a relevant payments card. You must therefore deduct RCT at 35% from **all** payments to that sub-contractor. RCT is deducted on the gross payment which includes VAT. When a payment is made from which RCT is deducted, you must:

- Complete a Form RCTDC;
- Enter details of each payment on an RCT Deduction Card (Form RCT48). Details of the gross amount, which includes VAT, the RCT deducted and the date of payment should be entered on the card **on the date on which the payment is made; and**
- Send to the Collector-General, within 10 days from the end of the tax month, a completed Form RCT 30, see Appendix 2, and a payment for the total amount of RCT deducted in that month. If payments are late interest of 1% a month is charged.

If the payment is being made to a gang or a group of sub-contractors you must complete a separate Form RCTDC and RCT 48 for each member for whom you have not received a relevant payments card.

## Annex 5

### **UK Construction Industry Scheme: Provisions to be Paid Gross (description as per HMRC's website (November 2008))**

If you run a business that meets certain conditions, you can ask us to register you for gross payment. Your business must:

- do construction work in the UK and be run largely through a bank account;
- have a construction turnover, excluding VAT and the cost of materials, of at least £30,000 each year (more for partnerships and most companies); and
- have complied with all its tax obligations.

Before we can grant you gross payment status so you can get paid with no deductions, you'll need to show us that your business passes three tests.

**Business test:** You'll need to show us that your business:

- carries out construction work - or provides labour for construction work - in the UK; and
- is run largely through a bank account.

**Turnover test:** We'll look at your business turnover from construction work for the 12 months before you apply for gross payment status. Ignoring VAT and the cost of materials, your construction turnover must be at least:

- £30,000 if you're a sole-trader;
- £30,000 for each partner in a partnership, or at least £200,000 for the whole partnership;
- £30,000 for each director of a company, or at least £200,000 for the whole company; or
- If five people or fewer control your company, it must have an annual construction turnover of at least £30,000 for each of these individuals.

**Compliance test:** You and any directors or partners in the business, or beneficial shareholders (where the company is controlled by five or fewer persons) must have submitted all tax returns and paid all tax due on time in the 12 months before your application. If we've asked for any information about your tax affairs in that period, you'll need to have given it to us. You're allowed a few lapses or late payments in the 12 months and we will ignore any, or all, of the following failures:

- three late submissions of the CIS contractor monthly return, including 'nil' returns - up to 28 days late;
- three late payments of CIS/PAYE deductions - up to 14 days late;
- one late payment of Self Assessment tax - up to 28 days late;
- any employer's end of year return made late;
- any late payment of Corporation Tax - up to 28 days late, including where any shortfall in the payment has incurred an interest charge but no penalty;
- any Self Assessment return made late; or
- any payment not made by the due date, where it is less than £100

If we agree that you can be paid gross, you must declare your payments in your tax return at the end of the tax year. If you are paid gross you may be subject to something called a Tax Treatment Qualification Test (TTQT) also known as a Scheduled Review. HMRC may check that you still qualify for gross tax payment.

## Annex 6

### Case Study<sup>20</sup> : UK Construction Industry Scheme Key Findings of 2005/06 Study to Estimate Administrative Burdens

#### Summary

The administrative burden of the Construction Industry Scheme ('CIS') in 2005-06 was estimated at £321m, **6% of the total burden placed on business**. This should be considered in the context of the limited sector of business to which it applies. The burden is made up, as set out in Table 1.

**Table 15: Burden by source**

Source of burden	Value (£m)	%
Internal costs	258.3	80.5
Acquisition costs	8.6	2.7
External costs	53.9	16.9
Total	320.8	100

The majority of Construction Industry Scheme burden is internal time. This is because the main certificate and voucher obligations are usually handled in house – these are day to day obligations and it would not be practical to outsource them. Annual returns may sometimes be outsourced.

The CIS is a scheme that tracks the payments to subcontractors within the construction industry. It imposes regulation on construction businesses that does not apply to any other industry. This is because the purpose of CIS is to seek to collect tax from what is a highly mobile workforce, primarily undertaking piecework. The CIS requires an exchange of information, in the form of vouchers, between businesses engaging workers and those undertaking the work. In some cases, the system requires presentation of documents in person, which can be particularly burdensome.

Clearly, the way in which this scheme works, and the volume of paperwork makes it intrinsically burdensome. Although none of the pieces of paper required is particularly difficult in theory, the practical operation of the system involves the cooperation of contractors and subcontractors, and simply ensuring that the right people have produced the right certificates or vouchers can prove time-consuming. Legislation was introduced in Finance Act 2004 that will radically overhaul the current scheme. However, the implementation of the new legislation has been delayed until 6 April 2007 and therefore it has not been measured in this project.

Many businesses made adverse comments about the current system. These were about practical aspects of the system but also a very strong feeling that the CIS was “disproportionate” and penalised the construction industry, particularly those who work hard to ensure that they comply with the rules. Some of the practical issues may be addressed by the 2007 changes, which is aimed at making compliance with the scheme cheaper and simpler as well as improving HMRC’s ability to ‘police’ the scheme.

#### **Administrative burden by most burdensome information obligations**

Table 16 sets out the 9 most burdensome information obligations. (NB: more detailed breakdown of the activity required for each obligation can be also be found in the study report.) The most

<sup>20</sup> The information in this case study was referenced solely from the report prepared for HMRC by KPMG as part of its study into the magnitude and nature of administrative burdens resulting from UK tax legislation. The information contained in this case study —see <http://www.hmrc.gov.uk/better-regulation/part6.pdf>— should be read in conjunction with Volume 1 of the overall study report, in particular to gain an overview of the model used and the dynamics of the tax administration burden for UK business.

burdensome IO is placed on subcontractors and is the requirement to present their certificate to contractors. This has a total burden of £59m, 18% of the total CIS burden. This IO will apply to all subcontractors, except those holding a CIS5 Tax Certificate (only available to companies with a significant turnover). The obligation will apply whenever the subcontractor starts a new engagement, which is a frequent occurrence. The cost of producing the return of payments to HMRC (Form CIS36) is second on the most burdensome list.

Most of the other high-ranking IOs relate to vouchers. However, rather than looking at individual IOs in this area, it is important to bear in mind that none of the key IOs is stand-alone and there can be knock-on implications for the other party to the arrangements. For example, a subcontractor may apply for a CIS 6 certificate, and will then have to present this in person to the contractor. The CIS certificate holder then has to complete a CIS24 voucher for each payment from a contractor in a month. Where a subcontractor has a CIS4 card instead, then the obligation to complete the voucher falls on the contractor who completes the CIS25 voucher. Thus, the status of both contractor and subcontractor will affect the burden for that particular arrangement. Although the requirements are slightly different for CIS4, CIS5 and CIS6 subcontractors, the fundamental tasks of presenting, checking certificates and preparing and sending vouchers are broadly the same.

**Table 16: Top 9 obligations by total administrative burden**

Information obligation	Total burden (£m)	Comprising costs (£m)		
		Internal	External	Acquisition
Production of tax certificate to contractor by sub-contractors for inspection	58.9	58.4		0.5
Requirement to make annual return of payments made to and deductions made from sub-contractors	45.6	5.0	40.6	
Requirement to obtain gross payment vouchers from sub-contractors (CIS24)	42.7	41.3		1.4
Requirement for contractor to provide tax voucher to sub-contractor for amounts deducted (CIS25)	40.2	36.2		4.0
Requirement for sub-contractor to provide gross payment voucher to contractor (CIS24)	34.2	32.7		1.4
Payments to HMRC of amount deducted from payment to sub-contractor	13.8	13.7		
Application of an individual for registration (CIS4 P&T)	13.6	7.4	6.1	
Requirement to maintain records relating to annual return (CIS23)	10.5	10.5		
Requirement to make return of vouchers to HMRC (CIS23)	8.9	8.9		
Totals	268.4	214.3	46.7	7.4
***** Total for tax area	320.8	258.3	53.9	8.6

**Administrative burden by size of business**

Table 17 shows the administrative burden broken down by business size. As outlined in Volume 1 Section 3.2 of the study report, the administrative burden was determined as a function of price and quantity. Thus the burden shown in a particular size segment was driven by the number of businesses affected by the IOs in that size segment as much as by the price for that size segment.

As outlined in Volume 1 Section 3.2.3.1 (of the study report), considerable efforts were made to ensure the population numbers were not unreasonable at a total level, noting that the allocation of total population to segment populations has been done using a generic model. This meant that the segment population in the model may have been out of line with the segment population in practice. Consequently, the analysis of the burden by size segment in Table 17 needs to be interpreted with



care. The table shows the majority (around 80%) of the burden is incurred by nano- and micro - businesses. This is purely based on the numbers of nano- and micro-subcontractors being greater than small, medium or large subcontractors.

**Table 17: Burden by business size**

Tax area	Total administrative burden (£m)					Total
	Nano	Micro	Small	Medium	Large	
CIS	96	181	37	6	1	321
HMRC total	1216	1952	925	364	642	5100

The study report contained further insights as to the workings of the CIS, including feedback from interviews of business as to which aspects cause the most “irritation” and how the scheme might be simplified.

***Changes made to reduce burden***

New regulations came into effect to make the scheme cheaper, simpler and easier to ‘police’. The main changes were to: 1) replace the Registration Cards (CIS4) and Gross Payment Certificates (CIS6 and CIS5) with a verification service; 2) introduce a new employment status declaration; 3) replace the vouchers in the current scheme with periodic returns; 4) replace the current HMRC computer system with a new one capable of supporting the use of electronic services, such as communication over the Internet.

In the Forum’s work published in January 2008 on reducing administrative burdens, it was noted that CIS regime changes had produced estimated benefits of £80 million (e.g. revamped Construction Industry Scheme (CIS) including new electronic reporting scheme and abolition of end-year returns), roughly 25% of the burden estimated for 2005/06.

## Annex 7

**Table 18. Withholding and reporting regimes in respect of SME/ self-employment income used in selected OECD and non-OECD countries**  
(countries not subject to detailed survey)

Country	Business income-related payments caught by withholding and/or reporting regime in place	Regime type /1	Rates of withholding (%)	Reporting frequency	Matched with tax returns
Australia	Services provided by non-residents for sports & entertainment, construction, & casino gambling tours	W&R	3-30; 46.5 if no ABN /2	Annually	No (but sent to countries)
	Individual labour-hire workers	W&R	Normal employee rates		Yes
	Alienated personal services payments paid by personal services entity				
	Entity that is a payee in a B2B transaction that fails to quote an ABN /2	W&R	46.5		No
	Individuals providing prescribed services (i.e. performing artists, tutors, translators/ interpreters) as defined in law	W&R	Varies on circumstances		Yes
	Individual contractors who enter into a voluntary agreement	W&R	20%		
Austria	Payments to unincorporated self-employed taxpayers for services supplied to other businesses.	R		Annually	Yes
Belgium	Payments by government for goods & services	R		Annually	Yes
	Construction industry payers must check before each payment if supplier has any fiscal or other government debts; if so, 15% of invoiced amount (excluding VAT) must be withheld	W&R	15	Annually	Yes
Chile	Payments to resident taxpayers (incl. companies) for independent personal services	W&R	10		Yes
	Payments to non-resident taxpayers for 1) technical/ professional services; 2) scientific, cultural, and sporting services; & 3) other personal services.	W&R	1) 15, 20	Annually	
	Payments to small mining taxpayers, or mining taxpayers subject to regime of deemed profits.	W&R	1-4 (turns on copper prices)		
Denmark	None identified	-	-	-	-
Finland	Self-employed & SMEs that are <u>not registered</u> : Business income from services, compensation for the use of immaterial right (e.g. copyright royalties) and (for self-employed only) proceeds from sales of wood.	W&R	13	Monthly	Yes
France	None identified	-	-	-	-
Hungary	None identified	-	-	-	-
Germany	All payments (incl .VAT) for construction work (Sec. 48 EStG). Construction work includes all supplies of goods and services in connection with the construction, maintenance, improvement or demolition of	W&R	15	When paid	Yes

	a building. The German service recipient must withhold the tax from any payments he makes to a resident or non-resident company performing the construction unless a valid waiver is presented by the company. /7				
Greece	Payments to subcontractors engaged in the construction of public or private works are subject to tax withholding by the payer (ex-IBFD).	W&R	3	-	-
	Contractors engaged in public or private works (ex-IBFD)	W&R	3	-	-
	Agents for conclusion of supplies from foreign industries (ex-IBFD)	W&R	15	-	-
	Suppliers to public bodies, excluding public welfare organisations, and state controlled businesses and organisations of: 1) fuel and tobacco; 2) suppliers of other goods; and 3) suppliers of services (ex-IBFD).	W&R	1) 1 2) 4 3) 8	-	-
Italy	Payments by entities in respect of professional services provided by self-employed persons	W&R	20%, 30% (for non-residents)	Annually	Yes
	Payments by businesses to agents, brokers and sales representatives	W&R	23% on reduced base /5	Annually	Yes
	Payments by condominiums to contractors for services provided	W&R	4%	Annually	Yes
Korea	Some income from independent personal services	W&R	3%	-	Yes
	All taxpayers (including governments and public institutions) must submit details of VAT invoices	R	-	Quarterly (business), annual (gov't)	Yes
Mexico	Banks withhold tax on cash deposits/ purchase of cashier's cheques > 25,000 pesos /3	W&R	2	Monthly	Yes
	System of VAT withholding /3	W&R		Annually	
	Payments to 1) individuals undertaking business activities; 2) self-employed professionals receiving payments from legal entities; and 3) individuals deriving income from leasing of real property to companies	W&R	10	Annually	Yes
	Payments to primary producers who don't keep records or issues invoices	W&R	5	Annually	
	Information on petrol station sales (i.e. volumes and retail prices to consumers)	R	-	Twice a year	Yes
Netherlands	Payments to persons for services provided (not being an employee)	R	-	Annually	Yes
Poland	None identified	-	-	-	-
Portugal	None identified	-	-	-	-
Singapore	Payments to non-resident professionals, public entertainers, directors, & companies	W&R	n. avail	When paid	No
Spain	Payments between businesses where the aggregated annual amount exceeds €3,000 /payee business operator	R	-		
	Payments for 1) professional services; 2) agricultural, stockbreeding & forestry activities; 3) certain activities taxed on lump	W&R	1) 15, 2) 1-2, 3) 1	Annually	Yes

	sum schemes; 4) rents from urban real estate; & 5) rights to use personal image		4) 18, 5) 18, 24		
Sweden	Government subsidies paid to business, royalties on intellectual property rights, payments to and from other countries	R	-	Annually	Yes
Switzerland	(Payments types reported were not in the nature of SME/ self-employment income)				
Turkey	Payments by contractors to sub-contractors for long term (> 1 year) construction & repair projects	W&R	13	Annually	No
	Prescribed agricultural payments for farmers not exceeding specific business sizes /6	W&R	1-4		No
	Prescribed range of professional services payments	W&R	22	Annually	Yes
	Business to business payments (for VAT administration only)	R		Monthly	Yes

Sources: Revenue bodies & IBFD.

/1. The data in this column refer to mandated 'withholding (W)' and 'reporting (R)' regimes that require automatic withholding and/or reporting as a normal procedure. It does not include the power to seek information on transactions carried out with third parties, as is the situation in many countries.

/2. ABN—the Australian Business Number (an identifier used by businesses for their government dealings).

/3. This is an advance payment of income tax, based on deposits etc that may be in respect of business income.

/4. There is an obligation to withhold VAT on certain transactions. Mexican VAT taxpayers are required to calculate and pay the VAT that should have been charged on the invoice amount, and then claim a credit on its VAT return. Withholding VAT agents for the above-mentioned purposes are: 1) financial and credit institutions receiving goods through a judicial settlement, foreclosure or trust; 2) resident legal entities with respect to payments made to individuals for the supply of independent personal services, rent or leasing of assets, acquisition of wastes to be used as raw material for industrial activities or for sale, land transportation services of goods (including services rendered by legal entities) and services rendered by commission agents; 3) taxpayers in general with respect to payments made to non-residents that do not have a permanent establishment in Mexico for the supply of goods, or if they use or temporarily use goods (for example leased or rented goods) that are made available to them by non-residents without an establishment in Mexico; and 4) assembly enterprises (*maquiladoras*), Pitex entities and entities with an authorized programme for exports according to the Customs Law, as well as manufacturers of automobiles and trucks and spare parts with respect to goods for introduction to the fiscal warehouses, purchased from national suppliers.

The withholding must take place at the time that liability to VAT arises according to the rules for determining the time of supply in each case (see 6.01 (g)) and the amounts withheld must be paid by the taxpayer together with his advance payments for the relevant period, or in any case, before the 17th day of the month following the date of the withholding. In addition, the withholding agent has to file a monthly informative return before the tax authorities, no later than the 17th of the following month, declaring the amount withheld and the suppliers for the corresponding month.

/5. Withholding is applied at a 23% rate on 50% of the amount paid (reduced to 20% of the amount paid whenever the recipient employs third parties in furtherance of their activities).

/6. These are 1) 2% on payments for animals, their produce and produce of hunting and fishing activities (1% for purchases in agriculture exchange markets); 2) 4% on payments for other agricultural products (2% for purchases in agriculture exchange markets); and 3) 4% on payments for agricultural services (2% for forestry services, such as cutting and maintenance of trees, gathering products and similar services).

/7. The service recipient must file a tax declaration with the tax and revenue office responsible for the party who performed the services, using the appropriate forms, by the 10<sup>th</sup> day of the month subsequent to the month in which he gave consideration (Declaration Period). No withholding tax applies if: 1) the supplier has provided the payer with an exemption certificate; 2) the total consideration per year does not exceed €15,000 where the German customer only carries out VAT-exempt rental services; or 3) the total consideration per year does not exceed €5,000 in all other cases.