Current Challenges in Revenue Mobilization: Improving Tax Compliance

CEPAL Regional Tax Seminar
March 10, 2015
Outline

• Recent trends in tax compliance

• Understanding and addressing noncompliance

• The ‘hard-to-tax’ transactions—emerging issues

• Managing compliance

• Supporting compliance management—*new tools*
Measurement and trends
The Crisis Exposed Tax Administration Weaknesses

• When the crisis hit, it made the task of RAs increasingly difficult

• Flaws in governance/management, and legal rigidities

• New approaches to foster compliance just emerging
Compliance, which was improving before the crisis, has—at best—stabilized now.
Changes in Compliance and Output Gaps, 2010 - 11 vs. 2006 - 7

The diagram illustrates the changes in compliance and output gaps for various countries. The x-axis represents the change in output gap, while the y-axis shows the change in compliance gap. Each country is marked with a red dot, indicating their position in the graph. Countries with positive change in compliance gap are located above the x-axis, and those with positive change in output gap are located to the right of the y-axis.

Key countries mentioned include:
- AUT
- BEL
- BGR
- CZE
- DNK
- EST
- FIN
- FRA
- DEU
- GRC
- HUN
- IRL
- ITA
- LVA
- LTU
- LUX
- MLT
- NLD
- POL
- PRT
- ROU
- SVK
- SVN
- ESP
- SWE
- GBR
- JPN
- MLT

The diagram provides a visual representation of how different countries have performed in terms of compliance and output gaps over the specified periods.
‘Compliance Gaps’ Remain Useful Tools

Calculated by an increasing number of RAs—but very far from all

- Do not necessarily indicate recoverable revenue
- Alone, do not indicate remedial action needed
- Various ways to calculate
Understanding and addressing noncompliance
Core Framework

• Evasion as a gamble (Allingham-Sandmo)
  ➢ with key parameters: Tax rate; Probability of detection; Punishment

• Important in practice:
  ➢ Audit strategies
  ➢ Costs of compliance
  ➢ Corruption/extortion
Key Role of Withholding and Third Party Information

I. Amounts subject to **substantial** information reporting and withholding
   - (Wages & Salaries)
   - Underreporting Gap: $11B, 1%

II. Amounts subject to **substantial** information reporting
   - (Pensions & annuities, unemployment compensation, dividend income, interest income, Social Security benefits)
   - Underreporting Gap: $12B, 8%

III. Amounts subject to **some** information reporting
   - (Deductions, exemptions, partnerships/S-Corp income, capital gains, alimony income)
   - Underreporting Gap: $64B, 11%

IV. Amounts subject to **little or no** information reporting
   - (Nonfarm proprietor income, other income, rents and royalties, farm income, Form 4797 income, adjustments)
   - Underreporting Gap: $120B, 56%
The hard-to-tax—emerging issues
Corporate Income Tax Rates, 1980 - 2013

Source: IMF staff estimates.

Note: Figure shows medians with countries ranked by income per capita each year and divided into four equal sized groups.
Corporate Taxes—
Base Erosion and Profit Shifting

Tax planning schemes

• Aim at *shifting taxable income to low tax jurisdictions*

• **Mechanisms:**
  - Transfer pricing abuse
  - Intra-company debt
  - Location of intangible assets
Corporate Taxation:

Tax planning schemes

- **Tax arbitrage opportunities**: taking advantage of mismatches in legislation across countries

- **Treaty shopping**

- **Risk transfer**: redefinition of risk (high margin) toward low corporate tax rate countries

- **Relocation**: From 1997-2007, about 6 percent of all MNEs relocated their headquarters

- **Deferral of taxes**
FDI Stocks Relative to GDP

FDI Stocks Relative to GDP – The Top Ten (2012)

<table>
<thead>
<tr>
<th>Country</th>
<th>FDI in percent of GDP</th>
<th>Share of world FDI (%)</th>
<th>Share of world GDP (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxembourg</td>
<td>4,710</td>
<td>10.2</td>
<td>0.07</td>
</tr>
<tr>
<td>Mauritius</td>
<td>2,504</td>
<td>1.1</td>
<td>0.01</td>
</tr>
<tr>
<td>Netherlands</td>
<td>530</td>
<td>15.4</td>
<td>0.91</td>
</tr>
<tr>
<td>Hong Kong SAR</td>
<td>409</td>
<td>4.1</td>
<td>0.31</td>
</tr>
<tr>
<td>Cyprus</td>
<td>252</td>
<td>0.2</td>
<td>0.03</td>
</tr>
<tr>
<td>Ireland</td>
<td>171</td>
<td>1.4</td>
<td>0.25</td>
</tr>
<tr>
<td>Hungary</td>
<td>170</td>
<td>0.8</td>
<td>0.15</td>
</tr>
<tr>
<td>Switzerland</td>
<td>148</td>
<td>3.6</td>
<td>0.75</td>
</tr>
<tr>
<td>Malta</td>
<td>101</td>
<td>0.0</td>
<td>0.01</td>
</tr>
<tr>
<td>Belgium</td>
<td>100</td>
<td>1.8</td>
<td>0.57</td>
</tr>
</tbody>
</table>

Source: Calculations from IMF Coordinated Direct Investment Survey (http://cdis.imf.org/).

Note: Figure shown is average of outward and inward positions. Singapore and Mongolia (for which outward data are unavailable) would enter the top ten if only inward positions were considered.
High Wealth Individuals

Treatment matters for equity—and revenue

**Income Tax Liability of Top 1% of Taxpayers**

- **US**
- **UK**

**Income Tax Liability of Top 5% of Taxpayers**

- **US**
- **UK**
- **Netherlands**


Income Tax Liability, %
HWI Problems and Dealing with Them...

- Complex affairs, well-advised, powerful, mobile...

- Specialized HWI compliance programs...
  - HWI unit: risk analysis, audit, debt collection

  ...have shown results
  - E.g. UK collected £1 billion since 2009
  - Credit Suisse fine $2.6 bn; HSBC

- Several post crisis Exchange of Information initiatives
  - FATCA, G20 and AEOI
More on the Hard-to-Tax

- Professionals
- Small enterprises
- B2C transactions
  - Lotteries
  - Electronic fiscal devices
  - Internet and intangible services; Amazon
Managing compliance
Revenue Administrations

Are large, complex organizations…

That have been through turbulent times and face rapidly changing environment ahead
Organizational Management Requires Strong HQs....

High turnover of senior staff a common problem

Rotation of Commissioners by Region, 2009-2013

<table>
<thead>
<tr>
<th>Region</th>
<th>1 Commissioner</th>
<th>2 Commissioners</th>
<th>3 Commissioners</th>
</tr>
</thead>
<tbody>
<tr>
<td>AFR (31)</td>
<td>40.0%</td>
<td>20.0%</td>
<td>10.0%</td>
</tr>
<tr>
<td>APD (21)</td>
<td>10.0%</td>
<td>40.0%</td>
<td>50.0%</td>
</tr>
<tr>
<td>EUR (36)</td>
<td>20.0%</td>
<td>30.0%</td>
<td>30.0%</td>
</tr>
<tr>
<td>MCD (16)</td>
<td>50.0%</td>
<td>20.0%</td>
<td>10.0%</td>
</tr>
<tr>
<td>WHD (26)</td>
<td>15.0%</td>
<td>30.0%</td>
<td>55.0%</td>
</tr>
</tbody>
</table>
Changes in Spending on Tax Administration, 2008-2011
(In percent of GDP)

Source: CIAT, RA-FIT data, OECD
To Do List for Operational Management

• *Focus on main compliance risks* and prompt payment of refunds

• Pressure to take on new major expenditure functions...but important to *keep priority on administering core taxes*

• Some countries still struggle with *automating* basic compliance operations

• Need for *proactive relationship* with taxpaying community
Supporting compliance management
...with New Analytical Tools

**RA-GAP**: Actual vs. full compliance

**RA-FIT**: Collects RA data and establish baselines/benchmarks

**TADAT**: Assessment tool

- Accountability and Transparency
- Integrity of the Registered Taxpayer Base
- Assessment and Mitigation of Risk
- Supporting Voluntary Compliance
- Filing of Tax Returns
- Payment of Obligations
- Ensuring Accuracy of Reporting
- Tax Dispute Resolution
- Operational Efficiency and Effectiveness

Performance Outcome Areas
Conclusions

• Tax administration is catching up, but the challenges are big

• International tax competition is very strong and for CIT there are strong incentives to a race to the bottom

• International cooperation is more and more critical—BEPS Initiative
Thank You!