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Handbook

on Tax Administration

Second Revised Edition

IBFD

Handbook on Tax Administration (Second Revised Edition)

Why this book?

The Handbook on Tax Administration provides a complete, systematic overview of modern Tax Administration. The book includes chapters on taxation; core business of a Tax Administration; developments in society; organizational structures; risk management, primary processes of Tax Administration, staff and support processes; planning and control; performance management; and change management. In this second edition a new chapter is included on the design and implementation of a diagnostic tool for Tax Administrations. It is an international Handbook in the sense that it aims to provide insight into the administration of taxes based on the experiences in various countries, by identifying examples of good practices of effective and efficient tax administration. The Handbook does not, however, aim to provide a blueprint for Tax Administrations, as legal, institutional, economic, social and cultural differences between countries prevent such an exercise.

The Handbook on Tax Administration is a valuable reference tool for tax policymakers, tax administrators and tax students, as well as for those interested in trends and developments in the structure and management of large public organizations.

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Core Business of a Tax Administration

The core tasks of a Tax Administration are centred on the implementation and enforcement of tax legislation and regulations. These activities include identification and registration of taxpayers, processing of tax returns and third-party information, examination of the completeness and correctness of tax returns, assessment of tax obligations, (enforced) collection of taxes and provision of services to taxpayers.

Tax Administrations operate in societies that are rapidly changing and have to fulfil increasing demands and growing expectations from their stakeholders, including new and rising demands from taxpayers for sophisticated government services. A Tax Administration must develop a contemporary vision and translate its mandate into a clear mission, vision and a set of objectives. Tax Administrations need to develop effective organizational structures and be provided with adequate powers to effectively and efficiently implement and operate the tax systems they administer. A Tax Administration needs an adequate level of autonomy that is reflected in its structure and operational responsibilities. A Tax Administration needs to be provided with adequate resources and is accountable for its operations. Its relationship with taxpayers must be laid down in a system of rights and obligations.

2.1. Definition of a Tax Administration

By definition, Tax Administrations administer taxes. They implement and enforce tax laws and receive their mandates by law.

Tax Administrations, like private companies and other organizations, have a core business. The core business of Tax Administrations is the levying and collection of taxes imposed by law. It is important that Tax Administrations establish a clear definition of their core business from the outset and make it known to their stakeholders. The core functions of a Tax Administration include, inter alia:

- registration of taxpayers, including detection of non-registration and false registration;
- processing of tax returns, withholdings and third-party information;
- verification or examination of the correctness and completeness of received information (including audit activities);

- assessment of taxes due;
- process of enforced debt collection;
- handling of administrative appeals and complaints;
- provision of service and assistance to taxpayers;
- detection and prosecution of tax fraud; and
- imposing of penalties and interest payments.

Most countries have one single Tax Administration for direct and (most) indirect taxes, but there are still countries with separate organizations responsible for collecting direct and indirect taxes.

Many countries have separate organizations for taxes and customs. In some countries, the Customs Administration is tasked with administering excise duties; in others, this is the task of the Tax Administration. In other countries the responsibilities for collecting taxes and operating customs are merged into one single Tax and Customs Administration. However, even in countries with a merged Tax and Customs Administration the processes of tax and customs are usually operated by distinct divisions supported by a pool of common services departments and shared administration functions, such as intelligence/investigations and service provision. The rationale for this is that the processes of tax operations and customs operations differ significantly both on the side of the administration and on the side of the customers. The commonalities are limited and these may be better served by intensive exchanging and sharing of information between customs and tax divisions and by operating joint audits where appropriate.

There also exist different institutional arrangements for the collection of social security contributions. In many countries, collecting social security contributions is a responsibility of one or more separate bodies, but in a growing number of countries this task is integrated within Tax Administrations. The rationale for this integration is the commonality of the core processes involved in the collection of wage taxes and social security contributions.

In some countries Tax (and Customs) Administrations are tasked with assessment and collection activities on behalf of other governmental organizations and sometimes even with the payment of social benefits on behalf of other governmental agencies. Given their professional capacity and core competence for collecting revenue, Tax Administrations are potentially well placed to collect other (non-tax) debts owing to government. Many Tax Administrations have been tasked with collecting non-tax debts such as student loans, child support and overpaid welfare benefits. In some countries,

there has been a tendency (which has usually been initiated by politicians) to also give the Tax Administration, as “the best performing administration” in the country, other responsibilities besides its core tasks. Examples include payment of social benefits, social security payments and collection for public libraries. Other responsibilities given to Tax Administrations may include property valuation and population registration. Furthermore, in connection with the tax intelligence and investigation function, which is a core activity of a Tax Administration, its responsibilities may also include the monitoring and investigation of non-tax offences such as financial (e.g. money laundering and insider trade), social (e.g. benefit fraud) and economic offences.

An important and critical part of the collection function of Tax Administrations is enforced tax debt collection. There is a growing awareness of the importance of this function for Tax Administrations. Tax debt collection should be considered as an important and integral part of the overall tax administration process and in our view is not a function that can be readily separated (e.g. outsourced) from mainstream operations. Tax debt collection is typically a core and major responsibility of Tax Administrations. There are, however, a few exceptions to this basic rule; for instance, in Australia, Ireland, Italy, Singapore, the United Kingdom, the United States and a few Nordic countries, (parts of) the process of tax debt collection is or has been separately managed by one or more independent organizations.

A US example

The vast majority of US states use private firms to help collect delinquent taxes. At federal level, this work was traditionally done by the government. Since 2006 until 2010, however, the IRS has been assisted by private firms to collect federal tax debts. By law, several limitations were included to ensure the private firms would be subject to the same stringent taxpayer protection and privacy rules that IRS experts work under. In addition, private firms could not subcontract the work.

The IRS also developed its own guidelines for the private firms, including background checks on all private firm personnel associated with the project and mandatory, IRS-directed training programmes for company personnel.

Private firms were not authorized to take enforcement actions such as liens, levies or seizures. In addition, private firms were not authorized to work on technical issues such as offers in compromise, bankruptcies, hardship issues or litigation. The IRS assigned to the private firms only those cases in which the taxpayer had not disputed the liability. The private firm would contact taxpayers to make payment arrangements.

Redirecting relatively simple cases to private firms permitted the IRS to focus its existing collection and enforcement personnel on more complex tax issues.

However, the programme was discontinued after a few years because the private firms that were engaged turned out to be significantly less cost efficient than the IRS.

Australia: Use of external collection agents

The ATO launched a pilot programme in 2006 to use external collection agents that was subsequently implemented in 2007. The outstanding collectable debt had increased significantly by large numbers of debt cases individually, mostly representing small amounts of debt but collectively representing significant values. The ATO is outsourcing lower value, non-complex debt cases to external collection agents that employ a correspondence and telephone-based approach. The ATO pays a flat fee to the external collection agents. The results achieved by these external collection agents reported by the ATO were either payment in full or negotiated payment arrangements with taxpayers in around 50% of cases involved. From an operational perspective this approach seems effective; however, it is unclear to what extent this approach operated by separate agencies lacking the benefits of a more integrated strategic approach would contribute to long-term overall compliance levels.

In summary the (core) business of a Tax and Customs Administration will usually consist of one or more of the following activities:

- assessing, collecting and auditing government-imposed taxes, as well as preventing and combating fraud;
- surveillance by customs of goods imported and exported (in order to assess, collect and monitor the various duties linked with import and export, but also to protect the quality of society, i.e. the quality of food, health, cultural inheritance, protection against falsity, etc.);
- assessing and collecting social security contributions;
- assessing and collecting fees and duties on behalf of other governmental agencies; and
- payment of social benefits.

The definition of the core business of a Tax Administration or its mandate is the answer to the question, “What should a Tax (and Customs) Administration do?” Another question relates to how the Administration performs the responsibilities assigned to it – its mission and vision. This relates to the field of organizational philosophy, strategic planning, risk management and management control, including performance management, inter alia, by measuring of performance indicators based on critical success factors.

Administering the tax laws of a country should serve the public interest, i.e. it should meet the needs of the government and the people of the country served by the government. In order for the governmental body charged with

administration of the laws to serve the public interest properly, the governmental body and its employees must have the confidence and esteem of the public they serve. The primary responsibility of a Tax Administration is to collect the proper amount of tax due to the government at the least possible cost to the public. In addition, it is essential that a Tax Administration carries out its responsibilities in a manner which warrants the highest degree of public confidence in the organization's effectiveness, efficiency, integrity and fairness. In some cases, a Tax Administration may also be responsible for drafting tax legislation. If it is not directly responsible for drafting legislation, it should at least be involved in determining the effectiveness, efficiency and feasibility of proposed provisions of the tax law.¹⁵⁹

The tax-paying public should be affirmed in its expectation that the organization responsible for administering the country's tax system will administer the tax laws consistently and fairly so that similarly situated taxpayers will be treated equally and consistently under the laws and that, as a result, all taxpayers pay their fair share. Taxpayers should also receive good value for the money spent by the Tax Administration in administering the tax laws, i.e. the Tax Administration should operate as efficiently and cost effectively as possible. In addition to receiving value for their money, the public would expect that the Tax Administration and its employees would be free from any type of corruption or undue influence and would adhere to strict integrity standards.

The most cost-effective means of collecting taxes is through the voluntary compliance of the public with the tax laws. The more enforcement activities would be necessary, the more expensive the administration of the tax system will be. In order to encourage taxpayers to comply with their tax-paying responsibilities voluntarily, it is important that the Tax Administration assists them in understanding their responsibilities. This can be done through taxpayer assistance over the telephone, in writing, face to face or by using electronic communication tools such as website technology and e-mail, or through taxpayer education activities. It is essential for the Tax Administration to establish procedures and processes for providing guidance to taxpayers.

Also critical to the concept of voluntary compliance is the belief on the part of the tax-paying public that the Tax Administration respects the rights of taxpayers and operates on the principles of integrity and honesty. For there to be confidence in the tax system, people must believe that it is a

159. Discussed in detail in chapter 1, *see* section 1.11.

fair system administered in an even-handed manner. For these reasons, it is important for the Tax Administration to provide the proper mix of customer service and fair enforcement of the tax laws.

Too much emphasis on raising revenue and less on customer service and taxpayers' rights can lead to a lack of confidence on the part of the public in a Tax Administration's ability to manage its responsibilities properly. Lack of confidence in the Tax Administration, which administers the laws, can also reduce levels of voluntary compliance with the laws.

It is advisable that Tax Administrations enshrine, in writing, the specific rights of taxpayers when they are dealing with the Tax Administration (these rights may be enumerated in the tax laws). This will provide clear guidance to taxpayers regarding their rights in dealing with the Tax Administration. Ethical standards and rules of conduct for employees should also be set down in writing, and every employee of the Tax Administration should be trained both in the rights of taxpayers and in the rules of conduct to which they are expected to adhere. There should be provisions for (and a process for) dealing with employees whose actions violate taxpayers' rights or who fail to comply with the rules of conduct. There should also be a means of redress for taxpayers whose rights have been violated (this is also often a part of the tax law).

Any disclosure of tax information should be within strict guidelines established in the law and only for the purpose of the proper administration of the tax laws. Taxpayers should be able to expect that their tax information will remain private and there should be legal and employment-related consequences for improper disclosures by any employee of the Tax Administration. Every employee of the Tax Administration should be trained regarding the confidentiality of tax information and the consequences for improper disclosures.

Taxpayers have the right to expect that employees of the Tax Administration will be well trained in their area of technical responsibility. Employees should also have an overall understanding of the Tax Administration's operations so taxpayer problems can be resolved without forcing taxpayers to make numerous contacts. It is a valid expectation on the part of the public that the Tax Administration will have procedures and processes in place on how the law should be applied and how employees should conduct themselves in performing their duties. Proper attention must be paid

to the training of employees in order to ensure that the Tax Administration has a technically proficient and professional workforce as well as one that respects the rights of taxpayers.

A public expectation that the Tax Administration will have a management information system in place to provide information necessary for proper decision-making by the leaders of the organization is a valid one. Effective management control systems are linked to the overall strategy of the Tax Administration with explicit objectives defined for a certain period. Tax Administrations should measure their performance and report on how and to what extent they have realized their objectives. The management information systems should also provide sufficient information enabling the Tax Administration to be responsive to inquiries by government bodies charged with supervisory responsibility as well as to internal organizations charged with review and evaluation of tax administration procedures, processes and operations, thus making the Tax Administration accountable for its operations and subject to external control and assessment. Great care should be exercised in determining the critical factors to be measured in order to gauge the effectiveness and efficiency of operations. These performance measures should support the Tax Administration to improve its future operations.

As described in chapter 1, there are many facets to a Tax Administration's role. In order to administer the tax laws of the country successfully, a careful balance must be maintained among the various responsibilities. Establishing a system for obtaining regular feedback from employees, the tax-paying public, tax professionals and anyone with whom the Tax Administration deals will provide important information that it can use to assess how well it is fulfilling its responsibilities. A willingness to solicit and be responsive to feedback from stakeholders of the Tax Administration will improve the confidence that the tax-paying public has in the Tax Administration. As indicated earlier, this confidence is a critical factor in the Tax Administration's ability to successfully administer the tax laws.

CIAT has proposed a minimum set of necessary attributes for a sound and effective tax administration.¹⁶⁰ These attributes were considered as a common objective for the Tax Administrations of CIAT member countries and a precondition for efficient, effective, modern and professional tax administration. The declaration describes the requirements for guaranteeing:

160. Minimum necessary attributes for a sound and effective tax administration, approved by the CIAT General Assembly held in Santo Domingo, Dominican Republic, 19 March 1966.

- the integrity and impartiality of a Tax Administration;
- the continuity of a sound Tax Administration; and
- taxpayers’ trust in the Tax Administration.

In summary, these requirements include:

- a strict code of behaviour promoting ethical and professional standards;
- incompatibility of staff for carrying out tax advisory activities or running private companies;
- recruitment, admission and promotion of staff exclusively on professional grounds without political interference;
- competitive remuneration for staff;
- autonomy in strategies to control compliance and interpretation of the law;
- protection of privacy and confidentiality of information provided by taxpayers;
- promoting voluntary compliance and reducing tax evasion;
- improving productivity, quality of service and taxpayer satisfaction;
- reducing compliance costs for taxpayers;
- availability of adequate human, financial and technological resources;
- consultation of the Tax Administration in the design of tax legislation;
- providing adequate technical training programmes to their officials;
- fair, reliable and transparent application of the tax laws;
- reliable service provision;
- efficient processing of taxpayers’ returns, requests, appeals and enquiries;
- professional communication strategies to improve awareness; and
- disseminating and respecting the rights of taxpayers.

In its *Fiscal Blueprints*, the European Commission sets out what it considers to be essential requirements for a modern Tax Administration.¹⁶¹ These include:

- it is guaranteed an adequate level of autonomy;
- its obligations are clearly translated into its mission, vision and objectives;
- it has its own structure and powers allowing for efficient and effective operations;
- it is provided with adequate resources to implement and manage the tax system;

161. European Commission, Taxation and Customs Union, *Fiscal Blueprints: A path to a robust, modern and efficient tax administration*, 2007.

- it is provided with a stable legal framework ensuring proper administration and enforcement of taxes due;
- it is accountable for its operations, which are subject to control and assessment; and
- its operations are managed and assessed on the basis of the performance management system.

The *Fiscal Blueprints* provide key indicators enabling Tax Administrations to measure if and to what extent they would meet these essential requirements for modern Tax Administrations.

2.2. Mandate of a Tax Administration

2.2.1. Introduction

As indicated above, mandates of Tax Administrations vary widely. In some countries, Tax Administrations are mandated to administer all taxes at central government level; in others they have limited mandates restricted to the administration of direct taxes or indirect taxes, e.g. the positioning of administering VAT differs significantly in different countries.

In some federal-based countries, the Tax Administration at federal level is also tasked with the collection of local taxes or state taxes for all states or for a limited number of states. In other countries, central Tax Administrations have no task in collecting local or state taxes.

In some countries, taxes and Customs are merged in a single Tax and Customs Administration; in others the responsibility for administering taxes and Customs are mandated to separate organizations.

Tax Administrations in quite a few countries are tasked with the collection of social security contributions and/or the collection of other payments from citizens and businesses to central government. In a limited number of countries, the central Tax Administration is also tasked with the payment of social benefits. In some countries the Tax Administration is responsible for typical non-tax roles such as property valuation and population registration.

In some countries, Tax Administrations are also responsible for criminal tax investigations and in a few countries the mandate also includes the investigation of non-tax related financial, social and economic offences.

In other countries these activities are mandated to a separate Tax Criminal Investigations Department or even to the general Criminal Investigations Department.

Differences can be explained by different legal, economic, governmental and cultural traditions and histories. Merging of different similar functions into one single organization and integrating different processes with similar characteristics and purposes enables Tax Administrations to effectively achieve their objectives in a more cost-efficient way and also to provide better services to taxpayers.

2.2.2. Integration: Theoretical framework

The organizational design of an organization reflects the chosen combination of differentiation and integration of the organization's operations. Differentiation refers to the subdivision of functional units, each concentrating on a particular aspect of the organization's operations; integration refers to the linking of differentiated units to achieve unity of effort in working toward the organization's goals.

The different models used by Tax Administrations to structure their organizations following the principles of differentiation and integration will be discussed in chapter 4.

For the purpose of this chapter we use a broader concept of integration. Integration is the constitution of one process, system or resource to be applied in different applications, instead of every application having its own. This definition also includes the constitution of cross reference links, which connect processes with different objectives, but with usage of identical source data. For example:

- one Tax Identification Number (TNI) applied for all types of taxes;
- one appeal process and procedure applied for multiple or all types of tax assessments;
- one invoicing system for different types of taxes; and
- one information channel for multiple or all sorts of tax clients.

To illustrate this, assume that a taxpayer's Excise Duty file includes information that may also be relevant to the VAT and income tax affairs of that taxpayer. Cross reference links to that information would connect the taxpayer's VAT and Income Tax files.

Many Tax Administrations have built in certain integration elements in their operations. These are often the result of incidental improvements of their organization and seldom the result of an orchestrated search for integration possibilities.

Possibilities for integration depend on cultural, economical and organizational circumstances in a country. There is a strong interrelationship between these. A society's social norms and values or culture form the fundament of any organization in that society. Indissolubly connected with culture is the stage of development of a society.

Different cultures may lead to different organization models and management styles. On the other hand, different stages of economic, demographic and technology development in a country lead to different taxation policies and different organizational needs for the Tax Administration. Both influences, culture and development stages, result in different tax organization models and thus in different needs for integration.

2.2.3. Business process redesign

A precondition for integration is the ability to introduce organizational changes effectively, with care and systematically. In many cases an attempt to improve the operations without a systematic approach appeared to be futile. An important tool for implementing integration ideas is the so-called Business Process Redesign (BPR). This method stems from the notion that operational processes often slice through the functional layers of an organization, this layering thus being an obstacle for optimal operations. BPR provides the opportunity to detect identical steps in different processes, which can be developed and operated once for all of these, instead of repeating the same step for every process. This is what we defined earlier as integration.

The advantages of BPR are eliminating gaps, duplications and unnecessary bureaucracies. The redesign passes the stages of identifying critical business processes, appointing process owners with strict responsibilities and evaluating the processes and the total business operation, including defining integration opportunities.

A BPR project starts from certain premises:

- a process is a collection of logically related tasks in order to obtain a pre-defined result (product);

- a process can be subdivided into sub-processes that are logically related, which consist of sequential activities that contribute to the mission of the (macro-) process;
- every (sub-) process leads to a product; every product (or service) again is based on a process;
- every process has an owner, who is held accountable for how well the process performs; and
- every process has well-defined boundaries, in- and output, interfaces with other processes; every process has documented procedures, cycle times and measurement/feedback controls.

A typical BPR project passes through the following stages:

- (1) identify critical business processes and perform a weighted rating, e.g. by weighing the customer impact, changeability and business impact;
- (2) select and appoint process owners with process knowledge and power to act on the process;
- (3) define responsibilities of the process owners in terms of set targets and measurements of the process results, description of input with supplier, output with client, boundaries, cycle times, interfaces with other processes, etc.;
- (4) let the process owners describe and analyse the processes, preferably in the form of block diagrams – this will force the process owner to mentally walk through the process;
- (5) evaluate the processes and all the sub-processes and activities and assess the value they add to the business goals – eliminate inefficiencies, duplications, bureaucracies and non-value adding parts;
- (6) evaluate the complete set of processes, streamline the whole and define the parts which may be integrated;
- (7) analyse the possibilities to bring in or change information and communication technology tools; and
- (8) review the organization according to the redesigned processes.

2.2.4. Integration aspects

Integration is never a goal in itself; however, it can be an instrument to help achieving one or more of the following objectives:

- *effectiveness*: implementation of the political goals to an optimal extent;
- *efficiency*: execute the tasks with maximum result at minimum cost; and
- *improved service levels*: obtaining a high level of client's satisfaction will increase the compliance of the client.

The responsibility for the development and implementation of integration possibilities depends on the level of these possibilities. They may be at strategic, tactical or operational level; however, the impact of integration may very well exceed the borders of its implementation area. Managerial attention to any integration effort is therefore essential.

There are several aspects or areas to take into consideration when dealing with tax integration:

- *Legislation and regulation*: Bringing together or linking to each other tax regulations and/or other regulations such as social laws. The incentive to this is mostly the government policy to cover public issues by looking at them from the outside, namely from the citizen's point of view rather than from the administration's point of view.
- *Processes*: Integration of (sub-) processes of different taxes and duties within the Tax Administration, but also process integration of processes with external organizations such as the collection of social security contributions governed by the Ministry of Social Affairs.
- *Management*: The integrated management of execution of the main and primary tasks of the Tax Administration.
- *Systems*: Developing and operating (mainly information and communication) systems, both of hardware and software, so that they function for multiple purposes.
- *Resources*: Integrating facilitating business components like offices, canteens and maintenance can be easily foreseen. More challenging is integrating support functions such as training and development services, planning, control and finance activities and, probably the most important, human resources management.

The main objective of integration in the *legislative* area (e.g. creating links between different laws or combining different tax types in one regulation) is effectiveness. However, especially with increasing internationalization of societies and increasing cooperation between countries, efficiency becomes more and more an important issue: simplification, easy to implement, fit for internationalization.

There is a strong connection between legislation and tax organization. The conventional situation is that legislation and tax organizations

follow tax-type lines: for every tax type own law and organization units. Increasingly, also in EU countries, we see a trend for integration: tax functions and regulations combined in multipurpose entities. This can be seen even outside the typical tax area, such as, for example, integration of collection tax revenues and social security contributions.

The main processes within the Tax Administration are registration, assessment, collecting, auditing and investigation, and service delivery. When integrating processes we must think about integration within the process, integration between more processes and integration with external processes. All three basic objectives can be reached: effectiveness (improving law enforcement), efficiency (lower cost) and improved service levels. Most essential in nearly all integration situations is the creation of a unique TIN per citizen or organization.

There is a broad range of integration possibilities; examples implemented by many countries include:

- Integration of data and files containing all information of individual taxpayers. Essential to this integration (and others) is the creation of a unique TIN for every citizen.
- Cross-government integration: As an example, the intensive cooperation in the Netherlands between the Tax Administration and the Ministry of Social Affairs in the areas of fraud policy, client approach and collection process. In Spain and Portugal, the tax processes of registration and collection are integrated with commercial banking processes – taxpayers send their returns and pay their tax to banks.
- Front office/back office organization: Integrating client contacts for all taxes within one office, while specializing the back-office processes.
- Target group orientation: Integrating taxpayers' information according to their characteristics; often based on risk assessments of the group (some groups represent different and higher or lower risks for non-compliance than others).
- Integrated case management: Integration of handling all tax cases for the same client.

- Mass processing centres: Integrating the administrative digitizing and processing of mass data.

Processes	Cooperation with third parties	Interest of taxpayer	Law enforcement	System advantages
services	information centre and services public sector	client treatment “one stop shopping” as integrated structure		design of front and back office approach
registration	use of identical number combined file system			
assessment	use calculation of the income also as base for other regulations (social security, subsidies, grants, etc.)		risk assessment with other law enforcement agencies	
auditing	joint audits or at least a good planning and coordination of visits to the taxpayer			
collection	payment activities with private banks or using the same collection function			
investigation			risk analysis with other investigation agencies	

2.2.5. Customs

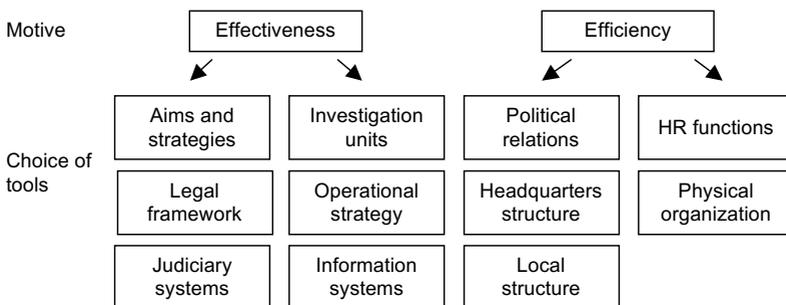
This section discusses the significance of good cooperation between tax and Customs authorities, focusing on the following:

- why cooperation is essential;
- how VAT can be organized; and
- what kind of activities can be developed and executed together.

The basic motivation for merging the Tax Administration and Customs is the need and desire to increase efficiency (resources spent on each unit of revenue collected) and/or effectiveness (ways in which the revenue is

collected) of those parts of states' administration. Depending on the main motive, different tools are used in the merger process. An example is illustrated by Fig. 13.¹⁶²

Fig. 13



There are two basic merger strategies depending on the motives of integration:

- *Operational integration*: Cases of external motives and focus is on performance of the Tax Administration, i.e. results or effectiveness.
- *Functional integration*: Motivated by the desire to increase efficiency.

In our view, it does not make much difference if the Customs function is tasked to a separate agency or department or if the Customs service would be an integrated part of the Tax Administration. Organizations using the model of an integrated Tax and Customs Administration usually allot the Customs operations to a separate division in the organization and shared functions will usually be limited to management.

Customs processes are by nature different from the processes of taxation. These different types of processes are also reflected in the administration of large companies. As regards administrative processes of multinationals, a distinction can be made between two different kinds of administrative organization and related procedures:

- administration related to capital and profit (corporate income tax (CIT), wages withholding tax, personal income tax (PIT) for director/owner, property tax, dividend tax, etc.); and

162. Source: The World Bank Group, *Supporting Institutional Reforms in Tax and Customs: Integrating Tax and Customs Administrations*, 2003.

- administration related to logistics (excises, VAT, Customs duties, environmental taxes, etc.).

This distinction is quite evident and requires different skills to manage the different processes. This not only applies to (large) enterprises but also to government agencies. Given the clear distinction in processes between taxes and Customs we can hardly see any synergy advantages for Tax Administrations to merge the operations of taxation and Customs. However, this separation by nature, and also from a historical perspective, does not mean that cooperation is not required. Quite the contrary, and furthermore, it is evident that cooperation between tax authorities and Customs agencies in many countries could be improved.

Some of the reasons why mutual adjustment and cooperation between the tax and Customs authorities is crucial for the performance of both organizations are:

- For CIT, in the area of transfer pricing as regards the relationship of sister companies it is important to calculate the right amount of tax due. For Customs, there is the issue of validation. More cooperation between Customs (the taxpayer as importer has a motive for under-declaring (less Customs duties) and the Tax Administration (the same taxpayer has a motive to calculate a higher cost price for purchases of the related sister company, meaning a shift of profit to a country with a lower tax regime) is therefore required.
- A well-elaborated system of Customs licences is established in some countries (based on the reliability of the company's administration, parts of the Customs process are outsourced to this company to ease the process of logistics and formal procedures). Before such licence is given, Customs authorities examine the internal administrative organization of the company in question. The so-called initial audit provides an insight as regards the strengths and weaknesses of the company. The findings of such a risk detection system based on initial audits are also very useful for tax authorities.
- Customs has by nature a better understanding of the business of producers, importers and exporters. Also, as a result of their traditional role of inspection, they may better function similar to the "eyes and ears" of law enforcement agencies. Customs officers have an understanding of the physics of the production process (otherwise, they cannot audit an oil firm, brewery or pharmaceutical producer). If the tax authorities

recognize Customs' knowledge in these areas, they can then incorporate this branch-related information in their risk assessment process (e.g. as regards the high-tech environment of the pharmaceutical industry, the requirements (and related internal procedures) for protecting the innovation process, trademarks, licences, patents and fighting counterfeit are so sophisticated and complex that the risk of avoiding paying the right amount of tax or duties has far less priority, meaning that Customs and Tax Administrations can rely on the internal bookkeeping and process descriptions).

- Tax authorities on the other hand have a better insight of the financial and commercial risks of a company. Based on their information (trends in turnovers, costs and profits) they can better determine whether the company is facing rough seas or is in rather good shape to sail to another profitable year, as these trends have a major impact on company decisions taken with a tax-related impact (mergers, reorganizations, costs reductions, takeovers, liquidations, share issues, capital injections, etc.).
- The complexity and costs of information technology can be stimuli to explore the possibilities to find synergy between the tax and Customs processes. Similarities to consider are in the nature of registration for enterprises, design of audit files, risk assessment profiles and improving exchange of information. In the end, tax and Customs processes are about the same kind of activities: registration and classification of taxpayers, assessment and filing procedures, auditing activities and categorizing of risks. The legal aspects are different but the chain of activities is similar. The collection and payment process can surely be integrated.
- The merging of investigation and intelligence processes must be taken into consideration in order to achieve more effectiveness. Criminal behaviour is not limited to just one aspect of taxation. Horizontal fraud means that the suspect of criminal behaviour is not only violating one kind of regulations but the criminal performance is widespread; hence, thorough cooperation and, if possible, integration of investigation processes is one of the most effective ways to counter tax evasion and related criminal activities.

2.2.6. Different models for positioning VAT operations

When considering the introduction of a VAT system the question arises as to which organization should be tasked with execution of VAT. This issue is

particularly relevant for smaller jurisdictions, such as Caribbean and Pacific countries, as well as countries with a limited tax regime, such as oil-producing countries in the Gulf region. Customs authorities in these countries usually play a very significant and influential role in society. For instance, some island economies do not see a need to introduce complicated income tax regimes because most goods and services are imported, making the Customs authorities the gatekeepers of these societies.

In countries like many Caribbean jurisdictions where the origin of most of the consumption is imported, the reality behind the introduction of a VAT is a disguised Customs duty.

2.2.6.1. VAT operated by Customs Administration

For some of the countries as described above there exists a relatively high interest in imports for their economy so that they have to consider that Customs can be the organization to better execute VAT.

There are, however, some limitations to this model. Generally speaking, the Customs Administration is an organization that primarily focuses on goods and related risks. Moreover, Customs sees the flow of goods for import/export transit from the angle of what kinds of goods are harmful for the economy and/or society. The first step in the Customs process is to have an overview of these flows of goods and the second step is to consider whether the goods are allowed to be brought into or leave the country. If the Customs Administration gives their approval, only then does the levying process begin. For Customs, to assess and collect taxes is a side product of their approval system. In the case of jurisdictions that are members of economic communities, there is another trend, which is the continuous movement to abolish Customs duties in the member states of a common market. However, with an eventual introduction of VAT in all or some countries of the common market the presence of a control unit at the borders (and of course this will be the Customs Administration) is recommended in order to implement the correct VAT regime and tariff on the goods to their final destination. Otherwise, it is likely that residents of the community would purchase their (luxury) goods in the member country with the lowest VAT tariff on the desired goods.

There are also other trends that do not favour placing execution of VAT in the hands of the Customs Administration:

- Based on the emerging need for governments to protect their society from terrorism, a movement can be seen towards merging Customs with other security forces and then establish a border patrol organization. It is obvious that such an organization would have a different view on certain processes related to taxation (assessment, taxpayer service, examination and collection) and that the only processes that will likely have priority are risk detection and investigation. The attitude of such an organization will be regressive instead of the proactive profile that is required for taxation (promoting voluntary compliance and understanding the needs of commercial entities in society).
- Other influences on Customs are the demanding tasks put on them by other public agencies. Customs are the port keepers of the country and in this role they are expected to examine many other laws and regulations.¹⁶³ Currently, it can be seen that Customs has a priority in safeguarding the health of the country's citizens (e.g. the spread of an epidemic of bird flu, mad cow disease or pig fever). Other examples include protection by Customs of items of national heritage or, in the case of Islamic countries, the illegal import of alcohol and goods that are considered harmful to the religious feelings among citizens. Under such circumstances, it can be concluded that the levying process will most likely not be given a high priority by Customs Administrations.

Although the synergy advantages at operational level of merging Tax and Customs Administrations seem to be quite limited, there is nevertheless a clear trend to merge Customs with the Tax Administration.¹⁶⁴ The main reason behind this is cost efficiency (joint use of facilities and support systems, such as finance, human resource management, planning, ICT, and joint development and use of databases for registration, data storing and risk assessment, etc.).

In many countries that operate a VAT system the responsibility for its administration is in the hands of two different organizations: Customs

163. Supervision of Customs Administrations is increasingly becoming a political issue in several countries. Traditionally, it is the Ministry of Finance that is in charge, but more recently a tendency can be observed that Ministries for Justice and Ministries for the Interior want to have full oversight and control on the Customs process. As well, other ministries such as Economic Affairs, Foreign Affairs, Health Care, Transport and Agriculture also want to have a stake in the decision-making process of Customs.

164. Countries having a long tradition with a merged Tax and Customs Administration include Denmark and the Netherlands. The United Kingdom merged its Inland Revenue and HM Customs and Excise Departments into the newly formed HM Revenue & Customs (HMRC) on 18 April 2005.

collects VAT on imports of goods, whereas domestic VAT is collected by the Tax Administration. It is obvious that under these circumstances, these two organizations need to cooperate closely.

2.2.6.2. Separate organization for VAT

Another option is to set up an independent organization for execution of the VAT law and related regulations. The benefit is this creates a strong focus on VAT because of lesser interference with existing dominant forces within the organizations tasked with the application of Customs regulations, income tax and other tax legislations. By building up a separate organization for VAT, a fresh start can be made to set up management, legal and technological systems without prioritizing them with existing tax regulations; however, the disadvantages of a separate organization will be more evident. A third administration for taxes does not make things easier for taxpayers. Instead of public institutions taking care of coordination of the different taxation processes, the burden of coordinating would then be shifted to taxpayers.¹⁶⁵ In addition, the creation of a separate administration tasked with the implementation of VAT would also generate more coordination issues and management disagreements between the public entities themselves. Lastly, there is a serious risk that all different administrations would only own a part of the total picture of the taxpayer profile, which would make it very difficult for the different organizations to manage compliance risks of taxpayers and deliver adequate services to their customers.

2.2.6.3. VAT as an integrated part of the Tax Administration

The most common practice – and by far the most preferred – solution is to also task the Tax Administration responsible for the implementation of the main (direct) taxes with the implementation of VAT, fully integrating the activities related to VAT with the total management of taxpayers.

If one single department or agency handles Customs and tax, the necessary cooperation can be easily facilitated. However, when handled by different organizations, it is strongly recommended that Customs and tax authorities work together closely and that they find ways to run similar processes in a more efficient and cost-effective way. Some examples where cooperation

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