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## Chapter 2

### Core Business of a Tax Administration

The core tasks of a Tax Administration are centred around 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 demands from taxpayers for sophisticated government services. Tax Administrations must develop a contemporary vision. Rapid economic developments and ever-higher expectations on the part of taxpayers make it necessary for a Tax Administration to redefine its strategic course. 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);
- process of enforced debt collection;
- handling of administrative appeals and complaints;

- provision of service and assistance to taxpayers; and
- detection and prosecution of tax fraud.

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. The responsibilities for collecting taxes and operating Customs are integrated in other countries in one single Tax and Customs Administration.

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 core business of a Tax and Customs Administration usually consists of one or more of the following activities:

- assessing, collecting and auditing government-imposed taxes, as well as preventing 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; and
- other assessment and collection activities on behalf of other governmental agencies.

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 Italy, the United States and a few Nordic countries, 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.

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. Australia, Canada, the United States and the Netherlands are examples of countries where this can be seen.

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. This is the field of organizational philosophy, strategic planning, risk management and control of 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 agency charged with administration of the laws to serve the public interest properly, the agency 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 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 administrability of proposed provisions of the tax law.

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 will be free from any type of corruption or undue influence.

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 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 law can also lead to reduced levels of voluntary compliance with the law.

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. These systems should also provide sufficient information so the Tax Administration can 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 practices. Great care should be exercised in determining the critical factors that should be measured in order to gauge the effectiveness of operations. The performance measures that the Tax Administration relies on will be looked to by its workforce in deciding how their assigned responsibilities should be carried out. These performance measures should support the vision of the Tax Administration for fair, consistent administration of the laws it is charged with enforcing.

As described in Chap. 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.<sup>54</sup> 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:

- integrity and impartiality of a Tax Administration;
- 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;

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54. 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.

- 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.<sup>55</sup> 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;
- it is provided with a stable legal framework ensuring proper administration and enforcement of tax dues
- 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.

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

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 number of 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.

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

Tax integration is the constitution of one process, system or resource to be applied in different tax 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 identical source data. For example:

- one appeal process and procedure for all tax assessments;
- one invoicing system for different taxes; and
- one information desk for all sorts of tax clients.

To illustrate this, assume that a message is included in the Excise Duty file of a taxpayer indicating that a certain event might also influence the VAT and income tax situations of that taxpayer. Cross-reference links to that message are also included in the taxpayer's VAT and Income Tax files.

Many Tax Administrations have built in certain tax integration facilities 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.

### 2.2.3. Preconditions for integration

Preconditions for tax integration are based on cultural, economical and organizational circumstances. There is a strong interrelationship between these three. A society's social behaviour and values or culture are 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 stage, result in different tax organization models and thus in different needs for tax integration.

A second set of preconditions consists in the need to introduce organizational changes such as tax integration very carefully and systematically. In many cases an attempt to improve the operations without a systematic approach appeared to be futile. An important tool for implementing tax integration ideas may be 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 some 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, 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

Tax 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
- *serviceability*: 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 Ministry of Social Affairs.
- *Management*: The (integrated) way how to organize the 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.