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Tax Implementation: Commentary

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Tax Implementation Issues in the United Kingdom

Commentary

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Abstract

This commentary assesses the contribution of Slemrod, Whiting and Shaw (2008) and discusses further issues relating to stakeholders and reporting to them, as well as the under-researched area of the management of tax agencies and the development of best practice.

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1. Introduction

The chapter on *Tax implementation issues in the United Kingdom* authored by Joel Slemrod, John Whiting and Jonathan Shaw (2008) is an important milestone in the tax administration and compliance literature. This commentary outlines the key contributions of the Slemrod *et al.* (2008) chapter and then briefly discusses two further implementation issues that should be considered by any tax administration in the 21st century. The first analyses the current environmental context of tax administration and highlights the necessity for consideration to be given to the nature and implementation of monitoring of tax agencies and level and nature of their public performance reporting. The second issue is a discussion of the importance of considering the internal management of tax agencies and how they might learn from each other through benchmarking efforts and surveys of best practice. The commentary then offers some brief concluding remarks.

2. The Contribution of Slemrod, Whiting and Shaw (2008)

2.1 Conceptualization of tax system design and integration

An important contribution of Slemrod *et al.* (2008) is the framework they have applied to the wide topic of tax system design and implementation. Through their detailed discussion of an extensive literature, a review is provided on important issues such as revenue raising, equity, privacy, taxpayer rights and the concept of transparency. To these issues, they add the enforcement systems required to ‘manage’ non-compliance and the costs of these enforcement systems – to both the tax agency and taxpayers themselves. The authors are to be complimented on the rigour with which they buttress their discussion and their outline of an optimal approach to resource allocation.

The framework in Part I of their chapter is then used by the authors to outline the ‘mechanics’ of the U.K. tax system including PAYE, Self-assessment, Corporation Tax, VAT and issues concerning HMRC such as performance indicators, and the measurement of the tax gap and compliance costs.

2.2 *The use of comparative information*

Throughout the chapter, the authors have made use of comparative information e.g. sourced from OECD data and highlighted relevant examples from overseas jurisdictions. For instance, when discussing information reporting and withholding requirements they cite international practice among OECD countries, the use of over-withholding by some such as Australia and New Zealand, and how important this particular example is in terms of compliance by citing National Research Program results from the U.S.

2.3 *The role of business in tax systems*

Related to the example outlined above on withholding, the authors observe that business plays a key role in the U.K. tax system. The authors calculate (Table 1) that out of the £398Bn receipts collected by HMRC, £361Bn (91%) is remitted by business. This is a huge proportion and clearly emphasizes the importance of maintaining good relationships with advisors and businesses to facilitate compliance (HMRC, 2006). Further discussion of this point and the importance of a consultative approach appears in Section 3 of this commentary.

2.4 *“Say it how it is”*

The authors make a number of interesting concluding remarks which may not be entirely novel, certainly need to be stated. First, the difficulties imposed by the hard-to-tax sector (e.g. eBay) and challenges imposed by globalization must be addressed. Second, the authors correctly in my opinion offer some important conclusions. These include the importance of modernization of IT systems which in turn, partly dictates the efficiency of tax regimes such as PAYE and VAT. Then, due to increasing complexity, the authors suggest there is a dire need for strategic thinking on PAYE/NICs (“in simple terms, the PAYE system is creaking”). Then the authors focus on two areas where implementation mechanisms cannot be relied on: Corporation Tax – where cross-border transactions invariably appear and small business and the self-employed – where various measures have been introduced to help small firms (e.g. in VAT), but the authors believe more could be done to help small employers.

While they state that the UK system is “... all things considered, not doing too badly” they correctly state there is increasing pressure on the tax system to adapt. Concerning PAYE, they state an important caveat that “resting on the status quo and just tinkering is not an option”. Radical options such as universal ‘citizenship’ returns and a simplified system for small employers must be considered as the risk that demographic and economic change will have an adverse impact on the system is increasing.

3.0 Considering the Stakeholders of Tax Administrations

3.1 The current environmental context of tax administration

The environment facing tax agencies has changed considerably in recent times (Tomkins *et al.*, 2001) with issues such as tax shelters, large-scale fraud, tax code complexity, customer service, e-commerce and globalization requiring consideration and response. These issues affect not only taxpayers and the tax agency itself, but also other stakeholders such as tax practitioners, those involved in processes of tax policy and tax disputes – thus including industry associations, professional organizations and ultimately every citizen. In addition, one can speculate that actual process of tax policy formulation has become more politicised in recent years with the establishment of tax-focused pressure groups and more vocal employer representative groups.

The over-riding question is how do environmental characteristics impact on tax compliance, and the behaviour of taxpayers, tax practitioners and tax administrators? From a compliance view, traditional audits consume agency resource, because compliance enforcement measures and performance indicators need careful specification and monitoring (at aggregate, sector, and individual levels). Of course, these issues are not unique to the U.K. (Weisbach and Plesko, 2007) and other countries face similar pressures and uncertainty.

One well-publicised example is the strategic focus on responsive regulation adopted in Australia where the introduction of the Australian Tax Office’s (ATO) Compliance Model (Braithwaite, 2003; 2007) has led to a culture shift, and arguably, can now be viewed as “best practice”. Essentially the compliance model is a pyramid that conceptually represents

taxpayers' motivational postures ranging from Commitment (at the base) through Capitulation, Resistance and Disengagement (at the peak). Thus appropriate strategies for tax agencies include non-discretionary Command Regulation (at the peak), discretionary Command Regulation, Enforced Self-Regulation to Self-Regulation (at the base, which is the desired state). Thus, the model is consistent with the customary goal of voluntary compliance, and at the base, tax agencies can focus on enabling efforts such as education and service delivery. At middle levels, strategies can include business examinations and record keeping reviews, then moving to the top levels there are audits (with/without penalty) and finally prosecution (Hasseldine and Hite, 2007; Hasseldine *et al.* 2007).

In the U.K., following the merger of 'Customs and Excise' with 'Inland Revenue', different working practices, powers and penalties has meant an agenda of modernization of these areas. With the (stated) adoption of broad principles of legitimacy and mutual respect into the compliance environment (Feld and Frey, 2007; Picciotto, 2007), a consultative approach has been adopted in the U.K. (e.g. see the work of the "Powers" committee at www.hmrc.gov.uk/about/powers-appeal.htm). Hence, consultative committees have become the rule, rather than the exception and this now includes both the setting of policy and the provision of guidance to 'customers' - especially businesses and their advisers. A further principle is to minimize taxpayer burden, and so the application of risk management techniques in audit selection is being refined especially for large business (NAO, 2007). There is international evidence that tax administrations (e.g. HMRC, 2007) are seeking to understand firms' behaviour rather than simply focusing on technical aspects of the tax code.

3.2 Public Performance Reporting and the Use of Monitoring Agencies

Many tax agencies have, for a variety of reasons, become more transparent in their public performance reporting and/or in the amount of oversight that they are subject to e.g. by internal or external bodies with an audit or accountability role. For example, in the U.S., there is a taxpayer advocate function within the IRS, as well as the Treasury Inspector General of Tax Administration. In addition the IRS Oversight Board was created as part of the 1998 IRS

reforms designed to allow IRS to better serve the public and meet the needs of taxpayers. The IRSOB is a nine-member independent body charged to oversee the IRS in its administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws and to provide experience, independence, and stability to the IRS so that it may move forward in a cogent, focused direction (www.treas.gov/irsob/). Of course, there also remains an issue of oversight at the point of enactment of tax legislation (e.g. by U.S. Congress or U.K. Parliament) – as estimated revenue gains/losses can be very imprecise with “revenue neutral” policy and the resulting legislation complex.

Australia established a Board of Taxation in 2000 to advise the government on the formulation and development of tax policy. Several reviews have been undertaken and its work program currently includes a scoping study on small business compliance costs and a review of the application of consistent self-assessment principles (www.taxboard.gov.au). Further, in 2003, an Office of the Inspector General of Taxation was established as an independent statutory office to review systematic tax administration issues and to report to government, in the interests of taxpayers, on recommendations that would improve the fairness, efficiency and integrity of the tax system (McKerchar, 2007).

A further example in the spirit of responsive regulation of transparent public performance reporting both generally (such as agency business plans), and in detail, is Canada. The Canada Revenue Agency publishes its internal audit reports on the internet and discloses to stakeholders its public opinion research where executive summaries are published on the website and full reports are available on request.

The examples given in this section are in addition to any role played through a public sector audit function such as the Government Accountability Office in the U.S. and the National Audit Office in the U.K. Given the increasingly political nature of tax policy, and the frequent accusations of selectivity when tax-related statistics are used (e.g. by political parties), one possibility is the establishment of an independent body responsible for commissioning the collection and publication of certain tax statistics although overlap issues with the Office for National Statistics would need resolving.

In summary, just as large companies increasingly consider tax issues as part of corporate governance (KPMG, 2004; PwC 2004, Ernst and Young 2006), so too must tax administrations consider governance and reporting issues. One of the key reasons for this is if there is to be mutual trust and co-operation on the part of taxpayer, tax agent and tax official, then tax administrations must act and report in a transparent manner. It is not a one-way street.

4.0 Managing Tax Agencies and the notion of “best practice”

4.1 Internal management of tax agencies

Gill’s (2003) World Bank study sets out a useful framework on the main tasks of revenue administration requiring analysis. These tasks can be classified as: (1) operational areas; including: taxpayer registration; processing of customer information; monitoring of withholders / agents; information collection about taxable transactions - and audit / investigation work; risk analysis; recovery of tax arrears and debt management; legal and judicial matters; external relations and customer focus and (2) organization and management tasks including: strategy; planning; monitoring; personnel management; IT systems; internal control and asset management. Far less attention has been devoted in the academic literature to the latter broad category, although this is likely to be of concern to review agencies and oversight boards (such as the Public Accounts Committee in the U.K.).

As part of an edited volume on the “crisis” in tax administration, Owens and Hamilton (2003) discuss, provide support for, and observe that:

- (i) just simplifying the law does not work
- (ii) policy simplification needs a stronger voice
- (iii) the complexity of policy and law may need to be reduced
- (iv) small business needs special consideration
- (v) new compliance approaches are needed
- (vi) a new compact is needed
- (vii) tax administrations are underfunded

Recognising the above is obviously a useful first step, but clearly these issues interact and the magnitude of issues facing tax administrators is clearly huge. Having said that, progress is being made and the next section illustrates some of these efforts.

4.2 The notion of “best practice” in tax administration

Until the Centre of Tax Policy & Administration of the OECD began serious work on the ‘administration’ side there was very little sharing on “best practice” although there have been several surveys of administrative practices. For example, the OECD’s Forum on Tax Administration (FTA) allows tax administrators to share information and experience, and identify effective strategies/measures for various areas of tax administration e.g. the “Comparative Information Series” (OECD, 2007a). This report provides internationally comparative data on various aspects of tax systems and their administration in OECD and selected non-OECD countries in terms of international and organizational arrangements for tax administration; aspects of management approaches and practices; return filing, payment, and assessment regimes for the major taxes; selected administrative powers of revenue bodies; tax revenue collections; operational performance information; administrative practice.

Other reports to date include topics such as: compliance risk management (OECD, 2004); strengthening tax audit capabilities (OECD, 2006a; 2006b; 2006c); surveying trends in taxpayer service delivery using new technologies, (OECD, 2005); the use of pre-populated tax returns (OECD, 2006d) and a study on tax intermediaries (OECD, 2007b; 2007c).

In the future, more in-depth benchmarking and documentation of best practices seems highly likely. Such work will need to identify how to create new and better practices and will require collaboration between international and regional tax organisations and a willingness to share initiatives and results.

5.0 Concluding remarks

Modern tax administrations are large, complex organisations and there is still only a relatively small scholarly literature in the field of tax administration per se. There are many knowledge

gaps that tax agencies must seek to understand. For example, why do taxpayers comply? Why don't they comply? Why do simplified tax regimes often suffer from poor take-up rates? How can compliance costs be minimised?

In summary, there are a number of fundamental characteristics that are likely to be associated with leading tax administrations of the 21st century. These are:

- A professional approach to internal management issues (HR; strategic planning)
- Attention to cost efficiency and effectiveness
- Responsive engagement with all stakeholders
- Successful introduction of technology applications
- Understanding what drives taxpayer and tax agent behaviour
- Sophisticated risk profiling and informed responses to taxpayer behaviour, including the areas of enforcement and service provision
- Transparency of governance and detailed performance reporting

Attention to these however is not a panacea, and whatever the end-goal is, it will always be difficult for tax administrations to demonstrate to all stakeholders that they are doing well. Perhaps, we should consider whether they are doing well enough and examine whether the glass is half-full or half-empty (McCaffery and Baron, 2006)! Certainly, the chapter by Slemrod *et al.* (2008) clearly spells out the lessons to be learned and areas where progress can be made, not only by HMRC in the U.K., but by tax administrations worldwide.

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