

Chapter 1

Introduction

This chapter explains the background to this study, the methodology used and the countries involved in the task group that undertook the work. It also sets out how the report is structured.

Context and background

When designing the modern personal income tax in the early 20th century policy makers in most countries recognised the enormous challenges to effective tax administration that would arise if their relatively large populations of employee taxpayers were each required to accurately calculate their own employment income for tax assessment purposes and make timely provision for their own payments of income tax. For this reason, they decided to introduce “employer tax withholding and income reporting” requirements as core elements of their systems for the collection of personal income tax, an approach which today has become just about universal practice. With the passage of time, the wisdom of this approach for achieving very high levels of compliance in respect of employment income, an example of what this study terms “*tax compliance by design*”, has become clearly apparent. Research studies from a number of revenue bodies (Swedish Tax Agency, 2008) consistently point to the very high levels of compliance achieved in respect of employment income (and other categories of income subject to similar requirements).

Unfortunately, the same very high compliance outcomes are not enjoyed for income derived from business activities, in particular by the relatively large numbers of small and mid-sized enterprises that are seen in any economy – hereafter referred to as the SME segment. To the present time, it has proved largely impracticable (e.g. owing to compliance costs considerations and technological limitations) to devise equally effective arrangements for collecting income taxes in respect of such incomes. While revenue bodies continue to make progress in refining their risk management processes and educating and supporting SME taxpayers in a variety of ways, there is no evidence to suggest that these approaches alone can lead to levels of compliance comparable to those achieved in respect of employment income. In fact, revenue body research¹ from a number of countries consistently points to relatively large amounts of revenue leakage from within the SME segment, notwithstanding the fact that Governments (through their revenue bodies) continue to invest significant resources in SME tax administration.

Acknowledging these systemic shortcomings while at the same time taking a lead from recent work of the Forum, this study aims to take a fresh look at the emerging SME business landscape and thinking from a few revenue bodies about possible new approaches to achieving improved compliance and reducing taxpayers’ compliance burden.

End to end – Achieving tax compliance “right from the start”

In early 2012, the OECD’s Forum on Tax Administration (FTA) released its report *Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises* that introduced the approach of influencing behaviour by changing conditions in the taxpayers’ environment in co-operation with taxpayers and participants. This approach entails the application of measures “upstream” in the value chain in order to support compliance and prevent non-compliance from arising. The 2012 report alluded to some potential examples (e.g. extended third party reporting, user-friendly e-services, and increased co-operation with tax intermediaries and industry organisations) but did not explore their practical application or overall potential in any detail.

The right from the start approach highlights the need to focus on taxpayers’ and revenue bodies’ combined processes for collecting the right amount of tax. This “end-to-end” process starts with business taxpayers’ taxable business transactions and ends with the final correct tax being paid. Business transactions form the basis for taxation regardless whether it is based on profit, turnover or value added. The taxpayer and the

revenue body both want to know what amount of tax the taxpayer is due to pay. They have a shared interest in knowing the tax consequences of any transaction, with as little administrative burden as possible. This study uses the end-to-end perspective in order to find opportunities to achieve opportunities for “tax compliance by design”.

Purpose of the study

Against the background provided, the purpose of this study is to collect and share knowledge about strategies to improve compliance by seeing the taxpayer’s process and the revenue body’s processes “end to end”. This includes efforts to simplify process design and to build in quality “right from the start”. Of particular relevance and interest are the opportunities presented by modern technologies and the rapid growth in the numbers of businesses deploying these technologies for many aspects of their operations (e.g. accounting, invoicing, payroll, and tax). The study is also required to explore possibilities and ideas about how improved end-to-end processes could be further developed in the future.

Methodology

The project was carried out by a project team from Sweden, and sponsored by the Swedish Tax Agency and supported by the OECD Centre for Tax Policy and Administration, working in close co-operation with members of the FTA’s SME Compliance Sub-group, including a small task group of countries (i.e. Australia, Canada, Denmark, New Zealand, Singapore, South Africa, Sweden, The Netherlands and United Kingdom).

For the purposes of the study a survey instrument was designed and completed by task group countries to provide information concerning: 1) members’ expectations from the study; 2) examples of implemented or planned initiatives relevant to the study’s scope; and 3) ideas on possible new initiatives relevant to the study’s scope. In February 2014, a workshop of officials from task group countries and the OECD was dedicated to exploring and discussing aspects of the subject study in greater detail. The workshop included a presentation by Dr Martin Fransson from the Service Research Center at the University of Karlstad on service dominant logic. The workshop was also informed by the participation of representatives of two Swedish bodies (i.e. Professional Institute for Accountants and the Association of Swedish Accounting Consultants) together representing the views of Swedish tax intermediaries. The project team and Secretariat further developed the content of the report with experts of the FTA’s SME Compliance Sub-group, including through detailed discussion at its annual meeting in May 2014.

Structure of the report

The report begins with a description of some of the main steps in the development and evolution of compliance strategies within the FTA with special attention to the “right from the start” approach. The concept of a service perspective is introduced as an additional perspective to understand tax compliance as a form of public service delivery. Relevant technological developments are described because they are fundamental drivers for these changes. The conclusions from the current directions of strategic developments and the insights added by bringing a service perspective and the technological developments are then combined in order to outline a possible future environment characterised by “tax compliance by design”. (*Readers familiar with this background may wish to go straight to Chapter 3 for the main subject of this report.*)

In Chapter 3, the report describes at a high level what a compliance system for small businesses that has compliance “designed in” might look like and sets provides a number of practical examples reported by participating revenue bodies. To provide practical guidance, Chapter 4 outlines a number of useful components that are needed for implementation of “tax compliance by design” together with some ideas on possible further developments. Chapter 5 concludes with some final observations and a recommendation.

Note

1. See references in bibliography.

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