

VAT

RISK AREAS

IOTA Report for Tax Administrations



Intra-European Organisation of Tax Administrations

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Intra-European Organisation of Tax Administrations (IOTA)



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PREFACE

A key factor in a constitutional state, the necessity to reduce and monitor risks inherent within a fiscal system, seems to have greater resonance now considering the increasing importance of the tax gap and citizen expectation towards tax administrations' assignments. The adoption of an effective risk management process is all the more important given the external pressures tax administrations have to face. In the field of tax evasion, a risk management strategy mostly leads to implementation of dedicated tools and to specific actions and mechanisms aimed at undermining non-compliance.

One of the most important risks that face tax administrations stems from the existence of fraudulent activities perpetrated in risk areas. By contributing to stimulate and raise non-compliance, especially in the field of VAT, this reality represents a paramount challenge for the IOTA region. Supervising these risk areas therefore remains a necessity for tax administrations that have to adopt a dynamic approach by conducting actions in preventing, detecting, tackling and solving tax evasion schemes as and when necessary.

To address this issue, the IOTA Area Group Prevention and Detection of VAT Fraud decided to form a Task Team with the purpose to study and report on VAT risk areas. The Team compiled different approaches and experiences on VAT risk areas from 22 Member administrations within the IOTA region who answered the survey. The work being undertaken by the Task Team's members aims to contribute to develop our knowledge about risk areas and share experiences on means to detect and monitor risk areas.

During the development of the material used in this publication, input was provided by the Area Group members from the majority of IOTA tax administrations¹, who supported the efforts to collect experiences in the field of risk areas. We would like to thank them all and but more specifically the Task Team members who compiled this report: **Irina Andrejeva** (Latvia), **Erik Andersen** (Denmark), **Christine Lafolie** (France), **Marjan Macek** (Slovenia), **Sanda Malevic** (Serbia), **Bart Pardon** (Belgium), **Jean-Luc Wichoud** (Switzerland).

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¹ Austria, Azerbaijan, Belgium, Bulgaria, Croatia, Denmark, Estonia, Finland, France, Greece, Hungary, Italy, Latvia, Lithuania, Netherlands, Norway, Poland, Romania, Slovenia, Sweden, Switzerland, United Kingdom

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1. SUMMARY

The work of the Task Team focused on the following fields:

- Definition of risk area;
- Risk areas as part of the risk management process;
- List of most risk areas;
- Measure to tackle risks;
- Data and software used;
- Analysis and use of experiences.

Task Team members worked under the condition of the following definition:

A risk area is a group of taxpayers who have a higher risk to be non-compliant or fraudsters. It could be an economical sector, a profile, the nature of goods or a combination of them.

The work of the Task Team was not only focused on the list of risk areas in the IOTA region, but also on ways of finding risk areas and providing solutions, taking into consideration efficiency and organisational aspects.

Risk areas definition is one part of the risk management process. The simplified map (see Figure 1) aims to illustrate the generic process:

1. Risk areas, risk criteria and audit plans are defined on the basis of data and knowledge bank.
2. Audits are planned and organized.
3. Internal and external data available for risk analysis & selection
4. Results of audits and other knowledge are collected and analysed

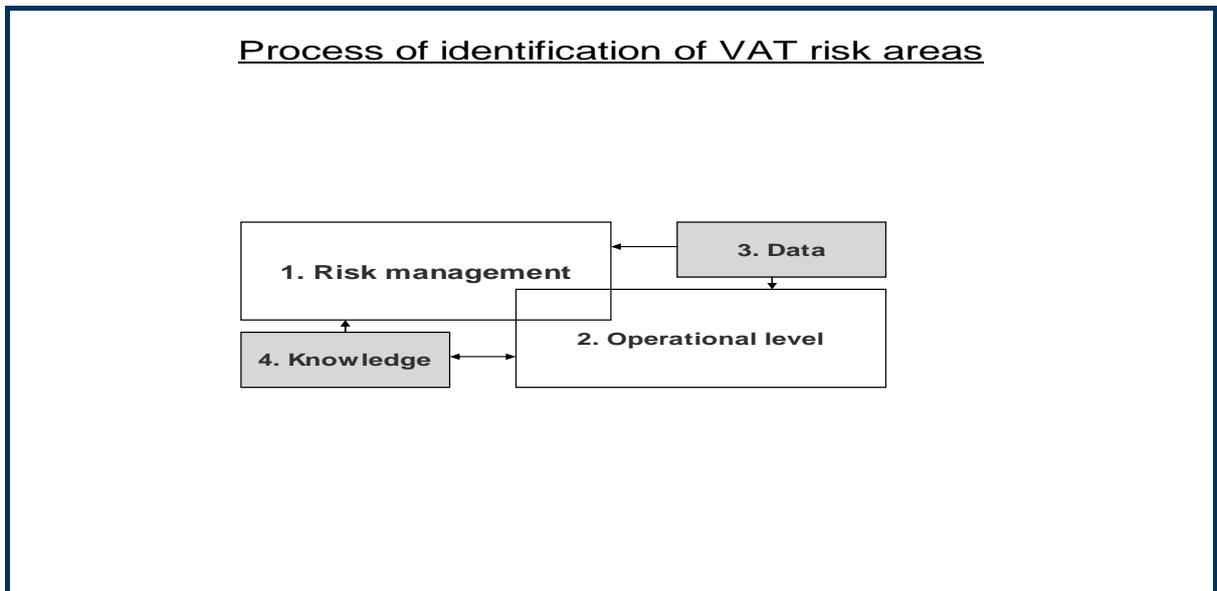


Figure 1. Generic process of risk management

Risk areas are firstly defined by the risk analysis system existing in every IOTA tax administration surveyed except for three of them. In most of the administrations other sources include experiences from audits, third party information, VAT refunds, etc. Risk areas are defined by the central level in 15 tax administrations,

four administrations use a top-down method and only two a bottom-up approach. Yearly audit plans with risk areas are broadly adopted by IOTA Members, with a decentralized selection at the regional or local level in most cases.

No unique solution can be given as each tax administration has its organisation, special units, power to investigate criminal cases, etc.

There are many specific risk areas depending on local criteria, but some areas are common for most of the IOTA's surveyed tax administrations:

- Economical sectors: telecommunication, construction, IT trade, financial transactions.
- Profile: VAT refunding, MTIC², buffers, conduit companies.
- Nature of goods: cars, PC accessories, mobile phones.

Countries use different measures to fight against fraud in these risk areas:

- Pro-active: communication with taxpayer, media, seminar, cooperation agreement, etc.
- Repressive: criminal investigation, raid with other authorities, audit.
- Legislative: change in legislation; simplify forms and rules, studies.

Same software is used for risk analysis purpose and to define risk areas, with the most popular ones being Microsoft Office, SQL, SPSS, Clementine, Business Objects, Eskort, SAS, IDEA, and many other specific or home-made tools. Data which is used depends on countries legal and technical possibilities.

Knowledge banks are very important in improving the performance of the system. They allow the collection of basic information on audits (number of audits, additional assessments, etc.) but also of data with additional value like nature of penalties, result of random audits. An analysis of this data is made possible by computing for example performance indicators. Influence of campaigns on awareness of taxpayers seems also to be a good way of improving the results.

Improving voluntary compliance in risk areas is one of the final goals of the system. It was nevertheless stated that only few tax administrations measure and analyse these results, probably due to methodological difficulties and possible debates around the interpretation of the results.

The compulsory de-registration of abusive or non-active taxpayers is generally accepted as a useful tool in maintaining a healthy VAT system. Generally the vast majority of tax administrations have the ability to compulsorily de-register VAT registrations either on the grounds of a lack of economic activity, non-compliance or outright abuse. Only four tax administrations do not have the legislative tools to de-register taxpayers on their own initiative although at least one could proceed through courts' decisions and two are in the process of legislative changes.

Companies' de-registration is information publicly available in a minority of IOTA administrations. However enquirers will be told if a VAT number is no longer valid

² Missing Trader Intra-Community Fraud

if they ask the tax administration directly about a specific trader. For EU VAT number, both tax administrations and the public have the ability to verify whether an EU VAT number is valid via the European Commission's VIES VAT validations site: http://ec.europa.eu/taxation_customs/vies/vieshome.do. Information is however fairly basic and relies on elements supplied by EU Member States.

In demonstrating the potential involvement of others in using an abusive VAT number to commit fraud, it is essential that information on invalid VAT numbers is made as easily accessible as possible. Additionally this also supports legitimate businesses in undertaking their due diligent responsibilities.

In ensuring that VAT numbers are not abused, some administrations use IT and risk analysis to identify potentially fraudulent traders as soon as possible.

In taking the next step and implementing de-registration, some administrations reported difficulties in the amount of evidence needed to demonstrate abuse or non-compliance, whilst others reported that in some cases, traders could immediately re-apply for a new registration.

In the fight against fraud and non-compliance, the ability to quickly de-register abusive traders is an essential tool, even if in isolation de-registration is not the answer to defeat fraudsters as it must form part of a comprehensive compliance strategy.

In case of voluntary de-registration requests from businesses, it is essential that tax administrations carry out a final audit to ensure that the request is valid. Additionally it would be wise to re-visit the trader at a later date to ensure that conditions have not changed and that they should re-register.

For de-registration to be an effective tool, the system needs to be open and transparent offering the administration the ability to delete an abusive VAT number as quickly as possible, whilst balancing the needs of the taxpayer by offering an appropriate appeal process.

2. INTRODUCTION

The Task Team “Vat Risk Areas” was established in December 2006 in order to get a better knowledge of areas at risk and measures taken to improve the effectiveness of the actions undertaken by tax administrations in the IOTA region. For this purpose, the Task Team sent a questionnaire to all members of IOTA and collected their responses.

2.1. Aim of the report

The report aims to give an overview of the strategic and organisational levels of the methods implemented by tax administrations to identify risk areas:

- Methodology and implementation of national risk areas;
- Means to develop these strategies: tax audit plans, communication campaigns, description of a rational system aiming at coordinating actions to develop the strategies implemented;
- Adaptability and reactivity of tax administration: the organization of the circulation of information;
- Fields of interest, economic sectors under observation, risk economic sectors, grey economy;
- Measures taken by tax administrations in these fields, actions plans;
- The management of performance through the measurement of the tax administration actions; the good or bad results;
- Concrete measures undertaken to tackle risk areas;
- Concrete measures undertaken to evaluate the selection methods used to detect and tackle risk areas;
- Role and impact of the international network; effectiveness.

2.2. Task Team working methods

The Task Team organised its work on two levels:

- During Task Team meetings to discuss the main points of the analysis.
- For detailed and specific subtopics the tasks were shared and each participant was responsible for some topics.

The Task Team members carried out an analysis of the documents received from members of IOTA Area Group Prevention and Detection of VAT Fraud (PDVF). A first general questionnaire was answered by 22 IOTA Members whereas 14 tax administrations responded to the second one.

The first questionnaire was divided into 5 main parts:

1. Organisational issues;
2. Strategic issues;
3. Technical issues;
4. Risk areas issues;
5. Evaluation issues.

The aim of this questionnaire was to give an overview of IOTA tax administrations' approaches towards VAT risk areas and risk management in general.

The second questionnaire was meant to collect detailed information but also to clarify possible confusion between risk analysis and risk area. Another goal of this questionnaire was to have a ranking of the risk areas across IOTA's tax administrations.

2.3. Reading guide (Caveat)

The report is based on answers to questionnaires and discussions held during Task Team meetings.

The guide could be read on different levels:

1. Through the summary, which presents an overview of the results or the report;
2. The report without the annexes, offers you a complete view of the subject, but some details and special cases are not presented;
3. The report and annexes offer you the possibility to access all information in a comprehensive way.

3. PRESENTATION OF RESULTS

Based on the IOTA Members' responses³, it should be acknowledged that some of the questions are equivocal in the way that they may be interpreted differently from country to country. The answers given to these questions therefore reflect the respondent's own interpretation. Many tax administrations have indicated presuppositions in their answers. The compilation of the results therefore cannot stand alone but should be supplemented with the responses from each IOTA Member. Useful information about the tools and methods employed in the Member administrations may be also found in the respective responses.

This section constitutes the main part of the report. It is divided into 5 parts covering:

- Definitions and generic process of risk management which integrates the identification of risk areas;
- Risk management strategy based on defined risk areas;
- Operational level and the identification of the risk areas;
- Ranking of risk areas, with information on data and software used to proceed with risk management;
- Knowledge, this means how to analyse and get useful information from risk areas selected and how to evaluate and improve the process.

The report not only presents the results of the questionnaire but also provides an in-depth analysis of the answers received based on the experts' experiences and knowledge. It aims to give good solutions to improve the performances of the VAT system.

3.1. Generic risk management process

In general the process of identification of risk areas is a combination of four major steps (See Figure 1):

- Risk management concept;
- Input to the production on the operational level;
- Access to objective information, data;
- Access to an input from earlier experiences, knowledge.

Risk management:

The risk management concept is based on a tool which uses limited resources in an optimal way. Many parameters can influence the success of a risk management tool.

Operational level:

It is the place where the theory meets the facts, where the success rate of a risk management system will be seen on the different risk areas.

³ 22 Member administrations sent their responses to the first questionnaire and 14 to the second.

Data:

Resources are limited. To test and compare risk areas, it is essential to have access to objective data, thus allowing for documentation with rank and selection of risk areas. Access to data is also of paramount importance to identify and select taxpayers.

Knowledge:

To get input and pick up new trends/ideas from the operational level, knowledge is very important for a successful risk management concept and for detection of new risk areas. Significant experiences put into a knowledge bank, but not used in the risk management, will not be shared and will not be used optimally.

3.1.1. Preliminary observations

The scheme related to the risk management process which is presented in the executive summary chapter Figure 1 is generic and could apply to every organisation. But details of each box can change significantly from one country to another depending on the following:

- Many tax administrations in IOTA, many different cases;
- Culture and traditions;
- Organisations;
- Kind of taxes involved;
- Civil act or civil and justice act;
- Laws, legislation;
- Economic conditions;
- Taxpayer behaviour/opinions;
- "Environments in which the tax administration operates";
- And many others.

3.1.2. Definition of risk areas

A risk area can be defined as an area - type of problem - which is the source of the identified risk. In this context risk areas consist of segments of taxpayers, either displaying a high frequency of a specific type of tax error or a different set of behaviours in comparison to other groups of taxpayers.

Risk areas can be divided into three main domains:

- Economical sector;
- Profile;
- Nature of goods.

Each of them can be combined or considered separately.

3.1.3. Process map

The process map presents a generic overview of the risk management process in tax administrations.

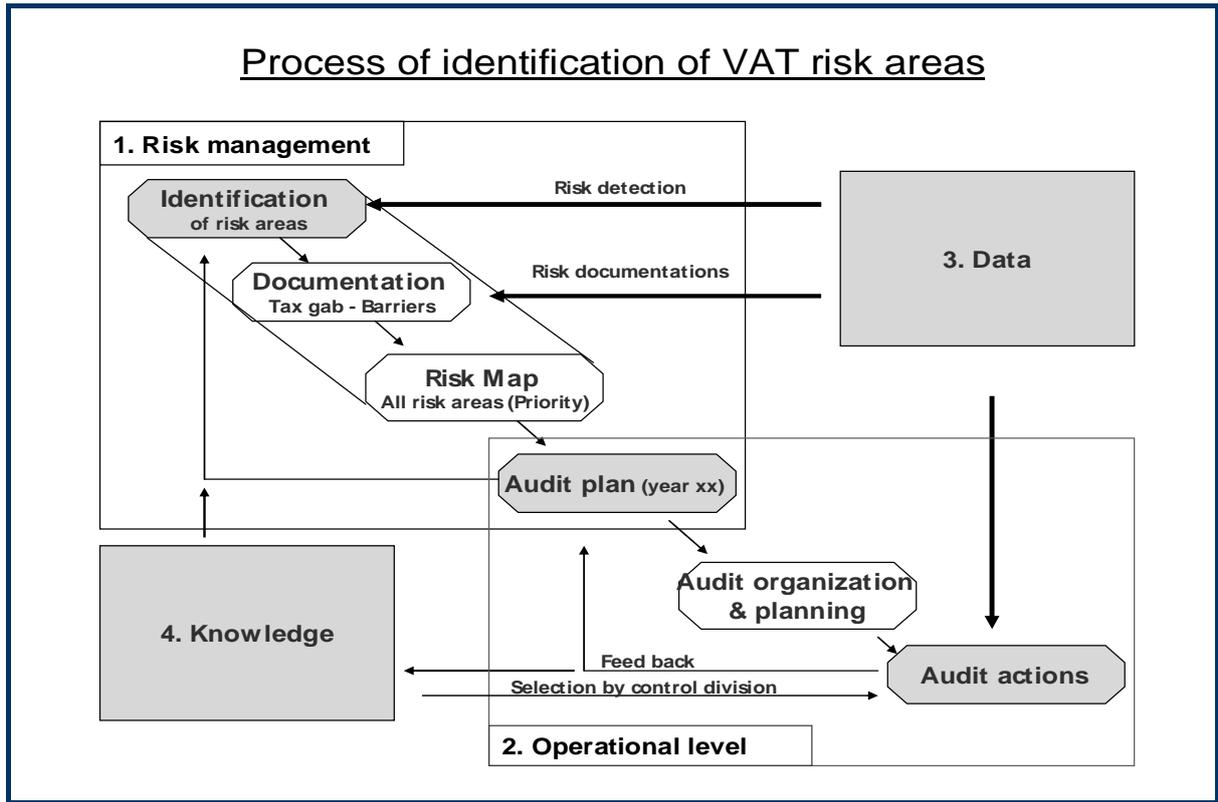


Figure 2. Process of identification of VAT risk areas

1. Risk management

The risk management concept is a tool to use limited resources optimally. Many parameters have influence on the success of a risk management tool.

Identification of risk areas

Analysis of the result from the operational level and learning from the experiences in the knowledge bank is the best input in detection of risk areas. Significant changes in the data bank can also indicate a new risk area.

Documentation

In general, the importance of new and known risk areas must be documented (estimated) according to the tax administrations' risk definitions, tax gap, etc. Documentation can be made on different levels.

Risk Map

To get an overview of all risk areas and to compare the different risk areas, they must be joined in a structured way. Ranking and prioritisation of all documented risk area is then easier.

Audit plan, year xx

Based on the knowledge about all the risk areas and resources available for the next period, the audit plan is the result of the decision made, and will be the working document for the operational level.

2. Operational level

Audit organization and planning

Depending on the nature of the risk areas and the tax administration organisation, audits can be organised and planned in different ways. They can be solved in specialised units, projects, groups or as a common target on the regional/local level.

Audit actions

Audit actions are important to go past the theoretical approach. They can be undertaken at different levels and in different ways and generally lead to foster contacts with taxpayers. Selection of taxpayers for audit purpose can be done at this stage, during the course of tax audits.

Even if risk criteria used to select taxpayers must match the risk area, they always depend on data and resources available for tax administration. It can be remarked that in case taxpayers' population appears to be too large, tax officers responsible for the risk analysis process can use sampling methods. Additionally, tools such as data mining can be used in order to further develop and document risk criteria already known.

New risk areas can also be detected during the course of tax audits, thus highlighting the importance given to the selection process operated by control divisions during the tax audit planning phase. Another important parameter lies in the tax audit results and experiences stored in the knowledge bank.

3. Data

The organisation and availability of data has a paramount influence on the way risk areas can be documented and risk criteria elaborated. Nevertheless, responses to the questionnaire point out that the access to internal and/or external data and software can be different from a country to another.

The organisation of data in a data warehouse with regularly updates routines would have a positive impact on the risk analysis process.

4. Knowledge

Either formalised on paper, or remaining intangible, as for example tax auditors' experience, knowledge can be facts, but also subjective judgement. Reports can contain facts and subjective judgements.

The knowledge which is not used in the risk management process will not be shared and will not be used in an optimal way. Therefore, it appears to be vital to incorporate auditor's experiences in the risk management process.

Additionally, sharing experiences through national and international networking can lead to valuable inputs in the national process of detections of new risk areas.

3.2. Risk management

3.2.1. Methods and strategies

Risk management is used worldwide for making the best possible choices in taking decisions in both public and private sectors. This topic was raised and discussed in many international organizations and in this context the IOTA tax administrations were asked whether a risk management process had been implemented.

- **Risk management - "wide spread strategy" in the IOTA region**

Most of the IOTA Members have developed external risk management strategies for detecting risk areas.

At the time of the survey for example, the project on implementing the detection methods of the VAT risk areas was running in **Romania** as they were in the stage of implementing a risk management strategy.

- **Specific strategy for VAT purposes**

Related to the IOTA Area Group Prevention and Detection of VAT Fraud, the Task Team work focused on VAT. The respondents of the questionnaires were asked whether the implemented risk management strategies have been developed specially for VAT or cover all taxes.

Half of the respondent administrations indicated not having a specific developed risk management strategy for VAT.

In **Bulgaria, Denmark, Estonia, Finland, France, Greece, Hungary, Latvia, Norway, Poland, Slovenia and Sweden**, strategies describe the common approaches that should be used for the detection, prevention and fight against non-compliance, avoidance, evasion, and tax fraud for all taxes.

Different approaches adopted by tax administrations have been used for a VAT risk management strategy.

Lithuania has a VAT control strategy that covers pre and post-registration controls as well as administrative cooperation.

In **Belgium** economic areas are defined as risk areas based on several factors that are evaluated and analyzed.

Switzerland supervises risks per economical sectors. Due to the particular structure of the Swiss tax administration, where VAT is administrated separately from other taxes, a risk analysis strategy has been implemented for VAT.

In the **United Kingdom** the Risk and Intelligence Directorate has strategic, tactical and operational capacity for delivering risk management strategy: identification of risks, planning and coordination of controls, selection of appropriate cases.

Azerbaijan and Italy carry out regular analysis procedures.

Although most tax administrations have adopted common risk management strategies, differences remain in handling different tax types. Risk management strategies for VAT and direct taxes differ as regards aims, methods and measures used, some types of fraud are specific for some taxes which entails different ways of tackling it. The main reason for having different approaches for handling different taxes lies in the existence of specific regulations which entail different fraudulent tax evasion schemes.

- **Methods implemented to define VAT risk areas**

Most surveyed tax administrations have adopted risk management systems which have been broadly implemented for VAT or other tax control purposes, even though not all of them are using risk analysis to detect VAT risk areas.

Norway, Switzerland and Lithuania started in 2006 to use risk analysis for the identification of risk areas.

Croatia and Romania are in the process of implementing a risk analysis process.

The Finnish tax administration has not implemented yet this approach.

As a consequence, it appears that the risk analysis process is mostly used in the IOTA region for tax control purposes.

Besides risk analysis, 18 countries also use other methods to detect VAT risk areas (Azerbaijan, Belgium, Bulgaria, Croatia, Denmark, Estonia, Finland, France, Greece, Hungary, Italy, Latvia, Lithuania, Norway, Poland, Slovenia, Sweden and Switzerland). These methods can be divided into five groups:

- Experience such as information provided by previous audits, local experiences, random audits, preventive audits (e.g. Azerbaijan, Bulgaria, Croatia, Denmark, Lithuania, Norway, Slovenia, Sweden, Switzerland);
- Third-party information, including international exchange of information and anonymous information (e.g. Belgium, Denmark, Estonia, Italy, Latvia, Lithuania, Slovenia);
- VAT refunds (e.g. Greece, Poland);
- Investigation on the field in order to identify new areas of risk (France);
- Newly registered taxpayers (Slovenia, Hungary).

Austria, the Netherlands and United Kingdom do not use alternative methods other than risk analysis.

In the United Kingdom intelligence and external information is treated as part of the risk analysis process.

3.2.2. Organisational aspects

Tax administrations differ in their size and organisation. In some countries the tax administration is an independent institution, whereas in others it operates under the Ministry of Finance or other responsible ministry. Tax administrations can be merged with customs, excise or financial police bodies. These aspects have an impact on the organization of procedures running within the tax administration. Consequently by detecting risk areas there are several approaches adopted by tax administrations in different countries.

- **Centralized decision for detection of risk areas**

In case the tax administration is not an independent institution and operates as part of the ministry, prior risk areas are assigned by the central level of the tax administration or by the Ministry of Finance. This approach has been adopted by the following surveyed countries - **Austria, Azerbaijan, Belgium, Bulgaria, Croatia, Denmark, Estonia, Finland, Greece, Italy, Lithuania, the Netherlands, Romania, Switzerland and the UK.**

- **Top-down method for detecting risk areas**

The top-down approach consists in defining the main risk areas on the national level on basis of guidelines received from the responsible ministry. After the analysis and evaluation of various areas on a central level, a prior set of risk areas is provided to subordinate levels, regional and local offices responsible for the selection of taxpayers for control measures. In addition to prior areas defined at the highest level, regional and/or local offices can also detect their own risk areas which can differ or be more specific.

In Poland, Hungary, Latvia and Norway risk areas to be taken under observation are detected by using a top-down method.

- **Bottom-up method for detection of risk areas**

Only two of the countries that responded, **Slovenia and Sweden**, use a bottom-up method for the detection of risk areas. The bottom-up method means that the decision comes from subordinate levels. Risk areas are firstly detected at the local level and then provided to responsible units on a higher level. The central level evaluates the information received from regional and local offices and decides which risk areas should be identified as a risk area on the national level. The information from subordinate levels can be provided in different ways.

In Sweden a special project group is working on compiling and evaluating information on risk areas.

Slovenia uses proposals of specific risk areas.

France has adopted a specific approach towards the detection and definition of risk areas. The whole country territory is divided into 9 regions comprising regional and local units for investigation and audit. Risk areas are defined within each region depending on their main features. The selection of the areas to be taken under observation is also made in accordance with the information given by the National Directorate of Fiscal Investigations (DNEF) acting as an "intelligence directorate".

3.3. Operational level

The (yearly) audit plans implemented by tax administrations result from the risk management system and have to be implemented. On the operational level, the organisation has to be based on the nature of the subject or risk areas. It can be organized in project groups on national/region level or it can be a common subject dealt with in all regional levels.

The (yearly) audit plans should not involve 100% of human resources, as there is a need for investigating cases not planned in advance (e.g. police cases, denunciation or simple cross-checking during an audit)

The audits results have to be integrated into the audit plan and the evaluation database in order to give input to the knowledge "bank".

3.3.1. Operational aspects of audit planning

In almost all IOTA tax administrations, the selection of taxpayers for audits consists in a decentralized process, where central (or national), regional and/or local levels are involved in the selection process.

In countries with a decentralized selection system, the central level of the tax administration is in charge of defining possible risk areas through:

- National compliance plans, where specific risk areas are defined to that the special attention have to be paid;
- National projects and campaigns dedicated to specific areas with possible high risks;
- Guidelines or priorities to risk areas to focus on;
- Lists of taxpayers at risk lists based on developed risk criteria;
- Lists of taxpayers to be audited.

The subordinate institutions (regional and/or local offices) are those who analyze the taxpayers' data in greater depth and make the final decision as regards tax audit.

- **Decentralized selection of taxpayers**

Depending on tax administrations, tax audit plans related to specific categories of taxpayers can be prepared by:

- Regional offices in Sweden, Latvia, Lithuania (until 2007), Estonia, Croatia, Bulgaria, Italy, Hungary, UK, Greece, Belgium;
- Local offices in Slovenia, Poland, Romania, Azerbaijan, Norway;

- Regional and local offices in **Austria, Denmark, Finland, France and the Netherlands**.

In some tax administrations with a three-level organizational structure, tax audit plans are prepared by local offices which correspond to the lowest level in the organization. In that case, it was reported that regional offices provide support to the selection of taxpayers for audits.

- **Centralized selection of taxpayers**

Switzerland is the only country where the selection of taxpayers for audit is centralized. Due to the specific federal structure of this country the administration of direct taxes is in charge of every region (canton) but the administration of VAT is centralized for the whole country therefore the selection of taxpayers for VAT audits is also centralized.

Due to the implementation of new unified software by the end of 2007 **Lithuania** planned to adopt a centralized selection process of the taxpayers for audit purpose.

3.3.2. Specific aspects for tackling VAT fraud cases

The surveyed countries were asked whether in their tax administration special audit units or teams are established for that purpose.

- **Common approach towards the handling of specific fraud cases**

Third of the countries - **Bulgaria, Croatia, Estonia, Greece, Latvia, Poland, Romania, Switzerland** - do not have special teams for auditing large fraud cases and controls are therefore carried out by common audit teams.

Previously in **Switzerland** there was a special unit for tackling significant VAT fraud cases but it does not exist anymore.

- **Special units for specific fraud cases**

For tackling large fraud cases in specific areas, special knowledge and experience are needed. More than half of the surveyed countries have set up special units within the tax administration in order to deal with significant VAT fraud cases. In one country this unit is specialized in the detection of such cases. The implementation of special audit teams reflects different approaches of organizing the teams' work:

- Special projects teams. These teams are set up for a specific period of time and comprise of experienced specialists in the targeted risk area project (**Denmark, Finland, Sweden**);
- Dedicated teams, specialized in specific types of fraud or investigation units. These teams are regular structures (**Austria, Azerbaijan, Belgium, Slovenia, France, Hungary, Italy, the Netherlands, Norway and the UK**).

In **Lithuania** there is no permanent special team for tackling large fraud cases but such team can be implemented for special cases.

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In **Austria** both possibilities exist: large fraud cases can be investigated by special or common audit teams depending on the circumstances and how the fraud was detected.

- **Large fraud considered as criminal case**

Some tax authorities may also operate under criminal act and have power to investigate criminal cases. In several surveyed IOTA countries - **Austria, Azerbaijan, Estonia, Italy, Latvia, the Netherlands, Poland and UK** - tax authorities have the right to investigate large fraud cases considered as criminal cases. In these countries tax administrations have established special units responsible for these areas.

Latvia and Italy have within their tax authority's structure financial police (Guardia di Finanza in Italy and Financial police Board in Latvia) and customs police (Customs Criminal Board in Latvia).

In **The Netherlands, Poland and United Kingdom** special units have criminal investigation powers (units for penal fiscal cases in Poland, FIOD-ECD in the Netherlands and specialist directorates in UK).

In **Sweden**, the tax administration can conduct criminal investigations under the supervision of the public prosecutor.

The **Swiss** tax administration has also the possibility to investigate criminal cases, but because of a complex federal structure this measure has not been adopted in practice. Such cases are investigated by the financial police under the responsibility of the canton.

In 11 surveyed IOTA countries, investigation of criminal cases is undertaken by:

- Justice as in **Belgium, Croatia, France, Romania and Slovenia**;
- Police in **Denmark, Lithuania and Norway**;
- Police and justice in **Bulgaria** (National police and Prosecutors' office);
- Customs and police in **Hungary** (Customs and Finance Guard) and **Finland** (Police and crime investigation units within customs).

3.4. Risk areas

Responses received from the IOTA Members contain a broad range of risk areas. Some can be common to tax administrations (e.g. the construction industry, IT trade, agriculture, the finance industry, VAT refund, MTIC, conduit companies, buffers, the car trading sector, mobile phones and PC components) whereas some remain more specific (e.g. production of alcohol in Italy, shipping services in Hungary and Latvia, the fishing industry in Greece, foreign workers in Hungary, timber/wood in Lithuania and Latvia or sugar in Estonia).

The evaluation of risk areas is mostly done on a yearly basis, but with the possibility to adapt in between if there is an evolution of a risk profile. It can be underlined that the fight against fiscal fraud in a selected risk area requires proactive, repressive and legislative measures to be implemented, such as change in legislation, simplification of rules/forms or tax audit procedures. An important place has to be given as well to the exchange of information between tax authorities during the course of international events.

In order to analyse data and define risk areas, common risk analysis software are used, in particular Microsoft Office and SQL, but also SPSS, Clementine, Business objects, ESKORT, SAS, IDEA as well as other specific analysis software. Many internal and external data are stored in data warehouse or in (remote) external database.

The risk criteria used to define risk areas can be found in the Annex 1; and the tools used by tax administrations to process the data are listed in the Annex 2 at the end of this report.

3.4.1. Three main groups of risk areas

- **Definition**

Based on the responses received from tax administrations, risk areas can be divided into three main groups in relation to:

- Economic sectors: telecommunication, construction, phone shops, etc.;
- Profiles: e-commerce, MTIC, VAT refunds, newly registered companies, etc.;
- Or even the nature of the goods: scrap metal, mobile phones, calling credit cards, etc.

As previously mentioned some countries or regions have specific risk areas depending on their situation but some others are more common like construction, IT trade, MTIC, VAT-refund, etc.

Answers related to the second questionnaire are presented in different maps for the year 2007:

- Map "Economic Sector ";
- Map "Profile";
- Map "Nature of the Goods".

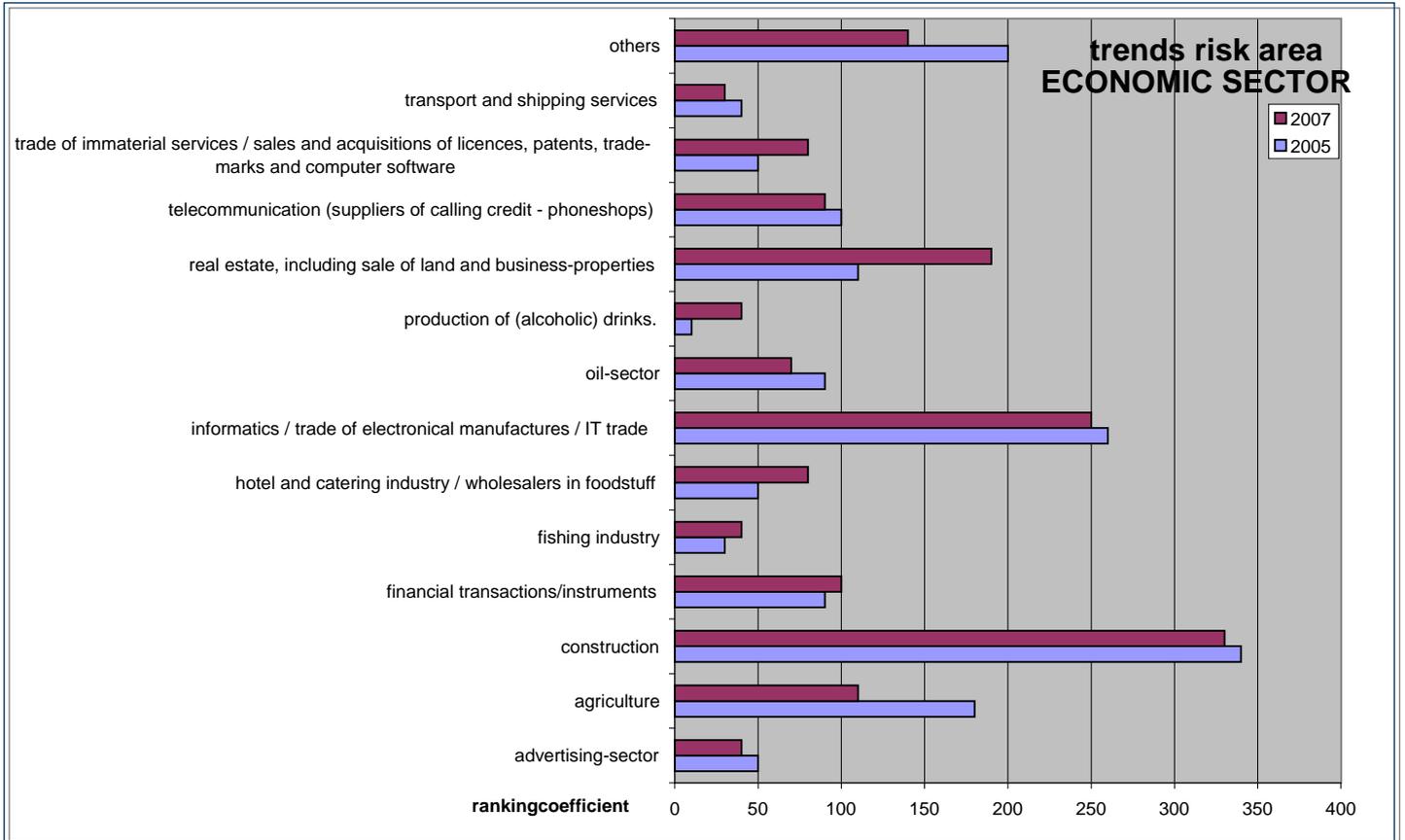
- **The most important risk areas mentioned by IOTA's tax administrations (trends 2005-2007)**

The following graphs are based on the answers received from the second questionnaire and aim at representing the trends over the period 2005-2007.

As regards the evolution of the most significant risk areas over the period 2005-2007, it can be noticed that:

- The importance of the construction industry, conduit companies, buffers and mobile phone and car trading have increased;
- Whereas some other risk areas have been reported as less significant in 2007.

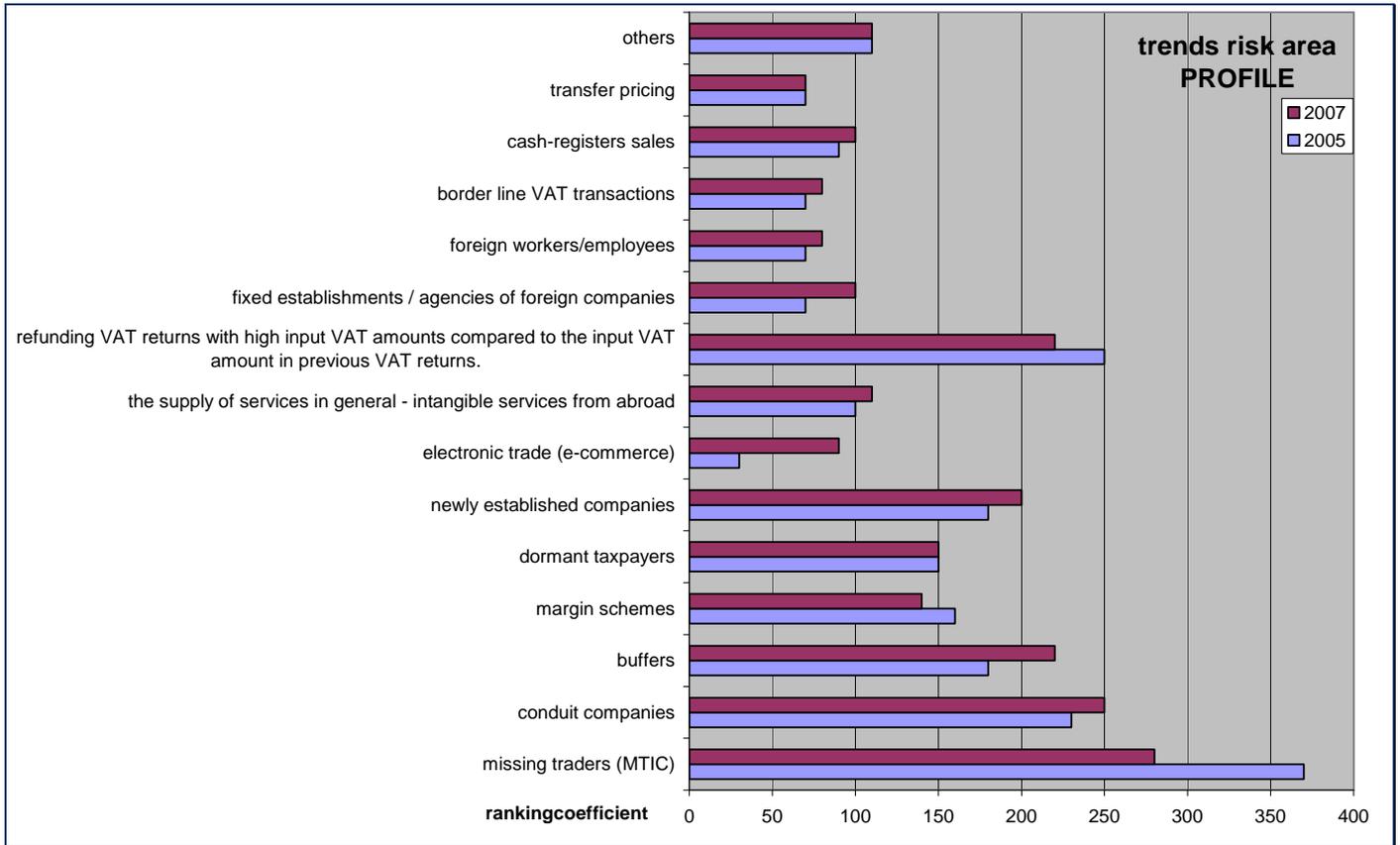
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Graph 3. Risk areas trends per economic sector

The most popular risk areas within this group are construction, informatics, agriculture and real estate. It can be noticed for example that compared with the situation in 2005 agriculture becomes less important whereas the influence of real-estate business is growing.

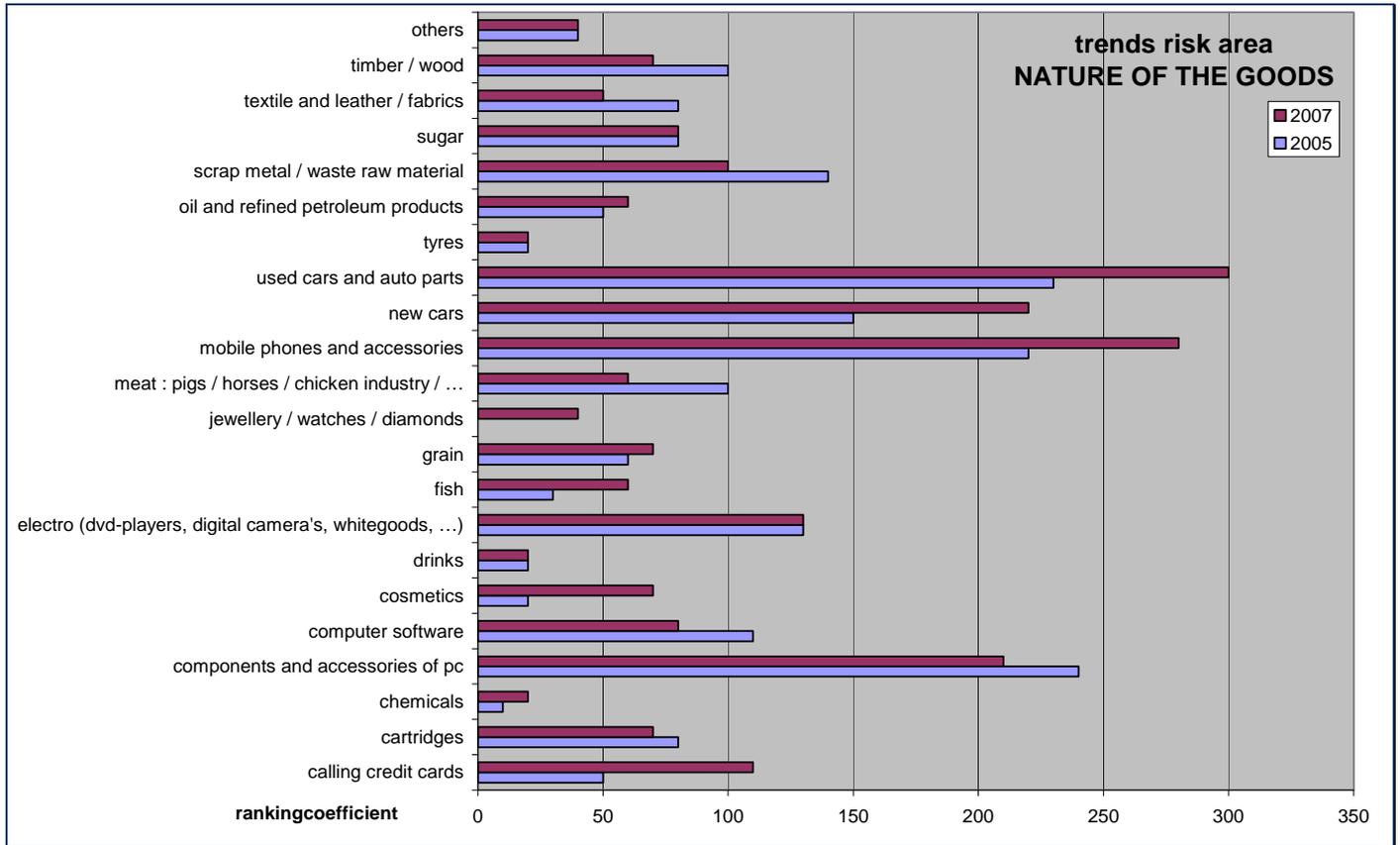
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Graph 4. Risk areas trends per profile

The most popular risk areas within this group are missing traders, conduit companies and refunding VAT returns. Compared with the situation in 2005 missing traders are less important in 2007 but still on the first place whereas the influence of conduit companies and buffers within this group of risk areas is rising.

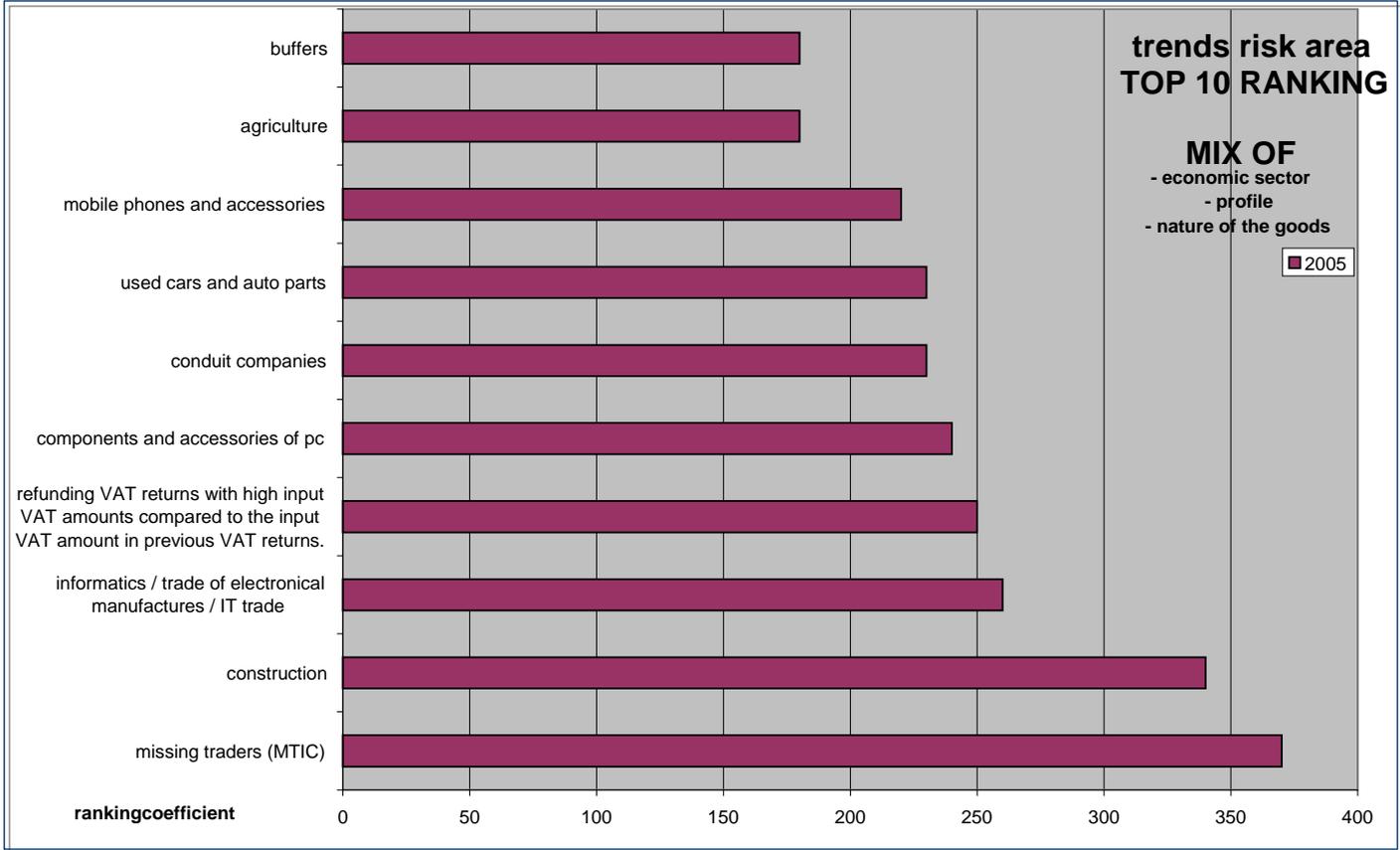
IOTA Report for Tax Administrations - VAT Risk Areas



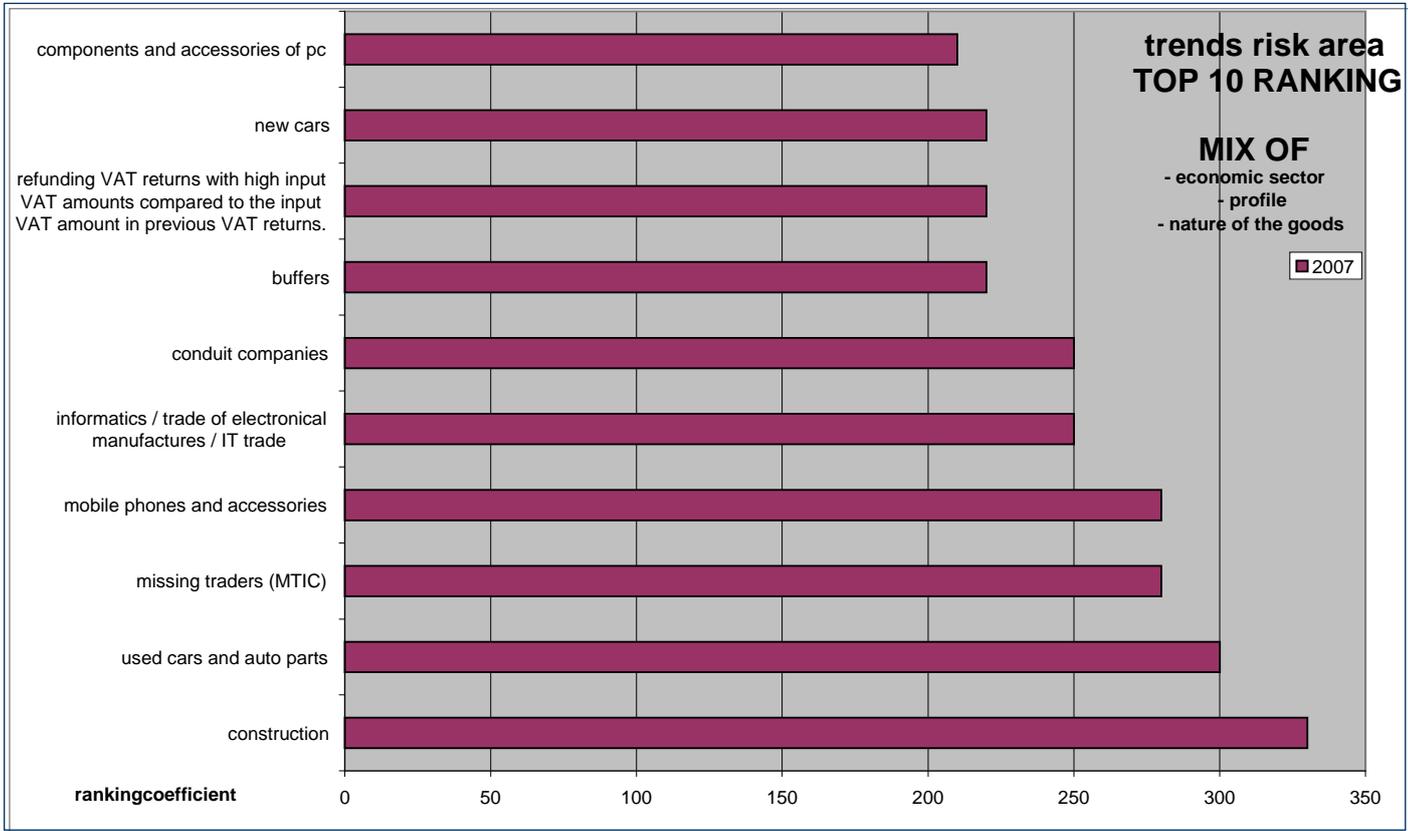
Graph 5. Risk areas trends per nature of the goods

The most popular risk areas within this group are components and accessories of computers, mobile phones, used cars and auto spare pieces. Compared with the situation in 2005 components and accessories for computers are less important in 2007 but still within the top 5 whilst mobile phones and accessories increase.

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Graph 6. Risk areas trends, top ten 2005



Graph 7. Risk areas trends, top ten 2007

Even if a comparison between risk areas appears to be not always relevant as they might belong to different groups, the graphs above highlight a certain consistency of the risk areas' structure of the most ten significant risk areas over a three-year period.

More specifically, it can be noticed that the car business becomes more important. Agriculture has been replaced by "new cars" in 2007. The profiles of missing traders and conduit companies are very important although missing traders became less important in 2007 compared to the situation in 2005.

This report tries to compare "the effort" that tax administrations have taken in "the risk area policy".

3.4.2. Frequency

In general risk areas are evaluated on a yearly basis but sudden significant new parameters can lead to swift changes in the risk analysis process.

3.4.3. Actions implemented against the selected risk areas

The actions implemented against the selected risk areas are closely in accordance to their intrinsic characteristics of risk areas itself and remain based on a mix of pro-active, repressive and legislative measures.

- **Pro-active measures**

In order to guarantee a swift spontaneous payment of taxes, it is necessary in certain fields or certain sectors to steer tax behaviour.

By means of a well-thought-out communication policy where both the staff, the press and pressure groups are involved, deterrent effects and improved ostensible behaviour can be brought about. This includes working with relevant trade bodies to promote and encourage voluntary compliance, making use of publicity and providing advice and information at business seminars and events.

In this respect the achieved results and the *modus operandi* can be communicated in some countries to the press thus entailing opportune announcements of possible future initiatives.

- **Repressive measures**

- Tax audits resulting for instance in a notification to the Ministry of Justice who can launch a criminal investigation;
- Combined raid with other authorities;
- Intensification of tax control measures:
 - Desk-based inspections;
 - Premises inspections;
 - Task teams / project groups.

- **Legislative Measures**
 - Change in legislation;
 - Simplification of forms;
 - Simplification of rules;
 - Pilot studies.

3.4.4. Data

The accuracy of data used for assessing risk areas is usually very difficult to determine. Depending on the sector (such as automotive or construction) other parameters are used or databases consulted for drawing up the selection criteria for audit.

Annex 3 gives the detail of data used by tax administrations.

3.4.5. IT Tools

All tax administrations surveyed use software for analyzing data and formulating decisions. The border between the software used *for risk analysis* and *for determining risk areas based on the analyzed data* is not always clear.

The distinction between these two concepts does not always stem from the questionnaire but the fact remains that, given the interdependence of the two concepts, a number of very interesting findings can be formulated.

For further details, readers should refer to Annex 2.

3.5. Knowledge “bank”

3.5.1. The evaluation process

The evaluation process of risk analysis measures has become an important part of the tax administration's strategy as emphasis has been put on effectiveness, efficiency and quality of services. As regards the scope of the report, the measurement of the effectiveness of tax administrations' operations has been voluntarily limited to risk management in the field of VAT.

The majority of tax administrations emphasize the importance of checking results of performed work due to the fact that results indicate whether the selected risk analysis methods are appropriate or not. If certain selection methods do not provide appropriate results, it is deemed necessary to abandon or change them according to tax administrations' responses. In its final phase the evaluation process gives a larger effectiveness to the whole risk management approaches of tax administrations and at the same time allows assessing the performance of tax administrations as regards their capability to effectively monitor the established risks.

It is necessary to monitor/measure the effects of the VAT supervision procedure in order to establish the effectiveness of the implemented risk analysis system. For

these purposes tax administrations use various indicators to monitor the effectiveness of VAT audit supervision. On the basis of replies received from tax administrations the most frequently used criteria are as follows:

- Number of conducted audits;
- Quality of audits;
- Number of "zero" audits;
- Amount of additional assessment;
- Number of zero audit cases;
- Amount of additional fines;
- Amount of collected revenues.

There are also uncommon or more sophisticated indicators which are used by some tax administrations for measuring the efficiency of VAT audit process e.g.:

- Relation between the fines imposed and the change in the behaviour of fraudsters and of the types of fraud (Greece);
- Nature of penalty (good faith, bad faith or penalty for swindling) (France);
- Number of cancelled taxpayers, number of self-revision submitted (Hungary);
- Random audits (Norway);
- Equal treatment of taxpayers (Estonia, Finland, Hungary, Switzerland);
- Receipt to account (Estonia).

It can be noticed from tax administrations' responses that an average of six criteria are being used for measuring the effectiveness of VAT audit supervision, with Greece using the lowest number of criteria (2) and Hungary the highest (11).

Some countries have reported checking permanently the results of the risk analysis process (Belgium, the UK), or on a quarterly basis (Estonia, Latvia, Lithuania), or even semi-annually or annually (Bulgaria, Poland, Slovenia) whereas some countries do not check any risk analysis results (Croatia, Romania). But a majority of countries (Azerbaijan, Denmark, Finland, France, Hungary, Italy, Norway, the Netherlands, Sweden and Switzerland) have not provided the information about this frequency.

Responses to the questionnaires also emphasize the importance of the internal flow of information in the tax administration where employees expose risks, which they face as controllers or inspectors. Feedback on risks resulting from practitioners remains of high importance for the risk management process.

Some tax administrations do not use measurable results of work as the first and only efficiency indicator for risk analysis. They underline the fact that in future more emphasis should be placed on evaluating the quality of work. Evaluation should be proportional in all tax administration's working fields, not only the supervision field, and it has to include all other tasks, which are mutually interconnected.

In this respect they also emphasize the influence of the information campaigns on awareness of taxpayers on audit procedures in risk areas, which have a very

positive effect on increasing voluntary compliance. Even though an evaluation of this effect seems difficult, tax administrations have stressed that the objective is to change taxpayers' behaviour for the benefit of the country.

Some tax administrations (Belgium, Switzerland, Sweden and the UK) have special (computer) systems developed for analysing results of conducted work.

Good practices observed:

- It is important to check the risk analysis process as tax administrations' assignments are driven by cost effectiveness principles;
- Indicators for measuring efficiency should not be only quantitative, but also qualitative;
- Introduction of a computer-supported system for establishing the effectiveness of the risk analysis process;
- Evaluation of the performance of individual control officials;
- Use of feedback on risks from the practice, provided by inspectors and other employees remains very important;
- Feedback on the implementation of the control plan should also, besides quantitative criteria, include qualitative criteria in order to improve taxpayers' compliance on the long-term.

3.5.2. Use of the media and voluntary compliance

The question of voluntary compliance is of paramount importance and remains the best indicator of the tax supervision quality and tax administration's operations in general. The level of voluntary compliance is not just related to the success of tax administration's operations, but also general fiscal discipline of taxpayers, where increasing the level of voluntary compliance decreases also comparative advantages, which emerges from non-compliance. This provides equality between taxpayers on the market and at also the same time a stronger and fair competition.

Tax administrations were asked to provide information on how media are used to promote voluntary compliance in connection with the implementation of VAT supervision. It can be noted that a majority of administrations use media, i.e. television, newspapers or the Internet, with the assistance of which they publish the results of their work.

Tax administrations usually publish:

- Annual reports for the previous year;
- Annual work programme for the current year, which includes the main fields of tax audit supervision;
- Announced audits (against construction companies, undeclared work, missing trader companies, hairdressers, taxi drivers, dentists, etc.);
- Results of conducted audits;
- Most frequent irregularities or evasion cases, which are conducted by taxable persons within the risk area.

The main purpose of publishing announced audits is mainly related to the preventive activity conducted by tax authorities with the aim of improving voluntary compliance. Tax administrations establish that the effect of this type of communication with the media is difficult to measure, but irrespective of this, they are all convinced of the positive effect on the level of self-taxation or voluntary compliance.

Responses to the questionnaires underline the fact that some tax administrations use the media only for specific types of taxes, whereas some others have not used them as a way to present their work strategies and results.

Amongst 14 tax administrations having answered the question of voluntary compliance measurement in risk areas, only four of them have indicated that they measure or monitor voluntary compliance in risk sectors. The basic method for monitoring voluntary compliance consists in analysing the audit supervision results (Estonia, Slovenia) or submitting VAT settlements (Italy) in the field of risk activities. Analysing or measuring voluntary compliance is conducted by the above-mentioned countries on an annual basis or after the conclusion of a project (Estonia).

The effective criterion to measure the level of voluntary compliance is also the tax gap, which represents the estimated difference between theoretical tax inflows, which taxpayers should have paid into the budget, and the actually collected tax. This is the reason why tax administrations were asked whether they measure the tax gap.

Six countries out of 14 (Belgium, Denmark, Estonia, France, Greece and Italy) have mentioned measuring the tax gap level in the field of VAT in risk fields of activities. At this point tax administrations list various statistical methods for the calculation of the tax gap: data on turnover in a specific business activity and data about the level of additionally estimated tax liabilities in tax supervision. Therefore it is relevant to conclude that a majority of tax administrations do not monitor or establish the tax gap. Additionally the existence of different methods to calculate the tax gap does not allow any comparison between the systems.

As regards the influence of media on voluntary compliance, almost half of the 14 IOTA Members who replied to the questionnaire indicated having no special experiences or analyses in this field. Only three tax administrations mentioned that the use of media has had no special/large influence on tax compliance. The replies obviously revealed for a majority of administrations the interest to use the media for the purpose of increasing voluntary compliance. Some of the IOTA Members pointed out having detected positive effects of media influence, i.e. increase in the number of submitted VAT settlements or increase in the number of self-reports (Estonia, Italy and Slovenia). But the sole use of the media will not increase voluntary compliance as it additionally requires the implementation of a relevant coordinated policy comprised of preventive and repressive measures stemming from legislative measures.

4. CONCLUSIONS

The analysis carried out by the Task Team members firstly highlights the fact that most tax administrations have adopted a global approach towards risk areas. Therefore, even though this report was aimed at giving an overview of risk areas in the IOTA region in the field of VAT, the findings can nevertheless be applied to a broader scope of taxes.

Although many different risk areas exist in the IOTA region, some remain common: construction industry, IT trade, agriculture, finance industry, VAT refunds, MTIC (Missing Trader Intra-Community Fraud), conduit companies, buffers, car trading, mobile phones and PC components. It might be relevant to find and develop common approaches and strategies between IOTA Members to tackle VAT fraud in these specific areas.

Another finding is related to the lack of general rules adopted by tax administrations to tackle VAT risk areas, only the necessity to swiftly adapt strategies. Nevertheless, it was noticed that some tax administrations seem to have retained a passive approach in defining risk areas, mostly consisting in awaiting the risk analysis system to reveal many hits on a specific area before marking it as risk.

The accuracy of the definition of risk areas is also of paramount importance for the effectiveness of the tax administrations' actions. One of the obstacles is in the fact that audit plans are normally carried out on an annual basis, which entails a slow reaction towards new risk areas. Therefore a frequent readjustment of tax audit plans seems necessary and should lead to an effective monitoring of risk areas.

This report consequently reveals that risk management systems implemented in the IOTA region have in common a lack of effectiveness in the feedback processes. This issue has been seen by the Task Team members as the weakest point in the system. As a consequence, improvements should be made in the methodology to get knowledge from the field, enabling the implementation of new strategies and the discovery of new risk areas. It can be added that external sources of information and international cooperation remains of paramount importance to detect new risks.

Eventually, it can be indicated that tools to evaluate the effectiveness of the risk analysis strategy are needed. A statistical analysis on audits carried out and the amount of additional assessments should be completed by a qualitative measurement.

5. ANNEX 1 - RISK CRITERIA USED TO DEFINE RISK AREAS

The list here below contains the most popular risk criteria.

General approach developed by tax administrations:

- The potential value of tax losses at both sector and individual levels meaning: "Anything negative that can affect the organisation's ability to achieve its objectives". One of the main objectives is to reduce the so called tax gap, i.e. the difference between the total tax that theoretically should be paid by all taxpayers and the tax that is actually paid.

Risk criteria related to taxpayers:

- History of the taxpayers;
- Connections with problematic persons or 'doubtful' advisers;
- Individual indicators (financial threshold, transactions, money, amount of income declared, etc).

Risk criteria referring to tax declarations:

- Registration aspects;
- Value of income and loss, costs, revenue, sale and turnover, reliefs and deductions;
- Low profit margin;
- Low incomes;
- Number of employees;
- Ratio of sum of direct taxes paid to total turnover;
- Low level of salaries;
- Lack of specific documents or documents not submitted on time;
- Comparison of the tax declarations (for example, sudden increase in output, output equal to input, etc.)

Risk criteria related to tax audit procedures:

- Experience and expert knowledge;
- Aspects related to tax audits carried out and results of the audits;
- Experience/findings from previous tax inspections - data from the investigative-analysis departments;
- Taxpayers who deduct input VAT over the deductible amount.

Tax-related criteria:

- Type of tax;
- VAT rate;
- Complex legislation (or new risk areas due to changes in legislation).

Economic criteria:

- International character of the market (e.g. mobile phones: high VAT rate, easy to transport, etc.);
- Booming sectors of economy - necessities of the market;

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- Nature of the goods (mobile phones, suppliers and wholesalers of calling credit, phone shops, computers - CPU, new cars, used cars);
- Transport facilities of the goods;
- Cash operations.

Software are sometimes used (e.g. Clementine, SPSS) to determine and redefine parameters (i.e. for specific fraud profiles).

6. ANNEX 2 - IT TOOLS USED TO PROCESS DATA

Most popular tool:

- Microsoft-Office software (Excel, Access, etc.), SQL-queries.

More specialized software:

- Database-software:
 - Oracle (Discoverer);
 - PUMA selection system (a SQL database).
- Most popular IT tools to analyse all data stored in data warehouse:
 - SPSS;
 - Clementine;
 - Business Objects;
 - ESKORT;
 - SAS;
 - IDEA (Interactive Data Extraction and Analysis).
- Most popular IT tools to analyze book-keeping data up to particular transactions, filter and summarize data according to many criteria:
 - ACL (Audit Command Language);
 - Sesam Analysis.

Other IT tools used by only one or a few countries

- Quadstone;
- Xenon;
- anagrafe tributaria (registry tax);
- POLTAX;
- KONTROLA (AUDIT);
- SeRCe (Heart);
- Celina;
- RemDat;
- Analyst's Notebook;
- Infoserver, Blaze Innovator;
- SERADA (for exemptions of excises duties);
- IT tool for excises analysis for AAD's administration (home made);
- Amadeus.

7. ANNEX 3 - DATA USED FOR RISK ANALYSIS PURPOSE

- **Internal data**

Most popular:

- Taxpayer's registration information:
 - Fiscal code, name, legal address, date of registration, type of economic activity, quantities, officials of taxpayer, etc.;
 - Bank accounts, phone numbers, VAT payer, information about company's owners, shareholders, managers, etc.;
 - Structural units (address, name, date of registration);
 - Taxpayer's characteristics:
 - Tax history of the taxpayer;
 - Registration data;
 - Taxpayer information for the individual taxpayers and equivalent information from that taxpayers peer group;
- Tax returns and reports:
 - VAT returns and annexes;
 - Social security contributions;
 - Personal Income Tax returns;
 - Corporate Income Tax returns;
 - Data regarding payroll taxes;
 - Annual reports (balance sheet, profit and loss account);
 - Custom declarations - data from customs;
 - Data from excise;
 - State officials declarations - official journal;
 - Additional declarations on personal income, property and savings (on request);
 - Database of companies who declare (e.g. VAT, tax, import) via the Internet.
- Results of audits/inspections (tax audit, thematic check, observation, inspection);
- 3rd party declarations (complaints, etc.);
- Information from international exchange of information:
 - Customers on Intra-Community acquisitions lists;
 - Exports;
 - System for the Exchange of Excise Data inside EC;
- VAT-refunds;
- VAT account database;
- Database for tax liabilities and payments:
 - List of taxpayers avoiding taxes;
 - List of taxpayers in area of defaulting - data from bankruptcy;
 - Database of suspicious taxpayers;
 - Enforcement agency register;
- Sales and purchases registers;
- Property / real estate register;
- Data regarding motor vehicle taxes;
- Data regarding the assessment of compensation for the use of building land;

- Data from records of tax on vessels;
- Database of foreign companies with activities in each country;
- Internal criminal suspect database;
- Tax payments;
- Data from financial police board.

- **External data**

Most popular:

- Commerce and companies' agencies / commercial register / chamber of commerce;
- European business register;
- Citizens register - population register;
- Data from traders;
- State Statistical Committee;
- Data from Social Insurance Fund (administration) (all about employees, employers, salaries);
- Registry of the Ministry of Internal Affairs;
- Data from notaries;
- Employment agency;
- EU subsidies;
- AMADEUS;
- National Bank;
- Information from banks;
- Custom data (exportation, importation, contentious);
- Data of Border Guard;
- Public notification;
- Data received in the form of Third Party Intelligence (TPI):
 - Information received from the public;
 - Complaints (anonymous information or not);
 - Private sector (cooperation agreements):
 - Pass information of the workers on the construction sector. This is based on the agreement between administration and interest groups.
- Press-articles;
- Information received from other EU tax administrations:
 - VIES;
 - EUROCANET;
 - International contacts;
- Notifications from the police:
 - Traffic police;
 - Financial police;
- State Land Service (real estate owned by natural and legal persons);
- Registers:
 - Real estate;
 - Land (ownership);
- Registers of vehicles:
 - Car register;

- External database which contains trading information related to car registrations;
- Car tax decisions from customs (Finland has a special car tax connected with the purchase price);
- Tractor register;
- Shipping register;
- Aircraft register;
- Registers of different licences (information from institutions about issued licenses);
- Currency transaction register;
- Judicial sentences;
- Prosecution agency;
- Data regarding income and expenditures by transaction accounts of legal persons on a monthly basis.

- **Websites**
“Database of Public Websites Relevant to Competent Authorities” (OECD document, 17 March 2006)