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Report to Congressional Requesters

May 2011

TAX ADMINISTRATION

Information on Selected Foreign Practices That May Provide Useful Insights

GAO-11-439

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Accountability • Integrity • Reliability

Highlights

Highlights of GAO-11-439, report to congressional requesters

May 2011

TAX ADMINISTRATION

Information on Selected Foreign Practices That May Provide Useful Insights

Why GAO Did This Study

The Internal Revenue Service (IRS) and foreign tax administrators face similar issues regardless of the particular provisions of their laws. These issues include, for example, helping taxpayers prepare and file returns, and assuring tax compliance. Understanding how other tax administrators have used certain practices to address common issues can provide insights to help inform deliberations about tax reform and about possible administrative changes in the U.S. existing system to improve compliance, better serve taxpayers, reduce burdens, and increase efficiencies.

GAO was asked to describe (1) how foreign tax administrators have approached issues that are similar to those in the U.S. tax system and (2) whether and how the IRS identifies and adopts tax administration practices used elsewhere.

To do this, GAO reviewed documents and interviewed six foreign tax administrators. In some cases, GAO also interviewed tax experts, tax practitioners, taxpayers, and trade-group representatives who were selected based on their expertise or involvement in developing or using the foreign systems. GAO also examined documents and met with IRS officials.

What GAO Recommends

GAO makes no recommendations in this report.

The IRS provided technical comments that are included in this report.

View GAO-11-439 or key components.
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What GAO Found

Foreign and U.S. tax administrators use many of the same practices such as information reporting, tax withholding, providing Web-based services, and finding new approaches for tax compliance. These practices, although common to each system, have important differences. This report describes the following six foreign tax administration practices that address common issues in tax administration.

Selected Foreign Tax Administration Practices

Foreign administrator	Practice
New Zealand	Does integrated evaluations of tax expenditures and discretionary spending programs to analyze their effects and improve program delivery
Finland	Uses the Internet to calculate individual tax withholding rates and revise preprepared tax returns to improve service at lower costs
European Union	Uses multilateral treaty information exchange on interest payments to member nations' citizens to spur compliance by individual taxpayers
United Kingdom	Uses information reporting and withholding so most wage earners do not need to file a tax return
Australia	Uses a compliance program for high-net-wealth individuals that focuses on their full set of business interests to improve compliance
Hong Kong	Uses semiannual payments instead of periodic withholding for the Salaries Tax

Source: GAO.

Although differences in laws, culture, or other factors likely would affect the transferability of foreign tax practices to the United States, these practices may provide useful insights for policymakers and the IRS. For example, New Zealand integrates evaluations of its tax and discretionary spending programs. The evaluation of its Working For Families tax benefits and discretionary spending, which together financially assist low- and middle-income families to promote employment, found that its programs aided the transition to employment but that it still had an underserved population; these findings likely would not have emerged from separate evaluations. GAO previously has reported that the United States lacks clarity on evaluating tax expenditures and related discretionary spending programs and does not generally undertake integrated evaluations. In Finland, electronic tax administration is part of a government policy to use electronic services to lower the cost of government and encourage private-sector growth. Overall, according to Finnish officials, electronic services have helped to reduce Tax Administration staff by over 11 percent from 2003 to 2009 while improving taxpayer service.

IRS officials learn about these practices based on interactions with other tax administrators and participation in international organizations, such as the Organisation for Economic Co-operation and Development. In turn, the IRS may adopt new practices based on the needs of the U.S. tax system. For example, in 2009, the IRS formed the Global High Wealth Industry program. The IRS consulted with Australia about its approach and operational practices.

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Abbreviations

ATO	Australian Taxation Office
CIAT	Center for Inter-American Tax Administration
EU	European Union
FTA	Forum on Tax Administration
HMRC	Her Majesty's Revenue and Customs
HNWI	High Net Wealth Individuals
IRD	Inland Revenue Department
IRS	Internal Revenue Service
JITSIC	Joint International Tax Shelter Information Centre
MOU	Memorandum of Understanding
MSD	Ministry of Social Development
OECD	Organisation for Economic Co-operation and Development
OMB	Office of Management and Budget
PAYE	Pay As You Earn
RDF	Risk Differentiation Framework
TIN	Taxpayer Identification Number
UK	United Kingdom
VAT	Value Added Tax
WFF	Working For Families

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United States Government Accountability Office
Washington, DC 20548

May 24, 2011

The Honorable Max Baucus
Chairman
The Honorable Orrin G. Hatch
Ranking Member
Committee on Finance
United States Senate

The Honorable Charles E. Grassley
Ranking Member
Committee on the Judiciary
United States Senate

Tax administrators around the world all strive to address similar issues regardless of the specific provisions of their laws. These issues include helping taxpayers prepare and file tax returns, keeping track of taxes owed and paid by various types of taxpayers, and assuring tax compliance. Understanding how other tax administrators have used certain practices to address these common issues can provide insights to help inform deliberations about tax reform and about possible administrative changes in our existing system to improve compliance, better serve taxpayers, reduce burden, and increase efficiencies. To assist you in considering the potential applicability of foreign tax administration practices for U.S. policy and practices, we will describe (1) how foreign tax administrators have approached issues that are similar to those in the U.S. tax system and (2) whether and how the Internal Revenue Service (IRS) identifies and adopts tax administration practices used elsewhere.

We selected six foreign tax administrators' approaches to practices that were different than the approach to a similar practice in the United States as shown in table 1.

Table 1: Selected Foreign Tax Administration Practices

Foreign tax administrators	Practice
New Zealand	Does integrated evaluations of tax expenditures and discretionary spending programs to analyze their effects and improve program delivery
Finland	Uses the Internet to calculate individual tax withholding rates and revise preprepared tax returns to improve service at lower costs
European Union	Uses multilateral treaty information exchange on interest payments to member nations' citizens to spur compliance by individual taxpayers
United Kingdom	Uses information reporting and withholding so most wage earners do not need to file a tax return
Australia	Uses a compliance program for high-net-wealth individuals that focuses on their full set of business interests to improve compliance
Hong Kong	Uses semiannual payments instead of periodic withholding for the Salaries Tax

Source: GAO.

We based our selection of these practices on several factors, including whether the tax administrators had advanced economies and tax systems, tax information was available in English, and the foreign tax administrator's approach differed, at least in part, from how the United States approaches similar issues. We primarily used documentation from each government's reports that are publicly available. When possible, we confirmed additional information provided to us by officials. To identify taxpayers' attitudes toward Hong Kong's semiannual payment system, we interviewed experts who were either university professors, were the authors of publications on Hong Kong's tax system, or were practitioners in well-known law or accounting firms. To understand the development of Finland's Internet-based withholding estimation and prepared returns system, we met with the public interest and trade groups that provided assistance to Finland's Parliament during the system's development.

To describe whether and how the IRS identifies and adopts tax administration practices used elsewhere, we reviewed related documents and interviewed IRS officials. To help ensure the accuracy of the information we present, we shared a summary of our descriptions with representatives of the six foreign tax administrators and incorporated their comments as appropriate. The IRS provided technical comments that are included in this report.

The descriptive information on the practices of foreign administrators presented in this report may provide useful insights for Congress and others on enhancements to current U.S. tax policies and practices. However, it was beyond the scope of this report to identify and assess the factors that might affect the transferability of the practices to the United States. For example, nations have differing cultures and differing attitudes toward government, sometimes called "tax morale." Generally, higher tax morale has been found to be positively related to high levels of voluntary tax compliance. To the extent that taxpayers in some countries are more willing to fully comply with tax rules, voluntary tax compliance is higher and less enforcement action is needed by the tax administrator. Thus, those nations' tax enforcement practices may not be as appropriate in other nations where citizens have lower tax morale. Measurements of tax morale generally are not well defined or uniform; nor are measurements of voluntary tax compliance.

We conducted our work from October 2009 to May 2011 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions in this report. A more detailed discussion of our methodology for each objective is in appendix I.

Background

The IRS and tax administrators worldwide generally use similar administrative practices.

Information reporting. Information reporting is a widely accepted practice for increasing taxpayer compliance. Under U.S. law, some types of transactions are required to be reported to the IRS by third parties who make payments to, or sometimes receive payments from, individual taxpayers. Typically, information returns represent income paid to the taxpayer, such as wages or bank account interest.[1] After tax returns are filed, the IRS then matches the amounts reported on information returns to the amounts reported on the taxpayer's return. For any differences, the IRS may send a notice to the taxpayer requesting an explanation. If the

[1]See 26 U.S.C. § 6041-6050W.

taxpayer does not respond to the notice, the IRS may make an additional assessment. For fiscal year 2010, the IRS received over 2.7 billion information returns, sent 5.5 million notices on differences between information returns and tax returns, and assessed an additional $20.7 billion in taxes, interest, and penalties.

Withholding. Withholding is a widely accepted practice to increase taxpayer compliance. Under U.S. law, employers must withhold income tax from the wages paid to employees.[2] Withholding from salaries requires wage earners to pay enough tax during the tax year to assure that they will not face a large payment at year end. Also, withholding can be required as a backup to information reporting if a payee fails to furnish a correct taxpayer identification number (TIN). If the payee refuses to furnish a TIN, the payer generally withholds 28 percent of the amount of the payment—for example, interest payments on a bank account—and remits that amount to the IRS.

Electronic tax administration. Many tax administrators in the United States and worldwide have increasingly used electronic tax administration to improve services and reduce costs. The IRS has focused its electronic tax administration on filing tax returns over the Internet, providing taxpayer assistance through its Web site, and providing telephone assistance. To accept electronically filed tax returns, IRS has authorized preapproved e-file providers to submit the returns. IRS cannot accept electronically filed returns directly from taxpayers. Through its Web site, IRS provides taxpayers with publications explaining tax law and IRS administrative procedure. The Web site also provides automated services such as "Where's My Refund?" During the 2010 filing season, the IRS Web site had 239 million total visits and 277 million searches. IRS also received 77 million telephone calls of which IRS phone assistors answered about 24 million calls.[3]

Tax enforcement. The U.S. tax system, as well as many other tax systems worldwide, is based on some degree of self-reporting and voluntary compliance by taxpayers. Tax administrations worldwide have

[2]26 U.S.C. § 3402.

[3]GAO, *2010 Tax Filing Season: IRS's Performance Improved in Key Areas, but Efficiency Gains are Possible in Others*, GAO-11-111 (Washington, D.C.: Dec. 16, 2010). The Web site data are from January 1 to July 31, 2010, and the telephone call data are from January 1 to June 30, 2010.

enforcement programs to ensure that tax returns are accurate and complete and taxes are paid. Among others, IRS uses two principal enforcement programs. After tax returns have been filed, the Automated Underreporter Program matches data on information returns (usually on income) provided by employers, banks, and other payers of income to data reported on taxpayers' tax returns. IRS may contact taxpayers about any differences. The Examination Program relies on IRS auditors to check compliance in reporting income, deductions, credits, and other issues on tax returns by reviewing the documents taxpayers provided to support their tax return.

IRS, like revenue agencies in many countries, administers tax expenditures. Tax expenditures are tax provisions that grant special tax relief for certain kinds of behavior by taxpayers or for taxpayers in special circumstances. Tax expenditures reduce the amount of taxes owed and therefore are seen as resulting in the government forgoing revenues. These provisions are viewed by many analysts as spending channeled through the tax system. For fiscal year 2010, the U.S. Department of the Treasury reported 173 tax expenditures costing, in aggregate, more than $1 trillion.[4] Tax expenditures are often aimed at policy goals similar to those of federal spending programs, such encouraging economic development in disadvantaged areas and financing postsecondary education. In 2005, we reported that all U.S. federal spending and tax policy tools, including tax expenditures, should be reexamined to ensure that they are achieving their intended purposes and designed in the most efficient and effective manner.[5]

[4]Revenue loss estimates are intended to provide information about the value of tax expenditures. However, separate tax expenditure estimates do not incorporate any behavioral responses and thus do not necessarily represent the exact amount of revenue to be gained by repealing a specific tax expenditure.

[5]For a discussion of the issues related to tax expenditures, see GAO, *Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined*, GAO-05-690 (Washington, D.C.: Sept. 23, 2005), and Office of Management and Budget, *Analytical Perspectives*, *Budget of the United States Government*, *Fiscal Year 2012* (Washington, D.C.: 2010).

Examples of Selected Tax Administration Practices to Address Known Tax Administration Issues

The following examples illustrate how New Zealand, Finland, the European Union (EU), the United Kingdom (UK), Australia, and Hong Kong have addressed well-known tax administration issues.[6] Our work does not suggest that these practices should or should not be adopted by the United States.

New Zealand Does Integrated Evaluations of Tax Expenditures and Discretionary Spending Programs to Analyze Their Effects and Improve Program Delivery

New Zealand, like the United States, addresses various national objectives through a combination of tax expenditures and discretionary spending programs. In New Zealand, tax expenditures are known as tax credits. New Zealand has overcome obstacles to evaluating these related programs at the same time to better judge whether they are working effectively. Rather than doing separate evaluations, New Zealand completes integrated evaluations of tax expenditures and discretionary spending programs to analyze their combined effects. Using this approach, New Zealand can determine, in part, whether tax expenditures and discretionary spending programs work together to accomplish government goals.

One example is the Working For Families (WFF) Tax Credits program, which is an entitlement for families with dependent children to promote employment. Prior to the introduction of WFF in 2004, New Zealand's Parliament discovered that many low-income families were not better off from holding a low-paying job, and those who needed to pay for childcare to work were generally worse off in low-paid work compared to receiving government benefits absent having a job. This prompted Parliament to change its in-work incentives and financial support including tax expenditures.

The WFF Tax Credits program differs from tax credit programs in the United States in that it is an umbrella program that spans certain tax credits administered by the Inland Revenue Department (IRD) as well as discretionary spending programs administered by the Ministry of Social Development (MSD). IRD collects most of the revenue and administers the tax expenditures for the government. Being responsible for collecting sensitive taxpayer information, IRD must maintain tax privacy and protect

[6]Details on these practices are provided in the appendixes. In addition, The Hong Kong Special Administrative Region is part of the People's Republic of China. Throughout this report, we will use Hong Kong as the abbreviation for this region.

the integrity of the New Zealand tax system. MSD administers the WFF's program funds and is responsible for collecting data that include monthly income received by its beneficiaries. Given different responsibilities, IRD and MSD keep separate datasets, making it difficult to assess the cumulative effect of the WFF program.

Therefore, to understand the cumulative effect of changes made to the WFF program and ensure that eligible participants were using it, New Zealand created a joint research program between IRD and MSD that ran from October 2004 to April 2010. The joint research program created linked datasets between IRD and MSD. Access to sensitive taxpayer information was restricted to IRD employees on the joint research program and to authorized MSD employees only after they were sworn in as IRD employees.

The research provided information on key outcomes that could only be tracked through the linked datasets. The research found that the WFF program aided the transition from relying on government benefits to employment, as intended. It also found that a disproportionate number of those not participating in the program faced barriers to taking advantage of the WFF. Barriers included the perceived stigma from receiving government aid, the transaction costs of too many rules and regulations, and the small amounts of aid for some participants. On the basis of these findings, Parliament made changes to WFF that provided an additional NZ$1.6 billion (US$1.2 billion) per year in increased financial entitlements and in-work support to low- to middle-income families.[7]

Appendix II provides more details on New Zealand's evaluation of tax expenditures as well as similarities and differences to the U.S. system.

[7]To adjust foreign currencies to U.S. dollars, we used the Federal Reserve Board's foreign exchange rates. New Zealand dollars converted to U.S. dollars as of December 31, 2004.

Finland Uses the Internet to Calculate Individual Tax Withholding Rates and Revise Preprepared Tax Returns to Improve Service at Lower Costs

Finland encourages accurate withholding of taxes from taxpayers' income, lowers its costs, and reduces taxpayers' filing burdens through Internet-based electronic services. In 2006, Finland established a system, called the Tax Card, to help taxpayers estimate a withholding rate for the individual income tax. The Tax Card, based in the Internet, covers Finland's national tax, municipality tax, social security tax, and church tax.[8] The Tax Card is accessed through secured systems in the taxpayer's Web bank or an access card issued by Finland's government. The Tax Card system enables taxpayers to update their withholding rate as many times as needed throughout the year, adjusting for events that increase or decrease their income tax liability. When completed, the employer is notified of the changed withholding tax rate through the mail or by the employee providing a copy to the employer. According to the Tax Administration, about a third of all taxpayers using the Tax Card—about 1.6 million people—change their withholding percentages at least annually. Finland generally refunds a small amount of the withheld funds to taxpayers (e.g., it refunded about 8 percent of the withheld money in 2007).

Finland also has been preparing income tax returns for individuals since 2006. The Tax Administration prepares the return for the tax year ending on December 31st based on third-party information returns, such as reporting by employers on wages paid or by banks on interest paid to taxpayers. During April, the Tax Administration mails the preprepared return for the taxpayer's review. Taxpayers can revise the paper form and return it to the Tax Administration in the mail or revise the return electronically online. According to Tax Administration officials, about 3.5 million people do not ask to change their tax return and about 1.5 million will request a tax change.

Electronic tax administration is part of a governmentwide policy to use electronic services to lower the cost of government and encourage growth in the private sector. According to Tax Administration staff, increasing electronic services to taxpayers helps to lower costs. Overall, the growth of electronic services, according to Finnish officials, has helped to reduce Tax Administration staff by over 11 percent from 2003 to 2009 while improving taxpayer service.

[8]Individuals who are members of the Evangelical-Lutheran Church or the Orthodox Church pay a flat-rate church tax. Local church communities determine the tax rate, which varies between 1 and 2 percent of taxable income. Individuals who are not members of either church do not pay the tax.

According to officials of the Finnish government as well as public-interest and trade groups, the Tax Card and preprepared return systems were established under a strong culture of national cooperation. For the preprepared return system to work properly, Finland's business and other organizations that prepare information returns had to accept the burden to comply in filing accurate returns promptly following the end of the tax year.

Finland's tax system is positively viewed by taxpayers and industry groups, according to our discussions with several industry and taxpayer groups. They stated that Finland has a simple, stable tax system which makes compliance easier to achieve. As a result, few individuals use a tax advisor to help prepare and file their annual income tax return.

Appendix III provides more details on Finland's electronic tax administration system as well as a discussion of similarities to and differences from the U.S. system.

EU's Multilateral Treaty Information Exchange on Interest Payments to Member Nations' Citizens to Spur Compliance by Individual Taxpayers

The EU seeks to improve tax compliance through a multilateral agreement on the exchange of information on interest earned by each nation's individual taxpayers. This agreement addresses common issues with the accuracy and usefulness of information exchanged among nations that have differing technical, language, and formatting approaches for recording and transmitting such information. Under the treaty, called the Savings Taxation Directive, adopted in June 2003, the 27 EU members and 10 other participants agreed to share information about income from interest payments made to individuals who are citizens in another member nation. With this information, the tax authorities are able to verify whether their citizens properly reported and paid tax on the interest income. The directive provides the basic framework for the information exchange, defining essential terms and establishing automatic information exchange among members.[9]

As part of the directive, 3 EU member nations as well as the 5 European nonmember nations agreed to apply a withholding tax with revenue sharing (described below) during a transition period through 2011, rather

[9]Under automatic information exchange, countries agree to routinely provide information about tax-related transactions. Under another information exchange practice, information exchange upon request, the exchange generally requires a specific justification for the information needed by the requesting tax authority.

than automatically exchanging information.[10] Under this provision, a 15 percent withholding tax gradually increases to 35 percent by July 1, 2011. The withholding provision included a revenue-sharing provision, which authorizes the withholding nation to retain 25 percent of the tax collected and transfer the other 75 percent to the nation of the account owner. The directive also requires the account owner's home nation to ensure that withholding does not result in double taxation. The directive does this by granting a tax credit equal to the amount of tax paid to the nation in which the account is located.

A September 2008 report to the EU Council described the status of the directive's implementation. During the first 18 months of information exchange and withholding, data limitations such as incomplete information on the data exchanged and tax withheld created major difficulties for evaluating the directive's effectiveness. Further, no benchmark was available to measure the effect of the changes.

According to EU officials, the most common administrative issues, especially during the first years of implementation of the directive, have been the identification of the owner reported in the computerized format. It is generally recognized that a Taxpayer Identification Number (TIN) provides the best means of identifying the owner. However, the current directive does not require paying agents to record a TIN. Using names has caused problems when other EU member states tried to access the data. For example, a name that is misspelled cannot be matched. In addition, how some member states format their mailing address may have led to data-access problems.

Other problems with implementing the directive include identifying whether investors moved their assets into categories not covered by the directive (e.g., shifting to equity investments), and concerns that tax withholding provisions may not be effective because withholding rates were low until 2011 when the rate became 35 percent. The EU also identified problems with the definition of terms, making uniform application of the directive difficult. Generally these terms identify which payments are covered by the directive, who must report under the directive, and who owns the interest for tax purposes.

[10]These nations are the Swiss Confederation, the Principality of Liechtenstein, the Republic of San Marino, the Principality of Monaco, and the Principality of Andorra.

Nevertheless, EU officials stated that the quality of data has improved over the years. The EU officials have worked with EU member nations to resolve specific data issues, which has contributed to the effective use of the information exchanged under the directive. EU officials told us that the monitoring role by the EU Commission, the data-corrections process, and frequent contacts to resolve specific issues have contributed to effective use of the data received by EU member states.

Appendix IV provides more details on the EU Saving Taxation Directive and related issues such as avoiding double taxation as well as a discussion of similarities to and differences from the U.S. system.

UK Uses Information Reporting and Withholding So Most Wage Earners Do Not Need to File a Tax Return

The UK promotes accurate tax withholding and reduces taxpayers' filing burdens by calculating withholding rates for taxpayers and requiring that payers of certain types of income withhold taxes at standard rates. The UK uses information reporting and withholding to simplify tax reporting and tax payments for individual tax returns. Both the individual taxpayer and Her Majesty's Revenue and Customs (HMRC)—the tax administrator—are to receive information returns from third parties that make payments to a taxpayer such as for bank account interest.

A key element is the UK's Pay As You Earn (PAYE) system. Under the PAYE system, HMRC calculates an amount of withholding from wages to meet a taxpayer's liability for the current tax year based on information reporting from the employer and other income information employees may provide. According to HMRC officials, the individual tax system in the UK is simple for most taxpayers who are subject to PAYE. PAYE makes it unnecessary for wage earners to file a yearly tax return, unless special circumstances apply. For example, wage earners do not need to file a return unless income from interest, dividends, or capital gains exceeds certain thresholds or if deductions need to be reported. Therefore, a tax return may not be required because most individuals do not earn enough of these income types to trigger self-reporting. For example, the first £10,100 (US$16,239) of capital gains income is exempt from being reported on tax returns.[11]

[11]We used rates that matched the time period cited for the foreign amount. The currency conversion for the capital gains amount is as of February 25, 2011.

PAYE also facilitates the reconciliation of tax liabilities for prior tax years through the use of withholding at source for wages. The withheld amount may be adjusted by HMRC to collect any unpaid taxes from previous years or refund overpayments. HMRC annually notifies the taxpayer and employer of the amount to withhold.

HMRC also may adjust the withheld amount through information provided by taxpayers. If taxpayers provide the information on their other income such as self-employment earnings, rental income, or investment income, HMRC can adjust the PAYE withholding. Individuals not under the PAYE system are required to file a tax return after the end of the tax year based on their records.

In addition, HMRC uses information reporting and tax withholding as part of its two-step process to assess the compliance risks on filed returns. In the first step, individual tax returns are reviewed for inherent compliance risks because of the taxpayers' income level and complexity of the tax return. For example, wealthy taxpayers with complex business income are considered to have a higher compliance risk than a wage earner. In the second step, information compiled from various sources—including information returns and public sources—is analyzed to identify returns with a high compliance risk. According to HMRC officials, these assessments have allowed HMRC to look at national and regional trends. HMRC is also attempting to uncover emerging compliance problems by combining and analyzing data from the above sources as well as others.

Appendix V provides more details on the UK's information reporting and withholding system as well as a discussion of similarities to and differences from the U.S. system.

Australia Uses a Compliance Program for High-Net-Wealth Individuals That Focuses on Their Full Set of Business Interests to Improve Compliance

The Australian High Net Wealth Individuals (HNWI) program focuses on the characteristics of wealthy taxpayers that affect their tax compliance. High-wealth individuals often have complex business relationships involving many entities they may directly control or indirectly influence and these relationships may be used to reduce taxes illegally or in a manner that policymakers may not have intended. The HNWI program requires these taxpayers to provide information on these relationships and provides such taxpayers additional guidance on proper tax reporting.

According to the Australian Taxation Office (ATO), in the mid-1990s, ATO was perceived as enforcing strict sanctions on the average taxpayers but not the wealthy. By 2008, ATO found that high-wealth taxpayers, those

with a net worth of more than A$30 million (US$20.9 million), had substantial income from complex arrangements,[12] which made it difficult for ATO to identify and assure compliance. ATO concluded that the wealthy required a different tax administration approach.

ATO set up a special task force to improve its understanding of wealthy taxpayers, identify their tax planning techniques, and improve voluntary compliance. Due to some wealthy taxpayers' aggressive tax planning, which ATO defines as investment schemes and legal structures that do not comply with the law, ATO quickly realized that it could not reach its goals for voluntary compliance for this group by examining taxpayers as individual entities. To tackle the problem, ATO began to view wealthy taxpayers as part of a group of related business and other entities. Focusing on control over related entities rather than on just individual tax obligations provided a better understanding of wealthy individuals' compliance issues.

The HNWI approach followed ATO's general compliance model. The model's premise is that tax administrators can influence tax compliance behavior through their responses and interventions. For compliant wealthy taxpayers, ATO developed a detailed questionnaire and expanded the information on business relationships that these taxpayers must report on their tax return. For noncompliant wealthy taxpayers, ATO is to assess the tax risk and then determine the intensity of ATO's compliance interventions.

According to 2008 ATO data, the HNWI program has produced financial benefits. From the establishment of the program in 1996 until 2007, ATO had collected A$1.9 billion (US$1.67 billion) in additional revenue and reduced revenue losses by A$1.75 billion (US$1.5 billion) through compliance activities focused on highly wealthy individuals and their associated entities.[13] ATO's program focus on high-wealth individuals and their related entities has been adopted by other tax administrators. By 2009, nine other countries, including the United States, had formed groups to focus resources on high-wealth individuals.

Appendix VI provides more details on Australia's high-wealth program as well as similarities and differences to the U.S. system.

[12]Australian dollars converted to U.S. dollars as of December 31, 2008.

[13]Australian dollars converted to U.S. dollars as of December 31, 2007.

Hong Kong Uses Semiannual Payments Instead of Periodic Employer Withholding for the Salaries Tax

Although withholding of taxes by payers of income is a common practice to ensure high levels of taxpayer compliance, Hong Kong's Salaries Tax does not require withholding by employers. Instead, tax administrators and taxpayers appear to find a semiannual payment approach effective. Hong Kong's Salaries Tax is a tax on wages and salaries with a small number of deductions (e.g., charitable donations and mortgage interest). The Salaries Tax is paid by about 40 percent of the estimated 3.4 million wage earners in Hong Kong, while the other 60 percent are exempt from Salaries Tax.

Rather than using periodic (e.g., biweekly or monthly) tax withholding by employers, Hong Kong collects the Salaries Tax through two payments by taxpayers for a tax year. Since the tax year runs for April 1st through March 31st, a substantial portion of income for the tax year is earned by January (i.e., income for April to December), and the taxpayer is to pay 75 percent of the tax for that tax year in January (as well as pay any unpaid tax from the previous year). The remaining 25 percent of the estimated tax is to be paid 3 months later in April.

By early May, the Inland Revenue Department (IRD)—the tax administrator—annually prepares individual tax returns for taxpayers based on information returns filed by employers. Taxpayers review the prepared return, make any revisions such as including deductions (e.g., charitable contributions), and file it with IRD. IRD then will review the returns and determine if any additional tax is due. If the final Salaries Tax assessment turns out to be higher than the estimated tax previously assessed, IRD is to notify the taxpayer, who is to pay the additional tax concurrently with the January payment of estimated tax for the next tax year.

Hong Kong's tax system is positively viewed by tax experts, practitioners, and a public opinion expert based on our discussions with them. They generally believe that low tax rates, a simple system, and cultural values contribute to Hong Kong's collection of the Salaries Tax through the two payments rather than periodic withholding. Tax rates are fairly low, starting at 2 percent of the adjusted salary earned and not exceeding 15 percent. Further, tax experts told us that the Salaries Tax system is simple. Few taxpayers use a tax preparer because the tax form is very straightforward and the tax system is described as "stable." Further, an expert on public opinion in Hong Kong told us that taxpayers fear a loss of face if recognized as not complying with tax law. This cultural attitude helps promote compliance.

Appendix VII provides more details on Hong Kong's Salaries Tax system as well as a discussion of similarities to and differences from the U.S. system.

IRS Considers Foreign Tax Practices That Might Merit Adoption

IRS officials learn about foreign tax practices by participating in international organizations of tax administrators. IRS is actively involved in two international tax organizations and one jointly run program that addresses common tax administration issues. First, the IRS participates with the Center for Inter-American Tax Administration (CIAT), a forum made up of 38 member countries and associate members, which exchange experiences with the aim of improving tax administration. CIAT, formed in 1967, is to promote integrity, increase tax compliance, and fight tax fraud. The IRS participates with CIAT in designing and developing tax administration products and with CIAT's International Tax Planning Control committee.[14] Second, the IRS participates with the Organisation for Economic Co-operation and Development (OECD) Forum on Tax Administration (FTA), which is chaired by the IRS Commissioner during 2011. The FTA was created in July 2002 to promote dialogue between tax administrations and identify good tax administration practices. Since 2002, the forum has issued over 50 comparative analyses on tax administration issues to assist member and selected nonmember countries.

IRS and OECD officials exchange tax administration knowledge. For example, the IRS is participating in the OECD's first peer review of information exchanged under tax treaties and tax information exchange agreements. Under the peer-review process, senior tax officials from several OECD countries examine each selected member's legal and regulatory framework and evaluate members' implementation of OECD tax standards. The peer-review report on IRS information exchange practices is expected to be published in mid-2011.

As for the jointly run program, the Joint International Tax Shelter Information Centre (JITSIC) attempts to supplement ongoing work in each country to identify and curb abusive tax schemes by exchanging information on these schemes. JITSIC was formed in 2004 and now includes tax agencies of Australia, Canada, China, Japan, South Korea, the United Kingdom, and the United States. According to the IRS, JITSIC members have identified and challenged the following highly artificial arrangements:

[14]Center for Inter-American Tax Administration, http://www.ciat.org.

- a cross-border scheme involving millions of dollars in improper deductions and unreported income on tax returns from retirement account withdrawals;
- highly structured financing transactions created by financial institutions that taxpayers used to generate inappropriate foreign tax credit benefits;[15] and
- made-to-order losses on futures and options transactions for individuals in other JITSIC jurisdictions, leading to more than $100 million in evaded taxes.

To date, the IRS has implemented one foreign tax administration practice. As presented earlier, Australia's HNWI program examines sophisticated legal structures that wealthy taxpayers may use to mask aggressive tax strategies. In 2009, the OECD issued a report for a project on the tax compliance problems of wealthy individuals and concluded that "high net worth individuals pose significant challenges to tax administrations" due to their complex business dealings across different business entities, higher tax rates, and higher likelihood of using aggressive tax planning or tax evasion.[16] According to an IRS official, during IRS's participation in 2008 in the OECD Project, IRS staff began to realize the value of Australia's program to the U.S. tax system. The IRS now has a program focused on wealthy individuals and their networks.[17]

Agency Comments

The IRS provided technical comments that are included in this report.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days after the report date. At that time, we will send copies to the Commissioner of Internal Revenue and other interested parties. This report also will be available at no charge on GAO's Web site at http://www.gao.gov.

[15]When JITSIC uncovered transactions used by large corporations to generate inappropriate foreign tax credit benefits, the information was shared among members. The IRS made the generator a compliance concern for large corporations and has been pursuing these cases.

[16]OECD, *Engaging with High Net Worth Individuals on Tax Compliance* (2009).

[17]For more information on IRS's related entities program, see GAO, *IRS Can Improve Efforts to Address Tax Evasion by Networks of Businesses and Related Entities*, GAO-10-968 (Washington, D.C.: Sept. 24, 2010).

If you or your staff has any questions about this report, please contact me at (202) 512-9110 or brostekm@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix IX.

Michael Brostek
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Strategic Issues

Appendix I: Scope and Methodology

For our objective to describe how other countries have approached tax administration issues that are similar to those in the U.S. tax system, we selected six foreign tax administrators. We based our selection of these practices on several factors, including whether the tax administrators had advanced economies and tax systems and the foreign tax administrator's approach differed, at least in part, from how the United States approaches similar issues. These tax systems also needed to have enough information available in English on their Web site for us to preliminarily understand their tax system and practices. In addition, we considered practices of interest to the requesters.

To describe each of the practices, we reviewed documents and held telephone conferences with officials from each tax administrator. We also met with officials of Finland's government in Helsinki. When possible, we confirmed additional information provided to us by officials to assure that we had a reasonable basis for the data presented. We used official reports published by the tax administrators, such as their annual reports, that are made available to the public on their Internet Web site. To identify taxpayers' attitudes toward Hong Kong's semiannual payment system, we interviewed experts who were either university professors, were the authors of publications on Hong Kong's tax system, or were practitioners in well-known law or accounting firms. To understand the development of Finland's Internet-based withholding estimation and prepared returns system, we met with the public interest and trade groups that provided assistance to Finland's Parliament during the system's development.

To describe whether and how the Internal Revenue Service (IRS) identifies and integrates tax administration practices used in other countries, we interviewed IRS officials and reviewed related documents. We also followed up with IRS officials based on any information we found independently about practices that relate to issues in the U.S. tax system and our comparison of U.S. and other administrator's practices. The descriptive information on the practices of foreign administrators presented in this report may provide useful insights for Congress and others on alternatives to current U.S. tax policies and practices. However, our work did not include the separate analytic step of identifying and

assessing the factors that might affect the transferability of the practices to the United States.[1]

To adjust foreign currencies to U.S. dollars, we used the Federal Reserve Board's database on foreign exchange rates. We used rates that matched the time period cited for the foreign amount. For current amounts, we used the exchange rates published for February 25, 2011. If the amounts were for a previous year, we used the exchange rate published for the last business day of that year. For example, if foreign amounts were cited as of 2006, we used exchange rates for December 29, 2006. We did not adjust amounts from previous years for inflation.

To help ensure the accuracy of the information we present, we shared a summary of our descriptions with representatives of the six foreign tax administrators and incorporated their comments as appropriate. The IRS provided technical comments that are included in this report.

We conducted our work from October 2009 to May 2011 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions in this report.

[1]For more information about factors that limit the comparability of tax administration systems, see Organisation for Economic Co-operation and Development (OECD), *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series* (2008).

Appendix II: New Zealand Does Integrated Evaluations of Tax Expenditures and Discretionary Spending Programs

Overview of the New Zealand Tax System

The New Zealand tax system is centralized through the Inland Revenue Department (IRD). Most of New Zealand's NZ$49 billion (US$35.5 billion) in revenue for fiscal year 2009 was raised by direct taxation that includes PAYE (Pay As You Earn), Company Tax, and Schedular Payments.[1] In addition, tax expenditures (tax credits in New Zealand) for social programs that were administered by IRD in 2009 include KiwiSaver and Working For Families (WFF) Tax Credits programs.[2]

What Is New Zealand's Working For Families Tax Credits Program?

The WFF Tax Credits program, started in 2004, seeks to assist low- to middle-income families with the goal of promoting employment and ensuring income adequacy. Prior to 2004, New Zealand had another program intended to assist families. However, the New Zealand government discovered that many low-income families were no better off from holding a low-paying job and that those who needed to pay for childcare to work generally were worse off in low-paid work compared to only receiving government benefits. This prompted the government to change in-work incentives and financial support for families with dependent children. These changes were incorporated into the WFF program in 2004. It was estimated that program costs would increase by NZ$1.6 billion (US$1.2 billion) per year.

The WFF Tax Credits program is an umbrella program that spans certain tax credits[3] administered by the IRD as well as discretionary spending programs[4] administered by the Ministry of Social Development (MSD).

[1]PAYE is an amount an employer deducts from an employee's salary and wages to satisfy income tax and other obligations. Company Tax is income taxed at the company rate. Schedular Payments are paid by self-employed contractors and companies often in the agricultural, horticultural, and viticulture industries. The business or person paying the contractor is required to deduct a pre-determined percentage of income and remit this to IRD.

[2]KiwiSaver is a voluntary, work-based retirement savings initiative.

[3]The Family tax credit provides payments to families with dependent children age 18 or younger earning less than specified minimum income levels and varying depending on the number of children. The In-work tax credit provides payments for parents based on the number of hours of weekly paid employment. The Minimum family tax credit provides payments to parents with dependent children based on the number of hours of weekly paid employment. The Parental tax credit provides payments for a newborn baby for the first 8 weeks and is an alternative to Paid Parental Leave, which is administered on behalf of the Department of Labour.

[4]Accommodation supplements assist families with rent, board, or costs of owning a home. Childcare subsidies assist families with childcare costs for children under 14. Temporary additional support is a weekly payment to help families meet essential living costs.

Table 2 shows the tax and discretionary spending components of the WFF tax credits program and the agency responsible for them.

Table 2: Joint Administration of New Zealand's WFF Tax Credits Program

	Administered by:	
Expenditures/outlays	**IRD**	**MSD**
Family tax credit	X	X
In-work tax credit	X	
Minimum family tax credit	X	
Parental tax credit	X	
Accommodation supplements		X
Childcare subsidies		X
Temporary additional support		X

Source: GAO analysis of New Zealand data.

Under the program IRD makes payments to the majority of eligible recipients during the tax year.[5] The IRD and MSD portions of the WFF tax credit program are intended to work together to assist low- to middle-income families and promote employment.

Information that IRD collects and uses in administering the tax credits is subject to New Zealand's protections for the privacy of sensitive taxpayer information contained in the Tax Administration Act. The information that MSD collects and uses is not subject to the same restrictions. To meet their separate needs, IRD and MSD keep separate datasets.

[5]Generally, IRD makes WFF tax credit payments (weekly, biweekly or annually). MSD may make the Family tax credit payment instead of IRD, such as when recipients are receiving welfare benefits. MSD makes its WFF tax credit payments mainly through the benefit system.

Why New Zealand Used Joint Research to Evaluate WFF Direct Benefit Payments and Tax Expenditures

New Zealand's joint research projects integrated research between IRD and other governmental agencies with related programs. The projects were designed to ensure that all disbursements of revenue through either direct program outlays or tax expenditures were administered effectively to meet the goals for social programs, making sure people get the assistance to which they are entitled.

One example of joint research was the study of the WFF tax credits program. To overcome the problem of the separate datasets and still protect sensitive tax data, the New Zealand government approved a joint research program that created interagency linked datasets between IRD and MSD. Parliament intended that these linked datasets be used to evaluate the tax expenditures and discretionary spending programs, to ensure that the benefits of the overall program were being fully used by its participants.

These linked datasets, known as the "WFF Research Datasets," were constructed from the combined records of the MSD and IRD. They contained several years of data, and included information about all families who had received a WFF payment during these years. The data included monthly amounts of income received from salary and wages from employment and from the main benefit payments. The linked dataset information was to be used solely to analyze the results of WFF. It could not be used to take any action, whether adverse or favorable, against a particular individual.

In 2004, MSD and IRD developed a Memorandum of Understanding (MOU) for the WFF program. The MOU included processes to share information while ensuring that all sensitive data were protected from unauthorized disclosure. The MOU permitted IRD to provide MSD with aggregate taxpayer information needed to conduct evaluations with a restriction that only allows IRD employees direct access to sensitive taxpayer information. However, IRD was authorized to distribute sensitive taxpayer information to authorized MSD employees if they were part of the joint research team and were sworn in as IRD employees. Swearing in MSD agents as IRD agents permitted IRD to apply the same sanctions to IRD and MSD agents who did not adhere to IRD's data-protection policies.

What Are the Known Results and Effects of the Joint Research Project?

The WFF joint research revealed social and cultural barriers that prevented targeted participants from taking full advantage of the WFF program. These barriers included the

- perceived stigma from receiving government aid if the person could work or felt that the aid infringed on independence or self-sufficiency;
- transaction costs from accepting government aid such as taking time off from work, arranging childcare, or following many rules and regulations;
- low value of applying for the program when the person was close to the maximum eligibility threshold; and
- geographic barriers when the person lived in areas that were remote or had no transportation, telephone, or Internet.

The WFF joint research provided information needed to identify the population that benefited from the program and reduce some of the barriers that kept recipients, particularly an indigenous population, from participating in the target program. Since the inception of the WFF program in 2004, the joint research documented the following benefits from reducing barriers to the targeted population:

- The percentage of single parents working 20 hours or more increased from 48 percent in June 2004 to 58 percent in June 2007. This represents 8,100 additional single parents in the workforce.
- The number of single parents receiving benefits from MSD fell by 12 percent from March 2004 to March 2008. Those that received the benefits did so for a shorter time and stayed off the benefit programs longer.

Similarities to and Differences from the U.S. Tax System

While structural differences exist between the New Zealand and U.S. tax systems, both systems use tax expenditures (i.e., tax credits in New Zealand). Unlike the United States, New Zealand has developed a method to evaluate the effectiveness of tax expenditures and discretionary spending programs through joint research that created interagency linked datasets. New Zealand did so while protecting confidential tax data from unauthorized disclosure.

In 2005, we reported that the United States had substantial tax expenditures but lacked clarity on the roles of the Office of Management and Budget (OMB), Department of the Treasury, IRS, and federal agencies with discretionary spending programs to evaluate the tax expenditures.[6]

[6]GAO, *Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue*, GAO-11-318SP (Washington, D.C.: Mar. 1, 2011).

Consequently, the United States lacked information on how effective tax expenditures were in achieving their intended objectives, how cost-effectively benefits were achieved, and whether tax expenditures or discretionary spending programs worked well together to accomplish federal objectives.[7] At that time, OMB disagreed with our recommendations to incorporate tax expenditures into federal performance management and budget review processes, citing methodological and conceptual issues. However, in its fiscal year 2012 budget guidance, OMB instructed agencies, where appropriate, to analyze how to better integrate tax and spending policies that have similar objectives and goals.[8]

[7]GAO, *Government Performance And Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined*, GAO-05-690 (Washington, D.C.: Sept. 23, 2005).

[8]A similar approach is now required under the recently enacted GPRA Modernization Act of 2010, Pub. L. No. 111-352, 124 Stat. 3866 (2011). The act requires OMB, in coordination with agencies, to develop federal government priority goals including a limited number of crosscutting goals, and assess the contributions made toward those goals by various agencies and federal activities—including spending programs and tax expenditures.

Appendix III: Finland Uses the Internet to Calculate Individual Tax Withholding Rates and Revise Preprepared Tax Returns

Overview of the Finland Tax System

Finland's national and municipal governments as well as local church councils levy taxes. Nationally, 39 percent of all taxes are paid under individual and corporate income taxes and a capital gains tax. Taxes on goods, services, and property total about 33 percent of revenue; most of this revenue is from the Value Added Tax (VAT). The final 28 percent comes from social security taxes (e.g., national health insurance system and employment pension insurance). Finland's individual income tax is levied on a graduated rate schedule with four tax brackets, ranging from 7.0 percent to 30.5 percent for incomes over €64,500 (US$92,441) with the tax on investment income levied at a flat rate of 28 percent in 2009. Finland's corporate income tax is levied at a flat rate of 26 percent.

Under the municipal tax, each municipal council sets its tax rate annually. For 2009, municipal taxes are levied at flat rates ranging from 16.5 percent to 21.0 percent of earned income and averaging 18.6 percent. Individuals who are members of the Evangelical-Lutheran Church or the Orthodox Church pay a church tax. For 2009, local church communities determine the rate of tax, which is levied at a flat rate between 1 and 2 percent.

How Do Withholding Estimation and Preprepared Returns Improve Service?

Using electronic means, Finland helps taxpayers in estimating their tax withholding and by preparing an income tax return for each individual taxpayer based on third-party information returns. The on-line Tax Card system, established in 2006, is an Internet-based system to help Finnish taxpayers estimate the withholding rate for individual income tax. The Tax Card covers national taxes, municipality tax, social security tax, and church tax. Taxpayers access the Tax Card through the Web sites of their bank or the Finland Tax Administration.

Using the Tax Card system, taxpayers can update their withholding rate as many times as needed throughout the year to adjust for events that increase or decrease their potential tax liability. For example, if the taxpayer takes a job with a higher salary, the taxpayer can estimate the change on his or her income tax liability by using the Tax Card system. Taxpayers enter information provided by the employer, based on payroll information, to estimate their adjusted withholding. Annually, 1.6 million taxpayers, about a third of those using the Tax Card, change their tax withholding rate.

When the Tax Card has been completed, employees provide the withholding tax rate to their employer through regular mail or in person. If the employer is not notified of any withholding rate, the employer must withhold at the top marginal rate in Finland for all types of taxes—which

is 60 percent of gross pay. Employers manually enter the withholding rate into their payroll systems.

According to Tax Administration officials, some social benefits can complicate the estimation of the tax due and may not be accurately estimated during the tax year. For example, Finland has a deduction for the cost of travel between a residence and work. If the taxpayer does not accurately estimate the deductions or make changes as the year progresses, the Tax Card withholding rate will be inaccurate.

Finland Tax Administration Prepares Returns for Taxpayers

Finland has been operating a tax-return preparation system since 2006. The Finnish Tax Administration prepares an income tax return for each individual taxpayer based on third-party information returns. According to Tax Administration officials, Finland uses information from over 30 types of information-return filers (e.g., employers, banks, and securities brokers). Tax Administration officials said that they have found very little misreporting on the information returns used to prepare the tax returns. They use many ways to try to verify the information. Some taxpayers will correct information returns when reviewing their prepared tax returns. Third parties can be penalized for inaccurate information and Finnish tax officials said those penalties are regularly assessed.

The system prepares the return each tax year, which ends on December 31. According to Tax Administration officials, the individual tax returns are mailed for review during April. The taxpayer has until May to make changes to the paper return.[1] Taxpayers can mark up the paper return for revisions and mail it to the Tax Administration whose staff keys in or electronically scans in the changes. Also, taxpayers can choose to make the changes to the return online, using the taxpayer's account with the Tax Administration.

According to Tax Administration officials, typically about 3.5 million people do not ask to change their tax return and about 1.5 million request a tax change. About 400,000 taxpayers will revise their return using the Tax Administration's Internet portal. Typically, the average taxpayer takes about half an hour to do the adjustments online. One deduction, the

[1]All returns are final at October 31. The taxpayer must appeal before the end of the 5th year following the assessment year.

commuting adjustment, is not reported on an information return. This adjustment accounts for changes to about 800,000 prepared returns.

Overall, taxpayers need to show some proof to support the change to the prepared return, including any changes they make to the information returns the Tax Administration used to prepare the returns. For example, taxpayers showing deductions for mortgage interest that were not reported on information returns would need to show they own a house and the mortgage interest was paid. Or, if an information return reports interest as income, but taxpayers deduct the interest as paid on a loan, the taxpayers need to document the reason for their deduction claims.

Finland does not prepare tax returns if individual taxpayers have business income. Rather, these taxpayers must file tax returns based on the data or business records that they maintained. However, some of these taxpayers with business income may get a partially prepared return on personal income and deductions based on third party information on their wages and other personal income in Finland's prepared return system. All businesses operating in Finland must register with the government.[2]

Why Did Finland Increase Its Use of Electronic Tax Administration?

Providing enhanced electronic services has been widely recognized in Finland as an approach for improving taxpayer service while reducing costs. Electronic services provide taxpayers with constant access to assistance regardless of the time of day or distance from the tax administration office. According to Tax Administration officials, electronic systems that provide routine taxpayer assistance allows Tax Administration staff to respond to more complex taxpayer problems.

Finland also moved to electronic tax administration to support national policies. As a national policy to encourage economic growth, Finland seeks to have a large private-sector workforce. According to an official of the Finland's government, a large number of citizens are nearing retirement.[3] Thus, the government is seeking to reduce its workforce so that more workers are available for the private sector. To achieve this

[2]Finland has about 500,000 businesses, of which about half were solely owned by individual taxpayers as of 2010.

[3]Based on 2011 estimates, the population median age in Finland is 42.5 years as compared to the U.S. median age of 36.9 years.

goal, Finland focused on making the delivery of government programs more efficient by using more electronic transactions.

Another reason for electronic tax administration was to provide equal access to government services. Finnish law requires all e-services to be accessible to all Finnish citizens. With a significant segment of its population living in remote regions, according to officials, improving e-government provides more equal access to government services. To encourage equal access and use of the Internet for delivering services, Finland established standard speeds of Internet access in July 2009.[4]

What Are the Known Results and Effects of Electronic Tax Administration?

Finland's tax system is viewed positively by taxpayers and industry groups. Members of several industry and taxpayer groups told us that Finland has a simple, stable tax system, which makes compliance relatively easy. They also commented that the Tax Card and preprepared annual return system work well and are easy to use. As a result, few individuals use a tax advisor to help prepare and file the annual income tax return. We were told that individuals using a tax advisor have complex tax issues, such as from owning a businesses or having complex investments.

Electronic tax administration has advantages for the government and Finnish taxpayers. According to tax officials, cost savings result from spending less time to prepare and process tax returns. These officials said that electronic tax administration has helped to reduce their full-time-equivalent positions over 11 percent from 2003 to 2009. Further, the tax withholding system results in a small amount of individual income tax withheld that needs to be refunded after final returns are filed. For tax year 2007, 8 percent of the tax withheld was refunded to taxpayers as compared to 26 percent refunded in the United States.

Finland's culture of cooperation and the resulting cooperative arrangements between government, banks, businesses, and taxpayers have led to acceptance of the new Tax Card Online service. According to public interest and trade groups in Finland, the Finnish society has a great deal of confidence in the banking system and its secure access. This confidence

[4]A Decree of the Ministry of Transport and Communications specifies the minimum rate of functional Internet access as a universal service and requires a functional rate for downstream traffic as 1 megabit per second.

influenced the decision to place the Tax Card online service on bank Web sites. With taxpayers having regular access to a banking Web site,[5] the banks offer a channel for delivering government services, according to government officials. Public interest and trade groups agreed, noting that the banking industry's willingness to support the Tax Card enhanced its development. Representatives of a Finnish banking trade group said that placing the Tax Card system on their Web sites helped banks. That is, the more time customers spend on banks' Web sites, the more opportunities the banks had to offer other services, helping to offset the cost of implementing the system.

According to Finnish trade and public interest groups, Finland's cooperative culture also supports the preprepared individual income tax return system. For this system to work properly, business and other organizations must file accurate information returns within 1 month after the end of the tax year. This short period for filing information returns creates some burden. The burden includes costs to purchase and install special software for collecting the information as well as preparing and filing the returns. According to a professional accounting organization in Finland, buying the yearly software updates can be expensive. Any update has to be available well before the start of the tax year so that transactions can be correctly recorded at the start of the year and not revised at the end of the year.

What Are the Similarities to and Differences from the U.S. System?

In contrast to Finland's self-described "simple" system, the U.S. tax system is complex and changing annually. Regarding withholding estimation, Finland's Tax Card system provides taxpayers an online return system for regularly updating the tax amount withheld. For employees in the United States, the IRS's Web site offers a withholding calculator to help employees determine whether to contact their employer about revising their tax withholding. Finland's system prepares a notice to the employer that can be sent through the mail or delivered in person, whereas in the United States the taxpayers must file a form with the employer on the amount to be withheld based on the taxpayers' estimation.

In the United States, individual income tax returns are completed by taxpayers—not IRS—using information returns mailed to their homes and

[5]About three-quarters of Finnish citizens use an Internet bank.

their own records.[6] Taxpayers are to file an accurate income tax return by its due date. Unlike in Finland, U.S. individual taxpayers heavily rely on tax advisors and tax software to prepare their annual return. In the United States, about 90 percent of individual income tax returns are prepared by paid preparers or by the taxpayer using commercial software.

[6]If the taxpayer fails to file a return and enough information returns reporting income have been filed, the IRS can create a return, based on that information, and mails it to the taxpayer for acceptance or adjustment. IRS prepares these returns under a compliance program and the taxpayer may be assessed penalties.

Appendix IV: EU's Multilateral Treaty Information Exchange on Interest Payments to Member Nations' Citizens

Overview of the EU Directive

In June 2003, the European Union (EU) adopted the Savings Taxation Directive to encourage tax compliance by exchanging information and in some cases using withholding. The directive is a multilateral agreement that establishes uniform procedures and definitions for exchanging information and facilitating the resolution of common technical problems. Under the directive, the 27 EU members[1] and 10 dependent and associated territories agreed to participate in the directive.[2] With this information, tax authorities in the citizen's nation are able to verify whether the citizen properly reported and paid tax on the interest income. Each of the 27 member nations has a separate tax system, and varies in the tax rates imposed on personal income, as shown in table 3.

Table 3: Range of Highest Personal Income Tax Rate for EU Countries, 2010

Highest personal income tax rate	Number of EU countries
50 percent or greater	6
40 percent or greater and less than 50 percent	10
30 percent or greater and less than 40 percent	4
20 percent or greater and less than 30 percent	2
10 percent or greater and less than 20 percent	5

Source: GAO analysis of EU data.

The highest personal income tax rates range from 10 percent in Bulgaria to over 56 percent in Sweden. This range of tax rates is an important reason for the need for the exchange of information on income. Residents in higher-tax countries could be motivated to move capital outside of the country of residence to potentially avoid reporting income earned on investments of the capital.

[1]EU members include Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.

[2]In addition to EU members, certain dependent and associated territories of member countries have agreed to participate with the directive. These territories include the Cayman Islands, Anguilla, Turks and Caicos Islands, Montserrat, Aruba, Jersey, Guernsey, the Isle of Man, the British Virgin Islands, and the Netherlands Antilles. Four of the territories (Anguilla, Aruba, Cayman Islands, and Montserrat) have agreed to information exchange. As of October 2010, the Netherlands Antilles became an independent nation.

How Does the EU Savings Taxation Directive Strive to Encourage Tax Compliance?

The directive provided a basic framework for information exchanges, defining essential terms such as beneficial owner of the asset paying interest, identity and residence of the owner, paying agents,[3] interest payments, and information to be reported, and establishing automatic information exchange among members. The directive also states that five other nonmember nations agreed to information exchange upon request for information defined under the Savings Taxation Directive.[4]

During a transition period from 2005 through 2011, Belgium, Luxembourg, and Austria as well as the five nonmember nations, and six associated territories, agreed to a withholding tax.[5] Under these agreements, a withholding tax was to be remitted at the rate of 15 percent during the first 3 years, 20 percent for the next 3 years, and 35 percent thereafter. The directive authorizes the withholding nations to retain 25 percent of the tax collected and transfer 75 percent of the revenue to the account owner's home nation. The withholding nations may develop procedures so that the owners can request that no tax be withheld. These procedures generally require that the owner provide identification information to the paying agent or to the account owner's home nation.

The directive also requires the account owner's home nation to ensure that the withholding does not result in double taxation. The home nation is to grant a tax credit equal to the amount of tax paid to the nation in which the account is located. If the tax paid exceeds the amount due to the home nation, the home nation is to refund to the account owner the excess amount that was withheld.

The role of the EU Commission is to coordinate among the participants in the directive. The commission sets up and maintains contact points for communications among members. All information to be exchanged must be submitted no later than June 13 each year to the commission and follow

[3]Paying agents are defined as intermediaries responsible for paying interest income received from debtors to owners of the debt. For example, a bank can be considered a paying agent.

[4]These nations are the Swiss Confederation, the Principality of Liechtenstein, the Republic of San Marino, the Principality of Monaco, and the Principality of Andorra. The information upon request exchange generally requires a more detailed justification for the information needed by the requesting tax authority.

[5]Six dependent and associated territories (Turks and Caicos Islands, Jersey, Guernsey, the Isle of Man, the British Virgin Islands, and the Netherlands Antilles) have agreed to the withholding provisions.

the standardized Organisation for Economic Co-operation and Development (OECD) format. The information exchange is completely electronic and automatic. All information is sent and received through a secure network that only member countries can access. As of 2010, all member countries are using this standard format except for Switzerland which is working with the EU on plans for information exchange. The commission is to keep the format updated and periodically review compliance by member countries.

The commission is to gather statistics to measure overall performance and success of the directive. Member countries have agreed to provide the commission with the statistics necessary to gauge performance. Every 2 years the commission hosts a conference to receive feedback from member nations on its performance and to gauge the directive's success. Additionally, every 3 years the commission reports to the European Parliament and Commission of the European Communities. The first report on the operation of the directive was issued in September 2008.[6]

Why Does the EU Use the Multilateral Treaty Information Exchange?

The EU adopted the Savings Taxation Directive to encourage tax compliance by exchanging information and using withholding. Using a multilateral agreement provided a way to uniformly establish procedures and definitions for exchanging information as well as for resolving any common technical problems to information exchange across the entire EU.

What Are the Known Results and Effects of the Information Exchange on Savings?

The September 2008 report to the EU described the status of the directive. The report found that 25 members started applying the rules as required in July 2005. In 2006, the first full year in which data were available, 17 members provided information to the exchange. Bulgaria and Romania began implementation in January 2007. The report concluded that the largest economies and financial centers reported the highest amounts of interest paid to other EU citizens. For 2006, Germany, France, Ireland, and the Netherlands accounted for over 98 percent of the dollar value of interest paid by all EU nations to citizens of other EU countries.[7]

[6]See Commission of the European Communities, Commission Staff Working Document, *Presenting an economic evaluation of the effects of the Council Directive 2003/48/EC on the basis of the available data*; SEC(2008) 2420 (Brussels: Sept. 15, 2008).

[7]The United Kingdom reported information from July 1, 2005, to April 5, 2006.

The report concluded that data limitations created major difficulties for evaluating the effectiveness of the directive. The EU did not have information on withholding results or time-series information from before the directive began. Without this information, the EU had no benchmark to measure the effect of the changes.

According to EU officials, the most common administrative difficulties have been information-technology system problems. Some members have not had the data formatted correctly, which caused problems when other member nations tried to access the data. For example, how member countries format their mailing address has led to data access problems. To overcome this problem, most member countries insert the taxpayer's mailing address in the free text field, but this makes the data difficult to efficiently analyze by other nations. Another example has been accessing data from languages that have special diacritical marks or characters. When information exchanged included these special characters, an error was created during the data importation process. The directive has suffered from other implementation problems, as follows.

Investor behavior. EU staff said the commission tried to measure changes in the different types of investments before and after implementation of the directive. The commission had difficulty in identifying the overall effect the directive has had on individual investment choices because the data used are generally limited to interest-bearing investments. On the basis of decreases in some investor's total interest savings, the report noted that investors appeared to change their investments before implementation to investments that were not covered by the directive.

Withholding. The effectiveness of the withholding system under the Saving Tax Directive is unclear. The report found that the 14 countries and dependent and associated territories applying the withholding provisions in 2006 shared €559.12 million (US$738 million) withheld on income earned in their nation with the account owner's home nation.[8] Some articles have commented that given the low withholding rates in the early years, taxpayers with higher tax rates in their home nation may have chosen not to report the income.

[8]The amount corresponds with 75 percent of the total withholding tax or about €745.47 million (about US$984 million). The British Virgin Islands and the Netherlands Antilles did not share withholding.

Definitions. The EU identified problems with the definition of terms, making uniform application of the directive difficult. First, the commission's report raised questions about consistency of coverage of payments made from life insurance contracts where investments were made in securities or funds. Second, confusion existed over whether some paying agents were covered by EU rules on investment managers or by the definition established under the directive for noncovered paying agents.[9] Third, identifying the account owners was another problem.

In general, the EU report suggests that improved monitoring and follow-up by the home nation can help locate paying agents in third counties and ensure accurate information on the citizen who owns the account. The EU is considering several solutions such as enforcing existing customer due diligence rules that are to be used by domestic paying agents, who would transmit interest payments to the owners. These rules require that the paying agents must know who they are paying and should not facilitate transactions to mask the owner(s) and avoid taxes or other legal requirements.

Nevertheless, EU officials stated that the quality of data has improved over the years. The EU officials have worked with EU member nations to resolve specific data issues, which has contributed to the effective use of the information exchanged under the directive.

What Are the Similarities to and Differences from the U.S. System for Sharing Tax Information?

Generally, unlike the EU multilateral directive, the United States establishes bilateral information-sharing agreements. Those agreements allow for automatic information exchange, but definitions of terms, technical standards, and other matters are not worked out and adopted multilaterally. Resolution of some of those issues may be facilitated by the United States' participation in the Convention on Multilateral Administrative Assistance in Tax Matters, which includes exchange of information agreement provisions and has been ratified by 15 nations and the United States.[10]

[9]An example would be Liechtenstein foundations where payments made are covered by the directive, but in practice the payments rarely were reported as interest payments.

[10]The convention is in force among Azerbaijan, Belgium, Denmark, Finland, France, Iceland, Italy, the Netherlands, Norway, Poland, Slovenia, Spain, Sweden, Ukraine, and the United Kingdom.

Appendix V: The UK Uses Information Reporting and Withholding So Most Wage Earners Do Not Need to File a Tax Return

Overview of the UK Tax System

The United Kingdom's (UK) main sources of tax revenue are income tax, national insurance contributions, value added tax, and corporate tax. Her Majesty's Revenue and Customs (HMRC) also administers taxes assessed for capital gains, inheritance, various stamp duties, insurance premium tax, petroleum revenue, and excise duties.[1] The income tax system—where the tax year runs from April 6 through April 5 —taxes individuals on their income from various sources, for example, employment earnings, self-employment earnings, and property income.

Taxable individuals under 65 years of age receive a tax-free personal allowance (£6,475, or US$10,410 for the 2010-11 tax year).[2] If their total income is below the allowance amount, no tax is payable. The three main individual income tax rates for income above the personal allowance are 20 percent (£0-£37,400 or up to US$60,132), 40 percent (£37,401-£150,000 or up to US$241,170), and 50 percent (over £150,000 or over US$241,170).[3] HMRC uses 3 payment systems to collect income tax from individual taxpayers, depending on the type of income and whether the individual is employed, self-employed, or retired.[4]

- Pay As You Earn (PAYE) is used to withhold tax on wages and salaries paid to individuals by employers. Employers are required to notify HMRC every time an employee starts or stops working for them. Then, HMRC determines a tax withholding code for each individual and employers use the tax codes, in conjunction with tax tables, to calculate the amount of tax to be deducted.
- Self-assessment tax returns are used by some employees with higher rates of income or complicated tax affairs and by self-employed individuals with different kinds of business income.
- At-source collection is when the tax, such as on interest and dividend income, is withheld at source when the income is paid. For example, tax is deducted from bank interest as it is credited to an individual.

[1]Excise duties are levied on items such as alcohol products, tobacco products, and mineral oils.

[2]After April 2011, the personal allowance will be reduced for those with income above £100,000 (US$160,780).

[3]The UK has additional tax rates for interest savings and dividend income. The rates for both savings and dividend income start at 10 percent, and higher rates may apply depending on the amount of the related income.

[4]Retired individuals receiving a pension will pay income tax through the Pay As You Earn (PAYE) or self-assessment systems.

According to HMRC officials, the majority (68 percent) of taxpayers pay their tax solely through the PAYE system without having to submit a return to HMRC. Other actions have helped remove a large number of taxpayers from submitting a return. For example, the UK requires that tax on some income paid to individuals (such as bank interest) be withheld at a 20 percent rate and remitted to HMRC by the payer, and capital gains income up to the first £10,100 (US$16,239) is exempted from tax.

The UK also is working towards burden reduction for the average taxpayer by simplifying the tax return. For example, according to HMRC officials, information that is not necessary has been removed from the return to reduce the return filing burden, and those taxpayers who are required to file a return find it straight-forward.

How Do Information Reporting and Withholding Facilitate Tax Reporting and Risk Assessment?

HMRC uses data from information reporting and withholding under the PAYE system to simplify the reporting of tax liability on income tax returns for individuals. PAYE adjusts income tax withheld so that the individual's tax liability is generally met by the end of the tax year.

Information reporting helps HMRC and the individual taxpayer determine the total income tax liability, according to HMRC officials. Information returns are to report tax-related transactions by the taxpayer. They are to be supplied by banks and local governments to the taxpayer and HMRC at the end of the tax year. For example, banks are to provide interest payment information. Over 400 local government organizations are to report information on payments made to small businesses. Local government as both an employer and contractor must report information on payments made to others.

The information provided by employers enables HMRC to update the employee's tax record and issue a tax code to the new employer to start the withholding against employee earnings. HMRC calculates the PAYE code using information about the previous year's income or other employment in the current tax year.[5] Employers are to match the PAYE code to a tax table, which shows how much tax to withhold each pay period. The employer has to remit the withheld tax to HMRC on a monthly or quarterly basis to fulfill the taxpayer's tax liability. HMRC annually

[5]The employees can also ask HMRC to include other income such as some self-employment, rental, or savings income in determining their PAYE code.

reviews taxpayer records and issues updated PAYE codes before the start of the tax year for employers to operate at the start of the tax year. The individual will receive a notice showing how the tax code has been calculated. To maintain taxpayer confidentiality, the employer will only receive the tax code itself.

HMRC can refund income tax overpayments or collect underpayments for previous tax years through adjustments to the PAYE code. HMRC reported in 2010 that around 5 million individuals overpaid or underpaid these taxes. HMRC officials said that they use information returns to help determine these adjustments under PAYE.[6] In lieu of having their PAYE codes adjusted, taxpayers may receive a onetime refund of the overpayment or pay the underpaid amount in one lump sum. Taxes owed usually are collected through code adjustments as long as the taxpayer stays within the PAYE system.

HMRC also uses information reporting and withholding to assess the compliance risks on filed returns. In assessing compliance risks, HMRC is attempting to identify underpaid and overpaid tax. The majority of the information for risk assessment is collected centrally from information returns, tax withholdings, filed tax returns, and public sources. This information is mined for risks by special risk-assessment teams. According to HMRC officials, the outcomes of such mining are to be used to verify tax compliance. If low compliance is found, risk specialists are to develop programs to increase compliance.

The data mining uses electronic warehouse "Data Marts" that HMRC has had for about 10 years.[7] They have been configured with subsets of data and have been supplemented by sophisticated analysis tools for doing risk assessments. For example, an analyst can create reports to assess the risk for all self-assessment income tax returns where the legal expense is above a specified amount. HMRC officials told us that Data Marts had recently been revamped and a strategic capability was added that links related information such as a business that files a corporate tax return for

[6]HMRC officials said that only HMRC can adjust PAYE codes because only HMRC knows a taxpayer's total income. A taxpayer can provide HMRC with additional information that can be used to adjust the PAYE code.

[7]Data mining is a technique for extracting knowledge from large volumes of data. See GAO, *Data Mining: Federal Efforts Cover a Wide Range of Uses*, GAO-04-548 (Washington, D.C.: May 4, 2004).

its business profits, pays value added tax, and has directors who submit self-assessment returns.

According to HMRC officials, the use of Data Marts combined with their more recent Strategic Risking Capability has allowed them to assess risks at the national and regional levels. HMRC officials said that they have moved towards national risk assessments because risk has not proven to be geographically based at regional levels. HMRC officials noted that while a return is being assessed for one type of risk, another type of risk can be found. HMRC is attempting to uncover emerging compliance risks by combining and reviewing data from the various sources in the Data Marts and elsewhere.

The risk assessment process has two steps, resulting in identifying tax returns for examination. The first step is to identify tax returns that have an inherent risk because of the taxpayers' size, complexity of the tax return, and past tendency for noncompliance. For example, returns filed by high-wealth individuals are viewed as risky returns that are sent to a related specialty office. The second step assesses risk on returns that are not sent to a specialty office. HMRC officials said that a relatively large proportion of the risk-assessment effort focuses on the self-employed, who are seen as having the greatest risk for tax noncompliance since they usually are not under the PAYE system (unless they have some wage income) and instead are to file a self-assessment return. HMRC has separate risk-assessment approaches, depending on the type of individual taxpayer, as discussed below.

- For individuals under the PAYE system, HMRC's computers capture most of the necessary data and the system carries out routine checks to verify data and link it to the taxpayer record. A risk to the PAYE system arises when employees receive benefits from their employers that are not provided to HMRC at the time it determines the annual tax code. Employer benefits may include a car, health insurance, or professional association fees that employers report on information returns after the tax year and that may be subject to income tax. If these benefits received are not included in the tax code then an underpayment of tax is likely to arise. The unpaid tax can be recovered by an annual reconciliation or when the employee reports the benefits on the employee's self-assessment tax return.
- Individuals not under the PAYE system are required to file a self-assessment tax return. To assess risk, HMRC checks some self-assessment tax returns for consistency by comparing them to returns from previous years, focusing on small businesses. For example, if the legal expense

jumped from £5,000 to £100,000 (US$8,039 to US$160,780) over 2 years, HMRC may decide to review the reason. HMRC permits any self-employed small business with gross receipts of less than £68,000 (US$109,330) to file a simple three-line tax return to report business income, expenses, and profit. HMRC officials said that the threshold allows over 85 percent of all self-employed businesses to file simplified returns with less burden.

Why Did the UK Use Information Reporting and Withholding for Tax Reporting and Risk Assessment?

According to HMRC officials, their policy is to collect as much data as possible up front through information returns, and correct the amounts of tax due with the PAYE system, facilitating the payment of tax liabilities. Since information is shared with HMRC, taxpayers are likely to voluntarily comply if they have to file a tax return. Further, data from information reporting and withholding are to help simplify or eliminate tax reporting at the end of a tax year. According to HMRC officials, the PAYE system makes it unnecessary for most wage earners to file an annual self-assessment tax return.

HMRC conducts risk assessments because staff cannot check every tax return in depth due to the large number of taxpayers and the need to lower the costs of administering the tax system. Data from information reporting and withholding provide consistent sources for doing risk assessments.

What Are the Known Results and Effects from Using Information Reporting and Withholding to Facilitate Tax Reporting and Risk Assessment?

HMRC officials said the income tax system has been simplified because most individual taxpayers fall under the PAYE system, which generally relieves them of the burden of filing a tax return. Even so, some implementation problems have occurred. The House of Commons identified problems with an upgrade to the PAYE information system in 2009-10.[8] The upgrade was to combine information on individuals' employment and pension income into a single record to support more accurate tax withholding codes and reduce the likelihood of over- and underpayments of tax. However, software problems delayed processing 2008-09 PAYE returns for a year. In addition, data-quality problems from the upgraded PAYE system for 2010-11 generated about 13 million more annual tax coding notices than HMRC had anticipated and some were incorrect or duplicates. With these problems, of the 45 million PAYE records to be reconciled, 10 million cases needed to be reconciled manually.

[8]House of Commons Committee of Public Accounts, *HM Revenue and Customs' 2009-10 Accounts* (January 2011).

The House of Commons reported a backlog of cases before the PAYE system was upgraded. Limitations of the previous PAYE system and increasingly complex working patterns have made it difficult to reconcile discrepancies without manual intervention. As of March 2010, a backlog of PAYE cases affected an estimated 15 million taxpayers from 2007-08 and earlier; the backlog included an estimated £1.4 billion (US$2.25 billion) of tax underpaid and £3 billion (US$4.82 billion) of tax overpaid.

HMRC has reported that risk assessment has provided three benefits: (1) improved examination decisions to ensure that they are necessary and reduce the burden on compliant taxpayers; (2) tailored examinations to the risk in question; and (3) deterred taxpayers from concealing income. HMRC's risk-assessment approach has increasingly focused on providing help and support to individuals and smaller businesses to voluntarily comply up front. To minimize the need for examinations, HMRC aims to help larger businesses achieve greater and earlier certainty on their tax liabilities. HMRC's sharper focus on risk assessment means that businesses with reliable track records of managing their own tax risks and being open in their dealings with HMRC benefit from fewer HMRC examinations while those with the highest risks can expect a more robust challenge from dedicated teams of specialists.

What Are the Similarities to and Differences from the U.S. System?

The UK and United States both have individual income tax returns and use information reporting and tax withholding to help ensure the correct tax is reported and paid. However, differences exist between the countries' systems.

- The United States has six tax rates that differ among five filing statuses for individuals (i.e., single, married, married filing separately, surviving spouse, or head of household) and covering all types of taxable income. In general, the UK system has three tax rates, one tax status (individuals), and a different tax return depending on the taxable income (e.g., self-employed or employed individuals).
- U.S. income tax withholding applies to wages paid but not interest and dividend income as it does in the UK.
- U.S. wage earners, rather than the Internal Revenue Service, are responsible for informing employers of how much income tax to withhold, if any, and must annually self-assess and file their tax returns, unlike most UK wage earners.

Another major difference is that the United States automatically matches data from information returns and the withholding system to data from the

income tax return to identify individuals who underreported income or failed to file required returns. Matching is done using a unique identifier taxpayer identification number (TIN). HMRC officials told us that they have no automated document-matching process and the UK does not use TINs as a universal identifier, which is needed for wide-scale document matching. The closest form of unique identifier in the UK is the national insurance number. HMRC officials said they are barred from using the national insurance number for widespread document matching. Instead, HMRC officials said that they may do limited manual document matching in risk assessments and compliance checks. For example, HMRC manually matches some taxpayer data—such as name, address, date of birth—from bank records to data on tax returns.

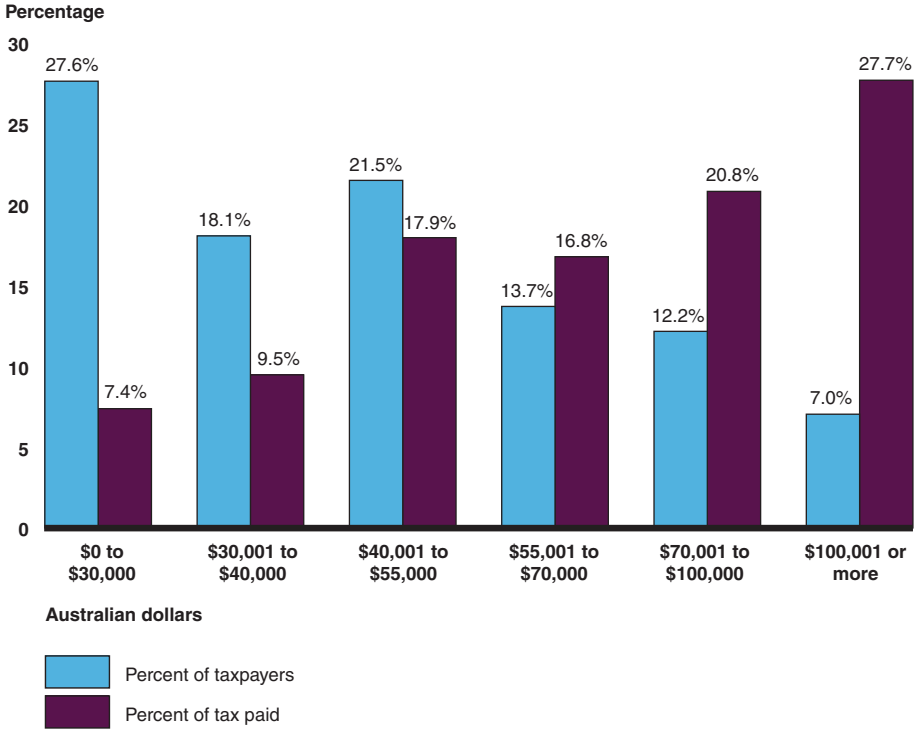
Appendix VI: Australia Uses a Compliance Program for High-Net-Wealth Individuals

Overview of the Australian Tax System

Australia has a federal system of government with revenue collected at the federal, state, and local levels. For 2009-2010, about 92 percent of federal revenue was collected from taxes rather than nontax sources, like fees. The principal source of federal revenue for Australia is the income tax, which accounted for about 71 percent. Australia's state and local governments rely on grants from the national government and have limited powers to raise taxes. The states receive significant financial support from the federal government. In 2009-10, total payments to the states were 28 percent of all federal expenditures.

Individuals accounted for about 65 percent of the 2009-2010 income tax revenue. The system is progressive with tax rates up to 45 percent for taxable income in excess of A$180,000 (US$161,622). In 2007-2008, a small proportion of Australian taxpayers paid a large proportion of Australian taxes, as shown in figure 1.

Figure 1: Australian Individual Income Tax Paid and Number of Taxpayers by Taxable Income for 2007-2008



Source: GAO analysis of government of Australia data.

What Is the Australian High Net Wealth Individuals Program?

The Australian High Net Wealth Individuals (HNWI) program focuses on the characteristics of wealthy taxpayers that affect their tax compliance. According to the Australian Taxation Office (ATO), in the mid 1990s, it was perceived as enforcing strict sanctions on the average taxpayers but not the wealthy. ATO found that high-wealth taxpayers, those with a net worth of more than A$30 million (US$20.9 million), tend to have complex business arrangements, which made it difficult for ATO to identify and assure compliance. ATO concluded that the wealthy required a different tax administration approach.

ATO set up a special task force to improve its understanding of wealthy taxpayers, identify their tax planning techniques, and improve voluntary compliance. Initially, the program focused on the tax return filed by a wealthy individual. Due to some wealthy taxpayers' aggressive tax planning, which ATO defines as investment schemes and legal structures that do not comply with the law, ATO quickly realized that it could not reach its goals for voluntary compliance for this group by examining taxpayers as individual entities.

To tackle the problem, ATO began to view wealthy taxpayers as part of a group of related business and other entities. Focusing on control over related entities rather than on just individual tax obligations provided a different understanding of wealthy individuals' compliance issues. To address the special needs of the wealthy, ATO developed publications that included a separate high-wealth income tax return form, a questionnaire on the wealthy as an entity and a tax guide, Wealthy and wise—A tax guide for Australia's wealthiest people.

Why Australia Developed the High Net Wealth Program

According to ATO, a number of factors led to the HNWI program. First, ATO was dealing with a perceived public image that it showed preference to the wealthy while enforcing strict sanctions on average taxpayers during the 1990s. Second, ATO was perceived as losing revenue from noncompliant taxpayers. Third, high-wealth individuals used special techniques to create and preserve their income and wealth through a "business life cycle." The cycle includes creating, maintaining, and passing on wealth through complex tax shelters. For example, businesses owned or controlled by wealthy individuals are more likely to have more diverse businesses arrangements, which tend to spread wealth across a group of companies and trusts. Each of these groups controlled by wealthy individuals was classified as a separate taxpayer entity, which made understanding the tax implications of these networks of entities difficult for the ATO.

The HNWI approach followed ATO's general compliance model. The model's premise is that tax administrators can influence tax compliance behavior through their responses and interventions. Since taxpayers have different attitudes on compliance, ATO used varied responses and interventions tailored to promote voluntary tax compliance across different taxpayer groups.

The first part of the standard model is to understand five factors that influence taxpayer compliance. The factors are Business, Industry, Social, Economic, and Psychological. For example, the Business factor included the size, location, nature, and capital structure of the business as well as its financial performance—all of which help ATO understand why compliance or noncompliance occurs.[1]

The second part of the model involves taxpayers' attitudes on compliance. It refers to one of four attitudes that a taxpayer may adopt when interacting with tax regulatory authorities. These attitudes are

- willing to do the right thing,
- try to do the right thing,
- do not want to comply, and
- decided not to comply.

The third part of the model aligns four compliance strategies with the four taxpayer attitudes on compliance[2] and refers to the degree of ATO enforcement under the concept of responsive regulation. ATO prefers to simplify the tax system and promote voluntary compliance through self-regulation. If the taxpayer tries to comply, ATO should respond by helping the taxpayer be compliant. If the taxpayer is not motivated to comply, ATO should respond to the level of noncompliance with some degree of enforcement, ending with harsh sanctions for the truly noncompliant.

ATO created a High Wealth Individual (HWI) taskforce to assess wealthy individuals on their probability of compliance and place them into one of four broad risk categories using its Risk Differentiation Framework (RDF). RDF is similar to the compliance model in that it is to assess the tax risk

[1]For the list of all factors and their elements, see the ATO publication on *Large Business and Tax Compliance*, Australian Taxation Office (June 2010).

[2]Kristina Murphy, *Moving forward towards a more effective model of regulatory enforcement in the Australian Taxation Office*, Centre for Tax System Integrity, Research School of Social Sciences, Australian National University (2004).

and determine the intensity of the response for those with high net wealth, ranging from minimizing burden on compliant wealthy taxpayers to aggressively pursuing the noncompliant. The four broad categories of the RDF are as follows:

- Higher Risk Taxpayers—ATO performs continuous risk reviews of them with the focus on enforcement.
- Medium Risk Taxpayers—ATO periodically reviews certain transactions from them or where there is a declining trend in effective tax performance with a focus on enforcement.
- Key Taxpayers—ATO continuously monitors them with the focus on service.
- Low Risk Taxpayers—ATO periodically monitors them with the focus on service.

What Are the Known Results and Effects of the Australian High Net Wealth Program?

The HNWI program has produced financial benefits since its establishment in 1996. ATO 2008 data showed that the program had collected A$1.9 billion (US$1.67 billion) in additional revenue and reduced revenue losses by A$1.75 billion (US$1.5 billion) through compliance activities focused on highly wealthy individuals and their associated entities. ATO's approach also has been adopted by other tax administrators. According to a 2009 Organisation for Economic Co-operation and Development (OECD) study, nine other OECD countries, including the United States, had adopted some aspect of Australia's HNWI program.[3]

Similarities to and Differences from the U.S. Tax System

Like ATO, the IRS is taking a close look at high-income and high-wealth individuals and their related entities. In 2009, IRS formed the Global High Wealth Industry (GHWI) program to take a holistic approach to high-wealth individuals. IRS consulted with the ATO to discuss ATO's approach to the high-wealth population as well as its operational best practices. As of February 2011, GHW field groups had a number of high-wealth individuals and several of their related entities under examination.

One difference is that Australia has a separate income tax return for high-wealth taxpayers to report information on assets owned or controlled by HNWIs. In contrast, the United States has no separate tax return for high-wealth individuals and generally does not seek asset information from individuals. According to IRS officials, the IRS traditionally scores the risk

[3]OECD, *Engaging with High Net Worth Individuals on Tax Compliance* (2009).

of individual tax returns based on individual reporting characteristics rather than a network of related entities.[4] However, IRS has been examining how to do risk assessments of networks through its GHWI program since 2009. Another difference is that ATO requires HNWIs to report their business networks, and IRS currently does not.

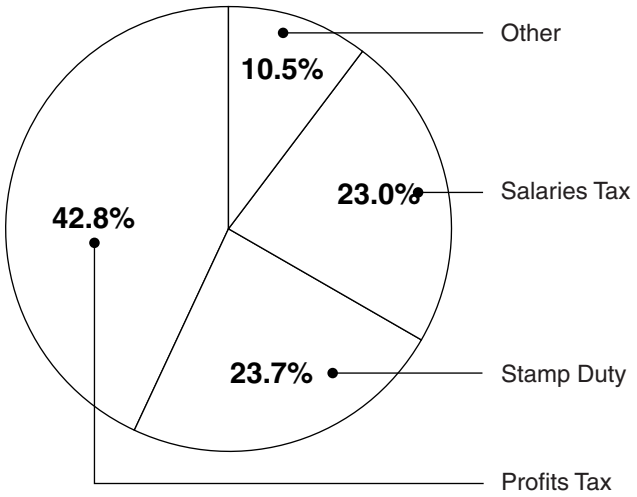
[4]GAO, *IRS Can Improve Efforts to Address Tax Evasion by Networks of Businesses and Related Entities*, GAO-10-968 (Washington, D.C.: Sept. 24, 2010).

Appendix VII: Hong Kong Uses Semiannual Payments Instead of Periodic Employer Withholding for the Salaries Tax

Overview of the Hong Kong Tax System

Hong Kong's Inland Revenue Department (IRD) assesses and collects the "earnings and profits tax," which includes a Profits Tax,[1] Salaries Tax, and Property Tax. IRD also assesses and collects certain "duties and fees" including a stamp duty, business registration fees, betting duty, and estate duty. Hong Kong only taxes income from sources within Hong Kong. Principle revenue sources for tax year 2009-10 are shown in figure 2.

Figure 2: Hong Kong Tax Year 2009 to 2010 Revenue Sources



Source: GAO analysis of Hong Kong data.

According to a Hong Kong tax expert, Hong Kong created the Salaries Tax at the start of World War II without using periodic tax withholding. The lack of withholding was not then, and is not now, considered to be a significant problem.[2] The Salaries Tax is paid by about 40 percent of the estimated 3.4 million wage earners in Hong Kong, while the 60 percent are exempt from the Salaries Tax.

Taxpayers whose salary income is lower than their entitlement to deductions (i.e., basic allowance, child allowance, dependent parent, etc.) are exempt from paying Salaries Tax and neither they nor IRD prepare a

[1]Profits tax is paid on all profits arising in or derived from Hong Kong from a trade, profession, or business carried on in Hong Kong.

[2]Michael Littlewood, *Taxation Without Representation: The History of Hong Kong's Troublingly Successful Tax System*, University of Hong Kong Press, Hong Kong, (2010).

tax return for this income. However, exempt taxpayers may receive a tax return from IRD once every few years to verify their tax-exempt status. If these exempt taxpayers receive a tax return from IRD, they are required to complete and submit it within 1 month.[3]

The Salaries Tax rates are fairly low, according to Hong Kong tax experts. The Salaries Tax has progressive rates starting at 2 percent of the adjusted salary earned and may not exceed the standard rate of 15 percent. In comparison, the highest personal income tax rates in the EU range from about 10 percent to over 56 percent as described in appendix IV.[4]

How Does Hong Kong Collect Salaries Tax?

Hong Kong does not use periodic tax withholding (e.g., biweekly or monthly) by employers to collect Salaries Taxes. Rather, IRD collects the Salaries Tax through two payments from taxpayers for a tax year, which runs from April 1 to March 31. The first payment is due in January (9 months into the tax year) and is to be 75 percent of the estimated tax for the whole year. The second payment is for the remaining 25 percent, which is due 3 months later in April—immediately after the end of the tax year.

In May, IRD is to mail the tax return to the individual for the just-completed tax year based on information provided by employers and other sources. Information reporting to IRD has four parts. First, employers must report when each employee is hired and the expected annual salary amount. Second, at the end of the tax year, employers must report the salary paid to each employee. Third, the employers must report when the employee ceases employment. Fourth, employers must report and temporarily withhold payments to an employee they know intends to leave Hong Kong. If the employer fails to comply with these requirements without a reasonable excuse, penalties may be imposed.

Individuals have 1 month to file the return.[5] For those who elect to file their returns electronically, IRD will prefill the return based on

[3]In addition to declaring income and any claimed deductions and allowances, the return includes name and address, and a Hong Kong Identity Card number or passport number.

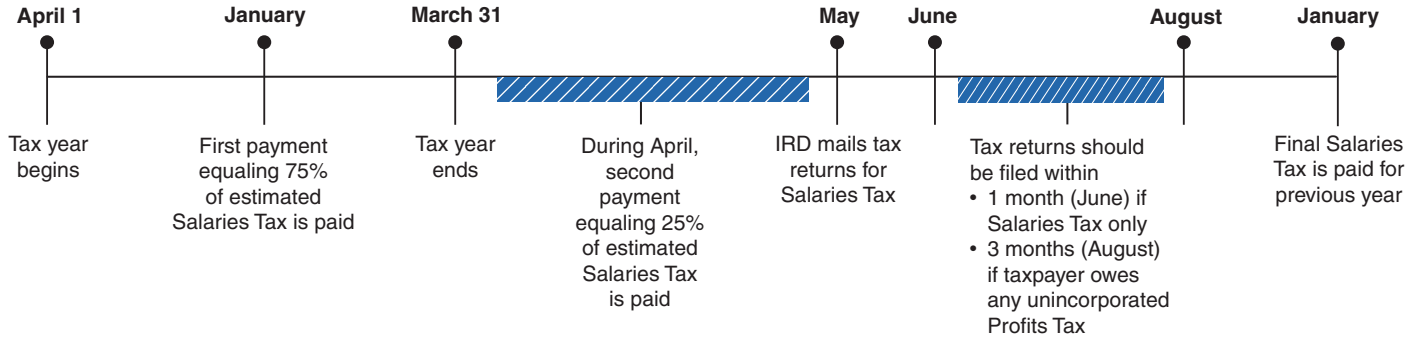
[4]The Salaries Tax is imposed on income from employment or pension, while income tax generally is imposed on income from many sources beyond salaries, including interest, dividends, and capital gains.

[5]Individuals have 3 months to file if they solely-owned any unincorporated business.

information provided in their past returns and by their employers. They have a month and a half to review the prepared tax return, make any revisions such as changes to deductions, and file it with IRD.

IRD reviews the filed tax returns to determine the final Salaries Tax. IRD electronically screens all returns to check for consistency between the information provided by the employer and taxpayer. Assessments will normally be made based on the higher amount reported, and taxpayers have the right to object within 1 month. IRD also can cross-check reported salary amounts with salary deductions claimed by businesses on Profit Tax returns, which should normally be supported by information returns on employee salary amounts. If the final Salaries Tax for the tax year turns out to be higher than the estimated tax assessment, taxpayers are to pay the additional tax along with the first payment of the estimated tax for the next tax year during the following January, as shown in figure 3.

Figure 3: Hong Kong's Salaries Tax Process Timeline



Source: GAO analysis of IRD data.

Why Does Hong Kong Collect Salaries Tax through Two Yearly Payments?

Several factors contribute to Hong Kong's collection of the Salaries Tax through two payments for a tax year without resorting to periodic withholding by employers.

- The tax only affects about 40 percent of the wage earners who have the highest salaries and uses relatively low tax rates, making it more likely that the taxpayers will have the funds necessary to make the two payments when due.
- The simplicity of Hong Kong's tax system, according to Hong Kong tax experts, makes it easier to compute tax liability and to manage the payments.

- IRD uses a combination of controls to assure that tax payments are made, according to a senior IRD official. In addition to information reporting, island geography contributes to the controls. Hong Kong entry/departure points are limited and tax evaders are likely to be identified. Hong Kong government can detain a tax evader from leaving or entering Hong Kong until the tax is paid. IRD has varied processes to trace the assets of delinquent taxpayers as part of collecting any unpaid tax.
- Culture encourages taxpayers to pay their taxes. Hong Kong experts said taxpayers fear a loss of face if they are recognized as noncompliant, which could reflect negatively on the family. A Hong Kong official told us that residents try to avoid being taken to court.

An expert on public opinion in Hong Kong told us that this cultural attitude generates high tax morale. The expert told us that Hong Kong residents have high regard for Hong Kong's government as being "cleanly" run and as putting tax revenues to good use. IRD is viewed as having fair and equal treatment of all taxpayers.

What Are the Known Results and Effects from Collecting the Salaries Tax through Two Yearly Payments?

A senior official of Hong Kong's IRD believes that the Salaries Tax collection system leads to high tax compliance. Low tax rates in concert with a simple tax system that offers generous deductions and effective enforcement mean that taxpayers are fairly compliant, according to the Hong Kong official. It also means that few taxpayers use a tax preparer because the tax forms are very straightforward and the tax system is "stable."

The official also said that taxpayers comply because the cost of noncompliance is high. If a taxpayer does not pay by the due date, the costs include paying the tax liability, interest surcharges on the debt, and legal costs. Further, submitting an incorrect tax return without reasonable excuse may carry a fine of HK$10,000 (US$1,283) plus three times the amount of tax underpaid and imprisonment.

What Are the Similarities to and Differences from the U.S. System?

Unlike Hong Kong's twice-a-year payments for the Salaries Tax, the U.S. income tax on wages relies on periodic tax withholding. IRS provides guidance (e.g., Publication 15) on how and when employers should withhold income tax (e.g., every other week) and deposit the withheld income taxes (e.g., monthly). Further, the U.S. individual tax rates are higher and the system is more complex. These tax rates begin at 10 percent and progress to 35 percent. Further, the United States taxes many forms of income beyond salary income on the individual tax return.

Appendix VIII: Overview of Tax Systems for Five Nations

Nations have many choices on how to structure their tax systems across the federal, as well as state and local, government levels. The proportion of revenue collected at each governmental level can widely vary. Finland, New Zealand, and the United Kingdom (UK) have a unitary system in which government, including tax administration, is generally centralized at the national level with limited state and local government. For example, in New Zealand, the national government assessed about 90 percent of all the revenue collected across the nation. In contrast, the United States has a federal system in which the national level shares governmental authority with state and local governments. In the United States about half of all tax revenue is collected by the national government and about half is collected by the 50 states and tens of thousands of local governments.

The revenue data in table 4 below were provided by each nation and compiled by the Organisation for Economic Co-operation and Development (OECD) for consistent presentation.[1] These data cover all taxes in each nation including federal and state/local levels. Using these data, we computed the percent that each type of tax represents of the nation's total revenue. OECD provided the following definition for each of the major categories of tax in the table:

- Taxes are compulsory unrequited payments to general government and are not for benefits provided by government to taxpayers in proportion to their payments. Governments include national governments and agencies whose operations are under their effective control, state and local governments and their administrations, certain social security schemes and autonomous governmental entities, excluding public enterprises.
- Taxes on income, profits, and capital gains cover taxes levied on the net income or profits (i.e., gross income minus allowable tax deductions) of individuals and businesses (including corporations). Also covered are taxes levied on the capital gains of individuals and enterprises, and gains from gambling.
- Social security contributions are classified as all compulsory payments that confer an entitlement to receive a (contingent) future social benefit. Such payments are usually earmarked to finance social benefits and are often paid to institutions of general government that provide such benefits. These social security benefits would include unemployment insurance benefits and supplements, accident, injury and sickness benefits, old-age,

[1]OECD, *Revenue Statistics 2010—Special feature: Environmental Related Taxation* (2010). More information about these taxes can be obtained from the OECD publication Annex A.

disability and survivors' pensions, family allowances, reimbursements for medical and hospital expenses or provision of hospital or medical services. Contributions may be levied on both employees and employers.

- Taxes on payroll and workforce cover taxes paid by employers, employees, or the self-employed either as a proportion of payroll or as a fixed amount per person, and which do not confer entitlement to social benefits.
- Taxes on property, goods, and services cover recurrent and nonrecurrent taxes on the use, ownership, or transfer of property. These include taxes on immovable property or net wealth, taxes on the change of ownership of property through inheritance or gift, and taxes on financial and capital transactions. Taxes on goods and services include all taxes and duties levied on the production, sale, and lease of goods or services. This category covers multistage cumulative taxes; general sales taxes, value added taxes, excise taxes, or taxes levied on imports and exports of goods.

Table 4 shows that the largest source of revenue for 4 of 5 countries is the tax on individuals' and corporations' income, profits, and capital gains. Also, the tax paid by individuals is a larger percentage of revenue than the corporation tax in each country. The tax on property, goods, and services is the next most important tax except in the UK where the income tax is the second largest source. A large component of the taxes on property, goods, and services is the value added tax and sales tax. In Australia, New Zealand, the UK, and Finland, value added tax and sales tax ranged from 25 percent to 31 percent of the taxes collected in the nation. The United States does not have a value added tax, but sales taxes alone totaled about 14 percent of all U.S. revenue.

Table 4: Revenue, Governmental Structure, and Population Data for Five Nations, 2008

Source of revenue	United States	United Kingdom	Finland	New Zealand	Australia
Taxes on income, profits and capital gains (percent)	45	40	39	60	59
Individuals (percent)	38	30	31	41	38
Corporate (percent)	7	10	8	13	22
Unallocable between individual and corporate (percent)	0	0	0	7	0
Social security contributions (percent)	25	19	28	0	0
Taxes on payroll and workforce (percent)	0	0	0	0	5
Taxes on propery, goods, and services (percent)	30	41	33	40	36
Value added and sales taxes (percent)	14	28	29	31	25
Total tax revenue, excluding customs duties (percent)	100	100	100	100	100
Other data					
Total tax revenue as a percentage of GDP (2008)	26.1	35.7	43.1	33.7	27.1

Source of revenue	United States	United Kingdom	Finland	New Zealand	Australia
Structure of government	federal	unitary	unitary	unitary	federal
2008 population in millions	304.4	61.4	5.3	4.3	21.4

Sources: GAO analysis of OECD and World Bank data.

Note: Data are from OECD, *Revenue Statistics 2010 – Special feature: Environmental Related Taxation* (OECD Publishing, 2010), and World Bank Population data set, 2000 to 2009 by Country, www.worldbank.org (downloaded Dec. 23, 2010).

Appendix IX: GAO Contact and Staff Acknowledgments

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