Fifty-First Session of the Commission for Social Development
United Nations
Division for Social Policy and Development
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FUNGLODE RD

Best practices in the tax administration for sustained revenue increase for social development

1. Context

The starting point of this discussion should be, necessarily, to remember that tax revenues are the ultimate source of revenue for states. There are no strong states without sufficient income to invest in providing citizens with services and public goods.

In that sense, their ability to spend or invest depends fundamentally on the resources generated by their tax system.

Therefore, when we talk about social investment it's necessary to discuss the tax burden, on the one hand, as this defines the size of a state that is measured by its ability to spend in relation to the size of the economy, and on the other hand the institutional strength to carry out spending.

In every decision to spend there is an implicit decision to raise money, therefore, more and more countries adopt rules so that each new investment or expenditure is usually accompanied by a new tax or the increase of an existing one.

Hence, it is not a coincidence that we speak more and more about a citizen-taxpayer.

So it is necessary to outline what we understand are the best practices to ensure the sustained growth of government revenues, thereby enabling consistent investment in social development, assuming that the aforementioned institutional strength to spend exists.

The term "consistent" should be noticed since achieving the qualitative change in many aspects of social development, such as education, health, etc. require long-term efforts. Both consistency of resource availability and persistence are essential for social investment.

In our view, three aspects allow for healthy public finances over time:

a) Capacity of the state to generate adequate resources - an efficient Tax System, simple and equitable;

b) Fiscal rules for management of public finances to ensure the rational use of resources and the creation of "countercyclical" funds to maintain social spending levels;

c) A strong Tax Administration capable of implementing the Tax System.

2. Tax System

The Tax System should involve, amongst others, such principles as adequacy, generality, simplicity, and fairness.

A proper Tax System is one that generates the resources required by the State as established in its design; this usually means establishing tax burden for all as a common duty of citizens. It is simple if the compliance process and control is clear, and it is fair when everyone pays according to their ability to pay (horizontal equity) and are treated as equal for all, and unequal for those who are under different circumstances (vertical equity).

Under this topic we stress that a properly designed Tax System forces society to agree on the amount of resources needed to determine the burden that each sector will support.[1]

Along these lines, the principles of generality, simplicity and fairness are greatly affected by the abuse of tax exemptions and privileges that make it hard for the System to achieve investment objectives, employment, etc.

It is not a coincidence that in recent years tax expenditures are considered as resources forgone by the State in granting exemptions to goods, services or sectors.

High tax expenditure is defined as a resource left in the hands of non-state entities to decide where to invest, spend or not, based on criteria that do not necessarily have to do with the common good or social priorities.

In short, society must agree on how to address these issues; whom to tax and what amount of money to ensure that those who enjoy boom periods pay a fair share.

[1] In the Dominican Republic, for example, Law no. 1-12, which establishes the National Development Strategy 2030 (END), a target tax burden is set until that year

3. Fiscal Rules

Regardless of whether there should be some flexibility in the administration of public finance for governments, especially to resolve short-term issues, fiscal rules aim to achieve financial discipline that allow certain substance; that time of growth, you think should be time of crisis, that there are caps or limits on indebtedness, control indicators for current expenditure levels, contingency funds, but also which provide indicators for monitoring fiscal management among other aspects. All this can be summarized as formal and informal rules, quantitative and qualitative, in order to manage fiscal policy in a prudent way, so as to achieve "fiscal responsibility."

The scope and complexity of the rules depend on every country, but all are very important because they impose limits and regulations on budgetary and fiscal policy.

In recent years, provisions of this kind, so common in developed countries, have come to Latin America on national as well as State levels.

Clear enough thta the first thing is to have resources provided by the Tax System, but then it's also necessary to administer them with fiscal regulations.

4. Tax Administration

In this exposition, given that our belief is that *"a Tax System is only worth the Tax Administration that runs it,"* we will strongly emphasize this aspect.

Tax systems are implemented by the work of the Tax Administration. Here, we describe the aspects that constitute best practices for achieving an effective and efficient tax administration. We address four key issues that we believe are essential and which have been pillars for modernizing Tax Administrations in the last decade: strengthening tax control, improving services, strengthening institutions and creating fiscally responsible citizens.

- **Tax Control**

The primary task for Tax Administrations is to exercise control over taxpayers' behavior to reduce tax evasion, avoidance and general defaults. Efficient tax control deters tax non-compliance and promotes voluntary compliance.

The control over billing and the efficient use of information and communications technologies (ICTs) for fiscal control are the two elements that characterize the approach of auditing by Tax Administrations in recent decades.

Implementing measures designed to control the release and use of billing invoices have been vital. From control of printers or print media, tax authorities increasingly make use of electronic invoices. Virtually all countries control presses where bills are generated, some of them control billing systems, others implement fiscal printers and electronic invoices. This control facilitates the ability to obtain diverse electronic information.

The use of technology to create databases that manage information on taxpayers that is obtained from other entities has been critical to the modernization of monitoring practices of taxpayers.

Computer systems which ensure that more and more taxpayers are reviewed in some way by Tax Administrations for fiscal control are crucial for the increase of awareness about risks, and computer systems that handle management of these revisions are crucial to ensure ethically correct handling of management of these reviews.

These days, ICT's represent an indispensable tool for tax control. Because the quintessential input for tax administrations is information, there is no possibility of preserving good levels of compliance without using technological tools for enforcement.

All this explains that planning for tax control involves a plan for using technology.

In addition, States are also evolving towards reducing financial opacity that protects tax havens.[2] This issue is of vital importance given that tax havens facilitate tax evasion and avoidance, and impede progress toward establishing effective financial regulations. This obviously makes it easier to drain resources from wealth generated in developing countries, which affects the availability of resources in those states. However, others have still been encouraged to quantify tax evasion hidden in tax havens.

In the same vein, in recent years tax control has also expanded into the international realm in order to achieve greater transparency from certain regulations set for information in tax havens.

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[2] In October 2009 the U.S. president said: "I congratulate the committee chairmen Baucus and Rangel, and Senator Kerry and Congressman Neal to move forward with the important task of giving the government the tools it needs to take action against U.S. citizens hiding assets in offshore tax havens. A small number of individuals and companies hide their assets abroad for the sole purpose of avoiding their responsibilities, even as the vast majority of hardworking Americans meet their civic obligations and responsibilities, even as the vast majority of hardworking Americans meet their civic obligations and responsibilities.

This has led to the proliferation of agreements to avoid double taxation and agreements to exchange information that facilitate international cooperation in tax control and clarify issues of jurisdiction and tax laws on transfer pricing that already exist in many countries.

The 2009 meeting of the G-20 [3] amid the financial-economic crisis that began that year, marked the beginning of a new way of approaching the issue of tax havens, abuse of banking secrecy and others.

- **Facilitate compliance**

Just as the simplicity of the tax system is important, Tax Administrations are required to facilitate voluntary compliance by taxpayers. Making things easier encourages compliance.

In this area the ICTs have also enabled intensive use of the Internet to create counters or tax offices, enabling individual and corporate citizens to comply at a lower cost.

Nowadays almost all modern Tax Administrations take tax returns and payments via the internet. This strategy of facilitating the process using the internet is part of a plan that is being considered by governments and States.

Similarly, improving services involves informing the public of all available information channels (print, Internet, social networks, news radio etc.) in a continuous and efficient manner about the work of the tax authorities and procedures that are related to a citizen-taxpayer.

Today a common communication strategy has been deployed through social networks in order to provide assistance to taxpayers.

"Shortly after taking office, I presented a set of proposals against illegal tax evasion abroad. The bill introduced today will fulfill that promise and prevent abuses amounting to billions of dollars. I look forward to working with Congress to ensure that these proposals become law so that honest Americans no longer have to carry the weight of a few people and companies that put profits above responsibility."

Receiving assistance and information in a timely and appropriate manner is part of the obligation a Tax Administration owes its citizen-taxpayers.

[3] We refer to the meeting held by the so-called Group of 20 (G-20) in London on April 2, 2009.

- **Fiscally Responsible Citizenship**

Fiscal education is the strategy of choice in forming a tax culture based on the concept of responsible fiscal citizenship. For this reason modern Tax Administrations have made tax education programs a priority in recent years.

Administrators have proposed to implement training programs for responsible citizens concerning their commitment to society, citizens' ability to exercise their rights and to meet their tax obligations. It aims to promote tax compliance as an ethical value as well as an awareness that tax evasion has harmful consequences for society.

It is a way to influence the moral/ethical tax system by referring to standards, perceptions etc. which determine the honest behavior of citizens-taxpayers regarding their duties to pay tax within the framework of laws and regulations in fiscal legislation.

Consider the following example of how this subject is perceived. A survey conducted by the firm Ernst and Young[4] in the U.S. asked the question "How much influence does each of the following issues factor into whether you declare and pay your taxes honestly?" These are the responses of those with the most influence:

• Fear of an audit: 64%

• Belief that their neighbors declare and pay honestly: 44%

• Third parties who report their income to the Internal Revenue Service: 66%

• Your personal integrity: 92%

In short, it's possible to see that people do feel they have a civic duty to pay taxes. Such surveys have been conducted in other developed countries, even in some Latin America nations, and they demonstrate the importance of working to have fiscally responsible citizens.

On this point: The Canadian Revenue (Canada Revenue Agency - CRA-) has identified "responsible citizenship" as an element of a sustainable tax system.

"*A sustainable tax system is one in which taxpayers believe that paying taxes is a civic responsibility that allows them to enjoy all the rights of a resident or a Canadian."*

[4] Source: Presented by Deborah Nolan at the 45th CIAT General Assembly, "Tax Morale as a determining factor in improving the effectiveness of the tax administration." 2011 in Ecuador.

Also, the CRA cites the following sentence by Former Minister Gordon O'Connor of the Tax Executives Institute:

"If you're doing business in Canada today, knowingly or not, you are dependent on government services. To be profitable in business, you rely on [...] a good infrastructure to bring the product to market, a strong education system to turn to a skilled workforce and health care to ensure that your employees are physically able to do their jobs. Without these basics, we have no well-functioning State. So with the interests of our country in mind, we must all do our part".

At the corporate level, fiscally responsible citizenship issues have also been addressed with the promotion of concepts such as "corporate social responsibility" which constitutes "corporate self-regulation built into the business model." It is also sometimes called "corporate conscience, corporate citizenship, social performance and sustainable responsible business."

Furthermore, the so-called Sarbanes-Oxley laws [5] , which establish Controls and Accountability in order to avoid fraud cover-up in bad accounting and finance, are designed to improve transparency in the actions of corporations, which have a positive impact on complying with tax obligations.

In short, countries that enjoy higher levels of voluntary compliance are those in which citizens show more fiscal responsibility. It is as if a permanent fiscal pact existed to build a better nation.

- **Institutional Strengthening**

All of the actions described above require institutional strength to achieve management systems that allow human resources to recruit and keep the best people in public service.

Providing Tax Administrations with public servants who are ethically and professionally unobjectionable must be a long-term commitment of all countries.

[5] The Sarbanes-Oxley Act (July 2002) also known as SOA (for its acronym in English Sarbanes Oxley Act) is the law regulating accounting and financial functions of audit and penalize corporate an white collar crime. Sarbanes-Oxley, (Julio 2002)

Hence it is important that Administrations be provided with special laws for management of human resources. Defining the type of people who are required, selecting the best people, creating an appropriate work environment and providing opportunities for development of technicians will ensure permanence of talent necessary for the Tax Administration to operate efficiently and with neatness.

Hence, many of the Tax Administrations, especially in Latin America, have sought budgetary and functional autonomy that allows them to achieve properly planned management.

5. Conclusions

Social development requires actions that preserve collection levels so that social investment is consistent in the long term, even in times of crisis.

It is relevant to engage in achieving revenue targets for the short, medium and long term to meet the needs of society. This sounds simple, but it gets complicated when we need to decide who gets taxed, and for how much.

We should also discuss the attitude towards investment in times of prosperity and crisis, especially in countries with longstanding needs that “owe” historical demands to their citizens.

We have seen that there are three factors that enable the long-term planning of social investment:

a) A tax system that generates the necessary resources.
b) Rules for handling tax revenues.
c) A strong tax administration

Income and expenses are two sides of the same coin.