Tax Gap: Causes and Solutions

By

Stephen PHUA
Associate Professor
Faculty of Law
National University of Singapore

Consultant
Rajah & Tann LLP
Advocates and Solicitors, Singapore
Email: LAWPLH@NUS.EDU.SG

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1 Introduction

The current global economic climate is dogged by unprecedented fiscal and economic imbalances. The flow of capital from developed nations that makes international resources available to developing nations has been severely impaired. As a result, nations that have grown accustomed to such resources need urgent solutions to mobilize domestic resources to compensate for the disruption to their funding model. There is no dearth of prescriptions for them. Some are told to fund tax cuts with expenditure restraint. Others are advised to maintain public expenditure but to hike tax rates or impose new taxes to balance the budgets. Yet, some countries may hit policy impasse from the lack of domestic consensus. Trite as it may sound, there is no one-size solution for ills as divergent as the world is confronted with.

As we have witnessed in the last few 2 years, the implementation of fiscal consolidation measures have met with some almost intractable political and social hurdles in several countries. Whether it is a tax increase or an expenditure reduction, any attempt to apply a solution that fails to take adequate account of unique local conditions is likely to face delays and aggravate societal polarization. In some cases, the remedy could be worse than the malady. For instance, the successful implementation of domestic austerity measures could be made a condition precedent for access to vital external financial assistance 1. Yet, such measures are likely to induce a deeper economic contraction that might compromise social cohesiveness and economic rejuvenation in the short term.

The entrenchment of globalized markets has made it difficult to analyze domestic tax issues without an assessment of the cause and effect of measures being implemented by trading partners. Where tax increases are deemed necessary to reverse debilitating budgetary deficits, the potential risks from the flight of mobile economic activities to other jurisdictions that offer more competitive business environments cannot be overlooked. The modern supply chain management in use by multi-national enterprises has also gradually reduced the impact of locational benefits on the cost of production even in traditionally less mobile sectors like manufacturing. The disproportionately large share of intra-firm transactions in international trade in goods and services undertaken by multi-national enterprises has also heightened the sensitivities to the impact of relative geographical tax incidence 2.

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1 Some food and beverage outlets in Greece have threatened to ignore the 10% VAT rate increase on the hospitality sector, which came into effect on September 1. The increase is part of the fiscal consolidation measures sought by bailout creditors, the International Monetary Fund and the European Union. The VAT rate is now 23% compared with 13% in 2010.

In the current circumstances, it is submitted that developing nations should consider allocating more resources to review the tax gap in the systems. Different countries have enhanced their existing mechanisms and implemented new ones to optimise the revenue yield from current taxes. This paper is not a comprehensive survey of all countries with such measures. Instead, it seeks to highlight some of the more interesting and perhaps effective solutions put in place by some countries that could be considered for adoption or adaption by the others.

2 Tax Gap Measurement

Tax gap is the difference between the full potential tax revenues that is legally due to the state and the actual tax revenues collected. The key variables that determine the size of tax gap in a country include the structure of the economy, the rule of law and tax morality. Although tax gap is often associated with tax evasion and avoidance, a broader measure of tax gap is simply non-compliance. The measurement of tax gap is a difficult exercise. The methodology adopted would vary with factors such as the type of tax, the nature of the sector, class of taxpayers and the quality of the information. There are two main methods to measure a country’s tax gap.

One method involves the use of macroeconomic data to estimate the aggregate value of transactions in the informal economy that has evaded taxation. It relies mainly on activities that leave some traces of their existence in macroeconomic data. Although this method seems to be more popular, the accuracy of its results should be treated with caution. It assumes that most underground activities are taxable and are subject to the same elasticities as those in the formal economy. As such, conflicting estimates are not uncommon. It has also been highlighted that miscalculations are more likely to occur when different deductions are involved or when wrong VAT rates are applied.

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6 Supra, Ahmed and Rider, p. 14

On the other hand, the alternative approach – micro method - involves the use of microeconomic data from different taxed sectors to estimate the potential tax liabilities.\(^8\) It utilises random samples from firm-level data to gauge the tax gap. One shortcoming of this method is the risk of error in highly complex sectors where even carefully selected sample populations may not provide accurate estimates of the actual tax gap.\(^9\) In addition, the micro method fails to capture the significant value of transactions in countries where vast informal or agricultural sectors exist and these activities remain largely unrecorded.

Different countries use different methods. The UK uses the macro method to estimate the size of tax gaps for VAT and excise duties. The micro method is mainly relied upon for direct taxes although it is sometimes used to supplement the macro calculation of VAT gaps in specific situations where risks like fraud are high\(^10\). The Swedish tax authority believes that macro and micro methods are complementary and utilises the combination to calculate its tax gaps.\(^11\) The USA appears to use mainly micro approaches as their studies often involve randomly selected samples to gather relevant data.\(^12\) In measuring Pakistan’s tax gap, the World Bank appears to utilise micro methods through a simulation based on potential revenues from major federal taxes.\(^13\)

### 3 Tax Gap Trends

Many developing countries have either vast agricultural sectors or significant informal economic activities the output from which cannot be readily measured or taxed. As such, the tax base as a proportion of the aggregate economic activity in such countries may be relatively small compared to that in developed countries.\(^14\) A main cause for the size of the informal economy in some developing nations may be attributable to persistent high rates of

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8 Ahmed and Rider, p. 16  
9 Swedish Tax Gap Report, p. 33  
unemployment in the formal sector. Another reason could be due to excessive taxes, costs and government regulations as well as endemic corruption in areas relating to the operation and taxation of formal business organisations\textsuperscript{15}. Previous studies have shown that the primary reason for entrepreneurs to operate within the informal economy was not to avoid official taxes but bureaucratic interference at various stages of economic activities\textsuperscript{16}.

A study on 145 countries estimates that the average size of the shadow economy in developing countries is approximately 40\% of the official GDP\textsuperscript{17}. Other national studies reveal that workers in the informal sector consists of approximately 90\% of the total workforce (based on national survey between 1999 and 2005 period) in India\textsuperscript{18}, almost 75\% in Kenya\textsuperscript{19} and 30\% in the Philippines\textsuperscript{20}. The shadow economy undermines the stability of revenue collection and equity among taxpayers as large amounts of income from activities taking place in the informal sectors escape untaxed unlike similar activities that are taxed in the formal sector.

While the tax system in developing countries is largely a product of the prevailing economic structures, revenue productivity is largely a function of the quality of design and implementation of a tax system. It has been aptly pointed out that a tax system that over-accommodates the shortcomings of the tax administration and the functioning of a parallel informal economy can have deleterious effects on tax equity, the efficiency of resource allocation, and the integrity of tax revenue collection in the long run\textsuperscript{21}.

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\textsuperscript{15} Ibid, Richard M. Bird and Eric M. Zolt at p 23


As a general trend, economic data demonstrates that developing countries appear to have a larger tax gap than developed nations. Developing nations such as Bangladesh, South Africa and Thailand had average tax gaps of about 36%, 23% and 53% respectively compared with significantly lower averages of about 14%, 13% and 9% respectively found in Australia, UK and USA during the period 1999-2000\textsuperscript{22}. Specific country reports support the conclusions on these trends. The Swedish National Tax Agency reported its tax gap in 2007 to be about 10% of taxable income\textsuperscript{23}. A study on New Zealand reported an average tax gap of about 9% during the period from 1968-1994\textsuperscript{24}. In contrast, selected developing nations like Pakistan revealed a gap of no less than 70% in 2007/2008\textsuperscript{25}. Romania’s VAT gap in 2002 was about 45\%. Afghanistan’s tax gap was indicated to be 60% in a 2005 World Bank report.\textsuperscript{27}

4 Tax Gap Reduction

The choice of remedy is dependent on the cause. If procedural incoherence or excessive complexity of the tax rules accounts for part of the tax gap, simplification of the tax system has been shown to increase compliance\textsuperscript{28}. Legislative clarity and certainty not only reduces administrative costs of collection but also the incidence of unintentional errors by taxpayers. Many countries including the USA, the UK, South Africa and Singapore have

\begin{itemize}
  \item \textit{Supra,} Swedish Tax Gap Report, p. 48 Figure 8. The Swedish Tax Authority identified under-declaration of tax accounted for the largest proportion of their tax gap at approximately 50%.
  \item Giles, p. 212
\end{itemize}
either embarked on projects that are aimed at simplifying the legal rules or the process of filing. Maximising revenue collection with minimal intervention is clearly optimal.

However, if tax gap is due to a lack of information sources and disclosure, withholding tax mechanism can be considered. The experiences in the USA and the UK demonstrate that compliance rates are much higher in cases where the payors of selected income are required to withhold taxes from their payments. In the USA, a very low misreporting rate of 1.2% occurred in cases where withholding and third party information reporting were in place compared with 4.6% in cases subject to only third party information reporting. In the UK, labor income subject to the Pay As You Earn Scheme (PAYE) had a lower level of under-declaration compared with earned business income.

Nevertheless, the reliance on withholding tax mechanism is contingent upon the ability of the state to pass on the costs of tax collection to the paying agents. In addition, it may create an enforcement asymmetry. For example, the Bureau of Internal Revenue (BIR) in the Philippines noticed that labor earnings subject to source withholding accounts for over 85% of the total individual income tax revenues. BIR intends to take enforcement measures to redress any imbalance between employment income and earned professional income. One effective way to do would be to consider measures to correct informational deficiency.

4.1 Correcting Informational Deficiency

The absence of data is a principal impediment to controlling tax evasion. It has been observed in some developing countries that a key reason is the under-utilization of financial institutions as a valuable source of tax-relevant information. A robust information exchange

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32 HMRC Tax Gap Report, p. 50.


framework among companies, financial institutions and the tax administration can provide a potent self-policing mechanism in which the cost of collection and verification can be effectively shared between the state and the private sector. The perceived increased in transparency and sharing of information between multiple unrelated parties would help to minimize the amount of tax revenue at risk.

4.1.1 Enhancing Accounting Disclosure Standards

As long as “the tax-avoidance game represents the triumph of technical proficiency”, those who devise them to outwit the taxman would argue that “shareholder value …demands no less”\(^{36}\). At risk of over-simplification, it is argued that the externalities created by such corporate behaviour have a pernicious effect on the other taxpayers and the integrity of the tax system in the long run. Afterall, “[t]ax is the price we pay for civilised society …”\(^{37}\).

In 2006, the US Financial Accounting Standards Board (FASB) released FIN 48 (FASB Interpretation 48) which clarified how Uncertain Tax Positions (“UTPs”)\(^ {38}\) are to be treated in the financial statements of businesses. These new guidelines are applicable to financial statements that adhere to the US Generally Accepted Accounting Principles (US GAAP).\(^ {39}\) Prior to that, taxpayers took full advantage of the flexibility to omit or even manipulate reported earnings through the positions taken on some uncertain tax issues.\(^ {40}\) The


\(^{37}\) Per Justice Oliver Wendell Holmes (dissenting), *Compañía General De Tabacos De Filipinas v Collector of Internal Revenue*, 275 U.S. 87 (1927) at p 100

\(^{38}\) FIN 48, pp. 1-2, paragraph 4 states that a tax position is a position taken in previous or expected future tax returns that is reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods. UTPs are basically contingent tax liabilities that would be incurred if the tax position taken could not be sustained should it be challenged by the tax authorities.

\(^{39}\) Andrew W. Jones, “FASB – The IRS’s New Best Friend: How FIN 48 Affects the Taxpayer-IRS Relationship and Potential Taxpayer Challenges,” 25 Georgia State University Law Review 767 [Jones], p. 773; IRS, FASB Interpretation No. 48 <http://www.irs.gov/businesses/corporations/article/0,,id=171443,00.html>; FIN 48 paragraph 3 states that FIN 48 applies to all tax positions accounted for in accordance with FASB Statement 109. FASB, “Statement of Financial Accounting Standards 109,” paragraph 4 states that the principles and requirements of 109 apply to income taxes for US enterprises and other enterprises preparing financial statements in accordance with the US GAAP; It is mandatory for most US enterprises to adhere to GAAP. The SEC Regulation S-X, §210.4-01(a)(1) states that financial statements filed with the SEC which do not comply with GAAP are presumed to be inaccurate or misleading; Jones, at pp. 788-789, notes that companies that fail to comply with the SEC requirement for GAAP-compliant audited financial statements run the risk of a qualified opinion with devastating consequences; In addition, stock exchanges including New York Stock Exchange mandate the use of GAAP.

\(^{40}\) Jones, p. 772 refers to this as the “cookie jar” approach whereby corporate managers reduce perceived risk to investors by decreasing their deferred tax liabilities to boost earnings when needed and increase their tax loss estimates to replace the “cookies” when income rises above forecast.
resulting inconsistencies in accounting treatment had severely limited IRS’s ability to make meaningful comparisons of UTPs with information from other sources.\(^41\)

The objective of FIN 48 is to improve the “relevance and comparability” of financial reporting by ensuring that “every tax position is accounted for” under a common standard.\(^42\) Under FIN 48, an uncertain tax benefit must be evaluated under the “more-likely-than-not” rule before it is measured and recorded in the financial statements.\(^43\) A tax benefit can only be recognised if the probability that it would be sustained upon examination, based on technical merits, is greater than 50%.\(^44\) For tax positions that satisfy the criteria, the largest amount that is regarded as having a greater than 50% probability of being obtainable in a final settlement with the tax authority may be recorded.\(^45\) If an uncertain position fails the test, the taxpayer is not permitted to record a tax benefit; alternatively, he may set aside a 100% reserve.\(^46\) Business entities are also required to provide extensive and detailed disclosures of unrecognised tax benefits\(^47\).

The International Accounting Standards Board (IASB) has also considered the inclusion of a common accounting standard for UTPs.\(^48\) IASB deliberations over this issue has been suspended pending the resolution of other issues.\(^49\) Nevertheless, it should be noted that under International Accounting Standards (IAS) detailed disclosure of changes to provisions as well as contingent liabilities including its nature and estimated financial impact must be recorded unless they are remote.\(^50\) The IAS disclosure requirements have been

\(^{41}\) Jones, p. 772; FIN 48.

\(^{42}\) FIN 48; see “How This Interpretation Will Improve Financial Reporting”. A “tax position” includes a decision not to file, to adopt a transfer price, to claim a relief or tax preference etc.

\(^{43}\) Harvey, p. 25; Jones, p. 774.

\(^{44}\) FIN 48, p. 2 paragraphs 6 and 7(a): In computing the probability, it is assumed that the tax authority has full knowledge of the facts when assessing the tax position; Harvey, p. 25.

\(^{45}\) FIN 48, p. 3 paragraph 8; Harvey, pp. 25-26.

\(^{46}\) Harvey, p. 25.

\(^{47}\) This includes tabular reconciliations showing change in unrecognised tax benefits between previous and current periods as a result of tax positions taken.\(^39\) Details relating to the nature of the uncertainties and possible changes are also required for those that are reasonably likely to change within 12 months of the reporting date.


\(^{49}\) IFRS Staff Paper, March 2010.

\(^{50}\) IAS 37 has a rather similar provision to FIN 48. Exemption from disclosure is permitted if the “possibility of any outflow in settlement is remote” (IAS 37, paragraph 86). Strictly speaking, IAS 37 does not apply to income taxes, IAS 12 (paragraph 88) directs that disclosure of contingent tax liabilities shall be comply with IAS 37.
adopted by many jurisdictions that apply the International Financial Reporting Standards (IFRS).  

4.1.2 Expanding Information Reporting Obligations

Where weak enforcement of tax laws is one of the causes of tax gap, revenue authorities ought to be given more resources to enhance prevention, improve early detection and provide speedy resolution of non-compliance. However, tax administrations must be mindful of the cost-benefit tradeoffs in the allocation of its internal resources. Some taxes are simply not cost-effective to collect. It may be more effective use of resources if a more targeted approach that focuses on significant areas of risk is adopted.

In the context of effective collection of taxes, it is not surprising that empirical evidence supports a greater reliance on information reporting obligation. Professor Lederman identified asymmetric information to be a key problem for the enforcement of tax laws. He points out that the state is entirely dependent on a taxpayer’s full disclosure or third-party sources while the taxpayer often is in possession of the complete set of relevant facts. In the USA, IRS found misreporting for sectors supported by some third party information reporting was only 8.6% while the rate for those without was 53.9%. Enhanced information reporting obligations by third parties can be an effective tool to verify tax returns filed by taxpayers. This significantly reduces the payoffs to under-report income.

52 See the initiatives in the USA: USDOT Report on Reducing Tax Gap 2009, p. 12
55 HMRC Protecting Tax Revenues 2009, p. 12 and 17; IRS Tax Gap Facts also provides information on the different contributing factors to the tax gap.
57 IRS Tax Gap Update.
58 Lederman, pp. 1738-1739
59 Carroll, pp. 45-46.
4.1.2.1 Enhanced Disclosures by Taxpayer

In the USA, the IRS decided to leverage on FIN 48 disclosures. In September 2010, the IRS issued final statements mandating certain corporations to disclose some of the information relating to UTPs directly to the tax authority.\(^{60}\) As a transitional measure, the implementation is phased in over 5 years based on value of assets of a corporation: assets $\geq$100m for 2010 and 2011; assets $\geq$50m for 2012 and 2013 and assets $\geq$10m for 2014 and beyond).\(^{61}\) The IRS UTP Schedule applies to positions on US federal income tax regardless of whether FIN 48 applies.\(^{62}\) Generally, disclosure is required if the corporation has recorded a reserve with respect to a tax position in its audited financial statements.\(^{63}\) Disclosure is also required if no reserve was recorded but the corporation (or a related party) determines that the probability that the tax position would be litigated is more than 50\%.\(^{64}\) This includes a description of facts affecting the tax position and “information that reasonably can be expected to apprise the IRS of the identity of the tax position and the nature of the issue.”\(^{65}\) As evidence of its policy of restraint, the IRS dropped its earlier position that would have required draconian disclosures of the rationale and nature of the uncertainty.\(^{66}\)

The adoption of a UTP disclosure regime has been hailed as “the biggest change in tax administration in the last 50 years”\(^{67}\). The description of tax positions and their relative rankings will greatly improve IRS’s efficiency and effectiveness in identifying the issues to audit and in the resolution of tax disputes faced by large corporations. Larger corporations have better access to an industry of professionals who have the expertise to navigate the

\(^{60}\) Kathryn J. Kennedy, “The IRS’s Recent Uncertain Tax Positions Initiative: A Tangle of Accounting, Tax and Privilege Issues,” 9 DePaul Business & Commercial Law Journal 401 [Kennedy], p. 434-435; Harvey, p. 11 notes that while the FIN 48 disclosures have provided some benefit to the IRS, they do not provide a detailed roadmap. Harvey, p. 23 notes that the IRS, in enacting the UTP schedule, leveraged on the work done by corporations when preparing their audited financial statements.

\(^{61}\) IRS 2010 Instructions for Schedule UTP [UTP Instructions]; IRS Announcement 2010-75 “Reporting for Uncertain Tax Positions,” p. 4; Harvey, p. 23.

\(^{62}\) Harvey, p. 37; UTP Instructions.

\(^{63}\) Harvey, p. 24; UTP Instructions; This also implies, in the case of FIN 48, that there were unrecognized tax benefits recorded in the FIN 48 financial statement.

\(^{64}\) UTP Instructions state that the UTP must be disclosed if the tax position is one which the corporation or a related party determines the probability of settling with the IRS to be less than 50\% and no reserve was recorded because the corporation intends to litigate and has determined that it is more likely than not to prevail on the merits of the litigation.

\(^{65}\) UTP Instructions p. 4, Part III.

\(^{66}\) IRS Announcement 2010-75, pp. 7-8.

\(^{67}\) Harvey, p 4 quoting a former Commissioner, Lawrence Gibbs.
complicated tax code to structure complex transactions around existing reporting obligations.68

The UTP disclosure regime is highly desirable from the standpoint of tax administration. It promotes and fosters disclosures that are arguably vital in a system of self-assessment. Nevertheless, it has been very controversial. It has been suggested that this reform misses the true cause of the tax gap.69 Doubts have also been cast on the legality of IRS’s attempt to rely on returns powers to support the demand for disclosures. It addition, some of the disclosures may potentially conflict with the protection conferred on certain classes of information subject to privilege despite IRS’s success in the case of United States v Textron Inc.70 Last, the impact of the absence of specific penalties for non-compliance remains to be seen even though taxpayers are likely to be mindful of the implication that manifestly inadequate compliance is likely to give rise to adverse inferences.71

The efficacy of the UTP regime is likely to be monitored closely by other tax administrations. It is premature at this stage to predict the response of large corporations until after some of the definitional and structural issues have been resolved. The outcome would also depend on the availability of resources at the disposal of tax authority to process and utilise the additional information collected. As an experimental reform, adhering to the policy of restraint would strike a better balance to foster acceptance by the affected taxpayer community. In that respect, it would appear to be sensible at this stage to refrain from penal sanctions for non-compliance as well as requiring detailed disclosures that are likely to impose an undue burden on taxpayers.72

68 Harvey, p 9.

69 See Kennedy, p 406. Over the last 15 years, nearly all of the EU countries have had their corporate tax rates cut: see Daniel Mitchell, Corporate Taxes: America Is Falling Behind, Cato Inst. Tax & Budget Bulletin (No. 48, July 2007) at p 1. In contrast, the USA has maintained an aggregate federal and state average tax burden of about 40%, the highest (about the same as Japan) in all OECD countries since 1993. As such, some US corporations had shifted operations to more competitive jurisdictions or succumbed to aggressive tax planning to remain in business.

70 Such as attorney-client privilege, work product privilege etc. Kennedy, p 422. United States v. Textron, Inc., 577 F.3d 21 (1st Cir. 2009)

71 Harvey recommends a carrot and stick approach in which full compliance with UTP schedule confers immunity from IRS scrutiny of tax opinions and reserves relating to disclosed UTPs, p 63

72 IRS Announcement 10-75, p. 5 notes that a reason for eliminating the requirement to compute the maximum tax adjustment were the comments that suggested that such a requirement would impose undue costs on corporations.
4.1.2.2 Supplementary Disclosures by Third Parties

However, improving information reporting processes must be undertaken with caution. One obvious drawback is the additional cost imposed on the reporting party. Further costs may be incurred due to opposition from affected third parties.\(^{73}\) Excessive information reporting requirements would be detrimental to the economy especially if the additional information fails to result in a meaningful reduction in the tax gap or produce efficiency gains elsewhere.\(^{74}\)

After the results of the last tax gap study were released, the IRS has successfully implemented several new measures to improve third party reporting.\(^ {75}\) From January 2011, organizations that process credit and debit card payments must submit annual reports of these payments to the IRS.\(^ {76}\) Brokerage firms are required to file returns containing information that includes the adjusted basis in the customers’ securities and the nature of any gains or profit.\(^ {77}\) Lederman believes that such a change would be valuable. The marginal cost imposed on the brokers would be nominal as the additional information required is currently being collected for regulatory or accountability purposes. From January 2012, businesses must file information returns for payments in excess of $600 to any corporation for services rendered.\(^ {78}\)

The UK government has also implemented a series of fairly robust measures to tackle tax avoidance. In March 2011, the UK government released a report “Tackling Tax Avoidance” detailing its new strategic approach to close the estimated tax gap of more than £40 billion.\(^ {79}\) One-third of the tax gap is due to tax evasion and tax avoidance. HMRC continues to invest in data-matching tools to improve the detection and measurement of tax

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\(^{73}\) Rifkin, p. 412.

\(^{74}\) Lederman, p. 1741.


\(^{76}\) Inland Revenue Code (Title 26) [IRC], §6050W; Housing Act 2008, §3091(a),

\(^{77}\) IRC, §6045

\(^{78}\) IRC, §6041 was amended by §9006 of the Patient Protection and Affordable Care Act 2010 to include payments from or to any corporation not exempted from tax. The effect of the amendments would end the regulatory regime which exempts payments to corporations from general requirements of information reporting.

evasion.\textsuperscript{80} Data collected from third party reporting is matched with the internal data of HMRC to identify the sources and scale of any undeclared income. Intentional tax evaders are either subject to closer scrutiny or to more burdensome disclosure requirements \textsuperscript{81}.

In relation to tax avoidance, the new approach targets prevention, early detection and counteraction. One of the key components of this strategy involves an enhancement of its tax disclosure regime. The Disclosure of Tax Avoidance Schemes legislation requires the promoter of a bespoke or generic tax avoidance scheme to disclose it to the HMRC within 5 days if it involves an arrangement that is expected to procure a tax advantage for any person.\textsuperscript{82} Each disclosed scheme is tagged with a scheme reference number (SRN). From 2010, every promoter is required to periodically furnish the HMRC with full details concerning clients to whom SRNs have been issued.\textsuperscript{83} HMRC reports that the total number of disclosures for direct and indirect taxes have increased by about 10 times from August 2004 to April 2010\textsuperscript{84}. This scheme has closed off £12bn in avoidance opportunities between 2004 and 2009\textsuperscript{85}.

Another pillar of the strategy involves a reinforcement of its legislative and operational powers to make immediate changes to revenue legislation to defeat tax avoidance schemes that have been identified. Briefly, the “Protocol on unscheduled announcement to changes in tax law” sets out the process and criteria for the exercise of Ministerial power to effect changes in tax legislation before the final amending legislation comes into force. Briefly, a Written Ministerial Statement outside a scheduled fiscal event may be made in situations where: (1) there would otherwise be significant risk to the Exchequer; (2) significant new information has emerged to identify the risk or indicate its scale; and (3) changing the law immediately would prevent significant losses to the Exchequer\textsuperscript{86}. HMRC acknowledges the concerns raised that have been raised during the public consultation. It has reiterated its commitment to strike a balance between the need for stability in the tax system

\textsuperscript{80} Supra, HMRC Protecting Tax Revenues 2009, pp. 14-15

\textsuperscript{81} See http://www.hmrc.gov.uk/about/tax-defaulters.htm for details of the HMRC Managing Deliberate Defaulters Programme.

\textsuperscript{82} Finance Act 2004 (Chapter 12), section 306. Introduced on 1 August 2004, the scheme was initially limited to employment income, financial products and VAT. By April 2010, it was extended to Income Tax, Capital Gains Tax, National Insurance Contributions and Stamp Duty Land Tax.

\textsuperscript{83} Finance Act 2010 (Chapter 13), Schedule 17, Clause 6

\textsuperscript{84} See http://www.hmrc.gov.uk/avoidance/avoidance-disclosure-statistics.htm


\textsuperscript{86} See http://cdn.hm-treasury.gov.uk/2011budget_taxavoidance.pdf at chapter 4
and allowing decisive action when risks to the Exchequer have been identified. In particular, it reassured the public that changes would generally be confined to specific risks and any retroactive changes to a date earlier than an announcement date would be “wholly exceptional”\(^87\).

### 4.1.2.3 Incentivising Disclosures: Whistleblowing

In this respect, the perception of the value of instituting a whistleblowing program to incentivise disclosures is rather divergent. As a tool to bridge the informational asymmetry, it has merits. Potential whistleblowers are typically insiders who possess some form of information on any tax evasion scheme. If the experiences of some countries are of any value, the amount of recovered tax revenues that are attributable to whistleblowing is not significant. Two reasons may be offered. First, potential whistleblowers who are insiders may refrain from divulging information if there is a real risk of self-incrimination by reason of their interests or involvement in the schemes. Second, the perceived value of confidentiality undertakings by the tax administration may be deemed to be inadequate. There will always be tensions between the tax administration’s commitment to protect the identity of the whistleblower and potential obligations to submit to discoveries in any civil proceedings.

In 2006, the IRS enhanced the whistleblowers’ program\(^88\). A Whistleblower Office was established to offer a reward of 15-30% of the amount of taxes recovered if the information supplied substantially contributes to the recovery of taxes or related payments in excess of $2m.\(^89\) The table below shows the details of the program from FY 2006 to 2010\(^90\).

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\(^88\) §7623(b) of the Code was created by the Tax Relief and Health Care Act of 2006 (section 406) (PL 109-432)

\(^89\) IRC, §7623b; those who do not exceed the monetary thresholds will be given awards at the discretion of the IRS (IRC, §7623[a]).

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The US Government Accountability Office has issued a report with recommendations to improve the processes and outcomes of the Whistleblower Office. The proposed changes include the tracking of processing time to reduce delays in awards, enhancing communication with whistleblowers, improving the robustness of criteria for the determinations of awards and detailed reporting to Congress on the progress. While the aggregate revenue yield may appear to be negligible relative to the size of the tax gap, it is submitted that the existence of such a facility has beneficial indirect benefits. An additional source of informational supply to the tax authority may restore a healthier level of fear in the purveyors and purchasers of tax planning schemes.

Singapore has a similar scheme for whistleblowers to come forward with information that leads to the recovery of tax. The reward is 15% on the tax recovered, capped at $100,000. The UK has yet to establish a comprehensive whistleblowing program. Currently, HMRC has a whistleblowing hotline although no reward has been posted in exchange for a successful tip off.

4.2 International Tax Gap Reduction

Tax evasion assumes greater dimensions with globalization. The opportunities for tax evasion have increased with the mobility and fungibility of capital. The complexity of cross-

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border transactions make it increasingly difficult for tax authorities to identify and monitor. In some countries, international tax evasion contributes a significant portion of the tax gap. Under an established rule in private international law, it is considered to be contrary to public policy and sovereignty for a country to assist another in the direct or indirect enforcement of the latter’s revenue claims. There has been limited success in judicial attempts to restrict the operation of this rule.

4.2.1 Exchange of Information (EOI)

In 2008, international tax cooperation changed dramatically when G20 and the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum") set out to secure the widespread global adoption of the OECD’s EOI standards. At present, there are 101 jurisdictions that are members. The primary aim of EOI is to prevent the frustration of domestic tax laws of one state with safeguards for appropriate privacy needs and the domestic interests of the assisting state.

Ongoing peer reviews by the Global Forum will ascertain the adequacy of national regulatory frameworks and their implementation processes. To preserve a level playing

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94 Supra, P Shome, (2006) at p 40

95 See Rifkin, at p. 391: approximately 15-30% of the US tax gap is due to offshore tax evasion. In Sweden, tax authority estimates that approximately 35% of the Swedish tax gap had an international connection: See Swedish Tax Gap Report [Swedish Tax Gap Report], p. 48

96 Government of India v Taylor [1955] 1 All ER 292 (HL)


99 OECD Model Tax Convention on Income and Capital [MTC], Article 26(1); Global Forum Information Brief, Annex V, p. 17. There are confidentiality safeguards in Article 26(2).

100 Ibid, Annex IV, p. 14. Nearly 200 reviews are expected to be concluded by the end of 2014. The reviews are conducted by 30 representative members of the Global Forum: Argentina, Australia, Bahamas, Brazil, BVI, Cayman Islands, China, Denmark, France, Germany, India, Ireland, Isle of Man, Italy, Japan, Jersey, Korea, Luxembourg, Malaysia, Malta, Mauritius, Mexico, Netherlands, St. Kitts and Nevis, Samoa, Singapore, South Africa, Switzerland, UK and USA. See http://www.eoi-tax.org/keydocs/schedule-of-reviews#y2012 for a schedule of national reviews over 2 phases.
field, the reviews extend to non-members too\textsuperscript{101}. Shortcomings identified in peer reports on several jurisdictions are being addressed\textsuperscript{102}. The Global Forum also acknowledges the need to provide technical assistance to some developing countries and smaller jurisdictions\textsuperscript{103}. Programmes designed for this purpose include drafting of guidelines, pilot projects, training and platforms for national tax authorities to share their best practices\textsuperscript{104}.

The massive success of the Global Forum’s efforts can be measured by the adoption rate of the new EOI standards in the short time between the Washington G20 Summit in November 2008 and August 2011. The number of Double Taxation Agreements (DTAs)/Tax Information Exchange Agreements (TIEAs) updated or inked rocketed by more than 15 times from 44 to 712\textsuperscript{105}. Unlike in 2009, all jurisdictions (save 5) surveyed by the Global Forum in 2011 have substantially implemented the EOI standard\textsuperscript{106}. There is currently no jurisdiction listed as an uncooperative tax haven.

Besides the OECD framework, the EU Savings Directive is worth a mention. It mandates automatic EOI between member states on interest payments from a paying agent in one state to the beneficial owner in the other\textsuperscript{107}. EU members who opt out of EOI are required to impose a withholding tax on the interest earned and transfer 75\% of the tax revenue collected to the resident state of the beneficial owner\textsuperscript{108}. Based on empirical information, the withholding tax option has yielded substantial revenues\textsuperscript{109}.

\textsuperscript{101} Global Forum Information Brief, Annex IV, p. 15 and FAQ, p. 31.

\textsuperscript{102} Statement of Outcomes, Global Forum Meeting, Bermuda, 31 May – 1 June 2011 (Statement of Outcomes, Bermuda), p. 3.

\textsuperscript{103} Statement of Outcomes, Bermuda, p. 2.

\textsuperscript{104} Ibid., p. 3.

\textsuperscript{105} Global Forum Information Brief, Annex IX, p. 24.

\textsuperscript{106} 36 tax havens and 8 financial centres had not implemented the international standards. 4 jurisdictions were not committed to the international standards: see \textit{A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard (2\textsuperscript{nd} April 2009)} at \url{http://www.oecd.org/dataoecd/38/14/42497950.pdf} and compare with the update as at 10 August 2011 available at \url{http://www.oecd.org/dataoecd/50/0/43606256.pdf}. The 5 jurisdictions that have yet to fully implement the standards are Guatemala, Montserrat, Nauru, Niue and Uruguay. Montserrat and Uruguay have concluded 11 and 9 relevant agreements so far.

\textsuperscript{107} See Articles 2, 4, 8 and 9 of the Council Directive 2003/48/EC. Information such as the identity and residence of the beneficial owner together with the identification of the debt claim giving rise to the interest has to be transmitted to tax authority of the state in which the beneficial owner is located. See \url{http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/rules_applicable/index_en.htm}

\textsuperscript{108} See Articles 11 and 12 of the Council Directive 2003/48/EC. Initially, Belgium, Austria and Luxembourg opted out to levy a withholding tax: see Article 11. The rate is 35\% from 1 July 2011. On 1 January 2010,
4.2.2 Bilateral Withholding Tax Agreements

The unique developments in Switzerland merits a special mention. Since March 2009, Switzerland has amended many of their DTAs to comply with the new EOI standards. As at August 2011, twenty-one DTAs with an extended administrative assistance clause were approved by parliament. Besides these EOIs, an interesting alternative has emerged.

In August 2011, Switzerland signed agreements with Germany and the UK to withhold taxes on future investment income and capital gains of German and UK residents. The payment of the withholding tax (26.375% for Germany and between 27% and 48% for the UK, depending on the nature of the capital income) is deemed to discharge the tax obligations owed to the country of residence. In addition, these agreements provide for retrospective taxation. A German or UK resident may make an anonymous lump-sum tax payment (19% to 34% of the assets in question) or elect to disclose his past fiscal circumstances to the tax authorities.

Belgium elected to implement an automatic exchange of information. The withholding tax option expires when Liechtenstein, San Marino, Monaco, Andorra and Switzerland agree to exchange information. Except for Switzerland, all these countries have agreed to exchange information. Since there is no sunset clause, an EU-wide automatic exchange for all member states is unlikely to materialise so long as Switzerland maintains its rejection of automatic exchange of information.

The gross revenue from the retention tax on the interest income of EU taxpayers in Switzerland amounted to CHF 432 million in 2010. CHF 324 million were thus transferred to EU member states. Approximately 38,000 voluntary declarations were received for 2010. See http://www.efd.admin.ch/dokumentation/zahlen/00579/00608/00634/index.html?lang=en

However, information will only be provided if the taxpayer is identified by the requesting party in some way that satisfies the Swiss tax authority. See Switzerland Federal Department of Finance, “The requirements for administrative assistance in tax matters should be revised,” 15 February 2011, p. 4, available at http://www.news.admin.ch/NSBSubscriber/message/attachments/22119.pdf

The first ten DTA partners are Austria, Denmark, Finland, France, Luxembourg, Mexico, Norway, Qatar, Spain and the UK. The deadline for the optional referendum expired unused at the start of October 2010. See http://www.efd.admin.ch/dokumentation/zahlen/00579/00608/00642/index.html?lang=en. Another 14 DTAs or protocols have been signed and parliamentary approval is expected to be obtained in due course. See also OECD Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Review Report Phase 1 Switzerland (June 2011) [OECD Switzerland Review], pp. 73-74 paragraph 232, preview available online at <http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/global-forum-on-transparency-and-exchange-of-information-for-tax-purposes-peer-reviews-switzerland-2011_9789264114661-en>

Since such a withholding tax is considered as having a long-term impact equivalent to the automatic exchange of information, these agreements are likely to influence the debate within the EU\textsuperscript{113}. While agreements with other jurisdictions appear to be an attractive option, there are several implementation issues to bear in mind. Domestic laws may need to be amended to authorise the collection and exchange of information, or to withhold taxes for foreign jurisdictions\textsuperscript{114}. The effectiveness of the final mechanism may also be subject to the efficiency of the administrative process, the resources allocated and the complexity of the legal process.

4.2.3 Contractual Obligations to Share Information and withholding of tax

Aside from encouraging foreign authorities to disclose information, international tax information exchange could be enhanced by a carrot and stick approach. The USA enacted the Qualified Intermediary (QI) program in 2000 where foreign financial institutions contract voluntarily with the IRS to withhold and report taxable US income.\textsuperscript{115} QIs may maintain the privacy of their client while non-QIs have to reveal the client’s identity to be eligible for treaty benefits.\textsuperscript{116}

In a bid to further combat offshore tax evasion, the US enacted the Foreign Account Tax Compliance Act (FACTA) in 2010 which requires US taxpayers holding foreign financial assets exceeding $50,000 to report information about those assets to the IRS. Foreign financial institutions must report information about financial accounts held by these US taxpayers to the IRS.\textsuperscript{117} Under FACTA, the financial institutions must enter into an agreement with the IRS to withhold tax at 30\% on any payment of taxable US income to a

\textsuperscript{113} Greece and Austria have expressed their interest for similar agreements. France and Italy are firmly opposed to such a solution fearing that it could undermine the EU’s endeavours.

\textsuperscript{114} The ordinance of 1 September 2010 (OACDI, RS 672.204) is being replaced by an Act to be approved by parliament. See http://cms.unige.ch/droit/cdbf/spip.php?article764&lang=fr


\textsuperscript{116} USGAO QI Report, p. 11; QIs report their customer income and withholding information in groups of similar recipients receiving similar benefits.

non-participating foreign financial institution. Financial institutions that have entered into QI agreements are not exempted from this provision.

### 4.2.4 International Transfer Pricing

The rapid adoption and development in Transfer Pricing Laws around the world in recent years is nothing short of phenomenal. Tax Administrations are increasingly aware of the risk of tax erosion from the increased volume in trans-national activities and intra-firm transactions that may not comply with the arm’s length price. Some multi-national enterprises artificially manipulate the trade and non-trade payments for the transfer of goods or services between members of the group to reduce the aggregate tax burden of the group. In the absence of homogenous tax base or rate, countries that levy higher rates of tax fear that artificial transfer pricing may result in corporate profits being siphoned off to jurisdictions with lower tax burdens. Many countries have implemented aggressive audit programs and stepped up penalties for non-compliance. This area has received tremendous attention in the literature elsewhere and shall not be repeated here.

The urgency to address transfer pricing abuse can be seen in the developments even in countries that levy relatively lower rates of income tax. Singapore offers a good example. Up until 2009, Singapore did not have a comprehensive legislative provision to deal with transfer pricing. The move came as a surprise to some as it had always been thought that Singapore had little incentive to enforce the arm’s length standard given its relatively low tax rates. While is it generally true that financial incentives from aggressive transfer pricing practices are greatest in high tax jurisdictions, it does not follow that low incidence of transfer pricing is associated with low tax burdens. The factors that drive the demand for transfer pricing manipulation are as complex as the policy reasons that justify the imposition of lower

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119 Joint Committee Report, p. 42.

120 [OECD Intra-firm Trade] p 2

121 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, August 2010. See also P Shome, p 52-54.*


123 On 23 February 2006, IRAS took the historic step to issue the first set of transfer pricing guidelines that contain an explicit direction for related persons to adopt the arm’s length principle as the standard for pricing the transactions with each other.
Moreover, it is worthwhile to point out that the necessity for the enactment of a transfer pricing provision is not obviated by low tax burdens.

Several reasons may be offered. First, effective tax burdens are relative and can vary significantly across jurisdictions. Second, the actual incidence of tax can be reduced or avoided in many ways. Third, unless the prevalence of tax inducements in capital-importing jurisdictions and the seduction of tax havens diminish significantly, transfer pricing in some form or other will continue to flourish in our highly integrated world economy where a large percentage of the world trade consists of intra-group transactions. As such, it is not surprising that national revenue authorities, irrespective of their domestic tax rates, remain vigilant to changes in the trends in worldwide tax rates and developments in the global supply chain that may potentially jeopardize their fiscal sustainability.

In recent years, the national tax authorities in many leading jurisdictions have strengthened their enforcement powers and raised the penalties for transfer pricing violations. Thus, it is foreseeable that Singapore may have to expend substantially more resources to cope with an increasing volume of transfer pricing reviews and possibly confront inevitable revenue sacrifices for acceding to more requests for corresponding adjustments by global businesses under the Mutual Agreement Procedure found in all of the 70 Double Tax Agreements that Singapore has concluded with its trading partners. The assumption that “MNCs are more likely to place profits into Singapore rather than out of Singapore” may no longer be valid.

4.3 Tax Amnesty

Tax Amnesty programs are often used by tax authorities to target taxpayers who under-declare their taxable income. It is especially useful in cases involving foreign income

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125 While there is a dearth of data on intra-firm trade across jurisdictions, the liberalization of international goods and services in the last two decades has spawned an unprecedented growth in global value chains by MNCs. The growth in the volume of trade has outstripped GDP growth by a factor of 2 in the same period: see OECD, Working Party on International Trade in Goods and Trade in Services Statistics, Intra-firm Trade: A Work in Progress, 2010, p 32.

126 More than two-thirds of the 69 comprehensive DTAs that Singapore has concluded contain the equivalent of Article 9(2) of the OECD MC. Article 9(2) requires a contracting state to make a corresponding adjustment to a taxpayer who has suffered a primary adjustment in the other contracting state to eliminate any unrelieved double taxation. About a quarter of the DTAs that do not contain Article 9(2) are older DTAs concluded before 1980 that were likely to have been based on the 1977 OECD Model Convention.

where the enforcement powers of the tax authority is severely limited. The common inducement offered in exchange for voluntary disclosure of past untaxed income is a significant but temporary reduction in tax liabilities including penalties. The rationale for instituting tax amnesty programs usually involves a pragmatic judgment to forgo the maximum potential tax revenue that has proven to be difficult to enforce with the objective to maximise the current and future revenue collection for that category of income or taxpayers. The UK House of Lords in a case commonly known as the *Fleet Streets Casuals* case\(^{128}\) noted that the tax authority’s decision to forgo maximum potential taxes in the light of enforcement costs was made for “good management” reasons and ought to be upheld.\(^{129}\)

The attractiveness of tax amnesty programs is especially high where there is financial pressure to secure an immediate increase in tax revenue that cannot readily achieved through normal budgetary means.\(^{130}\) Tax amnesties may also prove to be helpful in improving the overall compliance levels through an enlargement of the taxpayer base.\(^{131}\) However, the effectiveness of a tax amnesty may well be contingent on the existence of a real and credible threat of detection and punishment.\(^{132}\) The success of tax amnesty programs may be said to be positively correlated to the robustness of the underlying infrastructure and legal framework of the tax system. Nevertheless, some academic scholars have cast doubts on the reliability of government statistics as success indicators since the receivables captured in the figures would invariably include amounts that might otherwise have been collected in the


\(^{129}\) *Ibid*, p. 637. In that case, the chairman of the Board of Inland Revenue stated that due to the large number of taxpayers, the sums involved and the limitations of resources, it was impossible to collect all the taxes due. The reduction of tax liability to improve future compliance was seen to be the most cost-effective.


\(^{131}\) Alm, p. 4; Uchitelle, p. 49. Baer and Le Borgne, p. 6.

\(^{132}\) Uchitelle, p. 51-52; The IRS’s Offshore Voluntary Disclosure program increases the incentives to comply with the program by citing the new Foreign Account Tax Compliance Act which threatens to increase the effectiveness of future enforcement efforts and hence the probability of detection (<http://www.irs.gov/businesses/international/article/0, id=235699,00.html>).
normal course of tax enforcement absent the tax amnesty program. There have also been disagreements among economists about the beneficial impact of such programs.

There have been some conflicting experiences with tax amnesty programs. California reported that its previous tax amnesty programs reaped returns that exceeded their costs. Italy’s tax amnesty program reportedly managed to repatriate 98% of illegally-held funds and provided €5bn in additional tax revenue. However, tax amnesty programs have also had some failures. Argentina, for instance, had a tax amnesty program that generated no significant returns.

If administered judiciously, they have the potential to increase the long term compliance rates. Yet, ill-considered repetitions of tax amnesty programs could create insidious expectations of future programs. At its worst, it could jeopardise the integrity of the tax system and encourage the perception among some taxpayers that tax evasion during the intervening periods could prove to be profitable. The reduction in perceived fairness of the system may adversely affect the compliance rates of otherwise honest taxpayers. Several

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135 The Voluntary Compliance Initiative (Jan-Apr 2004) and the Tax Amnesty Program (Feb-Mar 2005).

136 California Franchise Tax Board, “Tax Gap Plan: A Strategic Approach to Reducing California’s Tax Gap,” 2006 available online at <http://www.ftb.ca.gov/aboutFTB/TaxGapStratPlan.pdf>, p. 7 states that for an investment of under $13m, the tax amnesty programs managed to yield $6.2bn worth in taxes that would not otherwise have been paid.

137 A reduced penalty was offered for funds held offshore if those funds were repatriated or declared from September 15, 2009 to April 15, 2010.


140 Baer and Le Borgne, pp.2-3; Uchitelle, p.49, “These expectations can decrease the incentive to pay taxes routinely and lead eventually to an increase in the number of tax evaders.”

141 Carroll, p. 47 argues the motivation to comply with a tax system in inextricably linked to a taxpayer’s perception of the fairness in the outcome; Kristina Murphy, “Procedural Justice, Shame and Tax Compliance,” Working Paper 50, November 2004, Australian National University [Murphy], available online at <http://ctsi.anu.edu.au/publications/WP/50.pdf>, pp. 1-2, where several studies are cited that taxpayers become more compliant where they feel that they have been treated fairly by the tax authority.
studies have provided evidence that additional tax amnesties are likely to produce decreasing yields and discourage future compliance.\(^{142}\)

For instance, India had implemented at least four Voluntary Disclosure of Income Schemes (VDIS) in 1951, 1965, 1975 and 1997.\(^{143}\) While the absolute number of income disclosures had increased with each scheme, the ratio of VDIS collections to GDP figures in 1997 was only marginally higher than that in the earlier schemes\(^{144}\). It is also noteworthy that there is a decline in the percentage of declarants to assesses from 6.8% and 33% respectively in 1965 and 1975 to 3.6% in 1997. There has been no VDIS since 1997. A possible reason could be a realisation that frequent repetition of such schemes may incentivise further tax evasion among some delinquent taxpayers who expect a better deal in the next VDIS.\(^{145}\)

It has been reported that the US Congress is considering a repeat of a tax repatriation holiday that it last offered in 2004\(^{146}\). As some of the macro-economic indicators in the USA continue to deteriorate, there is a real a policy dilemma when forecast suggests that the repatriation of foreign sourced income to the US can result in the much vaunted boost to the economy. Yet, policymakers cannot lightly ignore the fact that short term gains from tax amnesty programs can inflict long term tax losses. The Joint Committee on Taxation estimates that the proposed 2011 tax repatriation holiday would net $25.5bn during the subsequent 3 fiscal years but may result in revenue losses of $78.7bn over a decade.\(^{147}\)


\(^{143}\) See http://www.incometaxindia.gov.in/HISTORY/PRE-1922.ASP

\(^{144}\) In the 1975 VDIS, Rs. 1500 Crore was disclosed as Undisclosed Income/Wealth compared with the aggregated of Rs. 267 Crore disclosed during the 1951 and 1965 VDIS: see http://www.incometaxindia.gov.in/archive/BreakingNews_PresidentSpeech150yrPublication_07152011.pdf. The 1997 scheme brought in more than 12 times the total collections from the earlier VDIS: see http://www.cag.gov.in/reports/d_taxes/2000_book2/index.htm, Report of the CAG on the union Government for the year ended March 1999- Voluntary Disclosure of Income Scheme, 1997- Union Government - (Direct Taxes) - (12A of 2000)

\(^{145}\) The 1997 Scheme was challenged before the Bombay High Court on grounds of being unconstitutional. While the validity of the scheme was upheld by the High Court, it was observed that frequent repetition of such schemes made tax payers optimistic of getting a better deal in the next VDIS: see All India Federation Of Tax Practitioners Association vs Union Of India & Ors. (1997) 228 ITR 68 Bombay. The High Court decision was upheld on appeal to the Supreme Court [(1998) 231 ITR 24 (SC)]

\(^{146}\) If it is finally offered on the same terms at the previous holiday, the tax rate will be temporarily reduced from 35% to 5.25% for a one year period.

\(^{147}\) Joint Committee on Taxation Report (April 15 2011) available online at http://doggett.house.gov/images/pdf/jct_repatriation_score.pdf, p. 2
4.4 **Shaming Offenders**

In some countries, an alternative to secure higher voluntary compliance without an attendant increase in administrative costs utilises a different tactic on tax evaders. Publishing the identities and details of tax evasion to divert public resentment against tax evaders can have a significant deterrent effect especially on large corporations and wealthy high profile individuals. Shaming subjects tax offenders to public criticism and increases the social and financial costs of evasion through the resultant loss of reputation or social standing.\(^{148}\) However, its effectiveness is the function of the offender’s ability to deal with the criticism including opportunities to deflect personal responsibility to third parties or the state.\(^{149}\) The discretion of a tax authority to freely publish details may also be constrained by the scope of the laws that safeguard taxpayer privacy and confidentiality of tax information.

Greece has recently started a program that publishes the names of high profile tax evaders.\(^{150}\) In the UK, the HMRC publishes information about deliberate tax defaulters if the tax penalties imposed exceed £25,000.\(^{151}\) The IRS has also been known to publish the names of tax offenders in a bid to shame them.\(^{152}\) However, the US has a relatively robust legal regime that protects the confidentiality of tax return information.\(^{153}\) As a result, it may not expedient for the IRS to shame errant taxpayers as freely as it would have been desired.\(^{154}\)

Some jurisdictions have enacted legislation to address the issue. South Africa’s income tax laws prohibit disclosure of tax related information except under limited circumstances which includes the publication of identities of some offenders.\(^{155}\) The UK has also enacted legislation to allow the shaming of offenders under the UK Managing Deliberate

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\(^{148}\) Rifkin, pp. 414-415.

\(^{149}\) Murphy, p. 5; p. 17.


\(^{153}\) IRC, §6103; Rifkin, p. 415.

\(^{154}\) Rifkin, pp. 415-416.

Defaulters programme. The Income Tax department in India is also working on a plan to enable the tax authorities to publish names of tax defaulters in newspapers, with a view to shame them.  

In the Philippines, the Bureau of Internal Revenue (BIR) has enlisted the help of the public to complement a new “name and shame” initiative. In August 2011, the BIR announced a plan to crackdown on the “highest-paid but perennially under-taxed” professional sector. It will embark on a “name and shame” drive by publishing lists that rank professionals for each industry based on taxes paid with particular attention paid to those at the top and bottom of their industry. It has been reported that employees who are subject to tax by source deduction bear over 85% of total individual income tax. It hopes to redress the imbalance by getting self-employed professionals like doctors, dentists, engineers, accountants, architects and lawyers to comply fully with their tax liabilities. Besides enhancing registration and booking keeping requirements, the BIR has urged the public to assist in the campaign by demanding for official receipts to be issued for services rendered.

5 Conclusion

The persistent tax gaps that exist in developing countries is a well-recognized and yet intractable challenge. There is consensus among scholars that the key solution lies in the centrality of tax administration. One of the strongest advocates, Richard Bird, noted that in most developing countries, “the administrative aspect of taxation is overwhelmingly important”. Thus, the provision of adequate resources for development programs in the tax administration would create a fundamentally important connection between tax policy and economic development. An effective tax administration will aid the implementation of legislated tax policies which in turn leads to an increase in fiscal resources. Richard Goode has observed that “while almost every developing country has enacted penalties for both negligent and intentional failure to comply with revenue laws, few civil, and virtually no

156 Section 94, Finance Act 2009 (Chapter 10).


158 See http://business.inquirer.net/9023/bir-lowers-boom-on-professionals


160 See http://www.philstar.com/Article.aspx?articleid=714218&publicationSubCategoryId=107

criminal penalties are ever assessed and collected. The UN also notes that 40% of the tax gap in Africa is “caused by inefficient administration within the taxation system. Improving tax administration would most certainly reduce the tax gap and enhance revenue yield.”

The OECD Practice Note on “Principles of Good Tax Administration” points to the critical importance of “competence” for tax authorities. It recommends the adoption of sound and rational policies on recruitment, training and promotion of employees on the basis of merit and equal opportunity. The power that is wielded by tax officers is substantial and tax administrations have to be alert to the risk of corruption taking root in the system. The level of corruption in some tax administrations of developing countries is partly due to the excessive and unnecessary complexity of tax laws. The need to provide competitive remuneration to attract and retain talent has also been highlighted. In many developing countries, where unskilled and ill-equipped revenue authorities prevail, “most work is done manually, causing delays and mistakes … many tax offices do not have computers, and those that have computers do not use them properly.”

The use of computer technology can greatly aid in the creation of a robust database that provides tools for search, retrieval and verification of information relating to taxpayers for the purpose of supporting audit selection, investigation and resolution functions. For instance, the relentless move towards automation and e-filing over the last 2 decades in Singapore has made the filing process extremely efficient. In YA 2010 the filing of tax returns was a non-event for a third of individual taxpayers. 94% of the rest filed their returns online.

Last, tax administrations need to ensure that there is a prompt and effective exchange of information with taxpayers on changes in the tax laws. The lack of transparency and uncertainty from frequent changes to tax rulings, coupled with a primitive management information system as described above, discourages tax compliance and fuels corruption.

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166 Ibid [Arindam] at p.270.

In this and the other aspects highlighted above, it is imperative that tax administrations continue to strive to adopt international standards to strengthen institutional legitimacy. They should support and participate actively at international tax forums to share and learn the best practices from one another.168

END

168 Supra, [OECD Principles of Good Tax Administration – Practice Note”