



Extract from the report to the  
Public Accounts Committee on  
SKAT's compliance strategy II

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## I. Introduction and conclusion

1. This report is about the strategy pursued by SKAT (Danish Tax and Customs Administration) to increase Danish taxpayers' compliance with tax regulations. Rigsrevisionen initiated the examination in October 2010.

2. SKAT's mission is to ensure fair and effective financing of the public sector. Fair financing means that individuals and businesses comply with the regulations and pay the correct amount of tax. It is essential that individuals and businesses comply with the regulations and pay the correct amount of tax in times like these when public finances are under pressure.

3. SKAT's compliance strategy was implemented in 2007 after the merger of the national and the municipal tax administration authorities. At the same time, SKAT decided to introduce a new overall objective of its activities, namely to cap the tax gap at 2 per cent of the gross domestic product.

The main objective of SKAT's compliance strategy is to increase the taxpayers' compliance with the tax regulations; SKAT will attempt to increase revenues from the ordinary tax collection and focus on preventing errors rather than controlling and correcting errors in the tax declarations. SKAT has made it a priority to provide individuals and businesses with the instruments and information required for them to make correct declarations and pay the correct amount of tax. The purpose of this approach is, among other things, to release resources for an intensified effort directed at deliberate tax evaders.

SKAT's compliance strategy is based on the understanding that the majority of Danish taxpayers wish to make correct declarations, i.e. they are considered *partners*, whereas a minority of the taxpayers are considered *adversaries*. According to the strategy, increasing the compliance of partners as well as adversaries will therefore require differentiated activities.

4. Rigsrevisionen had examined SKAT's compliance strategy in report no. 3 from December 2008. This report was mainly focused on the theoretical reasons for SKAT's change of strategy. In its comments to the report, the Public Accounts Committee noted that SKAT's new compliance strategy represented a significant change of strategy from control to prevention which would impact SKAT as an enterprise as well as national tax collection. On the same occasion the Public Accounts Committee remarked that it would be premature, at that time, to evaluate the effectiveness of the new strategy.

5. The objective of Rigsrevisionen's examination of SKAT's compliance strategy is to assess whether the strategy is achieving its objective, namely to increase the taxpayers' compliance with tax regulations. The report answers the following questions:

- Has SKAT's new compliance strategy produced the expected results?
- Has SKAT transformed the compliance strategy into projects that have led to increased compliance?

### Compliance

SKAT has for the tax years 2006 and 2008 analysed the taxpayers' compliance with the tax regulations. These studies are referred to as compliance studies.

### Tax gap

The tax gap is the difference between the amount of tax legally owed and the amount actually collected.

### Efforts

The activities launched by SKAT to increase the taxpayers' level of compliance. The activities can be preventive and aimed at making the taxpayers pay the correct amount the first time, or they may be focused on correcting errors made in the tax declarations, etc.

The efforts/activities are generally implemented in projects.

## MAIN CONCLUSION

In 2007 SKAT implemented a compliance strategy in order to increase individuals' and businesses' compliance with the tax regulations. The strategy calls for a differentiated approach to individual groups of taxpayers and reflects that SKAT wants to make it easy for the many taxpayers (partners), who wish to comply, and difficult for the taxpayers (adversaries) who do not wish to comply with the tax regulations. The differentiated approach provides an appropriate framework for SKAT's activities directed at individuals as well as businesses.

The examination showed that individuals' compliance has increased since SKAT implemented the compliance strategy. However, the compliance of businesses has decreased. In the opinion of Rigsrevisionen, SKAT's performance in respect to the level of compliance of businesses is not satisfactory.

Rigsrevisionen welcomes that SKAT is operating with an overall performance target – the tax gap – which is focused on ensuring the compliance of individuals and businesses. The tax gap was introduced as a performance target when SKAT in 2007 abandoned a management concept that was based on activity and tax adjustment targets. The tax gap is well suited to illustrate long-term development. Back in 2008 Rigsrevisionen emphasized that the tax gap did not cover the full range of SKAT's activities, and should be supplemented by relevant sub-targets, which would enable measurement of SKAT's performance also in the short term.

Rigsrevisionen has established that SKAT still has not finished the development of the target relating to the tax gap and set supplementary sub-targets relevant for performance management. This means that SKAT, four years after the change of strategy, still has not developed an overall performance management concept in replacement of the former concept.

It is essential that SKAT upgrades the development of its performance management concept. SKAT agrees and has taken steps to improve performance management.

Rigsrevisionen has examined SKAT's implementation of the compliance strategy. Successful implementation of the compliance strategy depends on the depth of SKAT's knowledge of the taxpayers and experience concerning the most effective approach to different target groups.

According to the examination, SKAT's implementation of the compliance strategy may be further improved, in particular in relation to adjusting the approach to the individual target groups.

Thus Rigsrevisionen's examination of eight compliance projects has shown that SKAT has generally organised the projects that were reviewed on the basis of a partner approach. This approach is based on the results of SKAT's general studies that show that the majority of taxpayers wish to comply with the rules. SKAT has therefore incorporated guidance in its projects as key to increasing compliance. Performing sample checks has been SKAT's preferred measure to determine whether the guidance has resulted in fewer errors.

SKAT's decision to approach the taxpayers as partners has in some cases been well-founded and has produced excellent results, but Rigsrevisionen's review of the eight projects also showed that the measures have not in all projects been used to their full potential. Consequently, the projects have not led to increased compliance.

In the opinion of Rigsrevisionen, SKAT has not to the extent required taken into consideration the segmentation into partners and adversaries, and as a consequence hereof, SKAT has not implemented a focused effort based on the appropriate measures.

Rigsrevisionen considers it essential that SKAT utilises all accessible knowledge of the taxpayers to ensure the effectiveness of the measures that are directed at the individual target groups. Rigsrevisionen's opinion is based on the fact that SKAT also prior to the implementation of the compliance strategy had robust knowledge of the taxpayers.

The main conclusion is based on the following findings:

#### Results of the activities

**SKAT's activities have not produced the expected results in all areas.**

Thus SKAT has not achieved its key objective (the tax gap) since it was introduced in 2006. Yet, the trend in SKAT's measurements of the tax gap in 2010 and 2011 is positive.

The development in the tax gap attributable to businesses has not been satisfactory, as the proportion of businesses that are making errors is quite high and on the increase. Rigsrevisionen is of the opinion that SKAT should improve its actions on the business area in order to increase the compliance of the business segment.

The results achieved in relation to individuals are excellent. Measurements of individuals' compliance indicate relatively few errors and a positive trend. SKAT has informed Rigsrevisionen that it will focus on sustaining the positive development.

In 2008, Rigsrevisionen pointed out that SKAT's compliance targets should be improved. Yet, the current targets still do not cover the full range of SKAT's activities and they are not adequately relevant for the performance management. SKAT should improve its target setting and follow-up on compliance activities to facilitate also short-term assessments of the performance of its activities. SKAT agrees and has taken steps to improve performance management.

### *SKAT's performance management*

- SKAT has an overall performance target – the tax gap - which is focused on ensuring that the taxpayers comply with the tax regulations. The tax gap target is not covering all types of taxes and is therefore not providing full overview of the development in the compliance area.
- Nor is the tax gap adequately relevant for the management of performance. The estimated tax gap is mainly suited to illustrate SKAT's long-term results. SKAT does not at this point operate with supplementary targets that – in the short term – reflect the extent to which SKAT is succeeding in making the taxpayers comply with the tax regulations and thereby reducing the tax gap.
- SKAT agrees that the current tax gap target viewed separately is of little value to performance management, and has taken steps to improve the tax gap target and develop performance management. However, Rigsrevisionen has noticed that significant areas like, for instance, shadow economy and large corporation tax are not included in SKAT's new tax gap targets.

### *Tax gap trend*

- SKAT has not achieved its overall objective (the tax gap) since it was introduced in 2006. The trend in SKAT's estimated tax gap for 2010 and 2011 is, however, positive.

### *Compliance trend*

- SKAT has achieved excellent results in relation to individuals. SKAT's measurements of individuals' compliance in the tax years 2006 and 2008 reflect a relatively high level of compliance, which is on the increase. The error rate in individuals' tax declarations dropped from 8 per cent to 6 per cent in the same period.
- Results achieved in relation to the compliance of businesses have not been satisfactory. SKAT's measurements show a decreasing and low level of compliance. The error rate attributable to businesses has thus increased from 42 per cent in the tax year 2006 to 52 per cent in 2008. At the same time the number of adversaries in the business segment has increased from 7 per cent in 2006 to 10 per cent in 2008. In conclusion, SKAT has not fulfilled its intention of making it more difficult for the taxpayers to deceive the tax authorities.
- Rigsrevisionen is of the opinion that SKAT should improve its actions on the business area to achieve increased compliance. SKAT considers the level of compliance among businesses unsatisfactory and is planning to implement activities to increase the level of compliance.

### *Total tax revenues generated by projects*

- SKAT is assessing the performance of individual projects, but is not estimating the proportion of total tax revenues that is generated by SKAT's compliance activities. As a consequence hereof, it is not possible to determine whether the number of man years invested in the various activities match the tax revenues generated by the activities. Rigsrevisionen recommends that SKAT, as a supplement to its long-term performance targets, should monitor this factor also, as it is of importance to SKAT's assessment of the effectiveness of the various measures used. SKAT will incorporate this issue in its development of a new performance management concept. Yet, SKAT finds that actual tax adjustment targets should not necessarily be incorporated in the future performance management concept.

### **SKAT's selection and implementation of compliance projects**

**SKAT implements its compliance projects in risk areas characterized by a low level of compliance on the basis of systematic analyses.**

**SKAT has in certain areas achieved excellent results, in particular in areas where it has reduced the scope for errors and made it easier for the taxpayers to comply.**

**SKAT's compliance projects have, however, not all been successful and lead to increased compliance. SKAT has not had specific knowledge of the causes of the low compliance in the individual areas, but has organised the specific projects on the basis of its general understanding that the majority of taxpayers are considered to be partners. Rigsrevisionen finds that SKAT on account of the partner approach has, in some cases, used guidance as an instrument to increase compliance although analyses of the target group did not warrant this approach.**

**Rigsrevisionen is of the opinion that SKAT should in general analyse very carefully the causes of the errors and on the basis thereof decide on the approach to partners as well as adversaries in the projects.**

### *SKAT's selection of compliance projects*

- SKAT's planning and selection of compliance projects are based on the results of systematic risk analyses. The analyses allow SKAT to direct its activities towards areas where action is required. SKAT is also ensuring that over time the projects will cover the most important areas. SKAT selects projects in areas (e.g. specific lines of business) that are particularly error prone.

### *SKAT's implementation of compliance projects*

- The objective of SKAT's compliance projects is to ensure, either directly or indirectly, that more taxpayers comply with the tax regulations. SKAT has in general defined measurable key performance indicators for the projects.
- Most of the compliance projects have been organised on the basis of a partner approach. This approach has been selected because SKAT's compliance studies of the behaviour of randomly selected taxpayers show that the majority of the taxpayers can be categorized as partners. Furthermore, more than half the tax gap is attributable to errors made by partners. Rigsrevisionen is of the opinion that the partner approach is not in all cases well-founded, because the compliance projects have been implemented in specific risk areas characterized by a low level of compliance and among randomly selected taxpayers.
- Complicated rules or the taxpayers' inadequate knowledge of the rules is, in the opinion of SKAT, the main cause of errors in tax declarations. SKAT has therefore, in compliance with the partner approach, decided to focus on guidance as the key element in its projects. SKAT has on several occasions performed sample checks to determine whether the guidance initiatives have reduced error rates. Rigsrevisionen is of the opinion that in the individual projects, SKAT's knowledge of the behaviour of the taxpayers has been too general. Moreover, SKAT has not to the extent required followed its own project template, according to which the organisation of projects should include careful analysing of the composition of the respective target groups. As a consequence hereof, SKAT has in some cases focused on providing guidance although this approach has not been supported by the analyses of the target group. SKAT has therefore not achieved the planned compliance results. SKAT has stated that the experience derived from the projects has been incorporated in a new and more targeted campaign directed at the areas where guidance has been ineffective.
- Rigsrevisionen is of the opinion that SKAT should analyse very carefully the causes of the errors and then decide on the appropriate approach to partners as well as adversaries. SKAT agrees and has informed Rigsrevisionen that back in 2010 it was decided to launch more pilot projects before major national campaigns are implemented. The pilot projects must include detailed analyses of the most effective and cost efficient measures.
- SKAT's activities to prevent errors have been successful in some areas, in particular where it has reduced the scope for errors and, for instance, increased third-party reporting of tax data, and locked fields in the online tax assessment form (TastSelv).
- SKAT has followed up on the experience derived from its projects. SKAT has measured the performance of several projects in order to gauge the effectiveness of various measures. The experience gained has been incorporated in SKAT's efforts to focus its activities.