

**COMPARATIVE ANALYSIS OF REVENUE AUTHORITIES'
APPROACH TO TAX AUDITING AND TAX CRIMINAL INVESTIGATION
AND ITS EFFECT ON TAX COMPLIANCE**

by

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ABSTRACT

COMPARATIVE ANALYSIS OF REVENUE AUTHORITIES' APPROACH TO TAX AUDITING AND TAX CRIMINAL INVESTIGATION AND ITS EFFECT ON TAX COMPLIANCE

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The paying of tax is essential for the economic survival of any country. The effectiveness of the revenue authority responsible for the collection of that tax is equally critical as it is tasked with collecting the correct amount of tax due from all eligible taxpayers in terms of its legislation.

This research study has identified that the problem with tax collection by revenue authorities is that the behaviour of people differs as a result of varying influences or circumstances. This results in not everyone paying the correct amount of tax due. Much of this non-compliance can be corrected with education and efficient, appropriate service for those wanting to comply. Social norms also have a significant influence in terms of taxpayers doing the right thing. When necessary, soft approaches such as reminders through telephone calls, letters, advertisements, etc., are used with great effect. Unfortunately there are always those taxpayers who are deliberately non-compliant. The main aim of this research study is therefore to highlight that in order for the revenue authorities to ensure compliance from this category of taxpayers, stricter enforcement approaches, such as tax auditing and tax criminal investigations are necessary.

By comparing the tax compliance strategies of the revenue authorities for Australia, Canada and South Africa, the research study concludes that there are strong similarities adopted by them. This is likely due to their involvement with the Organisation for Economic Co-operation and Development which conducts intensive research into these aspects and

publishes this information for the benefit of all countries. The research study concludes that tax auditing and tax criminal investigations are an essential type of intervention for those taxpayers who do not comply. The research study further concludes that the purpose of these hard enforcement interventions is to ensure that the remaining tax base is protected and that the number of taxpayers in this category is limited or reduced. This enables the revenue authorities to improve collections through voluntary compliance. The research study, however, concludes that the effect of these interventions has not been accurately quantified by the three revenue authorities. Further research on the quantification of this effect will be most useful to any revenue authority, as it will assist in determining the extent of hard enforcement coverage.

Keywords:

Enforcement

Tax auditing

Tax criminal investigation

Tax compliance

OPSOMMING

VERGELYKENDE ANALISE VAN INKOMSTE OUTORITEIT SE BENADERING TOT BELASTING OUDIT EN BELASTING STRAFREGTELIKE ONDERSOEKE EN DIE EFFEK OP DIE BELASTINGOWERHEID

deur

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Die betaling van belasting is noodsaaklik vir die ekonomiese oorlewing van enige land. Die doeltreffendheid van die belastingowerheid wat verantwoordelik is vir die invordering van die korrekte hoeveelheid belasting betaalbaar vanaf kwalifiserende belastingbetalers in terme van die belastingwetgewing, is dus ewe noodsaaklik.

Hierdie navorsingstudie toon dat die probleem wat belastingowerhede ondervind met die invordering van belasting, die gevolg is van menslike gedrag wat verskil weens wisselende invloede of omstandighede. Die resultaat is dat sommige nie die korrekte bedrag belasting deur hulle verskuldig betaal nie. Meeste van die wetsongehoorsaamheid kan reggestel word deur opvoeding en doeltreffende dienslewering aan diegene wie wetsgehoorsaam wil optree. Sosiale standaarde speel ook 'n belangrike rol in die besluit deur 'n belastingpligtige om die regte ding te doen of nie. Indien nodig sal 'n ligte benadering, soos 'n aanmaning deur middel van 'n telefoonoproep, skriftelike aanmaning en advertensies die gewenste uitwerking hê. Nietemin sal daar altyd daardie kategorie van belastingpligtige wees wat opsetlik die wet verontagsaam. Die hoof oogmerk van hierdie navorsingstudie is dus om te beklemtoon dat in die geval van hierdie kategorie van belastingpligtige, die belastingowerheid strengere gehoorafdwinging metodes, soos belasting oudits en selfs belasting strafregtelike ondersoeke, noodsaaklik mag ag om te verseker dat die wet toegepas word.

Deur die gehoorafdwingings strategie van Australië, Kanada en Suid Afrika te vergelyk is daar gevind dat dit sterk ooreenkomste toon. Dit is heel moontlik as gevolg van die feit dat al drie lande betrokke is by die *Organisation for Economic Co-operation and Development*. Hierdie organisasie onderneem verskeie navorsing studies aangaande hierdie onderwerp wat dan die resultate publiseer vir gebruik deur ander lande.

Hierdie navorsingstudie kom tot die gevolgtrekking dat belasting oudits en belasting strafregtelike ondersoeke noodsaaklike ingrypings is teen belastingpligtiges wat kies om die wet te verontagsaam. Die navorsingstudie bevind verder dat die doel van streng afdwingingsmetodes is om die oorblywende belastingbasis te beskerm en om die getal belastingpligtiges in hierdie kategorie te beperk of te verminder. Dit maak dit moontlik vir die belastingowerheid om invorderings te verbeter deur vrywillige wetsgehoorsaamheid. Die navorsingstudie bevind egter ook dat die effek van streng afdwingingsmetodes nie akkuraat gekwantifiseer kon word deur enige van die drie belastingowerhede nie. Verdere navorsing oor die kwantifisering van die uitwerking op wetsgehoorsaamheid sal baie nuttig wees vir enige belastingowerheid, aangesien dit behulpsaam sal wees om die dekking van die gehoorafdwingings metodes te bepaal.

Sleutelwoorde:

Belastingowerheid

Belasting gehoorafdwingings

Belasting oudits

Belasting strafregtelike ondersoeke

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COMPARATIVE ANALYSIS OF REVENUE AUTHORITIES' APPROACH TO TAX AUDITING AND TAX CRIMINAL INVESTIGATION AND ITS EFFECT ON TAX COMPLIANCE

1 CHAPTER 1: INTRODUCTION AND PROBLEM STATEMENT

1.1 BACKGROUND

Paying tax is not something that the general public wants to do, even understanding its purpose. The less they pay the better they feel. Some would go to the extent of not paying at all if they could get away with it.

Revenue authorities (RAs) use various means of ensuring that taxpayers (individuals and businesses) pay the correct amount of tax timeously. These include light interventions such as telephone calls, reminder letters, emails, etc. to taxpayers to submit returns and payment. Others are the serious enforcement interventions of tax auditing and tax criminal investigations.

Research conducted by the Organisation for Economic Co-operation and Development (OECD) and published in an Information Note in November 2010 has found that a deterrent strategy on its own does not have the desired effect of improving tax compliance. Other factors, such as societal behaviour and upbringing which influences personal behaviour have significant impact. RAs have a responsibility to simplify compliance with tax laws. A taxpayer should be in a position to be compliant without undue effort. Taxpayers' perception of whether an RA is fair to all taxpayers also has a role to play. Economic factors influence behaviour in that economic growth normally encourages compliance, whereas stagnation discourages it (OECD, 2010: 5 - 6).

However, in spite of the views on deterrence above, the South African Revenue Service (SARS) has completed a total number of 159 832 tax audits during the 2009/10 financial year reflecting an increase from 0.94% (72 926 audits) of the tax register in 2008/09 to 1.88% in 2009/10. This increase has mainly been due to the

automation of the tax audit process. In addition, 257 tax criminal prosecutions were completed during 2009/10 with a success rate of 97%. This number would have been much higher than the 518 cases (success rate – 99%) prosecuted in 2008/09. However, due to the limited number of National Prosecution Authorities (NPA) prosecutors available and the limited court time, of the backlog of 1 600 criminal investigation cases handed over to the NPA, only the more complex cases were focused on (SARS, 2010b: 29 - 31).

What are these factors that influence taxpayer behaviour that will result in improved compliance? Should only a certain category of taxpayer be addressed through tax audits and tax criminal investigations? If so – which? Answering such questions would be useful in gaining further understanding of the compliance behaviour of taxpayers. It would also be useful to RAs in determining what compliance strategy to adopt, thus maximising revenue collection.

1.2 PROBLEM STATEMENT

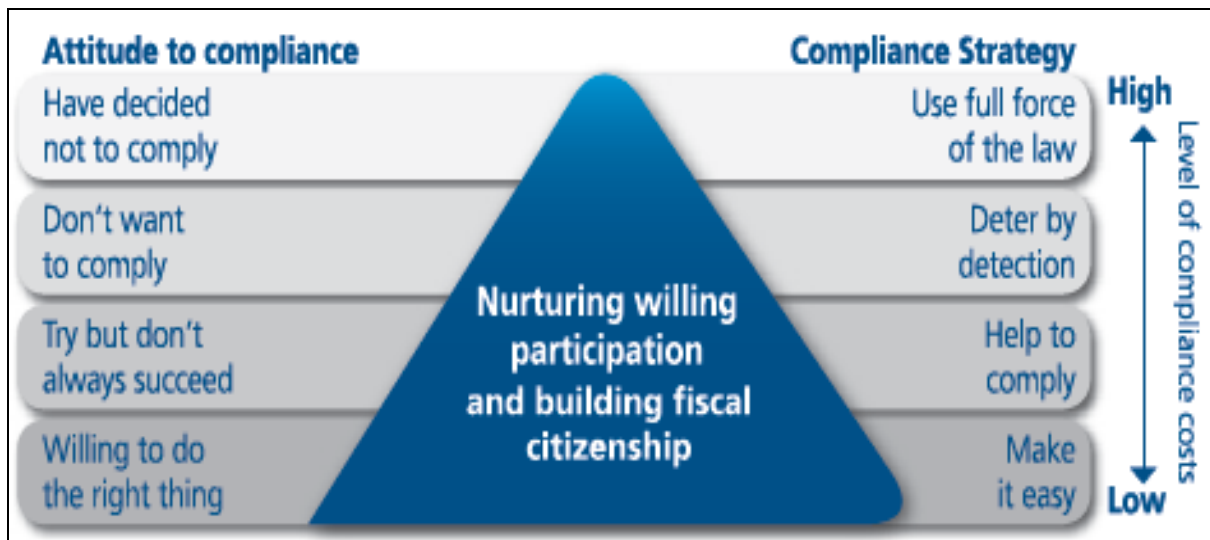
The SARS Annual Report 2009/10 highlights an increase in audit coverage from the previous year indicating that at the time the RA was, to some degree, of the view that large numbers of tax audits and tax criminal investigations should be conducted. This view is in line with the classic economic model which indicates that a taxpayer determines whether to be compliant or non-compliant based on the result of a cost-benefit calculation. 'Will I be caught by the RA? If this is likely to happen, I will be compliant. If not, I will not bother to be compliant.'

However, since then, SARS seems to have amended its view. In its strategy for 2011/12 to 2013/14 it highlights that the enforcement measure used to deter non-compliance should be matched by the nature of the non-compliance. This means that for unintentional, low level or first time offences, a softer enforcement approach should be adopted. However, for deliberate offences involving taxpayers who are deliberately non-compliant and are regular defaulters, a harder enforcement approach should be adopted. SARS further highlights that to address non-compliance, actions involving a combination of coverage, depth and leverage must

be applied. Coverage ensures that there is a greater likelihood of being detected, that is, there is sufficient volume of interventions by the RA. Depth ensures that the interventions are thorough and will detect any existing non-compliance. Leverage seeks to encourage compliance by highlighting to other taxpayers that non-compliance will be identified and punished (SARS, 2011: 24). This approach is in line with other RAs such as Australia, New Zealand, Canada, Denmark and the United Kingdom that currently adopt a model which specifies a compliance strategy for each type of attitude of taxpayer.

Figure 1 below highlights the spectrum of taxpayer attitudes to compliance and what compliance strategy SARS plans to use to address these in 2011 to 2014.

Figure 1: Spectrum of Taxpayer Attitudes towards Compliance



Source: SARS (2011: 23)

In the United States of America a researcher, Dubin (2007: 518), found that the Internal Revenue Service (IRS) decreased its number of tax audits and tax criminal investigations over the past 20 years in spite of an increase in its tax gap over the same period. This decrease is despite Dubin's research findings that an increase in tax audit rates leads to greater levels of compliance and a greater number of honestly prepared returns. He found that tax criminal investigation activity also has a statistically significant effect on tax compliance. Why the IRS did this is unclear. It may have been a cost factor as such hard enforcement interventions are expensive

and involve many resources, or perhaps they were also of the view that compliance could be better addressed through alternative means?

The issues of contention are therefore whether increased tax auditing and tax criminal investigations are the best ways to improve tax compliance or whether the combination of the soft and hard approaches should be used, depending on taxpayer attitude and behaviour.

1.3 PURPOSE STATEMENT

The main purpose of the study is to examine whether increased tax auditing and tax criminal investigations are the best ways of improving tax compliance. In doing so, three different RAs (Australia, Canada and South Africa) are compared to determine their approaches to the hard enforcement intervention of tax auditing and tax criminal investigation and what effect this may have on tax compliance. Other approaches which include an analysis of taxpayer behaviour and social and economic norms are also considered.

1.4 RESEARCH OBJECTIVES

The following specific objectives will guide the study:

- To determine what process and programmes are adopted by the Australian, Canadian and South African RAs for addressing tax non-compliance through tax auditing and tax criminal investigations and the effect thereof.
- To compare the approaches adopted by the Australian, Canadian and South African RAs regarding hard enforcement interventions with intent;
 - to determine the effect that tax audits and tax criminal investigations have on tax compliance in these countries
 - to determine to what extent the processes and programmes adopted by the Australian and Canadian RAs for addressing tax non-compliance through tax auditing and tax criminal investigations differ from those adopted by SARS.

1.5 IMPORTANCE AND BENEFITS OF THE STUDY

This study is important as there is generally a negative perception by the public of the strategy followed by RAs to maximise revenue and minimise tax non-compliance. This study will broaden the knowledge of the general public and academia in terms of taxpayers' compliance behaviours and which interventions have an impact on tax compliance. This study will assist in determining the effect of tax auditing and tax criminal investigations on tax compliance as an enforcement approach, and to what extent this approach is used by South Africa and other countries.

1.6 DEFINITION OF KEY TERMS

The study involves a number of key terms. The manner in which they are defined for the purpose of the study is determined below.

Tax Audits – This refers to ‘the examination and verification carried out by an outside agency (such as an accountancy firm or the tax authorities) of a taxpayer’s books and accounts and/or the general accuracy of returns and declarations, either as a routine operation, or where evasion is suspected’ (OECD, 2011).

Tax Avoidance – This term ‘is generally used to describe the arrangement of a taxpayer's affairs that is intended to reduce his tax liability and that, although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow’ (OECD, 2011).

Tax Compliance – This refers to the ‘degree to which a taxpayer complies (or fails to comply) with the tax rules of the country; for example, by filing a return, declaring the correct income and paying the tax due in a timely manner’ (OECD, 2011).

Tax Criminal Investigation – This refers to an ‘investigation which is the process of examining significant instances of non-compliance with tax statutes. This normally results in prosecution and jail time or heavy fines if found guilty’ (CRA, 2011).

Tax Evasion – This term is ‘generally used to mean illegal arrangements where liability to tax is hidden or ignored, that is, the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities’ (OECD, 2011).

Tax Gap – This refers to ‘the difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time’ (IRS, 2011).

The following recognised abbreviations in Table 1 are used in the body context of this research proposal.

Table 1: Abbreviations used in this Document

Abbreviation	Meaning
ACC	Australian Crime Commission
AFP	Australian Federal Police
ATO	Australian Tax Office
CIP	Criminal Investigation Program
DTA	Double Taxation Agreement
CRA	Canadian Revenue Agency
GST	Goods and Service Tax
HST	Harmonized Sales Tax
IRS	Internal Revenue Agency of the United States
LBC	Large Business Centre
NPA	National Prosecuting Authority
OECD	Organisation for Economic Co-operation and Development
PAYE	Pay-as-You-Earn
PPSC	Public Prosecution Service of Canada
RAs	Revenue Authorities’
SARS	South African Revenue Service
SME	Small and Medium Enterprises
SEP	Special Enforcement Program
VAT	Value-Added Tax

1.7 DELIMITATIONS

The proposed study has delimitations relating to the context, constructs and theoretical perspectives of this study. Firstly, it will be limited to the behaviour of

taxpayers as it relates to tax compliance and not to other general legislative compliance.

Secondly, the study will not include the strategic aspects of RAs that are not related to tax compliance; for example, its management of internal finances.

1.8 ASSUMPTIONS

It is assumed that most RAs worldwide will have a tax compliance strategy which they have developed or copied from other RAs.

It is assumed that all RAs have a tax gap highlighting that some taxpayers are compliant while others are non-compliant.

It is assumed that taxpayers are driven by different factors that influence compliance behaviour.

1.9 RESEARCH METHOD AND DESIGN

A qualitative approach was adopted in this research. The reason for this is that it is not aimed at resolving any numerical measurements or quantifying relationships, but at providing factual and descriptive analysis of certain situations. The research study uses an extensive literature review as a method of data collection and data analysis.

The researcher conducted a literature review on factors affecting taxpayers' tax compliance behaviour and used various credible sources of information. These included published research reports, journal articles and books on this topic. Various unpublished information from SARS was obtained. The information was sought from libraries, and various websites were accessed, including the OECD, SARS, CRA and ATO.

1.10 OVERVIEW OF THE CHAPTERS

Chapter 1 provides the introduction and problem statement to the research conducted.

Chapter 2 is a literature review covering research conducted by several academics, researchers and international organisations. It focuses on the OECD findings of the factors and drivers behind taxpayer compliance behaviour, and the motives for compliance and non-compliance are explored. The relationship between voluntary compliance, enforced compliance, tax avoidance and evasion and the motivational postures is considered. The effects and sequencing of auditing taxpayers is analysed as well as the impact sex differences and communication have on tax compliance.

Chapter 3 compares the Australian, Canadian and South African approaches to tax auditing and tax criminal investigation and the effect on tax compliance in each of those countries.

Chapter 4 concludes the research by highlighting the findings, the concluding remarks, what contribution the research had made and the future research that should be conducted.

1.11 CONCLUSION

This chapter provides the introduction and problem statement to the research study conducted. This includes the purpose of the study, what research objectives guide the study and what the benefits of the study are. It is clear from this chapter that tax auditing and tax criminal investigations requires further research to determine if they are effective means of addressing tax compliance.

The next chapter is the literature review that covers related research conducted by several academics, researchers and international organisations. This review contextualises the research study.

2 CHAPTER 2: LITERATURE REVIEW

2.1 INTRODUCTION

The previous chapter provided the introduction and problem statement to the research study. The purpose of this chapter is to explore the literature available relating to taxpayer behaviour, the approaches of RAs in relation to that behaviour and the resultant effects on tax compliance. Various factors that drive tax compliance or non-compliance are considered, including the differentiation between men and women. The motives of taxpayers in relation to tax compliance and non-compliance are explored. The indirect effects of tax auditing, its sequencing and communication to taxpayers as well as the effects of tax criminal investigation is considered.

2.2 TAX COMPLIANCE AND TAXPAYER BEHAVIOUR

According to Kirchler, Hoelzl and Wahl (2008: 210 - 211), citizens have a duty to pay taxes. Revenue through tax collection is integral to the optimal functioning of a country and its citizens must comply with its tax rules and pay what is due. This duty is regardless of the taxpayers motives for being compliant. Some taxpayers are motivated by the concern that if they are identified as being non-compliant, this will result in high costs, for example, fines or prosecution. Others are motivated by their willingness and obligation to do good for their community and country. Different approaches to tax regulation should be adopted depending on the motives of the taxpayer concerned. Taxpayers are inherently willing to pay tax; approaches only involving high volumes of tax audits and fines have been shown to be inconsistent in their effect on non-compliance. Many studies have been conducted to prove this. Most taxpayers believe in the RA's mandate and will pay what is due by them. The idea that all taxpayers are looking for ways and means to avoid or evade taxes is doubtful.

According to Wenzel (2005: 504) most research has been dominated by the view that taxpayers are out to benefit themselves. This means that taxpayers will determine the likely threat of sanctions and penalties and whether this outweighs the benefits of non-compliance. The indication is that there is no regard for doing what is right, but for what benefits the individual financially. This perspective is challenged by several researchers. Further studies have shown as indicated above by Kirchler *et al.* (2008), that taxpayers are concerned about what they and/or others around them consider to be right or wrong. According to Wenzel (2005: 504), taxpayers act on their moral and ethical beliefs regarding compliance or evasion. These personal beliefs are influenced by societal views on the ethicality or acceptability of tax evasion. However, the counter-argument is that these personal ethical and societal beliefs are only used to neutralise what is naturally a profit driven motive.

In the OECD Information Note – *Understanding and Influencing Taxpayer's Compliance behaviour – November 2010*, findings by several researchers is noted. Research into taxpayer compliance behaviour started in the 1970s with simple economic models and in later years, expanded to include taxpayer behaviour and other complexities. In the last three decades there has been a significant increase in the scientific publications on the subject which has allowed a broader perspective by RAs (OECD, 2010: 11).

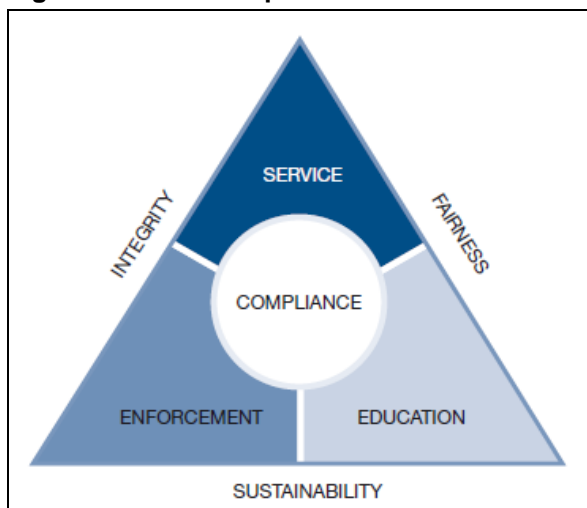
According to Allingham and Sandmo (in OECD, 2010:11), the classic economic model of the 1970s indicates that taxpayers' compliance behaviour is driven by a cost-benefit calculation. If the cost of evasion is less than its benefit through the non-payment of taxes, then the taxpayer is likely to be non-compliant. If the opposite occurs and the fines and penalties associated with detection of non-compliance outweigh the benefits of evasion, the taxpayer will likely be compliant. Such a model or understanding of compliance behaviour leads to many RAs focussing much of their resources on tax audits and the implementation of harsh fines. Every taxpayer was considered to be a possible tax evader if given the chance. This model, which places enormous resource strain on RAs, is also referred to as the economic deterrence model, as its main aim is deterrence. (OECD, 2010:11).

As indicated in the introduction, South Africa's increase in the number of audits in the 2009/2010 financial year indicates a partial use of this classic economic model, even though, at that time, a compliance model was considered based on a three component approach of education, service and enforcement.

- 'Taxpayers must know what is expected of them and how to comply (education).
- SARS must make it as easy and as cost effective as possible for taxpayers to be compliant (service).
- SARS must ensure that there is a credible and visible ability to detect and punish non-compliance (enforcement)' (SARS, 2010b: 27).

Figure 2 below indicates the SARS Compliance Model adopted during 2009/10.

Figure 2: SARS Compliance Model – 2009/10



Source: SARS (2010b: 270)

According to Frey (in OECD, 2010:11), the classic economic model cannot determine levels of compliance. Explanation for these levels is impossible with the single-minded view that taxpayer behaviour is only profit driven. Alm, McClelland and Schulze (in OECD, 2010:11) indicate that the theory of this model gives a distorted view of tax compliance levels. There is far less non-compliance observable than the model indicates. If taxpayers are making decisions about tax compliance from a purely economic perspective, then due to the low risk of detection as a result of the

limited number of auditors an RA may have, more taxpayers will be involved in tax evasion and fraud (OECD, 2010:11).

These shortcomings have resulted in several attempts made to adapt the classic economic model of tax compliance. According to Kirchler (in OECD, 2010: 11), this model does not effectively describe and predict tax behaviour. This has resulted in other factors being considered such as a greater focus on sociological and psychological factors. Personal and social norms, as well as justice and fairness are but some factors that have since been taken into consideration. (OECD, 2010:11).

Behavioural economics has been an area of interest, where behaviour is described based purely on experiential evidence on how people actually behave. Studies have shown that human beings are not able to process all facts available when making decisions. This limited ability allows them to learn for themselves by experience. They are therefore susceptible to biases in their decisions and are unable to make decisions based on fully informed economic rationale and self interest. According to Thaler and Sunstein (in OECD, 2010: 11), this does not mean that understanding, predictability or explanation of behaviour is impossible. Instead, biases and the ability for people to learn for themselves must be taken into consideration (OECD, 2010:11).

According to Braithwaite (in OECD, 2010: 11), RAs must limit the opportunity for tax evasion through its processes and legislation. There is strong empirical evidence that robust systems that keep evasion in check can impact the behaviour of taxpayers. Withholding tax systems such as pay-as-you-earn (PAYE) by employers, or dividends' tax on payments made by companies not only reduces the opportunity for evasion, but saves the RA compliance costs. Third party information obtained from banks, medical aids, pension funds, stock exchanges and such like, help to improve compliance. There is no longer a need to obtain information directly from taxpayers thus increasing the reliability and accuracy of information. Such a system improves the credibility of the RA which further improves levels of compliance (OECD, 2010:11).

This increasing knowledge on taxpayer behaviour has caught the interest of RAs and is influencing compliance strategies. There has been a shift from the classical economical model of rational agents to an understanding that behaviour can have great impact on how a RA designs its work. The SARS Strategic Plan 2011/12 – 2013/14 highlights a shift in the direction of such a model as depicted in Figure 1(OECD, 2010:11).

The above factors focus mainly on people and their behaviour towards tax compliance. The OECD highlights that due to their importance to RAs, there is a need for more research on what drives the compliance behaviour of businesses. An area that should be considered is the relationship between corporate governance and the business's compliance with tax legislation. Other legislation and regulations affecting businesses should also be considered (OECD, 2010: 12).

While knowledge of the drivers of tax compliance behaviour may help to determine strategies and interventions that impact these drivers and thus behaviour, it is necessary to have a sound general knowledge of human behaviour. Principles of persuasion can be extremely helpful to increase and improve the effectiveness of communication and solutions (OECD, 2010: 12).

According to Braithwaite (in OECD, 2010: 12), research has identified a large number of factors and drivers that influence tax compliance. Of particular significance to RAs in developing their policies is the fact that personal and social norms drive compliance behaviour. People do not wish to be embarrassed by their behaviour, particularly if others find it unacceptable. Deterrence can play a role where obligation and social pressure fails. However, moral obligation and feelings of shame and guilt are found to be the most consistent predictors in influencing tax compliance (OECD, 2010:12).

The OECD has determined the following five main categories as the factors and drivers behind taxpayer compliance behaviour:

- 'Deterrence: for example, tax audits, perceived risk of detection and severity of sanctions.

- Norms: both personal and social norms.
- Opportunity: both to be compliant (for example, low compliance costs, easy rules) and to be non-compliant (for example, opportunities for evasion).
- Fairness: related to outcomes and procedures; and trust, both in the government or tax authority and in other taxpayers.
- Economic factors: containing general economic factors, factors related to the business or industry and amount of tax due' (OECD, 2010: 12).

2.3 MOTIVES FOR COMPLIANCE OR NON-COMPLIANCE

Braithwaite (in Kirchler & Wahl, 2010: 333) distinguishes five motives underlying compliance and non-compliance and refers to them as motivational postures (see Table 2). These motivational postures can be positive or negative. According to Bogardus (in Kirchler & Wahl, 2010: 333), such postures originate from the perception of 'social distance' between taxpayers and the RAs. If this distance is close, then the view of the RA is positive and the taxpayer is likely to respect its role. Such positive motives are termed commitment and capitulation. If this distance is great, then the view of the RA is negative and the taxpayer is likely to be defiant. Such negative motives are termed resistance, disengagement, and game playing.

Table 2 describes the five motivational postures. This is accompanied by statements representing them.

Table 2: Taxpayer Motivational Postures and Representative Statements

Motivational posture	Description	Statements representing motivational postures
Commitment	Commitment combines a positive orientation towards tax authorities and deference. The tax system is perceived as desirable, tax law and tax collection are perceived as fair. Committed taxpayers feel a moral obligation to pay their share and to act in the interest of the collective.	<ul style="list-style-type: none"> • Paying tax is the right thing to do • Paying tax is a responsibility that should be willingly accepted by all Australians • I feel a moral obligation to pay my tax • Paying my tax ultimately advantages everyone • I think of tax paying as helping the government do



		<p>worthwhile things</p> <ul style="list-style-type: none"> • Overall, I pay my tax with goodwill • I resent paying tax (reversed) • I accept responsibility for paying my fair share of tax
Capitulation	<p>Capitulation reflects a positive orientation in terms of acceptance of the tax authorities which hold legitimate power to pursue the collective's goals. As long as citizens act according to the law, authorities are perceived to act in a supportive way</p>	<ul style="list-style-type: none"> • If you cooperate with the Tax Office, they are likely to be cooperative with you • Even if the Tax Office finds that I am doing something wrong, they will respect me in the long run as long as I admit my mistakes • The Tax Office is encouraging to those who have difficulty meeting their obligations through no fault of their own • The tax system may not be perfect, but it works well enough for most of us • No matter how cooperative or uncooperative the Tax Office is, the best policy is to always be cooperative with them
Resistance	<p>Resistance reflects a negative orientation and defiance. The authority of tax officers may be doubted and their acts may be perceived as controlling and dominating rather than as supportive</p>	<ul style="list-style-type: none"> • If you don't cooperate with the Tax Office, they will get tough with you • The Tax Office is more interested in catching you for doing the wrong thing, than helping you do the right thing • It's important not to let the Tax Office push you around • It's impossible to satisfy the Tax Office completely • Once the Tax Office has you branded as a non-compliant taxpayer, they will never change their mind • As a society, we need more people willing to take a stand against the Tax Office
Disengagement	<p>Disengagement also reflects a negative orientation and correlates with resistance. Individuals and groups keep socially distant and blocked from view and have moved beyond seeing any point in</p>	<ul style="list-style-type: none"> • If I find out that I am not doing what the Tax Office wants, I'm not going to lose any sleep over it • I personally don't think that there is much the Tax

	challenging tax authorities	<p>Office can do to me to make me pay tax if I don't want to</p> <ul style="list-style-type: none"> • I don't care if I am not doing the right thing by the Tax Office • If the Tax Office gets tough with me, I will become uncooperative with them • I don't really know what the Tax Office expects of me and I'm not about to ask
Game playing	<p>Game playing expresses a view of law as something that can be moulded to suit one's purposes rather than as a set of regulations that should be respected as guideline of one's actions. In the field of tax behaviour, game playing refers to 'cops-and robbers' games with taxpayers detecting loopholes to their advantage and perceiving tax officers as cops who engage in catching cunning taxpayers</p>	<ul style="list-style-type: none"> • I enjoy spending time working out how changes in the tax system will affect me • I enjoy talking to friends about loopholes in the tax system • I like the game of finding the grey area of tax law • I enjoy the challenge of minimising the tax I have to pay • The Tax Office respects taxpayers who can give them a run for the money

Source: Kirchler and Wahl (2010: 334-335)

2.4 THE RELATIONSHIP BETWEEN VOLUNTARY COMPLIANCE, ENFORCED COMPLIANCE, TAX AVOIDANCE, TAX EVASION AND MOTIVATIONAL POSTURES

According to Kirchler and Wahl (2010:333), behavioural intentions are linked with motives that influence taxpayer behaviour. There are four suggested intentions regarding compliance and non-compliance. These include voluntary compliance, enforced compliance, avoidance, and evasion. Taxpayers that are voluntarily compliant are motivated to cooperate and will not cheat even if given the opportunity to do so. Taxpayers whose compliance is enforced only comply out of fear that fines they may be charged will be more costly for them than actual compliance. If there is a chance that tax avoidance and evasion will not be detected or if the penalty charged is low, then taxpayers are likely to cheat.

Kirchler and Wahl (2010: 336) indicate that voluntary compliant taxpayers do not have a positive correlation with enforced compliant taxpayers as they have different underlying motives. This is in spite of them both being compliant and paying their tax owed by them. Voluntary compliant taxpayers have a negative correlation with tax avoidance and tax evasion. Enforced compliant taxpayers only originate from the RAs ability to constrain the taxpayer through its laws and processes. Such a taxpayer would seriously consider its decision to pay taxes honestly. Possible tax evasion would be weighed against the possibility of detection and fines. Such taxpayers are likely to look for loopholes in the legislation which they could utilise. This results in a positive correlation with tax avoidance. A negative correlation with tax evasion is more likely due to the possible risks associated.

Kirchler & Wahl (2010: 336) note that tax avoidance is aimed at reducing tax payments through legal means such as the use of loopholes in legislation and unclear interpretation of the law. Tax evasion is an illegal means of reducing payments and if detected is subject to fines and possible prosecution. This difference between legality and illegality makes the relationship between avoidance and evasion unclear. While certain taxpayers may consider the possibility of evasion, they would normally not pursue this due to the risk of detection and fines.

Braithwaite (in Kirchler & Wahl, 2010: 336) found that the motives of commitment and capitulation are negatively related to behaviours of tax avoidance and evasion, whereas the motives of resistance, disengagement, and game playing are positively related. This would mean that voluntary tax compliance is positively linked with commitment and capitulation, and negatively linked to resistance, disengagement, and game playing. Enforced tax compliance, tax avoidance, and tax evasion will be negatively linked to commitment and capitulation and positively linked to resistance, disengagement, and game playing. The negative correlation of enforced compliant taxpayers is likely due to their low perception of the RA's legal power. Tax avoiders and evaders often do not believe in the system of taxation and perceive tax collection as being unfair. As tax avoiders are often looking for ways and means to avoid tax, its correlation with game playing is much higher, whereas tax evaders have a higher correlation with resistance and disengagement.

2.5 DIFFERENCES BETWEEN MEN AND WOMEN IN TAX COMPLIANCE

According to Kastlunger, Dressler, Kirchler, Mittone and Voracek (2010: 542), the differences between the behaviour of men and women in relation to business decisions have been of keen interest to researchers. Studies have found that women are more risk averse to men and are less likely to participate in unethical business practices. Their taxpaying strategies also differ to those of men. Women are generally more compliant and are less affected by prior audits compared to men who are more likely to increase tax evasion after audits. Women's tax behaviour indicates that they are more likely to cooperate and less likely to evade, compared to men.

Kastlunger *et al.* (2010: 543 - 544) noted that a factor considered to cause this difference in compliance behaviour is that of gender role orientation. Women are expected to behave in a feminine, socially acceptable and friendly manner. However, men are entitled to display more masculine traits of aggression, competitiveness and dominance. This finding is cautioned as the behaviour of women may be largely dependent on education, socialisation and interest in the topic. Furthermore, as opportunities for women to adopt male roles increases, changes in their behaviour to be more like men will see an increase in masculine traits and therefore a similarity in behaviour in relation to tax compliance. Another factor causing such differences could be that of ethical standards and risk taking. Women are found to overestimate the probability of detection and of the severity of fines if found to be non-compliant. Attitudes to risk taking are closely linked to other demographic variables such as marital status. A married woman wants to protect her family and therefore is not willing to take risks that could jeopardise that.

Kastlunger *et al.* (2010: 543) noted that biological differences between men and women are mainly linked with hormonal factors. High testosterone levels are associated with domineering and anti-social behaviour with the intention of maintaining high status. As women have lower levels of testosterone, they are not driven to similar behaviour. This further explains the risk aversion that women have. The research conducted by Kastlunger *et al.* (2010: 549) determined that prenatal

masculinisation did not yield any significant findings relating to the differences between men and women. Infants are predisposed to femininity or masculinity, depending on the hormones they are exposed to prior to birth. This can result in a female being more masculine or a male being more feminine.

In summary, the findings of Kastlunger *et al.* (2010: 549) imply that the higher level of compliance by women compared to men is due to socialisation, education, feminine versus masculine traits, testosterone levels, but not prenatal masculinisation. This study is useful to RAs in that it identifies two possible categories of taxpayers with different tax compliance behaviours. To include such an aspect into the strategy of the RA, further research will need to be done specific to that country regarding how women are socialised and treated. A targeted approach to men in general and specific women with a greater likelihood of non-compliance will result in greater benefit to an RA, rather than a random approach to women in general.

2.6 THE INDIRECT EFFECTS OF AUDITING TAXPAYERS

Tax auditing is a civil action conducted by the auditors of an RA on a taxpayer with the intention of identifying non-compliance and then raising an assessment to correct it. A possible fine or penalty can be added to the assessment depending on the quantum and severity of the non-compliance. Most RAs have in their legislation, a section preventing the publication of the specific details of audits conducted for taxpayers. However, overall information on the types, numbers and success of audit interventions is normally shared with the public. Information relating to the audit of specific taxpayers does often leak out. This usually happens from the taxpayers themselves or through associated persons, for example, family members, work colleagues, employees or other.

The direct effect of tax auditing is the assessments raised and the additional fines or penalties which the affected taxpayers would have to pay to the RA. In a literature review conducted by Ratto, Thomas and Ulph (2009: 1), it was noted that the indirect effects of auditing were greater than the direct effects. This indirect effect was closely

associated with social norms and resulted in taxpayers paying the correct amount of tax even if they had not been audited.

Ratto *et al.*, (2009:21-22) highlights in their research that evasion is risky, therefore the decisions and motivations of the taxpayer must be understood. This is not always easy due to the elasticity of behaviours. However, where there is a social norm, the taxpayer believes in an increased probability of detection and is then more likely to be voluntarily compliant. This social norm is considered to have a multiplier effect and will result in more taxpayers being compliant. Where such a social norm does not exist, only the direct effect of auditing can be relied on. RAs must therefore perform an analysis of different groups of taxpayers and how they are impacted by their social norm. This will assist them in terms of setting policy and strategy for reducing non-compliance.

Ratto *et al.* (2009:22 - 23) highlights that this multiplier effect could be enhanced through announcements made by RAs on how many audits were conducted and what the results were. However, RAs should be careful when making these announcements, as taxpayers have perceptions of how many people are evading and have based their understanding of the probability of detection. If the announcement indicates that their perception was wrong and that perhaps there is a lower probability of being detected, then this may increase non-compliance. Nevertheless, the overall view is that the greater the number of compliant taxpayers, the greater the willingness for other taxpayers to be compliant. Understanding the taxpayer and their interaction with the social norms is therefore imperative for every RA to ensure that communication with them is appropriate and drives the desired behaviour.

2.7 THE EFFECT OF THE SEQUENCE OF AUDITS ON TAX COMPLIANCE

Audits can be conducted on a taxpayer more than once in their tax life. The general expectation by taxpayers is that this will not happen too frequently and probably not too soon after one has been conducted. Kastlunger, Kirchler, Mittone and Pitters (2009: 405) conducted a study which assesses the effect of the sequence of tax

audits over the tax life of a taxpayer and what that taxpayer's future behaviour is likely to be after an audit has been completed and fines charged for non-compliance. Will there be cooperation or evasion?

According to Kastlunger *et al.* (2009: 406), taxpayers who have been subjected to audit may either become compliant or may increase evasion in the future. Taxpayers may reason that the next audit is far in the future and therefore take risks on the subsequent returns filed. If the audit has resulted in additional payments to the RA, the taxpayer may be keen to recoup this money. It is therefore important that RAs understand the behaviour of their taxpayers in response to audits, to enable them to strategise future audit activities.

In their studies Kastlunger *et al.* (2009: 406) were not only interested in the patterns of audits and how taxpayers responded based on their perception of frequency or compensation. They were also interested in the timing of audits in relation to the tax life of the taxpayer and how that impacted on future behaviour. Previous studies have indicated that if the first audit was conducted early in the tax life of a taxpayer, then there was a greater likelihood of continuous compliance for the remainder of that life. However, if this first audit was conducted later in the tax life of the taxpayer, then that taxpayer would perceive the possibility of more audits less likely and thus increase evasion in the future. Furthermore, for the latter group, the loss resulting from the audit could have already been compensated for in undetected previous tax evasions.

There have been several debates about whether audits could improve compliance. Some studies have revealed that they could, whereas others show a weak connection (Kastlunger *et al.*, (2009: 406). Kastlunger *et al.*, (2009: 417) determined that audits could have the opposite effect from what they were intended for, as taxpayers developed 'escape' strategies. This was referred to as the 'bomb crater effect'. In a study conducted by Bergman and Nevarez (in Kastlunger *et al.*, 2009: 417) on Value-Added Tax (VAT) compliance, it was determined that taxpayers feel safe after an audit and less likely to be audited again. They then use the next opportunity to not file accurate information and possibly recoup some of their losses. Where an RA uses random audits and taxpayers are made aware of this, this

subsequent non-compliance is less likely as the taxpayers are not sure of when they will be re-audited. These random audits are made more effective by the possibility that the fines could be increased due to the multiple offences by a taxpayer, in a short period of time.

The study by Kastlunger *et al.* (2009: 417) has revealed that while random audits are effective, repeated audits at shorter intervals are more effective and lead to a higher level of compliance. There is little possibility of non-compliance when there is strong likelihood of a repeated audit and this forces those taxpayers to be compliant. Taxpayers that normally have repeated audits are those VAT vendors with refunds above a specific threshold.

However, it is necessary that the audit pattern of an RA is not too obvious, as this may be conspicuous and taxpayers could be more likely to evade. Taxpayers generally predict the possibility of an audit and the most effective way to prevent this is to ensure that the pattern is unpredictable Kastlunger *et al.* (2009: 417). Several RAs are now developing automated risk engines to assist in identifying cases with a risk of non-compliance. This increases the unpredictability of audits in that many more factors are taken into consideration for risk than if done manually.

2.8 THE COMMUNICATION OF AUDITS TO TAXPAYERS

Taxpayers learn about audits conducted by an RA in a variety of ways. This could be through the RA's communication mechanisms of monthly and annual reports, direct communications with themselves when they are being audited, or of other audits through persons around them. Alm, Jackson and McKee (2009: 401) conducted a study to determine the effects of the different types of communication on taxpayer behaviour. They determined that it was most effective for an RA to pre-announce the audit rate through their official channels and to ensure that the targets set were reached. Perusal of several compliance plans of RAs throughout the world indicates that this is what is normally done. Where pre-announcement is not done, an RA should ensure that a sufficiently high number of audits are conducted so that the unofficial taxpayer-to-taxpayer communication is frequent and widespread enough to

reach most taxpayers. If such communication is not able to reach many taxpayers, there will generally be greater non-compliance. The more a taxpayer hears about an audit – or the frequency of audits being conducted – the greater the likelihood that they may be next on the list for audit, resulting in them being compliant.

In their study, Alm *et al.* (2009: 401) and supported by Ratto *et al.* (2009:22), indicate that there is a multiplier effect that enables increased tax collection from taxpayers once they are aware of other audits. They have calculated this to be at least 440% of what has been assessed through audit. This ripple effect is also comparable in Dubin's (2007: 401) studies. Alm *et al.* (2009: 401) study supports the idea of social norms having an impact on compliance. The communication of this social norm through other taxpayers is therefore critical. When taxpayers communicate high levels of compliance, others generally follow and remain compliant. However, if taxpayers communicate low levels of compliance, evasion becomes more widespread.

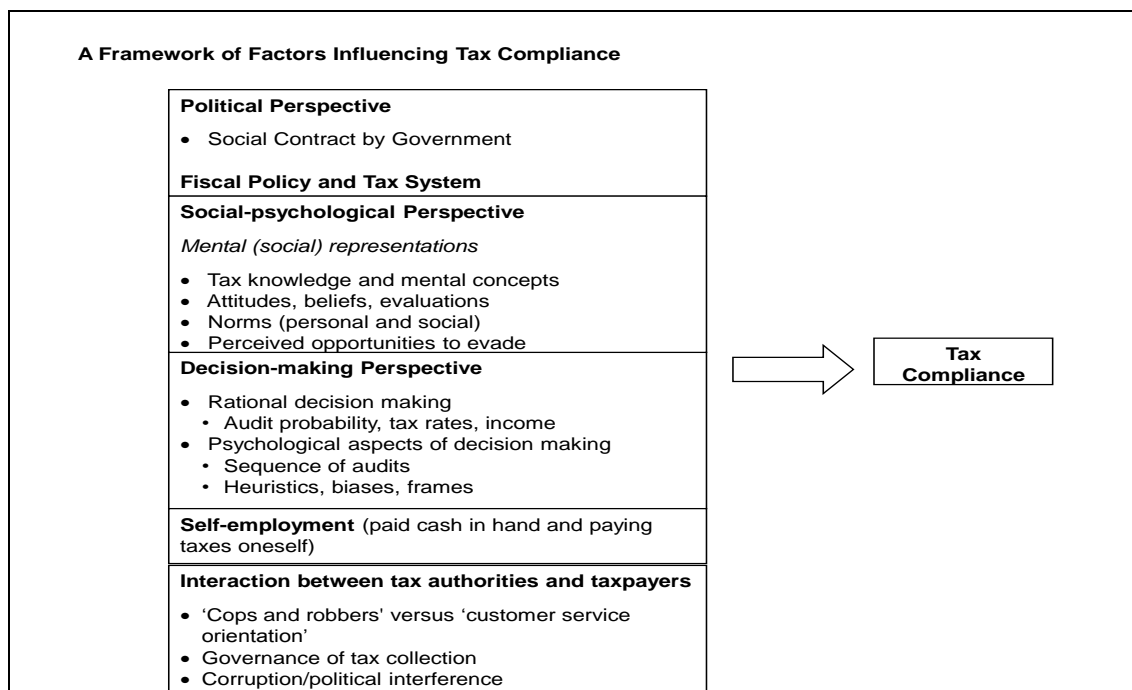
2.9 CRIMINAL INVESTIGATION ENFORCEMENT ACTIVITIES AND TAXPAYER NON-COMPLIANCE

In Dubin's (2007: 522 - 523) study of criminal investigation on tax compliance, he found a measurable correlation between the two. Criminal investigation activity is by its nature a deterrent activity as it results in prosecution with fines and possible jail time. He found that the threat of jail and probation had a greater impact on compliance than the imposition of fines, and encourages an increase in cases that will lead to this. While audit activity is a civil matter where specifics of cases and names of taxpayers cannot be communicated to the public, criminal investigation resulting in prosecution can be made public through the media. Alm *et al.* (2009: 401) found in their studies that widespread communication to taxpayers of audits and criminal investigations resulting in prosecutions, increases compliance. Alternatively, Dubin (2007: 500) found a weak correlation, unless the cases related to money laundering. He reasons that this weak correlation is due to many of the cases reported being old matters that had lost their impact on current affairs.

In a study conducted by Levi (2010: 494), he indicates that ‘serious tax fraud’ is a behavioural and administrative label rather than a legal one. Such non-compliance is normally dealt with by RAs through negotiation and civil or administrative intervention, utilising legislation resulting in large fines being paid, rather than prosecution. Where the RA targets a certain group where tax evasion is prominent, criminal investigation and prosecution will be considered to make a point and to leverage from the communication.

In figure 3, Levi structures a framework of factors influencing tax compliance based on the work done by Kirchler. This framework is useful in determining the appropriate sanctions for civil and criminal matters.

Figure 3: A Framework of Factors Influencing Tax Compliance



Source: Levi (2010: 498)

2.10 CONCLUSION

The literature review in this chapter highlights a wide range of factors influencing taxpayers to be tax compliant or non-compliant. It starts by considering the different behaviours of taxpayers and how that impacts on compliance. The complexity of human behaviour as a result of personal and social norms, economic factors, etc.

becomes clearer through the research conducted over the past three decades. Motives of persons are analysed and grouped into those that result in greater compliance and those that are more likely to lead to non-compliance. These motives are then further analysed against taxpayers' intentions, revealing more complex aspects to be considered by RAs. The literature review considers not just the grouping of compliant and non-compliant taxpayers but also how men and women differ in relation thereto. Auditing of taxpayers from an indirect perspective as well as the influences of communication types and the sequencing of audits, provides a wealth of information for consideration by RAs when determining their policies and strategies. Lastly, criminal investigation activities are considered with a view to determining its impact.

The purpose of the next chapter is to narrow the study to tax auditing and tax criminal investigations in three countries, namely Australia, Canada and South Africa. By comparing these countries' approach to hard enforcement interventions, we will determine whether this has a positive effect on tax compliance.

3 CHAPTER 3: COMPARATIVE STUDY OF TAX AUDITING AND TAX CRIMINAL INVESTIGATIONS IN AUSTRALIA, CANADA AND SOUTH AFRICA

3.1 INTRODUCTION

The previous chapter provided a literature review of research conducted on the issue of tax compliance and what factors affect this. The purpose of this chapter is to conduct a comparative analysis of the hard enforcement approach of the three RAs in Australia, Canada and South Africa. Australia and Canada have developed economies with established and well functioning RAs. They are members of the OECD and contribute much to its research and development of products for use by other countries. South Africa, a developing country, has made great strides regarding the functioning of its RA. Even though it is not a full member of the OECD (currently an observer), much of the OECD research is used to improve its strategies and operational policies and procedures.

This chapter covers mainly the tax auditing and tax criminal investigation aspects discussed in the previous chapter. The literature review is extended in this chapter and focuses on the strategies used by the three RAs and not the views of specific individuals or entities which could have been gathered through empirical research. An analysis of the strategies of these RAs will provide a broad overview of the impact of the hard enforcement approaches on the taxpayers of these countries.

This chapter will cover the compliance models used by each of the RAs. This includes what they consider to be tax auditing and tax criminal investigation and how these are undertaken. The results of these interventions are also considered.

The Australian Taxation Office (ATO) is considered next.

3.2 AUSTRALIAN TAX OFFICE (ATO)

3.2.1 The Compliance Model

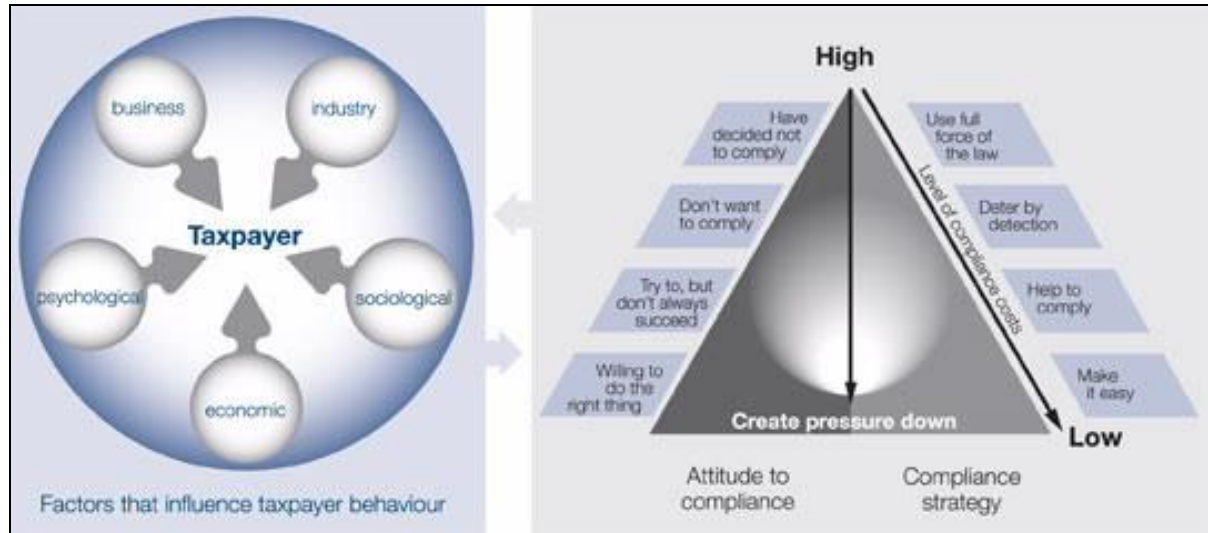
Each country usually develops a compliance model which is a structured way of understanding and improving taxpayer compliance. The ATO compliance model helps it to understand the factors that influence taxpayer behaviour and how to apply the most appropriate compliance strategy (ATO, 2010: 5).

In the 2009/10 financial year, the ATO have a compliance model consisting of two parts. The left side pictures the factors that influence taxpayer behaviour. These include business, industry, sociological, economic and psychological factors, sometimes referred to as the BISEP model. The right pictures taxpayers' attitudes along a triangular shape and what compliance strategy is appropriate to address each level of attitude. At its broader base, taxpayers 'willing to do the right thing' have compliance simplified for them. At the narrow top end, those that 'have decided not to comply' are dealt with using the full force of the law. This range of attitude and corresponding compliance strategy ensures that the type of intervention and punishment by the RA fits the crime. The triangle shape and arrows downwards indicate the intention of the ATO, through its strategy, to increase the number of taxpayers 'willing to do the right thing' (ATO, 2010: 5).

The compliance model also summarises the different types of support and intervention that the ATO may need to provide, so as to collect the required revenue. The model suggests that the ATO has the ability to influence taxpayer behaviour through its response and interaction (ATO, 2010: 5).

Figure 4 highlights the ATO Compliance Model in its Compliance Program for 2009/10. This model has not changed, except that in its Compliance Program for 2011/12, it is pictured the same as the SARS model as indicated in figure 1.

Figure 4: ATO Compliance Model – 2009/10



Source: ATO (2010: 5)

3.2.2 Tax Audits

The ATO is responsible for tax collection in Australia and in doing so, must ensure that all taxpayers pay the correct amount of tax in line with legislation. Audits and examination of taxpayers' information is necessary to ensure compliance with the legislation and fairness of its tax system. Audits check the following:

- 'Have you declared all the assessable income the taxpayer has received?
- Are you entitled to the deductions and tax offsets the taxpayer has claimed on their tax return?' (ATO, 2008).

The nature of the audits and enquiries differ depending on what is being addressed and the complexity thereof. The ATO does not make assumptions that everyone intends to evade tax and will select cases on the basis of risk. Some audits involve a simple approach of contacting a taxpayer via telephone call or through a letter requesting supporting documentation to verify their return information. These are commonly referred to as desk audits and large volumes of taxpayers can be addressed in this way thus increasing the audit coverage (ATO, 2008).

Taxpayers can be audited without their knowledge. The ATO has access to third party information, for example, from banks for interest received, medical aids and pension funds for contributions made, and so forth. A simple check of this information against the return will confirm accuracy and completeness. Often this exercise is done through automated systems which will extract those cases for audit where there is a mismatch (ATO, 2008).

The more complex and higher risk audit cases usually involve a field inspection where the taxpayer is requested to provide further documentation, information and accounting records for examination. Sometimes, when a specific industry is targeted, a group of taxpayers can be requested to provide information for comparison between them or to industry benchmarks (ATO, 2008).

In all audits, should discrepancies be found, the taxpayer would be informed of this through a 'Notice of amended assessment' issued to them. This notice will normally give the taxpayer direction in terms of what to do next. If payment is due, the notice will inform them of how much and what penalties and interest may be included. If the taxpayer disagrees with the notice, they may follow a dispute resolution process (ATO, 2008).

3.2.3 Tax Crime

The top of the triangle shaped compliance model indicates that it is usually a small number of people that are involved in the criminal behaviour of tax fraud and evasion resulting in improper financial benefit. The ATO has found that these include individuals and organised groups within the borders of Australia and beyond (ATO, 2011).

'The most common methods of tax crime perpetrated are:

- Identity crime
- Secret offshore dealings
- High-volume, low-value suspect transactions
- Credit and refund fraud

- Illicit tobacco growing and trading' (ATO, 2011).

The ATO treat tax fraud and evasion very seriously as this is unfair to those taxpayers who diligently meet their obligations. Effort is made to detect and deter such criminal behaviour through prosecutions and convictions so that other taxpayers' confidence in the RA is maintained, and the bulk of them remain or move to the base of the triangle (ATO, 2011).

Listed below are some of the ways the ATO addresses taxpayers and intermediaries involved in tax crime.

- 'Gathering and analysing intelligence on risks and threats to the tax system.
- Investigating suspected cases with a view to prosecution, often jointly with law enforcement agencies.
- Working with the Australian Federal Police and the Commonwealth Director of Public Prosecutions to restrain and confiscate assets obtained from tax-related crime using the powers of the *Proceeds of Crime Act 2002*.
- Complementing our criminal investigation work with civil audit work and the application of tax penalties.
- Publicising the outcomes of our work, combating tax crime to raise community awareness.
- Sharing information across partner agencies to achieve whole-of-government outcomes in tackling tax crime' (ATO, 2011).

Through double taxation agreements (DTA) with other countries, exchange of information opportunities exist thus allowing access to information beyond the borders of Australia to be used for prosecution.

3.2.4 Tax Crime Investigations and Results

Australian taxpayers generally have a strong culture of voluntary compliance with only a few trying to gain unfair advantage by avoiding their obligations. Through the ATO's compliance strategy, the full force of the law is used to address such

non-compliance. Governments and communities assist in the detection and deterring of tax criminals by allowing anonymous online reporting of such activity. With reference to the motivational postures in table 2, the ATO ensures that those people who are resistant, disengaged or involved in game playing in relation to their taxpaying obligations face serious consequences, including prosecution.

The seriousness with which the ATO addresses tax crime is evident from the sentences being handed down by the court. These sentences are published in the media to create awareness for all taxpayers (ATO, 2011).

Tables 3 and 4 below provide a summary of prosecutions for two categories of offences:

- Serious offences for fraud: These are investigated by the ATO and prosecuted by the Commonwealth Director of Public Prosecutions.
- Summary offences under the Tax Administration Act : These are prosecuted by the ATO and mainly involve lodgement offences.

Table 3: Serious Offences

Serious fraud*

	Cases	Convictions		Custodial sentences	Reparation orders (\$m)	Court fines (\$)
2011-12 **	4	4	100%	3	0.043	Nil
2010-11	62	60	97%	53	17.0	7 500
2009-10	61	60	98%	55	10.1	11 000
2008-09	60	56	93%	42	11.2	14.3 million
2007-08	78	78	100%	47	4.3	37 200
2006-07	108	106	98%	64	3.8	63 000

* The serious fraud cases and convictions include Project Wickenby-related cases.

** This information is current up to 31 July 2011.

Source: ATO (2011)

Table 4: Summary Offences

Summary offences*

	Cases	Convictions		Dismissals and withdrawals	Fines (\$m)
2011-12 **	153	138	90%	15	0.52
2010-11	1 747	1 518	87%	229	7.51
2009-10	2 792	2 517	90%	275	10.35
2008-09	3 253	2 912	90%	341	10.85
2007-08	2 510	2 207	88%	303	7.1

* The summary offence cases do not include multiple cases/convictions for the same individuals or companies.

** This information is current up to 31 July 2011.

Source: ATO (2011)

The ATO publishes updates of the above stats on its website regularly to keep taxpayers informed.

Project Wickenby

Tax crime is not a simple matter to address and a project approach normally provides the necessary focus for the RA to be most effective. The ATO determined that much of the tax crime in Australia was not isolated, but linked with other crimes in the country. This has led to the establishment of Project Wickenby in 2006. Project Wickenby is a multi-agency task force including national, state and territory government organisations. This combined force is responsible for protecting the integrity of Australia's financial and regulatory systems by preventing people from promoting and utilising secrecy havens to hide their criminal activity. Secrecy havens are usually countries or states that do not divulge information about people's financial affairs or structures. Most countries that have effective and responsible RAs do not normally have DTAs with secrecy havens, making it difficult to enforce exchange of information arrangements. In addition to its focus on secrecy havens, the project conducts work on the following:

- International tax evasion
- Breaches of Australian financial laws and regulations
- Attempts to defraud the community including investors and creditors
- Money laundering

- Concealment of assets (ATO, 2011).

The combined efforts of all the agencies have resulted in much success for the project which is regularly published. This increases the confidence of taxpayers in the ability of the RA to address taxpayers who do not comply.

Results of Project Wickenby

The success of Project Wickenby recorded at 31 May 2011 (Five-year period) is demonstrated by more than \$1 billion in liabilities raised as well as increased tax collections from improved compliance behaviour by those taxpayers who were targeted by the task force. This is expected to increase in the future due to the ongoing investigations and prosecution judgments that have resulted in substantial sentences and fines. This sends a strong deterrent message to those involved in such crimes. Recent results as per table 5 reveal that the task force has been very effective in closing in on promoters and participants in tax schemes involving the abusive use of secrecy havens (ATO, 2011).

Table 5: Project Wickenby Results at 31 May 2011

Investigations		
Audits - including risk reviews	Tax liabilities raised	\$1.085b
	Audits (including reviews) in progress	748
	Audits (including reviews) completed	2 182
Prosecutions		
	People charged	62
	Convictions	18
Money recouped		
	Tax collections	\$255.4m
	Tax collections in subsequent years from people subject to Project Wickenby action	\$306.1m
	Other moneys recouped	\$2.1m
	TOTAL	\$563.6m

Source: ATO (2011)

The ATO has claimed that there is sufficient evidence to indicate that Project Wickenby interventions are improving taxpayers' willingness to comply with their

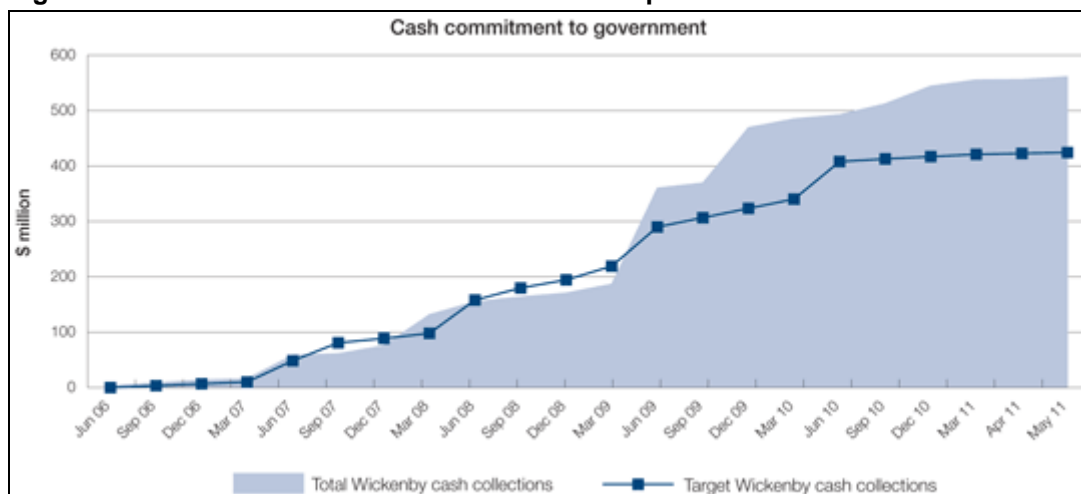
taxation obligations. People who have been investigated by Project Wickenby have subsequently voluntarily lodged more accurate tax returns and paid more tax than they have done in the past. Awareness of the effectiveness of the project through the media has also resulted in other taxpayers being less inclined to evade tax (ATO, 2011).

The ATO published on 31 May 2011 that since its establishment, Project Wickenby has collected almost \$564 million of outstanding revenue. This exceeds the targeted collection of \$424 million set for this date and includes:

- Over \$236 million in cash collections.
- Nearly \$19 million collected from return lodgements demanded.
- \$306 million made from increased voluntary compliance following interventions by the Project Wickenby task force.
- \$2 million in assets recovered by the CDPD under Commonwealth Proceeds of Crime provisions (ATO, 2011).

The following graph in figure 5 show how the collections made by 31 May 2011 are tracking against Project Wickenby's collection target.

Figure 5: Cash Commitment to Government Graph



Source: ATO (2011)

Prosecutions and Court Judgements

Project Wickenby was responsible for at least 62 individuals being charged with serious offences by August 2011. This includes 14 cases from the Australian

Crime Commission (ACC) investigations and 48 from investigations by the Australian Federal Police (AFP). Of the 48 AFP cases, 29 people were charged with money laundering. There have been 20 criminal convictions, with the courts emphasising the following details when making their judgments:

- The amount of the loss to the public purse.
- That the conduct was calculated criminal conduct.
- The offences that were planned.
- The offences were caused by greed and not need.
- The need for general and personal deterrence (ATO, 2011).

Several of the 20 criminal convictions attracted serious penalties and substantial jail time. An additional 65 people were prosecuted for summary tax offences which included mainly outstanding returns and information. These attracted penalties and imprisonment of less than 12 months. Two matters related to non-compliance with statutory obligations arising out of audit matters (ATO, 2011).

3.2.5 Conclusion

The above statistics relate mainly to the tax audits and tax criminal investigations of the more serious crimes addressed by the ATO. However, it is clear that a focused intervention by an RA in relation to tax auditing and tax criminal investigations has a positive contribution to tax compliance. It not only deters others from considering non-compliance, but gives others who do comply, the confidence that the tax system is being maintained. The harsh sentences, penalties and fines and the publishing of these are a significant deterrent.

The compliance model of the ATO provides focus and structure to its compliance approach and programmes. It has a structured process of conducting tax audits and tax criminal investigations and interventions such as Project Wickenby, assists in addressing the more serious tax crimes impacting the country. This enables the ATO to effectively carry out its plans over the years and to measure the results of its interventions.

Australia has the advantage of having a society that has a strong culture of voluntary compliance. However, even with this, there is a significant amount of revenue obtained through tax audits and tax criminal investigations with the added benefit of highlighting to society that tax crime does not pay. How much more would a country benefit through such interventions where there was not a strong culture of voluntary compliance?

The next part of this chapter focuses on the Canadian Revenue Agency (CRA) and how it addresses tax compliance through tax auditing and tax criminal investigations.

3.3 CANADIAN REVENUE AGENCY (CRA)

3.3.1 The Compliance Model

In its annual report to Parliament in 2009/10, the CRA describes its compliance role as being the undertaking of examinations, audits and investigations to ensure compliance with Canadian tax laws. This includes verification (soft approach) and enforcement (hard approach) activities at domestic and international levels, as well as the administration of international tax agreements. It is also responsible for educating taxpayers of their tax obligations and provides information to make it easier for them to comply. Research is undertaken to improve their detection capability of non-compliant activities and strategies are developed to address these (CRA, 2010a: 71).

The CRA further describes its goal as being the protection of Canada's tax revenue through activities designed to address non-compliance. It focuses on the accuracy and completeness of taxpayer information declared in their returns to determine taxpayer liability. In 2009/10, the CRA continued with its strong enforcement action and published much of its successes with the intention of increasing public awareness and thus deterring non-compliance. It improved the administration of its Voluntary Disclosures Program to encourage more taxpayers

to disclose unreported income and thus allowing them lesser penalties (CRA, 2010a: 71).

The CRA – as with other RAs – find it challenging to measure the exact outcome of its compliance activities and whether this has reduced non-compliance. It uses a number of measures in its scorecard, updating it regularly to effectively measure its achievement of the result. It focuses on to what extent the compliance activities change the amount of tax assessed for taxpayers and how much of that could be recovered. While it has achieved strong ratings on its performance measurement framework, the overall effectiveness of verification, audit and enforcement interventions on the detection and deterrence of non-compliance still remains a challenge. A further challenge experienced by the CRA is its response to the increasing complexity of the Canadian economy. There are increased international interaction and sophisticated systems in use. Updating the CRA staff knowledge and skill to address this will ensure continued success in its compliance role (CRA, 2010a: 71).

3.3.2 Tax Audits

The CRA conducts regular tax audits on its taxpayers to determine the validity and accuracy of tax returns and claims and to ensure that both the CRA and taxpayers receive what is due to them. The CRA have a self assessment tax process and audit verification checks assist in maintaining the integrity and fairness of the system. The CRA conduct both office and field audits depending on the nature of the risk being addressed (CRA, 2010c).

If a taxpayer's return is selected for audit, the auditor will normally contact them and inform them of the impending action. The taxpayer is informed of their rights and obligations and according to which regulations and statutes administered by the CRA the audit is being conducted. If the taxpayer owns a business, the auditor will normally visit the business premises to obtain an understanding of how the business operates and what record-keeping systems are in place. The auditor is obliged to present an identification card when visiting the taxpayer or their

premises and to respect the confidential nature of the information they obtain during the audit. The auditor then further explains the scope of the audit and the time it may take to complete. The time taken for the audit will normally be dependent on the complexity of the factors being addressed and the cooperation of the taxpayer. The taxpayer is made aware that the employees, particularly those involved in the accounting, may be contacted for explanation and clarification of information (CRA, 2010c).

Taxpayers are obliged by law to keep accurate and adequate business records for a minimum of six years which are then used to verify their tax liabilities and claims. The use of a tax professional does not relieve a taxpayer of these obligations. Audits normally involve an examination of business records such as ledgers, journals, sales and purchases' invoices, agreements and any other related documentation. In addition, previous returns, financial statements and previous audit findings are considered. A taxpayer may be requested to provide certain information to the CRA for the audit to be conducted in the office or to allow the auditor to conduct the audit at the taxpayer's premises. Information may be in electronic or manual format and must be made available on request. Delays in the provision of information and records will delay the completion of the audit (CRA, 2010c).

The auditor will engage with the taxpayer throughout the audit, obtaining explanation for issues identified and responding to questions the taxpayer may have. If there are proposed adjustments, these are explained to the taxpayer who is then allowed at least 30 days to respond. If there is disagreement regarding the proposed adjustments, the taxpayer may have further discussions with the auditor's supervisor. On finalising the audit, a notice of assessment is provided to the taxpayer. As the auditor is responsible for ensuring that the taxpayer's return information is correct, it may happen that adjustments are made in favour of the taxpayer, thus increasing the taxpayer's claim. If so, this additional claim is paid to the taxpayer. Where there is a liability owing to the CRA, the taxpayer should be informed of this timeously to enable them to make payments promptly, thus

avoiding interest costs. The taxpayer is entitled to follow a dispute resolution process should they disagree with the outcome of the audit (CRA, 2010c).

3.3.3 Tax Criminal Investigations

Criminal investigations are conducted where there are serious violations of tax laws. This includes mainly serious tax fraud and evasion. The CRA's Criminal Investigations Program (CIP) is mandated to investigate such suspected cases with a view to them being referred to the Public Prosecution Service (PPSC) of Canada for prosecution. Positive prosecution results are published in the local, regional and national media with the aim of creating awareness of the consequences of non-compliance. This assists in maintaining the integrity of the RA as well as motivating others to remain or become tax compliant (CRA, 2010b).

In the 2008/09 financial year, the CIP referred 164 Income Tax and Goods and Services Tax (GST)/Harmonized Sales Tax (HST) investigations to the PPSC for prosecution and in the previous year 180 investigations. The referrals in these two years resulted in 257 convictions with fines imposed by the court, of \$19.8 million and jail sentences of 63.67 years (CRA, 2010b).

In Quebec, the Ministère du Revenu du Québec, acting on the CRA's behalf, referred additional 58 GST investigation cases for prosecution. Together with cases referred from the previous year, the courts convicted a further 66 individuals and businesses imposing fines of \$9.4 million (CRA, 2010b).

The criminal investigations and prosecutions are seen to be an integral part of the deterrence measures against blatant tax non-compliance.

Publication of Convictions

Canadian taxpayers are generally voluntarily compliant and pay their fair share of tax in line with the legislation. These taxpayers also wish to see that everyone else is compliant and that the CRA is effective in ensuring this. To maintain fairness to all law-abiding citizens of the country, the CRA conducts compliance activities to

ensure uniform application of its laws. Tax legislation in most countries provides for the confidentiality of taxpayers' information. The specific details of actions conducted by an RA, even if in relation to non-compliant activity by certain taxpayers, cannot be made public. However, once a matter is in the domain of the courts, it is available to the public. The CRA then utilises the media to publish convictions, particularly those with significant fines imposed and jail sentences. This has a strong deterrent effect and assists in maintaining the integrity of the self-assessment system (CRA, 2010b).

Project Trident

The CRA, like the ATO, is of the view that a project approach to criminal investigations is the most effective means to target and prosecute serious tax fraud and evasion. In 2006, the CRA established Project Trident with the aim of investigating and prosecuting key players involved in fraudulent tax schemes. The project has targeted tax preparer fraud, charity fraud and identity theft. Such fraud can be conducted in a number of ways. Listed below are examples of each type.

- Tax preparer fraud: The tax preparer fraudulently alters the information on a return after it has been signed by the taxpayer with the aim of realising a higher refund which would then be paid directly to them.
- Charity fraud: Charities perform no charity work, but sell inflated tax receipts to taxpayers or tax preparers who in turn sell them to taxpayers.
- Identity fraud: This involves the unauthorised obtaining of personal information of another which would be utilised for criminal purposes such as forgery, theft, fraud, etc. (CRA, 2010b).

In normal audit cases, non-compliance is investigated over a certain period. Tax legislation would limit this period depending on the type of tax being investigated. However, with criminal investigation of serious tax fraud and evasion that would be referred to the courts for possible prosecution, this period would have no limits, thus allowing investigators to address 'old' periods.

Table 6 below highlights the convictions, fines and jail time due to Project Trident at 12 May 2011.

Table 6: Convictions, Fines and Jail Time – Project Trident

Description	# of convictions	Fines	Mandatory Jail time (in months)
ID theft by a tax return preparer	9	\$1 927 811	212
ID Theft (other)	7	\$392 420	204
Tax Preparer	5	\$174 828	22
Charities fraud by a tax return preparer	8	\$253 973	212
Charities frauds (other)	2	\$82 865	2
*** Total ***	31	\$2 831 907	652

Source: CRA (2010b)

3.3.4 2009/10 Compliance Programme Results

The Annual Report to Parliament for 2009/10 highlights the results of the compliance interventions of the CRA. These include the Project Trident results.

International and Large Business

International business relates to those multi-national corporations that conduct business activity between Canada and other countries. The risk associated with such corporations is usually the interpretation of residency and compliance relating to transfer pricing. Large businesses are defined by the CRA as those entities with annual revenues of over \$50 million. This group of entities is responsible for a large part of the CRA revenue income and non-compliance in this category has a significant effect on the collections of the CRA. The 2009/10 compliance results show an increase in the number of cases completed from the previous year in these categories. Table 7 shows the volumes of cases completed in the 2009/10 year (CRA, 2010a: 76).

Table 7: International and Large Business Results

Cases completed	2008-2009	2009-2010	Change
International Audits	1 471	1 621	10.2%
Large and Basic Files	2 359	2 652	12.4%

Source: CRA (2010a: 76)

Small and Medium-sized Enterprises

The small and medium enterprises (SME) cover a variety of taxpayer segments in Canada. Office audits are normally conducted using telephone calls, letters and face-to-face interviews to verify the accuracy of information submitted to the CRA. This type of intervention allows for a large coverage of taxpayers thus increasing the effectiveness of the deterrent activities of the CRA. Small businesses are defined as owner operated entities, partnerships and corporations with annual revenues of less than \$1 million. Medium businesses include corporations, trusts and public service bodies with annual revenues of between \$1 million and \$50 million. Various programmes such as the Pre-payment Risk assessment programme, Speciality Audit Program, Film Industry programme, GST/HST Non-Resident Audits, etc. are included in the SME category. Table 8 shows the volumes of cases completed in the 2009/10 financial year (CRA, 2010a: 76)

Table 8: Small and Medium Sized Enterprises Results

Cases completed	2008-2009	2009-2010	Change
Office audit activities	264 292	219 446	-17.0%
Small business audit activities	37 430	30 857	-17.6%
Medium-sized business audit activities	8 460	7 450	-11.9%
Other audits, reviews, and examinations (including service and education)	133 367	122 621	-8.1%

Source: CRA (2010a: 76)

Enforcement

Enforcement involves a combination of audit and criminal investigation activities. The Special Enforcement Program (SEP) is responsible for conducting audits and other civil enforcement actions on individuals and business which benefit illegally from tax non-compliance. More serious tax fraud and evasion is addressed through criminal investigations by the CIP which then refers such investigations for prosecution to the PPSC. Convictions are publicised creating an expanded effect even though few are done, compared to audits. Audits are conducted efficiently through a relationship of openness, cooperation and transparency, established with the taxpayers (CRA, 2010a: 77).

Table 9 highlights the results of these enforcement activities.

Table 9: Enforcement Activities

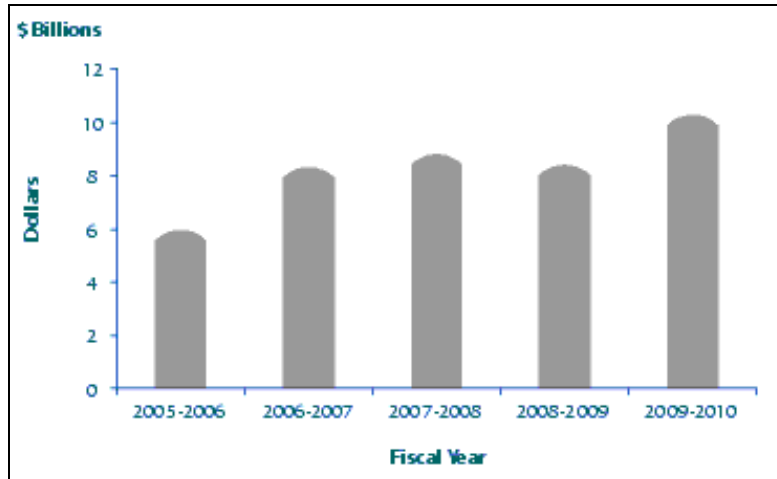
Enforcement activities	2008-2009	2009-2010	Change
SEP cases completed	874	928	6.2%
SEP delinquent actions completed	2 014	1 999	-0.1%
Enforcement actions (including investigations)	3 603	3 374	-6.4%
Convictions	257	216	-16.0%
Total years of jail sentences	63.67	58.25	-8.5%

Source: CRA (2010a: 77)

Fiscal Impact

In the 2009/10 annual report to parliament, the CRA has tried to measure the fiscal impact of its compliance programme in an effort to highlight the positive effect of tax auditing and tax criminal investigation activities. It does this by calculating the additional amounts of tax owing (including penalties and interest) by those addressed as well as the present value of future tax assessments. However, it does not calculate the impact of the media publication of convictions nor the indirect effect of auditing taxpayers. The CRA compliance programmes detected \$9.9 billion in fiscal impact during 2009/10. This includes \$7.2 billion identified through international and large business audits thus confirming the significant impact of this category on revenue collections for the CRA. It includes \$2.1 billion from field and office audits on SMEs; \$448 million from special-incentive audits; and \$150.5 million from audits conducted through the SEP. An additional amount of \$866.3 million is included from refunds relating to previous years where double taxation matters were addressed for foreign taxpayers (CRA, 2010a: 77). These statistics are reflected in figure 6 below.

Figure 6: Fiscal Impact of Reporting Compliance Activities



Source: CRA (2010a: 77)

3.3.5 Conclusion

As with the ATO, the CRA generally has a society that is voluntarily compliant. However, in spite of this, it has a focused approach regarding its compliance plans. Tax auditing and tax criminal investigation processes are formalised and made public so that all taxpayers are clear on what is expected. These interventions generally have positive results and thus impact the compliance of taxpayers. The CRA also uses projects such as the Project Trident to address more serious tax crimes. Publishing information on prosecutions is adopted, making the public aware of the CRA's efforts to protect the tax base.

In terms of its scorecard for 2009/10, the CRA has far exceeded its targets and benefitted as an RA in that it has increased its revenues while simultaneously addressing the issue on non-compliance. It is not easy to accurately determine the effect of tax audits and tax criminal investigations on the remaining base of taxpayers. However, it is fair to say that such interventions temper the need of those that would want to commit some form of tax evasion or fraud.

In the next part of this chapter, the South African Revenue Service is considered in relation to its approach to tax compliance through tax auditing and tax criminal investigations.

3.4 SOUTH AFRICAN REVENUE SERVICE (SARS)

3.4.1 The Compliance Model

In 2009/10, the compliance model used by SARS was based on a three component approach of education, service and enforcement. Refer to figure 2 in 2.2 above. However, with the OECD research regarding the factors influencing tax compliance behaviour, this model for the 2011/12 to 2013/14 financial years was altered slightly so that the compliance approach was dependent on the levels of attitude of taxpayers. Refer to figure 1 in 1.2 above. Notwithstanding this, the elements of education, service and enforcement are still significant in SARS's philosophy of addressing compliance as they are in many other RAs.

In its strategic plan for 2011/12 – 2013/14 SARS includes the increase of tax compliance as one of its core outcomes. This outcome cannot be achieved alone and is supported by other key factors such as the ease and fairness of taxpayers doing business with SARS as well as maximising the cost effectiveness of SARS. These factors improve the image of SARS as an effective RA, thus assisting in improving taxpayer attitude and resultant compliance (SARS, 2011: 21- 22).

SARS defines compliance as the degree to which taxpayers meet their obligations in relation to the tax legislation. This compliance is not only technical but behavioural as well. Compliance must be achieved in all four pillars, namely on-time registration, filing and payment as well as accurate and complete declaration of information (SARS, 2011: 22).

SARS's main function is to collect revenue for the country and to ensure that the laws related thereto are uniformly applied and complied with. In its philosophy of tax compliance it highlights that several factors influence taxpayer behaviour. These include individual and social norms, the ease and fairness of being tax compliant, the speed and accuracy of detection and correction measures, the punishment of those that are found to be non-compliant and the belief in the

fairness and justice of collecting tax for a country that historically was not fair to all its citizens. Therefore, with the range of taxpayer attitudes towards compliance, SARS is of the view that the compliance strategy applied should vary accordingly (SARS, 2011: 23).

The model developed by SARS has a triangular shape. At the base, which is widest and thought to have the majority of taxpayers, the attitude is generally that of wanting to do the right thing. Compliance costs for such people should be minimal and the compliance strategy focused on making it easy for them. As the attitude along the upward course of the triangle becomes more disengaged, the cost of compliance increases and the deterrent measures more severe. The top part of the triangle includes taxpayers that do not want to comply. They are few in number compared to the remaining taxpayers and the full force of the law is used to address their non-compliance (SARS, 2011: 22 - 23).

SARS believes that the most effective way to address non-compliance is to determine its root cause and to apply corrective measures to address this. Many taxpayers are ignorant of the tax legislative requirements. Education campaigns are undertaken to address this particularly when there are changes to legislation or when taxpayers are forming new businesses. Enhancements are made to service functions to reduce the frustration taxpayers have when engaging with SARS. Enforcement interventions have become more targeted on certain sectors known for non-compliance, and policies and procedures have been developed and improved to ensure efficiency of operation. The combination of coverage, depth and leverage are integral in increasing the effectiveness of enforcement interventions (SARS, 2011: 22 - 23).

3.4.2 Tax Audits

In 2007/08 SARS made a concerted effort to standardise the audit process by drafting audit programmes, policies and procedures to be used by auditors. This substantially improved the quality of audit work done. These processes continue to be updated and used by auditors. Standard letters and templates were drafted,

allowing improved communication with taxpayers under audit. Audit tools to improve the efficiency of conducting audits were purchased and developed and since then, have improved steadily in their sophistication and use in SARS (SARS, 2007: 82).

The process of audit followed by SARS is similar to that of the ATO and CRA. Taxpayers are selected for audit either randomly or through a risk identification process. Recently, through modernisation of its systems, SARS has introduced a risk engine for Personal Income Tax and VAT returns. This will be extended in the near future to Company Income Tax returns (SARS, 2010a).

When a taxpayer is selected for audit, a letter is sent to them informing them of the audit. Where desk audits are conducted, supporting documentation may be uploaded onto the system by the taxpayer or delivered directly to SARS. Where field audits are conducted, the auditor would visit the premises of the taxpayer to examine the books of account and supporting documentation (SARS, 2010a).

Taxpayers are obliged in terms of the tax legislation to keep adequate books and records in one of the eleven official languages to determine their tax liabilities and refund claim. Generally, books and records must be kept for a minimum of five years. If a computer is used to maintain accounting records, the taxpayer must keep the books and records in an electronically readable format, even if they are also kept on paper. The use of tax professionals does not remove the responsibility of a taxpayer to maintain adequate records. During an audit, these books and records must be made available to the auditor to determine if the declarations made to SARS are correct. Audit tools are used on the electronic data to determine completeness and accuracy of data (SARS, 2010a).

If there is a difference between what is declared by a taxpayer and what has been identified through the examination of the books and records as well as third party documentation, this is communicated to the taxpayer through a letter of findings giving the taxpayer at least 14 days to respond. A reasonable extension of time to respond can be requested by the taxpayer. Once the findings are discussed, the auditor will raise an assessment on the remaining differences, if any, of which the

taxpayer will be notified by mail. If the taxpayer does not agree with the assessment being raised, they are able to follow a dispute resolution process (SARS, 2010a).

SARS has a Large Business Centre (LBC) which focuses mainly on the larger corporate entities of the country. Although audits are conducted by them, their main focus is to develop good relationships with the entities to ensure mutual benefit and service. Tax structures are often discussed in advance so that there is clarity between them. There is also specific focus on mining and financial institutions. A project is currently underway to improve the LBC's ability to deliver on its mandate and ensure future sustainability by ensuring increased effectiveness in dealing with this segment. It aims to deliver an employee value disposition which recognises people as important assets, thereby retaining and attracting core competence (SARS, 2010b: 33).

3.4.3 Tax Criminal Investigations

The Criminal Investigations unit is responsible for investigating allegations of non-compliance in registration and filing, false declaration of tax information, fraud and theft, as well as statutory offences in terms of any of the acts that are administered by the SARS Commissioner. Any of these transgressions can lead to a criminal conviction (SARS, 2010b: 31).

Should an investigation lead to prosecution, this will be done by the NPA depending on availability of prosecutors and court time. As indicated in 1.1, SARS has a backlog of 1 600 cases with the NPA in 2009/10. This lack of capacity is severely affecting the impact of the criminal investigation function within SARS. Court cases are published widely and regularly in the media thus highlighting to the public that tax evasion and fraud does not pay (SARS, 2010b: 31).

SARS has a unit that focuses on illicit trading. Certain segments are identified for focused intervention, for example the illegal trading of cigarettes, abalone, et cetera. These are first audited and then referred for criminal investigation, the outcome of which is published if addressed through the courts (SARS, 2010b: 35).

Illegal Customs activities are often widely addressed through raids which are also published in the media.

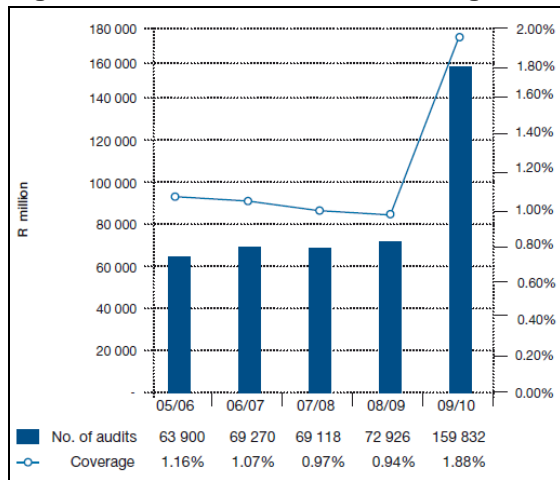
3.4.4 Enforcement Programme Results

SARS has recently introduced an automated filing and risk assessment process for certain categories of tax. In its 2009/10 annual report, it highlights certain benefits of this new system in relation to its enforcement interventions. These include the following:

- ‘The introduction of an employer tax season concept allowed the pre-population of tax returns, which vastly reduced manual capturing errors.
- Over one million salaried individuals with simple tax affairs and an annual income below R120 000 no longer had to complete and submit tax returns, hence releasing capacity for auditing and reducing the taxpayer compliance burden.
- Improved quality of third party data enabled SARS to identify declaration variances between the information declared by taxpayers on their tax returns and information obtained from third party data sources.
- The automated risk engine screened the returns to identify anomalous information contained therein for investigation.
- The integration of the automated risk engine with e-case management improved capacity utilisation through an enhanced workflow solution that assists auditors to plan, execute, finalise and conclude (feedback) cases’ (SARS, 2010b :29).

An outcome of automation activities has been mainly responsible for the increase in the audit coverage ratio from 0.94% (72 926 audits) in 2008/09 to 1.88% (159 832 audits) in 2009/10 as indicated by figure 7 below. In previous years, the manual assessment process included verification activities. In the 2009/10 year, the above verification activities have been standardised and became part of the broader audit activity (SARS, 2010b: 29 - 31).

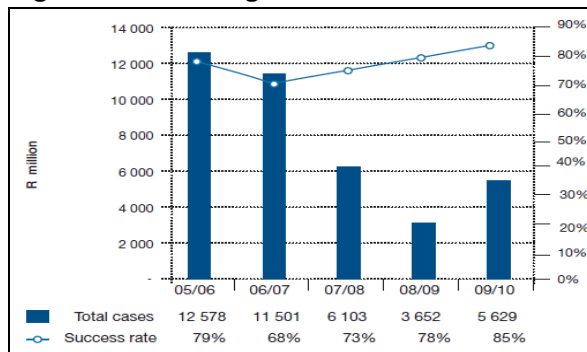
Figure 7: Audit Cases and Coverage



Source: SARS (2010b: 30)

The success rate of the investigative audits has shown a steady increase over the last three years culminating in a current success rate of 85% as illustrated in graph 5 (SARS, 2010b: 30).

Figure 8: Investigative Audits and Success Rate



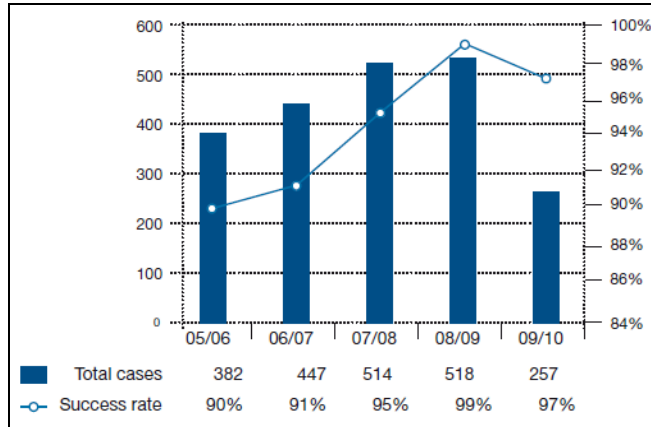
Source: SARS (2010b: 30)

Hard enforcement actions resulted in 257 criminal prosecutions with a success rate of 97% (SARS, 2010b: 31).

SARS is dependent on the NPA for prosecution of its criminal investigations cases. Due to the minimal numbers of prosecutors and the limitation of court time, the NPA has a substantial backlog of cases. While focus has been on the more significant and complex matters, this backlog undermines the efforts of SARS

improving compliance of taxpayers in the category of those who do not want to comply. The leverage that could have been obtained from the successful prosecution of some of the 1 600 cases would have assisted greatly in SARS’s campaign against non-compliance (SARS, 2010b: 31).

Figure 9: Prosecutions and Success Rate



Source: SARS (2010b: 31)

3.4.5 Conclusion

South Africa is a developing country and as yet not a full member of the OECD. Due to its historical factors, particularly the past political environment, its level of voluntary compliance is lower than that of other developed countries. However, in spite of this, it has made significant strides in addressing non-compliance through tax audits and tax criminal investigations. Its forward strategy is in line with that of other OECD countries which bodes well for the future of the RA. The automation developments will ensure a greater coverage of the tax base which is necessary to address the greater tax gap that exists. Establishment and increased publication of focused projects to address tax audits and tax criminal investigations similar to that of the ATO and CRA should be considered.

3.5 CONCLUSION

The purpose of this chapter was to conduct a comparative analysis of the hard enforcement approach by the three RAs of Australia, Canada and South Africa. The next chapter concludes the research study conducted and its findings.

4 CHAPTER 4: CONCLUSION

4.1 INTRODUCTION

The previous chapter provides a comparison of the approaches to tax compliance, using tax auditing and tax criminal investigations by the RAs of Australia, Canada and South Africa. This chapter concludes the research findings in relation to the objectives stated in the first chapter, which were to compare the hard enforcement interventions conducted in the three countries, Australia, Canada and South Africa, and to determine what effect such interventions had on tax compliance in those countries.

4.2 FINDINGS

There are a multitude of factors that influence tax compliance. These are a combination of social norms, behaviours, economic factors, historical, political and legislative influences as well as the operational functioning of an RA. All these factors create the range of behaviours which many RAs now address differently, depending on where they fit in relation to the Compliance model adopted. At the one end where mainly deliberate tax transgressions occur, hard enforcement interventions are necessary and in most cases applied by the RA. Its purpose is not only to address the transgression, but to create public awareness that something is being done to protect the tax system of the country, thus protecting their wealth.

It is clear that the RAs of Australia and Canada have very structured processes and programmes for addressing tax non-compliance through tax auditing and tax criminal investigations. Every year their tax compliance programmes are made available to the public. These indicate which sectors will be addressed and the types of interventions to be conducted. The process of tax auditing is clearly communicated through their websites and further clarification can be sought directly from the RAs. Projects are undertaken to address the more serious types of tax crime and these too are published and monitored by the RAs as well as by the public. Their websites are regularly updated with statistics regarding their interventions rather than publishing

these only through their annual reports. Staff capacity and the required level of skills required do not appear to be a problem, as many of their interventions have positive results in spite of the high level of voluntary compliance in those countries. The positive results in this climate also indicate that the risk identification process is robust and that those who have transgressed are identified for hard enforcement interventions.

South Africa's RA also has structured processes and programmes for addressing tax auditing and tax criminal investigations. However, these processes have only been put in place in the last five years. The tax auditing processes are not published clearly on the SARS website. However, these have been highlighted through media and other publications by tax practitioners and companies. The compliance model used by SARS is the same as that published by Australia in its compliance programme for 2011/12. There are similarities to developed countries in relation to its philosophy on compliance, the automation of processes, the process of tax audits, the use of the NPA in prosecuting tax crimes, the establishment of the LBC and the unit responsible for addressing illicit trading. These are strong indicators that SARS is on the right track in its attempts to address tax compliance in the country.

The results of tax audits and tax criminal investigations for SARS are positive, thus indicating that such interventions are influencing tax compliance in the country even though this effect is not quantified. It can be argued that with its lower level of voluntary compliance compared to Australia and Canada, any interventions by SARS should yield a positive result. There are so many transgressors to address that a positive outcome of such intervention is almost guaranteed.

The SARS tax auditing and tax criminal investigations unit as well as the LBC and illicit trading units have only been in existence for a few years compared to other developed countries. SARS therefore continues to have the challenge of effective implementation of its strategies and programmes. While great strides have been made in this direction through the recruitment of skilled and experienced persons from the private sector, it continues to have a skills challenge in relation to the majority of its staff. The reliance on the NPA for prosecution of criminal cases and the

limitations of capacity and court time, impact negatively on SARS's ability to increase its coverage on tax criminal investigations and the resultant impact this has on the public when published in the media.

4.3 CONCLUSIONS

It is clear that all three countries researched take into consideration the various factors that influence tax compliance when developing their compliance programmes. As Australia and Canada are full members of the OECD and South Africa is still in the process of being assessed for possible membership, their strategies for addressing tax compliance are similar as it is based on the OECD research and models developed.

All the countries are clear that interventions from tax auditing and tax criminal investigations have a positive effect on tax compliance. However, none are able to accurately quantify this effect.

Australia and Canada with their greater experience and high levels of voluntary compliance are willing to continue with hard enforcement interventions due to the positive results received every year. South Africa with its lesser experience and lower levels of non-compliance could possibly increase its coverage for tax auditing and tax criminal investigations. However, the risk identification process must be accurate so that it does not appear that the classic economic model is followed, which implies that every taxpayer is considering committing some tax transgression.

Hard enforcement interventions have a place in every compliance programme as there will always be persons that are blatantly non-compliant. These interventions have the effect of limiting or possibly reducing the number of such persons over time.

4.4 CONTRIBUTIONS

The research findings show clearly that the SARS strategy adopted is similar to those of developed countries. The research has not added new knowledge, but instead

created awareness that while SARS has some operational challenges it is functioning similarly to developed RAs. This should improve the negative perception of the general public in terms of SARS's strategy.

4.5 FURTHER RESEARCH

In the conclusion above, it was indicated that all the countries are clear that interventions from tax auditing and tax criminal investigations have a positive effect on tax compliance. However, none are able to accurately quantify this effect. Further research should be conducted to quantify this effect appropriately.

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