

## **REVIEW OF THE 13<sup>th</sup> INTERNATIONAL CONFERENCE ON TAX ADMINISTRATION, SYDNEY, 2018: TAX SYSTEM INTEGRITY IN A DIGITAL AGE**

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The impact of the digital economy on tax compliance, tax bases and tax administration has emerged as a key issue for taxpayers, tax advisors, tax administrators and tax academics. The topic was the focus of the 13th International Conference on Tax Administration organised by the University of New South Wales in Sydney (UNSW Sydney) in April 2018.

Most of the papers presented at the conference fell under the umbrella of three overarching themes: the challenges and opportunities for tax administrators created by the digital economy; issues in tax compliance; and the intersections of digitalisation and international tax issues. A fourth group of papers considered several discrete tax administration and compliance issues not confined to the digital age. Additionally, support from the Asian Development Bank Institute (ADBI) made it possible for administrators from Asian and Pacific countries to report on the interaction of the digital economy and tax administration in their jurisdictions.

### **THE DIGITAL ECONOMY AND TAX ADMINISTRATION: CREATING CHALLENGES OR OPPORTUNITIES**

Papers looking at whether the growth of the digital economy represents a threat to tax administrators or offers them new tools for enhancing compliance and collections considered the question both at a general level and in the context of some specific digital economy developments. The latter included the sharing economy and digital currency. Also considered was the rise of peer-to-peer supplies, a development that has attracted considerable attention but which may raise phantom red flags in terms of consequent tax issues.

#### **Administrative opportunities**

While digitalisation is undoubtedly a challenge to tax bases and traditional source of income and place of supply rules, the presentations by tax authorities mainly stressed the positive aspects of the impact of digitalisation on tax administration. One well-publicised change is the ease with which information can be stored and accessed. While the internet may be used in transactions intended to minimise tax, it also generates data. All it takes, as Neil Olesen, a second commissioner of taxation in the Australian Tax Office, pointed out, is one disgruntled person and a wealth of information becomes available to tax administrations. Sharon Thompson, a deputy commissioner in the New Zealand Inland Revenue, suggested that the widely publicised Panama Papers and Paradise Papers are just the tip of the iceberg in terms of the wealth of new information coming to tax administrators.

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In advanced economies, there has been a significant shift towards using the internet as a source of tax information and a means of submitting tax returns. Many speakers identified a link between client-tailored digital experiences offered by tax administrations and increased tax compliance and taxpayer trust in the integrity of the tax system. Services that enhance taxpayers' experience include pre-populated forms that draw on information provided by third parties and details of the taxpayer's circumstances. Pre-population of known data has been shown to prompt taxpayers to provide further disclosures, perhaps on the assumption that the information will be available to the tax administration through other sources. Equally importantly, taxpayers can appreciate how the digital system delivers personal benefits to them. Individualised prompts provide an example – a pop-up prompt alerting taxpayers to check to see if they are entitled to another deduction or credit they may have missed can be an important tool for establishing trust and encouraging full engagement with the tax administration. A further outcome from digitalisation is the speed with which tax authorities can respond to issues of concern to taxpayers. Automatic cross-checking of data can reduce refund times, for example, to one week from the time a return is filed, again strengthening respect for, and trust in, the tax system.

A New Zealand initiative that may not have been widely copied to date is the development of integrated digital programmes that include tax as one element of broader online systems for persons starting a business, closing a business, starting a family, dealing with a death in the family and so on. The systems pull together relevant information from all government departments, so users have a one-stop shop where they can learn about both responsibilities and benefits. Someone with an expanding family, for example, can learn about tax consequences and sign up for financial benefits from another department in one spot.

Presenters from both academia and tax administrations considered the nexus between enhanced information collection and greater tax collections. If information systems can be made to communicate with one another, data from a range of sources can be correlated with income tax information to verify information provided by taxpayers or third parties, or to uncover discrepancies. This process can be carried out in real time. It was explained, for example, that income tax authorities in Japan can draw on residential real estate value data based on actual and regularly updated assessed valuations prepared for local property tax purposes. Other possibilities discussed included additional documentation from companies—in addition to internal company documents prepared for financial accounting, inventory and business management, and other purposes, companies produce financial disclosure documentation for many other agencies with information that can be incorporated into automatic audit and checking systems.

Enhanced analysis of data provides tax administrators with an opportunity to uncover avoidance and evasion arrangements at an earlier stage than was previously possible. Initially, real-time targeting of potential evaders or avoiders can enable authorities to stymie arrangements before revenue is lost. At the next stage, greater data mining can be used to find links between apparently unconnected taxpayers exploring similar schemes and tax minimisation planners and promoters. This allows tax authorities to move more quickly when schemes are being developed and to track schemes more effectively once they have been implemented.

As senior tax administrators noted, in addition to providing access to conventional information sources and complementary analysis techniques, digitalisation has created new information

sources for tax administrators. Brooke Harrington (Copenhagen Business School) explained in more detail how technological developments have facilitated leaks detailing avoidance and evasion arrangements. The development of PGP encryption keys, for example, has made it possible for employees with conscience twinges to expose files without fear of being traced and retribution.

One unexpected source of data on avoidance that prompted discussion is social media boasting, where wealthy individuals expose their consumption on platforms such as Instagram, Snapchat and Facebook. Authorities in one jurisdiction were reported to be using sophisticated algorithms to match spending revealed on social media postings with stated income.

The powers of tax administrators to access and copy or retain information held by taxpayers were first legislated in a pre-digital age. Andrew Maples (University of Canterbury, Christchurch) and Robin Woellner (UNSW Sydney) presented a paper on the interpretation and application of those powers in respect of digital information in Australia, New Zealand and the UK, concluding that it is important to regularly review how these powers should apply to rapidly changing technology in order to find the optimal balance between coercion powers and taxpayer rights over digital information.

### **Sharing economy**

The development of the internet has opened the door to a new sharing economy, in which individuals can make their services available to a large potential customer base through internet platforms such as Airbnb and Uber. Homeowners can rent rooms through accommodation sites; car owners can provide rides through transportation sites. The possibilities are unlimited.

The key issue raised by the sharing economy from an income tax perspective is the non-reporting of receipts by individuals providing services as unincorporated entrepreneurs. The primary issue from a VAT viewpoint is the non-reporting of supplies, although where registration thresholds are high enough to exclude most small entrepreneurs, the VAT problem may not be as significant as the income tax consequences. It is, however, an issue in jurisdictions in which there are no thresholds for particular suppliers. This is the case in Australia, for example, where there is no registration threshold for persons providing taxi services, a term that has been interpreted as including sharing economy rides.

The tax issues arising from individuals offering sharing economy services are not new. Non-reporting of income and sales by unincorporated small businesses is as old as income tax and VAT. However, the challenges faced by tax authorities are multiplied many times as tens and hundreds of thousands of new sharing economy entrepreneurs start businesses via sharing economy platforms. As Jurie Wessels and Marina Bornman from the University of Johannesburg pointed out, while traditional studies of compliance and non-compliance decision-making by individuals operating as businesses might, with some modifications, be applicable to new entrepreneurs offering sharing economy services, the lessons they provide may have a limited impact on the new challenges. At the same time, the new technology that gives rise to administrative problems may hold the solution to these problems. The sharing economy entrepreneurs' reliance on internet platforms opens the door to comprehensive withholding regimes aimed at the platform operators, for example.

## **Digital currency**

The development of cryptocurrencies, such as Bitcoin, created both VAT and income tax issues for tax administrators. In terms of VAT, the question was whether cryptocurrencies are a form of money, which would remove the sale and acquisition of the currencies from the scope of VAT, or a type of property, which would make sales of currency taxable supplies. Jurisdictions have been divided on the question but the view that cryptocurrencies should be characterised as money seems to be emerging as the dominant view.

In the income tax sphere, ownership rights to cryptocurrencies are generally treated as property rights and the main income tax issue is whether gains on the sale of the currencies should be regarded as capital gains or revenue gains from a trading business, a distinction that matters when capital gains are taxed preferentially. While the type of property may be new, the underlying tax administration issue is not and tax administrators can apply the traditional revenue versus capital tests to characterise the gains on a case-by-case basis.

## **Peer-to-peer arrangements**

One question raised was whether the growth of peer-to-peer transactions through social media gives rise to new VAT avoidance opportunities. Peer-to-peer transactions between individuals have never previously been considered within the scope of VAT but it was asked whether the amplification of these arrangements by thousands or even millions through social media raises new concerns. The question prompted vigorous discussion, but the overall sentiment of participants was that the new relationship spawned by social media should rightfully remain outside the VAT net. The taxable supplies are not the peer-to-peer arrangements for no consideration but rather the provision by sharing websites hosting peer-to-peer platforms of space in which merchants can place advertisements targeted at peers using the websites.

## **TAX COMPLIANCE**

Two themes emerged in papers looking at tax compliance. One concerned the impact of digitalisation on individuals required to comply with tax obligations and the other considered the question of tax compliance costs in the changing tax environment.

### **The impact of digitalisation on individual taxpayers**

The digitalisation of tax administration raises a number of concerns for particular individuals with tax obligations. Nina Olson (U.S. National Taxpayer Advocate) and, separately, John Bevacqua (La Trobe University), both drawing on the U.S. experience, emphasised the concurrent risks to, and the need for protection of, the rights of taxpayers whose compliance activities are particularly affected by digitalisation. The primary concern was the impact of digitalisation on taxpayers lacking effective internet access, especially low-income persons, seniors and the disabled. The shift to digital sources of information and any requirement that taxpayers comply in a digital manner, such as online filing, if it were to be mandated, would have a profound impact on these taxpayers. While digital self-service improves efficiency for relatively simple tasks, some classes

of taxpayers will still need channels through which to talk to tax administrators, either face-to-face or over the phone, when problems arise.

As tax offices move to digitalise services, particularly the provision of information and assistance with resolving disputes, taxpayers may turn to third party providers for personal help, with digitalisation resulting in the outsourcing of personal support and the client being required to pay for a service previously provided by the revenue authority. As a result, Melinda Jone (University of Canterbury, Christchurch) suggested, removing personal services could risk alienating taxpayers and impact on compliance. In this light, wholesale shifts to digitalisation for client services is probably not an optimal policy choice. The question is thus not whether digital or traditional modes of communication and service delivery should be preferred but rather what is the appropriate balance between the two.

Another aspect of digitalisation that can affect taxpayer behaviour is the security of digital information. There are some taxpayers who do not feel comfortable sharing personal financial information on the internet. The optimal systems are those that exploit the benefits of digitalisation where possible and, at the same time, retain traditional systems where these are needed to accommodate persons with genuine concerns over the new technology. It follows that digitalisation of tax systems requires a high level of cybersecurity protection, so that taxpayer information is not at risk. This may not be achievable in many countries at this stage.

Taxpayers' compliance levels are also linked to their understanding of tax. One way of measuring taxpayers' ability to comply with obligations in the digital world is to measure their "tax literacy" or understanding of obligations and opportunities. Marina Bornman and Marianne Wassermann from the University of Johannesburg showed how a model for measuring tax literacy could be developed by modifying traditional financial literacy measurement techniques.

### **Compliance costs**

An initial paper on compliance costs by Richard Highfield, Michael Walpole and Chris Evans (UNSW Sydney) described an ambitious project that seeks to develop a diagnostic tool that reveals relative levels of compliance burdens around the globe. The project commenced with VAT but the organisers plan to work with a large group of collaborators and extend it to all business taxes. The preliminary findings of a pilot study of 13 countries showed that the VAT compliance burden is lower in advanced economies than in developing economies. The findings in terms of each participant country appeared to be broadly aligned with community and government expectations.

Studies on assessing compliance costs at the international level were complemented by investigations of compliance costs at the national level. Martyn Knottenbelt (New Zealand Inland Revenue) provided a summary of the New Zealand experience measuring compliance costs for individuals, which showed how tax procedure changes that reduce time, effort and stress for taxpayers can yield increased taxpayer compliance. Karen Stark (University of Pretoria) and Sharon Smulders (University of South Africa), reporting on the compliance costs of individuals in South Africa, found that by far the largest component of these costs was the personal time spent on tax affairs, in particular the time devoted to record keeping. The findings suggested the

development of more efficient record keeping tools could have a significant impact on compliance costs.

## **INTERNATIONAL TAXATION**

Three discrete issues concerning the emergence of the digital economy and international income taxation were discussed at the conference. The first related to information sharing in the fight against tax avoidance; the second concerned problems arising when allocating profits derived by digital suppliers; and the third looked at opportunities by which to improve the mutual agreement procedure.

### **Information sharing**

Issues concerning the sharing of tax information between tax administrations from different jurisdictions was considered in the context of the base erosion and profit shifting (BEPS) initiative of the Organisation for Economic Co-operation and Development (OECD). BEPS has been a true game changer in terms of the way in which countries unilaterally and mutually respond to the challenges of tax minimisation by evasion in tax havens and avoidance by way of transfer pricing. A study by Kerrie Sadiq (Queensland University of Technology), Adrian Sawyer (University of Canterbury, Christchurch) and Bronwyn McCredie (Queensland University of Technology) showed, unsurprisingly, that the take-up of measures to counter BEPS has been highest among OECD members, followed by G20 members and then countries that do not belong to either organisation. The BEPS procedures that are most relevant to digitalisation are country-by-country reporting and automatic exchanges of information. Although the failure of countries to adopt cooperation arrangements of these sorts in the past was, no doubt, attributable to political reservations, it is only with the digital transmission of information by taxpayers to revenue authorities and the means to distribute information between revenue authorities that programmes such as these have become technically feasible. Crucial to the success of the automatic exchange of information is the adoption of a common reporting standard.

Also important, as Ranjana Gupta (Auckland University of Technology) pointed out, is a review of confidentiality rules in domestic legislation. It is not uncommon for jurisdictions to place strict limits on tax authorities' power to release taxpayers' data to third parties, including other government departments. These rules appear incompatible with automatic exchanges of information between tax authorities in different countries and attention to this issue is needed to harmonise domestic law and international obligations.

### **Allocating digital profits**

Digitalisation creates new opportunities for local businesses to derive profits without a physical shop front presence and for non-residents to sell to customers in a foreign country without a sufficient infrastructure in the country to constitute a permanent establishment.

The first problem was illustrated by the situation in Thailand, where 75% of e-commerce providers sell solely over the internet without a physical sales premises. Traditional audit techniques based on field audits to check actual stock levels, the authenticity of input claims, and so forth are simply

not feasible in these circumstances. The enforcement of tax compliance must be undertaken from completely new perspectives. The first step is to find taxpayers, commencing with the organisation that issues IP addresses to identify local suppliers.

There remains the much larger problem, however, of attributing profits to foreign suppliers with no physical presence in the jurisdiction. Under current tax treaties, a source country can tax the profits of non-resident businesses from sales in that country if the non-resident has a permanent establishment in the country. A case study by Lusi Khairani Putri and Christine Tjen from Universitas Indonesia documenting Indonesian attempts to assess a non-resident Facebook subsidiary on profits derived in Indonesia successfully illustrated the practical difficulties countries have in overcoming the permanent establishment conundrum.

The only solution within the constraints of the current treaty framework would be, as several participants noted, to adopt extended deeming rules that treat servers as permanent establishments. This approach could, however, be easily circumvented by the use of offshore servers.

In the longer term, a fundamental rethink of when source countries should have taxing rights over gains attributable to their territories may be needed. An economic study by Nigar Hashimzade (Durham University) using game models suggested that the optimal outcome can be achieved through a negotiated split of taxing rights between the residence and source countries, but offered no insights into how a residence country can be enticed to negotiate away some of the taxing rights provided to it under current international tax law.

### **Mutual agreement procedure**

The third digital economy and international tax issue considered at the conference was the extent to which digitalisation could offer paths to dramatic improvements of the mutual agreement procedure set out in tax treaties for resolution of inter-country international tax disputes by competent authorities of the countries involved. A study by Christina Dimitropoulou, Sriram Govind and Laura Turcan (Vienna University of Economics and Business) detailed the steps that could be taken to achieve this goal.

### **OTHER ADMINISTRATIVE AND COMPLIANCE ISSUES**

In addition to the papers on the primary theme, a number of papers considered other tax administration and compliance issues. As Gareth Myles (University of Adelaide) noted, however, the tax implications of the shift to a digital economy go well beyond tax administration issues and, indeed, set the stage for a fundamental rethink of tax design and policy matters.

A paper by Monica Bhandari (University College London) on refunds on tax overpayments in the UK explored the implications of time limits imposed by the UK's revenue authority as a mechanism to control a flood of requests for refunds, with a focus on their compatibility with EU law.

Looking at the issue of directors' responsibility for the tax affairs of a company in the Australian context, Kalmes Datt (UNSW Sydney) suggested that, setting tax morale considerations aside,

directors of companies using aggressive tax minimisation tactics may find themselves subject to civil penalties imposed under company law for breaches of company duties if their companies suffer penalties as a result of participation in failed tax minimisation schemes.

The broad issue explored in a paper by Kristin Hickman (University of Minnesota) on judicial review of tax administration and executive regulations or guidelines, most significantly prior to application, will resonate with administrators in all jurisdictions, but the question is of particular interest to officials and taxpayers in the United States, where so much of the tax law is established in regulations issued by the Treasury and IRS guidance. The paper considered whether a shift in judicial interpretation of legislation governing pre-enforcement appeals to the courts is needed.

An Australian initiative to promote corporate tax transparency by way of Tax Transparency Reports has had limited take-up, Catriona Lavermicocca (Macquarie University) noted, with little evidence of company tax practices being modified as a consequence of these reports.

A factor that may be inhibiting the development of more effective simplification programmes is the reliance on input from tax policymakers or tax administrators when identifying areas of complexity or confusion. A South African initiative reported on by Bernadene de Clercq (University of South Africa) showed that taxpayers' perspectives of complexity or uncertainty differ from those of policymakers and administrators, suggesting that effective simplification initiatives require greater input from taxpayers.

Ali Noroozi, the Inspector-General of Taxation in Australia, noted that the digital economy poses challenges not only for tax administrators but also for those who scrutinise their work, such as the office of the Inspector-General of Taxation in Australia. The burgeoning growth of new sharing economy entrepreneurs has raised the number of potential complainants exponentially.

An experimental study reported by Miranda Stewart and Emily Millane (Australian National University) using behaviour insights methodology suggested that taxpayers respond positively and collections increase if tax is paid as close as possible to the time that income is derived. Changing administrative practices to achieve this goal will require associated statutory amendments that stipulate, for example, regular pay-as-you-go remittances, rather than annual payments of tax on investment income and other income not currently subject to withholding or periodic remittance rules.

In a study investigating the relationship between reminder notices and tax payments, Christian Gillitzer (University of Sydney) and Mathias Sinning (Australian National University) found that the earlier reminder notices about overdue taxes are sent, the faster the payment will be received, though the timing appears to have no effect on the ultimate probability of payment.

One tool used to evaluate administrative efficiency is a measurement of the tax gap, that is, the difference between what should be collected under the law and what is actually collected. Neil Warren (UNSW Sydney) provided some insights into measuring the tax gap and the actions that might be taken in response to the findings.



## **COUNTRY REPORTS**

A welcome addition to the conference was the participation of representatives from several regional jurisdictions, a development made possible thanks to the generous support of the Asian Development Bank Institute (ADBI). These and other delegates presented reports from Malaysia, Indonesia, Thailand, Samoa, Kiribati and Vanuatu. The regional reports were joined by a report from further afield from Qatar. The level of development ranged across the jurisdictions and circumstances impacting on tax administration varied.

The regional presentations reinforced, to some extent, a broader study that showed that taxation often involved more complexity for taxpayers in less developed countries than for taxpayers in more developed countries. At the same time, initiatives were being undertaken to reduce complexity, such as the removal of the requirement in Indonesia that businesses had to issue separate commercial and tax invoices for the same transaction.

While island countries share many features, they also exhibit important differences. There is a divide, for example, between those with income tax systems in place and those with no, or limited, income tax systems; the latter, unsurprisingly, face difficulties in generating information for multilateral sharing purposes. There is, similarly, a difference between those connected to the internet by cable and those that are not, with the external digital economy having limited impact on the second group. VAT administrative issues may also be strikingly different in island jurisdictions with broad VAT systems, as well as in those that have high VAT registration thresholds which result in only a small number of registrants paying domestic tax with the bulk of VAT being collected on imports.

The information shared at the conference provided useful ideas for other nations. An amnesty in Indonesia was seen as valuable, not for the revenue it generated, but rather as a tool to bring persons onto tax databases. An analysis of returns filed by companies in China showed how reliance on data coerced by the tax authority (that is, tax returns and information returns) was not sufficient to find non-compliant taxpayers. China's system of exempting, rather than zero-rating, exported services shows how policies at odds with tax design principles can greatly prejudice some domestic service providers. Malaysia's experience with separate agencies collecting VAT and income tax prior to its return to the Sales and Services Tax demonstrates the importance of information sharing between all tax agencies. The role of external forces in modernising domestic tax systems was clearly illustrated by the many changes driven by the OECD (country-by-country reporting, common reporting standards and the automatic exchange of information) and the U.S. (Fair and Accurate Credit Transactions Act [FACTA] requirements).

Finally, country experience showed the paramount importance of tax policy design in developing effective tax systems. It truly does not matter how effective and efficient a national tax authority is if the tax base is fragmented and suffering concessions that undermine the integrity of the tax system.