

Vote 9 - Office of the Revenue Commissioners

9. Revenue Account

Basis for Audit

An account showing all revenue received and paid over to the Exchequer by the Revenue Commissioners is furnished to me annually. I am required under Section 3 of the Comptroller and Auditor General (Amendment) Act, 1993 to carry out such examinations of this account as I consider appropriate in order to satisfy myself as to its completeness and accuracy and to report to Dáil Éireann on the results of my examinations. The results of my examinations have been generally satisfactory.

I am also required under Section 3 of the Comptroller and Auditor General (Amendment) Act, 1993 to carry out such examinations as I consider appropriate in order to ascertain whether systems, procedures and practices have been established that are adequate to secure an effective check on the assessment, collection and proper allocation of the revenue of the State and to satisfy myself that the manner in which they are being employed and applied is adequate. Paragraphs 15 and 16 refer to matters arising from this examination.

Revenue Collected

Revenue collected under its main headings in 2000 is shown in Table 5.

Table 5 Revenue Collected

	Gross Receipts £m	Repayments £m	Net Receipts £m	1999 Net Receipts £m
Income Tax	7,875	688	7,187	6,306
Value Added Tax	7,809	1,928	5,881	4,895
Excise	3,631	147	3,484	3,163
Corporation Tax	3,187	127	3,060	2,711
Stamps	884	25	859	719
Customs	174	11	163	144
Capital Acquisitions Tax	181	5	176	151
Capital Gains Tax	616	7	609	356
Residential Property Tax	2	1	1	1
Total	24,359	2,939	21,420	18,446

Of the net receipts of £21,420m, a total of £132m was paid during 2000 under Section 3 of the Appropriation Act, 1999 from the proceeds of tobacco excise to the Vote for Health and Children and £21,300m was paid into the Exchequer. As a result, there was a balance of £49m prepaid to the Exchequer at year end compared to a balance of £37m prepaid at the end of the previous year. As the final lodgment to the Exchequer at year end is required to be made on 31 December, before final reconciliations for each tax-head can be completed, there is necessarily an element of estimation which can result in over or under lodgments by Revenue to the Exchequer.

10. Write Offs

The Revenue Commissioners have furnished me with details of taxes written off during the year ended 31 December 2000. Details of the total amount written off and the distribution according to the grounds of

write-off are shown in Table 6 and Table 7.

Table 6 Taxes Written Off 2000

Tax	2000 £'000	1999 £'000
Value Added Tax	33,783	32,833
PAYE	13,202	15,018
Corporation Tax	5,445	5,573
Income Tax	15,092	19,860
Other Taxes	1,758	2,066
PRSI	12,831	12,959
Total	82,111	88,309

Table 7 Grounds of Write Off

Grounds of write-off	2000 No. of Cases	2000 £'000	1999 No. of cases	1999 £'000
Liquidation/Receivership/Bankruptcy	397	19,558	475	28,457
Ceased trading – no assets	1,432	32,980	2,347	33,128
Deceased and Estate Insolvent	144	2,579	194	3,324
Uneconomic to pursue	1,196	12,197	519	6,110
Unfounded Liability	34	458	40	2,397
Cannot be traced / Outside Jurisdiction	297	4,713	403	5,573
Compassionate Grounds	89	1,184	83	608
Uncollectable due to financial circumstances of taxpayer	382	7,965	439	8,395
Examinership	4	477	1	317
Totals	3,975	82,111	4,501	88,309

The Internal Audit Branch in Revenue undertakes an annual examination of a sample of cases written off. The internal audit of 1999 write-offs in which 185 or just over 4% of cases were examined has recently been completed. The results of the audit were satisfactory and while some procedural problems were identified, no instances were found where tax was improperly written off. The internal audit of 2000 write-offs has recently commenced and it is again planned to examine 4% of cases.

I have examined a sample of cases representing over 12% of the value written off through a review of the procedures followed and of supporting reports and records with a focus on high value cases. The results indicated that, in general, the authorised procedures were followed. However, I have also commenced a more in depth examination of a sample of cases in some categories of write-off in order to establish the extent and adequacy of Revenue activity over the years prior to write-off and whether the relevant lessons are learned from such cases. I intend reporting on the results of that examination in due course.

11. Outstanding Taxes and PRSI

Table 8 was prepared on the basis of information furnished by the Revenue Commissioners and reflects the activities and transactions in the twelve month period ended 31 May 2001 - the latest date for which data was available at the time of finalising my Report.

Table 8 Outstanding Taxes and Levies

Balance at 31 May 2000	Tax or Levy	Charges/Estimates Raised	Paid	Balance at 31 May 2001	Estimate of amount likely to be collected
£m		£m	£m	£m	£m
388	Income Tax (Excluding PAYE)	1,538	1,553	373	223
-	DIRT	350	350	-	-
100	VAT (Declared Liabilities Net of Repayments)	5,117	5,091	126	110
150	VAT (Estimates)	52	37	165	75
69	PAYE (Declared Liabilities)	5,476	5,471	74	49
22	PAYE (Estimates)	241	241	22	9
71	PRSI (Declared Liabilities)	2,896	2,889	78	45
17	PRSI (Estimates)	117	118	16	9
169	Corporation Tax	3,208	3,148	229	157
50	Capital Gains Tax	661	638	73	58
13	Capital Acquisitions Tax	182	181	14	9
6	Abolished Taxes	1	1	6	-
1,055	Total	19,839	19,718	1,176	744

The balance outstanding at 31 May 2001 of £1,176m is £121m greater than at the same point in 2000. It is estimated that £744m or 63% of the total outstanding is likely to be eventually collected. This compares with an estimated collection ratio of 53% at May 2000. The estimation of the amount likely to be collected takes into account such factors as anticipated reductions of estimated amounts brought forward, the level of liquidations and business closures and historical business patterns.

Included in the total of £350m for DIRT is a sum of £173m comprising tax, interest and penalties from 'look back' audits of financial institutions.

12. Revenue Audit Programme

Overall Audit Programme

In a self assessment system returns filed by compliant taxpayers are accepted as the basis for calculating tax liabilities. The validity of returns is established by the auditing of a selection of cases either through reviewing and seeking further verification of particular details or by the examination of documents and records at a taxpayer's premises. The majority of audits carried out by the Revenue Commissioners are specific to taxheads such as VAT or PAYE, but a significant number of comprehensive audits are also carried out. These may focus on all taxes but are primarily aimed at Income Tax, Corporation Tax and Capital Gains Tax. In the course of my audit, a small representative sample of settlements were reviewed with satisfactory results.

The outcome of the 2000 programme of Revenue audits is summarised in Table 9, which also includes 69 audits arising from investigation and anti-avoidance activity. I have been informed that the reduction of 1,040 in the overall number of audits over the 1999 figures was due mainly to the involvement of 67 auditors in the more intensive DIRT audits.

Table 9 Revenue Audit Programme

Audit Type	2000		1999	
	No. of audits completed	Yield £m	No. of audits completed	Yield £m
Comprehensive	2,270	53.8	2,512	47.3
Value Added Tax	4,409	27.6	5,101	31.9
PAYE Employers	2,104	9.4	2,768	12.3
Relevant Contracts Tax (RCT)	352	1.3	384	1.5
Combined Fiduciary (VAT, PAYE and RCT)	670	4.7	892	3.0
Capital Acquisitions Tax	388	2.9	490	3.2
Verification	1,733	3.7	1,848	3.1
Desk Verification	4,393	4.3	3,400	6.9
Investigation Branch	4	0.2	7	0.2
Anti-Avoidance	7	1.9	26	1.6
'Pick-Me-Ups'	21	0.1	-	-
DIRT	37	173.3	-	-
Total	16,388	283.2	17,428	111.0

Comprehensive Audits

The selection of cases for comprehensive audit from the 409,299 returns issued for 1999 is made on the basis of such factors as screening of annual returns, re-audit of cases with previous undercharges, other information available to Revenue and random selection. Generally, a settlement is agreed following completion of the audit and any outstanding amount is paid. A number of settlements involve the restriction of losses which may be carried forward against future years' profits. Where an Inspector is unsuccessful in collecting the additional amount of tax and interest arising on audit adjustments, the amounts are referred to the Collector General for collection.

The outcome of the 2,270 comprehensive audits completed in 2000 is detailed in Table 10. The highest individual settlements were £1,222,870 for Income Tax and £1,046,088 for Corporation Tax. The overall yield of £53.8m includes interest charges of £7.8m and penalties of £6.4m.

Table 10 Yield from Comprehensive Audits

	Income Tax		Corporation Tax	
	Number	Yield £'000	Number	Yield £'000
Agreed Settlements				
£1 to £5,000	400	1,058	93	314
£5,001 to £50,000	575	9,191	195	3,651
£50,001 to £100,000	50	3,413	35	2,427
Over £100,000	56	13,238	41	11,283
Other Settlement Activity				
Returns accepted – no additional tax payable	592	-	177	-
Settled by restriction of losses carried forward to future years	20	480	16	8,101
Referred to Collector General for enforcement action	17	414	3	258
Totals	1,710	27,794	560	26,034

Random Audits

Prior to 2001, it was Revenue policy that 2% of cases selected for audit as part of the comprehensive, VAT and PAYE/PRSI audit programmes would be selected randomly. This was increased to 6% with effect from 2001. The 2% policy for 2000 would indicate a target of approximately 175 random audits. In the event, 437 random audits were completed in 2000 consisting of 77 comprehensive (3%), 195 VAT (4%) and 165 PAYE/PRSI (8%). The returns of 342 taxpayers were accepted as originally submitted while additional liabilities of £493,459, including £105,564 in interest and penalties, were assessed in the other 95 cases

13. Revenue Prosecution Activity

Prosecutions for Serious Tax Evasion

Under Revenue prosecution strategy, audit districts are required to forward cases to Investigation Branch for investigation with a view to criminal prosecution where there is prima facie evidence of serious revenue offences having been committed. These cases are further evaluated within the Branch before commencement of the very resource intensive criminal investigation work which can take several years before reaching the Courts. Of a total of 37 cases on hands at the end of 2000, 19 are still under investigation, 13 are proceeding to prosecution, 3 have been closed and convictions have been secured in two cases.

Convictions were obtained in all three of the cases decided in Court in 2000. A director of a company was convicted of submitting false VAT repayment claims and sentenced to two years imprisonment. In the second case, a director of a company was convicted of delivering an incorrect return and fined £750. In the third case, an individual was convicted of submitting a false VAT repayment claim and received a twelve month suspended sentence.

Prosecution of Non-Filers

Taxpayers failing to submit returns of Income Tax and Corporation Tax normally receive a warning letter from the Revenue Solicitor. In the event that returns are still not submitted, legal proceedings are instituted. During 2000, 8,190 warning letters were issued and 1,017 cases (936 Income Tax and 81 Corporation Tax) were successfully prosecuted with fines totalling £734,656. Court orders were obtained in two of these cases which required the convicted person to submit all outstanding returns.

Penalties totalling £146,700 were imposed by the Courts on 79 employers for failing to make P35 Employer returns on time. In a further 219 cases, penalties totalling £277,500 were imposed by Revenue and were paid by employers. Penalties totalling £271,000 were also imposed by Revenue on 157 employers but were not paid and court proceedings are now being taken for recovery of the amounts due.

14. Special Investigations

DIRT and Financial Institutions

In accordance with Section 904B (inserted by Section 68 of the Finance Act 2000) of the Taxes Consolidation Act, 1997 Revenue submitted a report on the outcome of the DIRT 'look-back' audit of the financial institutions to the Committee of Public Accounts on 31 October 2000. The report, which indicated that a total of £173m in respect tax, interest and penalties had been collected from the institutions, was examined by the Committee in December 2000.

In the course of my audit of Revenue collection in 2000, I carried out an examination of the overall DIRT

look-back audit. This included an assessment of the reasonableness of the approach and methodology adopted by Revenue, the consistency with which the methodology was applied, an examination of the key documentation relating to the audits undertaken in four financial institutions, and discussions with the relevant Revenue staff. In the course of my examination the basis of any decision taken by the Revenue audit team in relation to any sampled account was not reviewed as the original papers examined by Revenue remained in the financial institutions.

The approach and methodology followed during the look-back audit is set out in detail in the Revenue report to the Committee of Public Accounts. In essence, listings of DIRT-exempt accounts together with deposit balances were obtained from each institution for dates in 1990, 1995, and 1998. These lists were accepted by Revenue without checking as the risks to the audit were considered to be minor, and the resources needed for a validation process would be excessive. Samples of these accounts were checked in detail by Revenue with a heavy weighting towards high value accounts. Where the Revenue audit of the financial institution found sufficient indicators of Irish residency in respect of DIRT-exempt accounts within the sample such accounts were deemed to be bogus unless the financial institution could provide satisfactory evidence to the contrary. The results of the sample were then applied to the total of the DIRT-exempt listing at each key date, and an overall liability established which also included interest and penalties.

As the result of my examination I am satisfied that the approach and methodology employed by Revenue were reasonable given the circumstances and timescale in which they had to operate. The methodology was consistently applied across the audits except where it was impractical to do so.

Offshore Investments via National Irish Bank

The investigation into 429 individuals who invested in an offshore investment scheme operated by National Irish Bank is continuing. By 31 May 2001, settlements were reached in 281 cases totalling £17,067,477 including interest of £5,960,909 and penalties of £3,432,551. Of these cases, 79 were settled with no liability.

In addition, payments on account totalling £7,258,828 have been received in respect of other unresolved cases. 12 cases have been referred for criminal investigation with a view to prosecution through the courts.

Ansbacher (Cayman) Limited

A special project team was established to examine the tax affairs of the 120 individuals named in the Report of the Authorised Officer appointed by the Minister for Enterprise, Trade and Employment to examine the books and documents of Ansbacher (Cayman) Limited held in Guinness and Mahon Bank. Offshore activity by persons other than those named in the report has also come to light during this on-going investigation.

Revenue have been availing of their powers under the Taxes Consolidation Act, 1997 to require persons, third parties and financial institutions to provide relevant records and information. Such records and information are sought by means of formal requests as well as the issue of notices under the Act. In addition, to date, four successful applications have been made to the High Court under the Act requiring third parties and financial institutions to provide records and information relevant to a person's tax liability. Under the Act, Revenue have applied to the Appeal Commissioners for their consent to issue a notice to a financial institution to provide records and information relevant to a person's tax liability

Payments on account totalling £4.64m have been received in 24 cases directly related to the Authorised Officer's report. A further £3.14m has been received as payments on account in respect of 15 other cases that have all the characteristics of the original Ansbacher list. Payments on account totalling £0.59m have been received from six other cases. Two cases have been settled, one for £0.2m and the other for no liability.

Pick-Me-Up Schemes

Pick-Me-Up Schemes involved expenses for goods or services incurred by a political party being invoiced by the supplier to another trader who paid the supplier as a means of supporting the party. Such payments were not deductible for tax purposes, the VAT was not reclaimable and the invoices issued were not in accordance with legal requirements. The investigation has found that while some traders treated these payments correctly for tax purposes quite a large number did not. Where the tax involved was small, Revenue decided to settle the case on the basis of payment of the tax underpaid plus statutory interest and a penalty based on the Code of Practice for Revenue Auditors. Settlements have been reached in 34 of these 'smaller' cases totalling £129,944 (including £41,015 in interest and £29,996 in penalties). Payments on account totalling in excess of £350,000 have been received in 16 'larger' cases. Investigations are on-going in these and 20 other 'large' cases.

Tribunals

Matters disclosed at the Moriarity and Flood Tribunals which suggest that tax evasion may have occurred are being investigated as they come to notice.

15. Customs Controls over Third Country Imports

Background - Customs in the EU context

Up to 1993 all imports from outside of the State were subject to customs control procedures at the 43 customs stations located at airports, seaports and at the land frontier with Northern Ireland. The establishment of the Single Market in that year removed all customs barriers between EU Member States, and now only goods imported from non-Member States (i.e. third countries) are subject to customs clearance. The legislative basis for the levy of duty is the EU Customs Code, and customs duties collected by Revenue, less a retention of 10% in respect of administration costs, are paid over to the EU. The 1994 GATT Agreement brought about a gradual reduction in the rates of customs duty. However, in addition to Customs Duty, Excise Duty and VAT may arise in respect of imports, and an indication of the amounts collected in the period 1994 - 2000 is given in Table 11. The customs function provides the first control point for the collection of these taxes.

Table 11 Customs Duty, Excise Duty and VAT on Imports 1994 and 2000

	1994	2000
	£m	£m
Customs Duty	189	163
Excise Duty	30	80
VAT	330	641
Total	549	884

Development of National Customs Procedures

National policy has been strongly influenced by the underlying policy of the EU to encourage the speedy clearance of goods and Revenue has adapted customs control procedures, since the mid-1980s, to facilitate the freer movement of goods. The current system is highly computerised. The previous system, which relied on extensive documentation and physical checks at point of entry, has been replaced with a routing system, which allows the vast majority of consignments to be cleared through customs without physical checking. Owners of approved premises undertake the physical handling and release of goods with a very limited

intervention by customs staff. In effect, there is now a system of self-assessment in place, which is similar to that in use for the collection of direct taxes. The system is policed by the extensive use of intelligence and the audit of a selected sample of traders.

Audit Objectives and Scope

The objective of the audit was to assess the extent to which current customs control procedures provide adequate assurance as to the assessment and collection of all amounts due in respect of both customs duty and other taxes arising on the importation of goods from third countries, against a background of radical change in customs procedures.

As part of the audit customs regulations and procedures and relevant reports were reviewed. The computerised system for recording customs entries and the role of customs stations in the clearance of goods were examined, as were the enforcement and intelligence gathering functions of Revenue. Outline examinations were conducted at Shannon and Cork Airports and at Tivoli Docks, and a comprehensive audit was carried out at Dublin Airport. Customs approved warehouses at these locations were visited to establish the physical and accounting controls and the customs reporting procedures in operation. The Central Transit Office in Donegal, which co-ordinates the receipt and return to other member states of transit documents in respect of consignments initially taken under customs control in another Member State, was also visited. The operation of post clearance controls through the customs audit function was reviewed, and the risk analysis approach, selection process, appraisal of results and quality control were examined.

Audit Findings

The audit findings are summarised by reference to the key activities undertaken at the point of entry, in the warehouse, during transit and internal customs audit, and as part of the enforcement and intelligence functions of the Revenue. The relevant procedures are briefly described in each case.

Point of Entry

AEP routings - green/orange/red

Import details for each consignment are declared on a form known as a Single Administrative Document (SAD) and input into the central Automatic Entry Processing (AEP) system. The system also requires transportation details for a consignment. Following the completion of validation checks, the AEP system automatically assigns either a green, orange or red colour coded 'routing' to each consignment. Goods which are routed 'green' are free for release without any further customs check. Goods routed 'orange' are subject to documentary checks, while 'red' routed goods are subject to documentary and physical checks.

Routings are assigned by the system through three selection phases – mandatory, profiling and random. Consignments falling within the criteria for mandatory checking e.g. all excisable goods, are always assigned a red or orange routing as appropriate. Import consignments are 'profiled' or targeted for customs checking on the basis of previously known problems, risk analysis criteria or intelligence reports. In addition, the system maintains a minimum level of orange and red routings through the random allocation of such routings to SADs which would normally have qualified for green routings. Figures supplied for 2000 indicate that a total of 3% of all consignments were routed 'orange' and 8% received a 'red' routing. Customs stations receive details of all orange and red routings on daily reports, and also receive a monthly report of uncleared orange and red routed cases.

The audit findings in relation to this activity are:

- There is a definite risk that importers, with direct input access to the AEP system, may be able to establish the customs routing of a particular consignment prior to committing that consignment to a specified flight. Such knowledge would remove the element of surprise associated with random checks and could provide an opportunity for importers to circumvent customs controls. Flight details are sometimes entered on the system before flight departure. Therefore, it is possible for an importer intent on circumventing customs controls, to establish the routing prior to departure and to withhold the consignment if 'red' routed. Alternately, any importer may re-input red or orange routed SADs until a favourable 'green' routing is obtained. However this will only be successful where the routing was assigned on the basis of random selection, and may come to Customs' attention either through a trader's claim for refund of the duplicate duty or the investigation of an uncleared SAD.
- During our audit at Dublin Airport, eleven instances were noted where SADs routed orange or red were not presented, but goods were cleared by a duplicate entry which had been routed green. There were many instances at Shannon Airport of goods arriving on a later flight than that recorded on the SAD. These may be attributable to normal commercial practice of switching goods between flights to maximise usage of available space.
- Station checks are made in response to the submission of documentation by clearance agents or traders. The daily AEP reports of goods routed orange or red were not used by the customs stations to initiate such checks. Station monitoring and follow up of red and orange routed cases are not initiated until receipt of the monthly report of uncleared items. By then it may be too late for effective action as the goods may have been removed from customs control. Significant numbers of SADs are not cleared promptly and many are never cleared or even investigated by the station. It was noted that there were 1,000 such uncleared SADs at Dublin Airport.

Selection of Import Consignments by Profile

Where import consignments are selected for customs checking through 'profiling', orange or red routings are assigned to SADs where declared particulars match the criteria specified in the profile. Particular consignments may be targeted either nationally, by sections such as the Investigation Branch or the National Freight Intelligence Unit, or locally, at each customs station. The computer system can handle a maximum of ten national profiles together with five at each local station.

The audit findings relating to this activity are:

- The availability of national profiles to counter evasion of duty or taxes is reduced by other demands for profiles e.g. detection of prohibited goods and health risks.
- The utilisation of local profiles is patchy. Of the four stations visited there were no active profiles at Shannon or Dublin Airports while the two Cork stations used their full allocations.
- Where risk analysis is used, the process is unstructured in comparison with that used for customs audit selection.
- Only traders registered on the AEP system can be directly targeted by profiles. The imports of traders using agents may not be profiled. The use of a trader's VAT number as a profile identifier can be countered by the trader making a 'Not Registered for VAT' declaration thereby avoiding selection. There are no checks on the correctness of VAT details declared. In January 2001 only one SAD had been selected from four traders profiled by their VAT No.
- The effectiveness of some profiles is dependent on the element of surprise. Leaving a profile in place overlong may reduce its utility by revealing selection criteria.

Use of the Cargo Manifest as an aid to Customs Control

All goods arriving by freighter from a third country should be listed on the ship or flight manifest which must be presented to customs on arrival. The manifest provides a focus for boarding checks by customs officers. It also facilitates a completeness check as customs entries are written-off the manifest when cleared. Follow-up enquires are made for goods not written-off. At airports, daily stock reports, submitted to customs by approved warehouse operators, fulfil a similar function. These reports include SAD reference numbers in respect of cleared items.

The audit findings relating to this activity are:

- Boarding checks have been severely curtailed e.g. there are no boarding checks at Dublin Airport and have been limited to about three each month at Shannon. Manifests are generally accepted by customs as complete in the absence of boarding checks.
- There are no checks to ensure that imports recorded on a manifest are subsequently declared i.e. verification through the follow-up of quoted SAD reference. Customs use of manifests is limited to follow-up of goods not written-off, and for reference purposes in case of query.

Release of Goods from Customs Controlled Warehouse/Compound

Imported goods are held under customs control in a warehouse or compound pending customs clearance. Approved licensees operate the warehouses. At airports these include freight handlers and the major airlines. Customs officers are not present in the warehouses on a regular basis. Warehouse operators forward daily reports of goods taken in under customs control. These reports provide documentary evidence of the arrival of goods. A warehouse operator will release goods on presentation of customs clearance documentation, which is either routed green, or routed orange or red and stamped by customs. A second daily report detailing how goods were released is forwarded to customs within 21 days. Items not written-off are subject to customs enquiry.

The audit findings in relation to this activity are:

- In response to explanations sought during audit relating to outstanding uncleared SADs, we were informed that seven consignments routed orange and two routed red at Shannon for the period March - May 2000 and 18 red routed consignments at Dublin Airport for the period July 1999 – June 2000, had been removed from the warehouse without customs clearance.
- The absence of a pre-determined format for customs clearance documentation may facilitate the use of bogus documentation.
- In two of the four warehouses visited, the systems used to account for goods under customs control were integrated with the warehouse operators' own accounting systems. This provided additional assurance as to the completeness of records.

Transit System

The EU Transit System facilitates trade by allowing the temporary suspension of duties and taxes while goods are transported through EU territory. The suspension, which is covered by guarantee, remains in place until the goods leave the EU, are transferred to an alternative customs regime or are released following payment of duties and taxes. The first EU country from where goods depart creates and retains the original transit documentation. One of two copies is stamped by the customs authority of the country of destination, returned, and matched with the original allowing release of the guarantee. If a stamped copy is not received back within 10 weeks, an enquiry is initiated by the country of departure to trace the documentation or, if

necessary, the consignment.

The audit findings in relation to the operation of the Transit System are:

- The audit at Dublin Airport indicated that stamped transit documents were not reconciled with corresponding SADs or other appropriate customs procedure. Reconciliation, which is carried out at land and harbour stations, verifies that imports have been entered in the customs system, and that duty has been assessed for payment.
- In 1999, 3,100 enquiries were initiated arising from 40,000 inward transits processed in Ireland, and £275,000 was collected from 18 SADs created retrospectively by Customs. In these 18 cases goods had been imported into Ireland without any form of customs declaration. These cases were treated as innocent oversights.

Customs Audit

The level of customs checks at point of entry has been greatly reduced in recent years. Customs audit units, located in each Collection area, but under the direction of the Audit Management Unit (AMU) in Dublin, are now the main means of policing the entire system. Risk analysis techniques are used to select traders for check. The focus is evenly divided between local selection, based on local knowledge, and national selection which is product and trader based. Checks can cover periods of up to three years, and are carried out at the premises of the trader who is required to retain all business and customs documentation for that period. The audit approach is set out in comprehensive guidelines, which require that work performed is recorded on detailed checklists.

During 2000, 396 or approximately 5% of traders were audited with the following results

- underpayments in 33% of cases totalling £1.4m,
- overpayments in 10% of cases with £0.4m repaid,
- less than half of cases were fully compliant.

Details of audits conducted during the years 1997 - 2000 are given in Table 12.

Table 12 Results of Customs Audit of Traders 1997-2000

	1997	1998	1999	2000
No. of Audits	258	324	321	396
Underpayment Cases	52%	41%	37%	33%
Underpayment Value	£4.5m	£2.3m	£1.9m	£1.4m
Overpayment Cases	6%	12%	20%	10%
Overpayment Value	£0.2m	£0.7m	£0.7m	£0.4m

A customs inspection of 70 clearance agents in December 1999 found numerous poorly completed SADs. Errors included misclassification of goods, wrong VAT number and no country of origin recorded. Some importers were marked 'not registered for VAT where VAT numbers were available. In other cases duplicate SAD entries were noted. These errors gave rise to both under and over payments of duty and VAT.

The audit findings in relation to this activity are:

- The risk analysis selection process for customs audit is confined to traders registered for VAT. A SAD which does not include a VAT No. will be excluded from selection for customs audit.
- No tests for non-declarations, e.g. tracing items from traders' records to declaration forms, were found in a random sample of 12 customs audit files reviewed in the course of my audit.
- Completed audit files are returned to the AMU, but are not subjected to quality control examinations. The audit checklist had been completed in only one of the 12 audit files examined. Audit evaluation and quality control is not possible without a record of work done, findings reached and action taken. Notwithstanding these findings it was noted that post-SADs in relation to customs duty were raised in all underpayment cases and repayments instigated in all overpayment cases in the sample examined. When adjustments giving rise to underpayments of customs duty also resulted in additional VAT charges, there was no evidence of any action being taken to collect the additional VAT.

Enforcement

The Investigation Bureau is the criminal investigation arm of the Customs and Excise service. Most of its work is directed against smuggling operations in the tobacco and alcohol sectors. It targets particular consignments for examination on the basis of both its own assessments and the results of mutual assistance arrangements with other countries. It also follows up referrals from the EU Anti Fraud Unit and the Irish customs and excise service. Targeted consignments are subjected to physical checks by local station staff under Investigation Branch supervision. Over 96 million cigarettes and 4.9 tonnes of tobacco were seized in 2000: £15m was the potential revenue loss. In excess of £5m was collected in additional duties and compromise penalties. A total of 10 cases were referred for prosecution.

The audit findings in relation to this activity are:

- The main priorities of Investigation Branch are the seizure of smuggled goods and the collection of unpaid duties. Interest and the threat of prosecution appear to be of little practical deterrent value. However, the disruption in the clearance of the goods of traders, which follows profiling, can act as a deterrent. Prior issue of a letter of sanction puts a trader on notice, that further irregularities may have such a result.
- Prosecutions of customs fraud, other than for the sale of smuggled alcohol or cigarettes, are rarely pursued due to the difficulty in obtaining convictions.
- There is no provision for the imposition of administrative monetary penalties in the case of a customs irregularity involving only error or neglect. In accordance with the EU Customs Code, interest is chargeable only from the date of the demand as distinct from the date of arrival of goods. Consequently interest amounts tend to be small and of little deterrent value.

Intelligence

The National Freight Intelligence Unit (NFIU) was established in 1999 to centrally collect, analyse, enhance and disseminate freight intelligence on a national basis. Its task is to target smuggled goods transported by sea. The Unit has access to Revenue and EU databases and various other sources of information. It continues to develop its own database from these resources and from information provided by customs operational units. Detailed intelligence reports are produced which assist operational units to identify high-risk traffic. These are passed to other areas of Revenue when relevant to tax compliance issues. The Unit issues messages categorised as 'high risk', 'low risk' or 'background'. The effective development of the Unit's work is dependent on adequate feedback from users of the information. The messages issued during 2000 led to the seizure of 53 million cigarettes and consignments of counterfeit goods when followed up by

operational units. The NFIU may respond directly to the information at its disposal by creating a “national profile” in the AEP system. Customs stations are required to notify the NFIU following the declaration of a consignment which the NFIU has profiled, and the Unit may decide on further action by the local station or the Revenue Mobile Service.

The audit findings in relation to this activity are:

- The NFIU does not cover airfreight.
- Responses to the information distributed by the NFIU vary. Good responses to 'high risk' messages were noted but the response to 'low risk' and 'background' messages appears patchy. There has been no feedback from the detailed intelligence reports issued.
- It would appear from AEP system reports that the NFIU is not always contacted in relation to cases it has profiled.

Conclusions

The requirements of national, EU and international trade dictate that the operation of customs controls by each country facilitates the rapid recording and clearance of imports. The assessment and collection of the appropriate duties and taxes must now adapt to the necessity to avoid disruption to trading activity. The customs authorities must operate adequate procedures for the detection of evasion of duty and the importation of prohibited goods within this constraint.

The Revenue approach has been to offset the greatly reduced level of policing and checking at point of entry with a combination of initiatives. These include a more focused sample selection process, a greater emphasis on the gathering and dissemination of quality intelligence, and the conduct of periodic audits on traders' premises. The findings of this audit note aspects of control procedures in different parts of the system which merit examination by Revenue with a view to making changes leading to an improvement in the overall quality of customs control.

In particular;

- At point of entry, verification of SAD references entered on a manifest, and early review and follow-up of uncleared red/orange routings on each AEP daily report would reduce the risk of manipulation of the system. The AEP system should be reviewed to ensure that importers have no opportunity to influence the “routing” given to any particular consignment.
- It is unsatisfactory that items from consignments selected for customs check can be released from warehouses without any customs authorisation.
- The option of providing each warehouse operator with an enquiry/verification facility might be considered together with the promotion of more widespread integration of warehouse accounting records with those relating to goods under customs control.
- It is unclear why all airport stations do not reconcile stamped transit documents with corresponding SADs, as is the practice at land and harbour stations. This check ensures that all items have entered the customs system and have been assessed for duty.
- Ongoing efforts to improve the quality of customs audit should continue. Standard audit programmes and checklists should be used for all checks, both to provide evidence of work done, and to facilitate review and quality control. The selection of cases for customs audit should be broadened to increase the possibility of detecting deliberate misdeclarations by infrequent users. At least some audits should trace items from traders' records to declaration forms. The outcomes and impact of the audit programme should be kept under review both from the audit viewpoint and as

part of the overall control system;

- The focus of controls on the collection of customs duty needs to be balanced with recognition for the greater revenue earning VAT on imports.

The collection and dissemination of quality information is very important in the changed environment in which customs controls now operate. Prompt feedback from stations would undoubtedly aid the operation and development of the intelligence function. The ongoing project to improve the flow of information throughout Revenue may impact positively on the information exchange both between NFIU and customs stations, and between the unit and the rest of Revenue.

16. The Administration of Relevant Contracts Tax

Background

Relevant Contracts Tax (RCT) is a tax deduction system introduced in 1970 to counter tax avoidance in sub-contracting or 'lumping' in the construction industry. Many of these sub-contractors had escaped the tax net due to the difficulty of identifying them. Under the RCT system, a sub-contractor faces the choice of registering with and obtaining clearance from Revenue for receipt of payments from principal contractors without deduction of tax, or of having tax deducted at a flat rate of 35% from all payments. The system also applies to forestry and meat processing operations, but most principal contractors (98%), certified sub-contractors (95%) and uncertified sub-contractors (98%) are involved in the construction industry. Indicators of the level of activity for 1999-2001 can be seen in Table 13.

Table 13 Relevant Contracts Tax Activity 1999-2001

	1999	2000	2001
RCT paid to Revenue	£196m	£267m	
No. of Contracts where RCT not deducted	155,000	196,000	
No. of Principal Contractors*		22,000	23,000
No. of Certified Sub-Contractors *		27,000	32,000
No. of Uncertified Sub-Contractors		36,000	37,000

* About 11,000 Principal Contractors also act as certified sub-contractors and these are included in both categories.

Under the RCT system, a principal contractor must establish, for each job, whether a worker is more properly considered as a sub-contractor or as an employee for that job. There is no absolute definition covering all cases, and the correct categorisation will be an overall assessment based on what each worker actually does, the way they do it and the terms and conditions under which they are engaged. In addition to whether the worker should be taxed under the PAYE or self assessment systems, there is an extended issue relating to PRSI contributions and benefits coverage for the workers concerned. In relation to all cases where it is appropriate to operate RCT, a principal contractor is required to keep certain records and to make monthly and annual returns and pay over tax deducted to Revenue.

Audit Objectives and Scope

The overall objective of my audit was to establish whether the systems and procedures for the administration of RCT, as operated by Revenue, were adequate to ensure that all tax due was collected and, in so far as it was reasonable for Revenue to do so, that any aspect of that tax scheme was not used to avoid payment of other

taxes or to perpetrate abuses in other areas of State administration e.g. Department of Social, Community and Family Affairs (DSCFA).

In particular, the audit examination focused on the key segments of the overall RCT system i.e.

- o the control of sub-contractors Certificates of Authorisation (C2 Certificates)
- o the issue of Relevant Payment Cards to principal contractors
- o compliance and enforcement activities of the Collector General
- o annual returns of RCT to Tax Districts
- o repayment or offset of RCT deductions from sub-contractors
- o Revenue audit and liaison with DSCFA.

Following discussions with officials in the Technical Services Branch of the Chief Inspector's Office, the operation of procedures were reviewed in two tax districts - Dublin Audit District 1 (which deals exclusively with the construction industry in the greater Dublin area) and Galway District. Work undertaken at each location included:

- o review of procedures for issue and renewal of C2 Certificates
- o review of procedures for issue of Relevant Payment Cards
- o identification of extent of processing and checking of year end returns
- o review of procedures for dealing with claims for refunds/offsets
- o examination of a sample of audit files for evidence of RCT checks
- o extent of liaison with DSCFA.

Compliance and collection procedures in operation in the Collector General's Office were also reviewed.

Further documentation and data were examined during the course of the audit relating to general RCT statistics, tax instructions issued to districts, Revenue audit statistics, liaison with DSCFA and sanctions for non-compliance, together with a 1999 report by Revenue's Internal Audit Division on procedures governing the issue of C2 Certificates.

While RCT applies to sub-contracting in both the forestry and meat processing industries, all of the cases which came under review during my audit related to the construction industry. This was not surprising as with up to 98% of the principals and sub-contractors based in that industry, it provides the main focus of the operation of the scheme and consequently of this report.

C2 Certificates for Certified Sub-Contractors

A sub-contractor whose tax affairs are fully in order for the previous three years may receive a C2 Certificate from Revenue. The certificate is valid for one year (3 years in the case of sub-contractors with a turnover in excess of £5m) and allows the sub-contractor to receive payments from the principal contractor without deduction of RCT. The legislation allows Revenue to issue a C2 Certificate even though there has not been full compliance if in all circumstances of the case they consider one should issue. If the sub-contractor falls into arrears with tax returns or payments, the renewal of certification is withheld. In the years 1999/2000 and 2000/01, Revenue policed the system by checking the tax position of all new applicants, together with a sample of renewals. There are approximately 32,000 certified sub-contractors.

The audit findings in relation to this section are:

- For 2000/01 Revenue checked 26% of renewals in the Dublin area and 12% or 839 were withheld. Galway had a higher check rate of 66% with 450 (24%) withheld.
- A Revenue Internal Audit report of November 2000 noted that the majority of cases in the Dublin area were renewed without an adequate check of the holders' tax affairs. Revenue have stated that there was a 100% check on renewals prior to 1999/2000 and that the low level of checking in 2000/01 was due to resource constraints. A subsequent general instruction, issued in November 2000, required that all future renewals were to be checked. Of the 8,600 Dublin renewals checked for 2001/02, 4,500 cases were initially withheld, and in excess of £8m in outstanding taxes was collected from 1,100 of these cases. 1,500 have not yet been released.
- The Internal Audit Report also found that proper records were not maintained of the reviews performed. This deficiency was also reflected in the sample examined during my audit, which noted that evidence was not retained on file to indicate checks completed or the extent of any outstanding tax. Revenue have stated that from November 2000, Districts are required to ensure that a record is maintained to indicate by whom the renewal decision was made.

Payments to Certified Sub-Contractors

Prior to making payments without deduction of RCT to a certified sub-contractor with a valid C2 Certificate, a principal contractor must obtain a Relevant Payments Card from Revenue in respect of the sub-contractor. In doing so, the principal and the sub-contractor make a joint declaration that the contract between them is not a contract of employment. Details from the payment cards of all principals making payments to each sub-contractor and of the number of contracts undertaken by each sub-contractor are entered on a computer system.

The audit findings in relation to this section are:

- Revenue set a case specific limit on the number of contracts held by each sub-contractor and each case is required to be reviewed before a payments card in excess of the limit is issued. However, details of the limit set are not held on the computer system which is used to issue payments cards. The requirement to review details from two separate systems increases the risk of a payments card being issued off one system which may breach the limit recorded on the other.
- At the end of a tax year, a principal contractor may submit a single application for the renewal of payment cards in respect of sub-contractors with ongoing contracts. Less information is required than with an original single application. Revenue checks to ensure that each sub-contractor has collected a valid C2 Certificate, but does not check that the principal contractor had originally submitted a full application and obtained a Relevant Payments Card for each sub-contractor. Revenue have indicated the practical difficulty in making such checks due to the very large number of payments card applications which are received shortly before the beginning of the tax year. The approach has been to deal with incorrect applications by principals by way of audit checks.

Compliance and Enforcement

The principal contractor is required to send to the Collector General a monthly return of RCT deducted from payments to sub-contractors and to pay over the total amount of tax. The Collector General is responsible for the pursuit of principal contractors who fail to comply. RCT has not been incorporated into the main computerised assessment and collection systems. The resulting weakness in the RCT collection process is considered below in the context of recent initiatives by the Collector General to improve the position.

1998 Collector General Working Group

The Group recommended amendments to legislation to address deficiencies in the legal framework underpinning the RCT collection and enforcement process and the legislative changes were introduced in the Finance Act, 1999. It also proposed that RCT be incorporated into the Collector General's co-ordinated tracking and case-working system pending eventual incorporation into the Revenue mainframe computer system. As interim measures, it recommended ongoing monthly monitoring of principal contractors who paid large amounts of RCT and a review of the register of principal contractors to remove any which may have gone out of business.

The audit findings in relation to this section are:

- The method of holding information in the existing RCT system did not fit easily into the Collector General's case-working system and the pursuit of arrears remained essentially a manual operation.
- Since 2000, the 400 principal contractors who have paid in excess of £75,000 annually are monitored quarterly to ensure that returns and payments are up to date. It is reckoned that estimates to the value of approximately £6m have been raised in about 200 cases as a result of this control. The shortcomings to this approach are that high value defaulters may not be included, and no other cases are systematically monitored for compliance. RCT arrears are followed up when coming to light in the pursuit of VAT or PAYE arrears cases.
- The full scale monitoring of RCT through the Collector General's computerised case working system will not be possible until RCT is incorporated into the main Integrated Taxation Processing system which is under continuing development. A final date has not been set for the inclusion of RCT in the development programme.

Collector General's Debt Management Task Force 1999

During 1999, the Collector General's Debt Management Task Force assessed the extent of Revenue's exposure to significant RCT liabilities through examination of a sample of 1,000 principal contractors selected on the basis of payment levels or through indications of non-compliance. 111 cases from a reduced sample of 354 arrears cases with annual balances outstanding in excess of £10,000, were examined in detail and it was found that £3.4m of the £6.3m total RCT liability on record in respect of these cases was collectible. £1.3m arrears were collected together with £0.5m relating to the current year.

On the basis of these results, the Task Force estimated that the amount collectible from the sample of 354 cases amounted to £13m. Based on this estimate, recorded arrears relating to a further sample of 460 similar cases were reduced from £43m to an estimated collectible £15m. An additional £8m was considered to be collectible in respect of assessments raised in a further 2,249 cases. Details are summarised in Table 14.

Table 14 - Collectible Arrears of Relevant Contracts Tax due by Principal Contractors

Description of Sample or Block of Cases	Number of Cases	Recorded Liability	Deemed Collectible
Reduced sample from original 1,000	354	£21m	£13m
Extrapolation to cases similar to 354	460	£43m	£15m
Cases where annual assessments issued	2,249	£8m	£8m
Total		£72m	£36m

The Task Force report concluded that there was a readily identifiable block of recent RCT arrears of the order of £30m - £35m, with perhaps half as much again in respect of other taxes, the bulk of which was concentrated in less than 1,000 cases. The amount collectible may be higher and further arrears would certainly have been identified if cases with an annual arrears balance of less than £10,000 had been included in the examination.

The audit findings in relation to this section are:

- The report recommended that resources be provided to carry out an intensive case by case review to finalise collection of the arrears of in excess of £30m. This has not been done due to continuing pressure on resources and an industrial relations dispute in relation to using the case working system for RCT collection. However, the industrial relations dispute has now been resolved and collection case working will henceforth include the pursuit of RCT.

Use of Revenue Mobile Service 2000

In recognition of the limitations of the current collection arrangements, the Collector General established a pilot project in 2000 under which certain non-compliant RCT cases were referred to the Revenue Mobile Service for investigation. The cases selected for referral are those where the monthly returns for the current year or the annual return for the previous year have not been submitted, and the objective was to obtain outstanding returns and collect outstanding tax. The initial referrals in February 2000 were to the Revenue Mobile Service units in Tullamore and Dublin. Units in Sligo, Letterkenny and Waterford commenced work in this area in October 2000.

In 2000, a total of 1,552 cases were sent to the Revenue Mobile Service. Work commenced on 1,086 of these before the year end and 756 were settled. Of the cases settled, 113 have paid £1.9m in outstanding taxes including RCT of £1.6m. The majority of the other cases were settled by submission of outstanding monthly returns, many of which were 'nil' returns.

The audit findings in relation to this section are:

- Due to concentration on other work, the units in Tulla more and Dublin ceased investigation of RCT cases in June 2000 and January 2001 respectively.
- Following a decision to establish the project on a permanent basis, lists of RCT cases were sent to other Revenue Mobile Service units in February 2001. However, due to industrial relations difficulties, these cases are not being worked at present.

Compliance Rates for Monthly Returns

Monthly RCT returns from principal contractors are due in the Office of the Collector General nine days after the end of each income tax month. From May 1999, it became obligatory to submit a return regardless of whether RCT had been deducted in the month. National monthly compliance rates for mid-2000 and for early 2001 are shown in Table 15.

Table 15 - National Compliance Rates for Monthly Returns of Tax within One Month of the Due Date

	RCT	PAYE / PRSI*	VAT*
July 2000	23%	52%	41%
Feb 2001	37%	53%	43%

*The monthly compliance rates for these taxes increases to 78% and 85%, respectively, 12 months after the due date.

The audit findings in relation to this section are:

- monthly compliance rates for RCT compare unfavourably with the rates for PAYE and VAT after one month. This may reflect the absence of a computerised collection system.

Annual Returns of Relevant Contracts Tax

Annual Returns of RCT are required to be sent to the principal contractor's local tax office within 46 days of the end of the tax year. The return shows the cumulative payments to all sub-contractors, the cumulative tax deducted, total payments to each sub-contractor (certified and uncertified) and the RCT deducted. In addition, the principal is required to provide each sub-contractor's tax reference number (whether certified or not), the number of the Relevant Payments Card issued by Revenue for each sub-contractor who was paid gross and the sub-contractor's date of birth, if uncertified and an individual.

The audit findings in relation to this section are:

- Long term levels of compliance would appear to be only of the order of 60% - 70%. The extent of returns in the Collector General's 1999 Task Force sample of 1,000 was 60%, while Galway District measured the 1999/2000 compliance rate at 62% in March 2001. Overall national rates are shown in Table 16. In comparison, overall rates of return for PAYE annual returns (P35s) are regularly in the region of 95% by seven months after the set deadline. However, as employment situations tend to be more permanent, Revenue would expect a higher rate of compliance as compared with RCT and also consider that the lower RCT rate may be due in part to principal contractors having no RCT activity in a particular year.

Table 16- Annual Relevant Contracts Tax Compliance Rates at March 2001

Year	1997/98	1998/99	1999/00
Number Issued	17,576	19,494	21,972
% received by 28-4-99	74%	Not available	-
% received by 30-4-00	78%	64%	Not available
% received by 2-2-01	Not available	69%	65%

- There is no formal compliance campaign for RCT annual returns as exists for P35s in the PAYE system. In Galway, a reminder letter is issued and a list of non-filers provided to the Inspector in charge of audit. In Dublin, a special six-week project was undertaken in respect of 1998/99 annual returns where non-filers were contacted by phone and letter. Records were updated as necessary and the final list of non-filers was transferred to audit. This was not repeated for subsequent years.
- It is not possible for districts to readily identify which principal contractors have not submitted annual returns. A special request is made to Computer Division to prepare a list.
- A limited level of checking is applied to annual returns received. My audit revealed that the level of checking varies considerably between Districts. Revenue have stated that the content of returns is checked by reference to the original records where a principal contractor is the subject of a Revenue Audit.
- Most of the information on the annual returns is not processed through the Revenue computer system. There is no programme in place to deal with underpaid returns and it is not possible to generate automatic demands in respect of balances due.

Further points noted from the audit samples were

- From my review of the Galway sample it was considered that tax should have been deducted from
 - o three sub-contractors who had a C2 Certificate but in respect of whom the principal contractor had not obtained a relevant payments card;
 - o three sub-contractors who did not hold a C2 Certificate;
 - o one sub-contractor who could not be identified;
- In the Dublin sample of Annual Returns, a Tax Serial Number was not quoted in the case of 271 (70%) sub-contractors without a payments card number and from whom RCT was deducted. The absence of this key reference number makes it very difficult to accurately trace any case through the records of Revenue or the DSCFA.
- Checks were not performed in either Tax District to establish whether any tax reference or payment card numbers quoted were valid.

In response to the points relating to the level of checking of annual returns, Revenue have indicated that the ability to carry out checks on annual returns, particularly in the Dublin area, has been severely limited by the growth in the numbers in RCT and in the building industry generally and by competing demands for staff. The growth in the numbers is illustrated by the increase in the numbers on Revenue records as self-employed individuals in the construction industry from 22,000 in 1995 to 47,000 in 1999. Over the same period the number of holders of C2 Certificates has increased from 17,000 to 28,000 with consequential increases in the numbers of payment cards to be issued (96,000 to 196,000). The numbers of uncertified sub-contractors to be serviced has also increased (repayments up from 33,000 to 55,000).

Repayment or Offset of Relevant Contracts Tax Deductions

Following deduction of RCT, the principal contractor issues a deduction certificate to the sub-contractor with each payment showing the gross amount of the payment and the tax deducted. Deduction certificates are pre-numbered and only issued by the tax office to registered principals. On the basis of the deduction certificate, a sub-contractor can claim for refund/credit of the RCT deducted after the end of the month in which the payment was made. RCT deducted can be credited against any tax owed or estimated, PAYE/PRSI owed for employees, and VAT or RCT deducted by the sub-contractor as a principal. Each refund claim is checked to ensure that no taxes or returns are outstanding from the sub-contractor. If there is any tax outstanding, the RCT withheld is offset against the liability prior to any refund being made.

The audit findings in relation to this section are

- When a claim is being processed, Revenue does not check that the principal contractor listed on the deduction certificate is valid, that his reference number is correct and that the certificate was issued to that principal. Revenue have stated that the sheer volume of repayment claims and the need to process such claims speedily make such checks very difficult to perform when the repayment is being processed. Districts have been advised to implement local security arrangements regarding deduction certificates.
- In processing a repayment claim by a sub-contractor, Revenue does not check that the principal is up to date with his RCT returns and payments. As monthly returns from principals do not detail the sub-contractors in respect of whom deductions were made, it is not possible for Revenue to establish if a principal had remitted the RCT in respect of which a sub-contractor is claiming a refund or offset. This, however, is in line with other fiduciary taxes. The fact that the principal may not have remitted the tax does not affect the sub-contractor's right to a refund, provided there is evidence that the deduction was suffered in a bona fide transaction.

- Of the sample of 19 claims for refund or offset examined during my audit, there was no evidence placed on file in 13 cases to show that all taxheads had been checked for outstanding liabilities when the claim was processed. Revenue have advised that it is standard procedure to check that other taxes were up to date, notwithstanding that such checks may not be recorded on the papers.
- RCT is in theory revenue neutral as the amounts deducted are taken into account when balancing the taxpayers' affairs. However many sub-contractors would appear to accept the liability rather than claim repayment or offset against other taxes. The total amount of RCT deducted but for which repayment or offset was not claimed over the four years 1997 - 2000 was £92m (or 12% of the RCT deducted in the period). The gross receipts, repayments and offsets on a cash basis for each of those years is shown in Table 17.
- As details of Annual Returns of RCT from principal contractors are not captured on the Revenue system, it is not possible to identify and investigate those sub-contractors who do not apply for refund/offset of RCT deducted. While failure to claim would not appear to be advantageous in many instances, it is also possible that some sub-contractors are avoiding tax at higher rates or may be claiming social welfare benefits. However, Revenue have stated that there is no evidence of working and signing in relation to non-claimants.

Table 17 - Relevant Contracts Tax cash collection, repayment and offset 1997-2000

	1997 £m	1998 £m	1999 £m	2000 £m	Total £m
Gross collected	154	175	196	267	792
Repaid	(45)	(55)	(61)	(80)	(241)
Offset against other tax liabilities	(84)	(110)	(118)	(147)	(459)
Not Allocated	25	10	17	40	92

Revenue consider that the reasons for the £92m difference shown between RCT collected and amounts repaid and offset include

- set off will tend to lag behind receipt as the principal contractor is obliged to pay over RCT monthly while claims and related tax returns of income may not be received from sub-contractors for a number of years;
- the size of the difference will be exacerbated in a time of growth in the industry;
- various other reasons, including, foreign sub-contractors who do not claim, evidence of deduction mislaid and repayment refused pending further action by the sub-contractor.

Revenue Audit Checks

Aspects of the RCT system may be examined during different types of Revenue audits:

- o comprehensive audits which examine all taxes including RCT;
- o employers' PAYE/PRSI audits which may include a review of whether workers should be classified as employees or sub-contractors;
- o combined fiduciary audits which examine VAT, RCT and PAYE/PRSI, and
- o audits which focus primarily on RCT.

Instructions, including risk indicators, are in place for Revenue auditors engaged in audits that include RCT. 352 single taxhead RCT audits were completed in 2000. Of these, 172 yielded no additional liability while the

remainder yielded £1.32m. No separate figure is available for the number of comprehensive and combined fiduciary audits that included RCT. However, a total of £860,000 in respect of RCT was included in the overall settlements for such audits. A further category of desk verification audits yielded £1.9m in PAYE and RCT (no breakdown is available).

In 1998, a special programme of 6,200 visits to principal contractors was undertaken by Revenue to check whether any persons registered and treated for RCT purposes as sub-contractors should be reclassified as employees. During the visits, the status of 63,000 sub-contract situations was examined and 12,000 were reclassified as employees. A similar campaign commenced in August 2001.

The audit findings in relation to this section are:

- files relating to 35 Revenue construction industry audits were examined. The absence from some files of a worksheet listing of tests completed made review difficult. However, while most Combined Fiduciary/RCT audits take place in one day, a substantial degree of checking is generally carried out;
- while the classification of employees is examined during every PAYE and RCT audit, figures are not available in relation to the number of reclassifications as a result of routine audit activity.

Revenue Liaison with Department of Social Community and Family Affairs

Since 1990 Revenue and the DSCFA have carried out joint investigations through Joint Investigation Units with staff from both departments. The units operate in all parts of the country and focus on cases where the claiming of unemployment benefit while working is likely to arise, or where there is evidence of non-operation of PAYE/PRSI by the employer. They operate in all industries including the construction industry. In dealing with construction industry cases, the operating practice of the units is to visit sites, interview all the persons on site, ascertain whether they are employees or subcontractors and holders of C2 Certificates and ascertain the wage levels. These details are subsequently checked to computer records to see for example, whether sub-contractors are set up for self-assessment. Officers from the DSCFA may check to see if any workers are claiming social welfare benefits. In some cases, a site may be placed under observation. As a result of visits by the Joint Investigation Unit, some businesses are selected for audit by Revenue. A list of visits is not maintained. Reports are only produced if the case subsequently becomes an audit case. The latest Galway JIU investigation into a construction industry case commenced in May 2000. The latest Revenue audit in Galway of a construction case, which was initiated as a result of a Joint Investigation Unit operation, took place in September 1998.

The audit findings in relation to this section are:

- Two Revenue officials are assigned to the Dublin Joint Investigation Unit on a full time basis as well as some 12 officials from the DSCFA. The Unit in Galway is staffed by four part time staff, of which one is from Revenue. In 2000, a total of 412 visits were undertaken in Dublin yielding £4.4m in taxes. There is no management information on the number of these that would have considered RCT issues. It is estimated that in Dublin 5-10% of visits relate to the construction industry.
- Apart from the Joint Investigation Units there is no interaction between Revenue and DSCFA in relation to RCT at an operational level. While a wide range of electronic data is exchanged, none relates specifically to RCT matters. Revenue obtains details of payments to all sub-contractors by means of the annual returns from each principal contractor. If all information was electronically captured, it could be compared with DSCFA records and assist in the identification of any instances of sub-contractors working while claiming social welfare payments.

- During my audit, 33 cases of a sample of 51 sub-contractors extracted from annual returns of RCT were identified on the DSCFA computer system from details on the completed RCT returns (serial number and/or date of birth). The records showed no claims for social welfare benefits in 30 of these cases, while 3 cases indicated drawings for short periods not incompatible with intermittent sub-contracting activity. The remaining 18 cases could not be identified due to incomplete information on the RCT annual return. Revenue have pointed out that every person in the construction industry who takes on either an employee or a sub-contractor is obliged to notify the DSCFA and that this is the primary method of detecting working and signing.

Sanction against Non-Compliance

The principal contractor is liable for breaches of RCT regulations and in general sanctions will be against the principal. RCT non-compliance is generally punished by the application of civil penalties and interest. These penalties are reflected in audit settlements. Since January 2000, there has been one case prosecuted in respect of an offence under RCT legislation. The taxpayer was charged with aiding and abetting the misuse of a C2 Certificate. The evidence for the prosecution was heard in the District Court in March 2001 and a bench warrant was issued for the defendant who had not appeared in court.

Conclusions

RCT has proved to be an effective means of obtaining tax from a recalcitrant category of taxpayers.

The significant increase in the number of sub-contractors operating in the construction industry has put a strain on the systems used for assessing and collecting RCT. The fact that RCT processing is not integrated into the main Revenue computer system is a considerable drawback to the efficient and effective collection of tax.

Revenue needs to prioritise the development of systems which will enable it to maximise the benefit from the information obtained from RCT activity.

The nature and extent of the checking of RCT returns needs to be reviewed to ensure that it is effective in detecting underpayments of RCT.

The 100% check of sub-contractors' tax affairs prior to the renewal of C2 Certificates lapsed in 1999/2000 due to resource constraints. Although instructions have since issued requiring all renewals be checked, it is important to reiterate that this fundamental control should operate at all times.

Some positive initiatives in collection arrangements were effected in the last two years

- an identifiable block of RCT arrears of £30m - £35m was pinpointed by a Debt Management Task Force in 1999
- in 2000, a pilot project was established under which certain non-compliant RCT cases were referred to the Revenue Mobile Service
- since 2000, large cases are monitored quarterly to ensure that payments and returns are up to date.

Revenue needs to capitalise on these initiatives by making sure that personnel and resources are deployed to collect the identified outstanding RCT.

The delay in following up the RCT arrears increases the risk of non-collection and sends an undesirable signal to non-compliant contractors.

The current programme of visits to principal contractors to check the employment status of workers on building sites is appropriate bearing in mind the increase in activity and changing employment patterns since 1998 when the last such programme was undertaken.