Chapter 4 - Office of the Revenue Commissioners

4.1 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.

Revenue Collected

Revenue collected under its main headings in 2001 is shown in Table 4.

Table 4 - Revenue Collected

	Gross Receipts €m	Repayments €m	Net Receipts €m	2000 Net Receipts €m
Income Tax	**10,549**	**1,231**	**9,318**	9,126
Value Added Tax	**10,548**	**2,641**	**7,907**	7,467
Excise	**4,382**	**169**	**4,213**	4,424
Corporation Tax	**4,623**	**479**	**4,144**	3,885
Stamps	**1,257**	**34**	**1,223**	1,091
Customs	**171**	**6**	**165**	207
Capital Acquisitions Tax	**174**	**6**	**168**	224
Capital Gains Tax	**890**	**14**	**876**	773
Residential Property Tax	**2**	**1**	**1**	1
Total	**32,596**	**4,581**	**28,015**	27,198

Of the net receipts of €28,015m, a total of €168m was paid during 2001 under Section 3 of the Appropriation Act, 1999 from the proceeds of tobacco excise to the Vote for Health and Children and €27,916m was paid into the Exchequer. As a result, there was a balance of €131m prepaid to the Exchequer at year end compared to a balance of €62m 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 taxhead can be completed, there is necessarily an element of estimation which can result in over or under lodgments by Revenue to the Exchequer.

4.2 Outstanding Taxes and PRSI

Table 5 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 2002 - the latest date for which data was available at the time of finalising my Report. Table 6 sets out an aged analysis of the balance outstanding at 31 May 2002.

Table 5 - Outstanding Taxes and Levies

Balance at 31 May 2001 €m	Tax or Levy	Charges/ Estimates Raised €m	Paid €m	Balance at 31 May 2002 €m	Estimate of amount likely to be collected €m
160	VAT (Declared Liabilities Net of Repayments)	7,120	7,161	119	104
210	VAT (Estimates)	38	41	207	113
94	PAYE (Declared Liabilities)	12,136	12,061	169	118
28	PAYE (Estimates)	169	170	27	20
98	PRSI (Declared Liabilities)	8,035	7,936	198	141
20	PRSI (Estimates)	128	128	19	16
474	Income Tax (Excluding PAYE)	1,487	1,518	443	328
-	DIRT	214	214	-	-
291	Corporation Tax	4,123	4,225	189	126
93	Capital Gains Tax	910	892	111	92
17	Capital Acquisitions Tax	176	175	18	14
8	Abolished Taxes	1	1	8	-
1,493	**Total**	**34,537**	**34,522**	**1,508**	**1,072**

Table 6 - Aged Analysis of Debt at 31 May 2002

Tax	Total tax outstanding at 31 May 2002 €m	Amounts outstanding for period 30/4/-31/12/01 €m	Amounts outstanding for 2000/01 €m	Due for periods 1990/91 to 1999/00 €m	Due for earlier periods €m
VAT	326	125	69	129	3
PAYE	196	58	40	78	20
PRSI	217	79	43	73	22
Income Tax	443	2	185	229	27
Corporation Tax	189	42	27	98	22
Capital Gains Tax	111	6	50	52	3
Capital Acquisitions Tax	18	18	-	-	-
Abolished Taxes	8	8	-	-	-
Total	**1,508**	**338**	**414**	**659**	**97**

The balance outstanding at 31 May 2002 of €1,508m is €15m greater than at the same point in 2001. It is estimated by Revenue that €1,072m or 71% of the total outstanding is likely to be eventually collected. This compares with an estimated collection ratio of 63% at May 2001. 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. The movement of the tax year to coincide with the calendar year has caused some alteration in the manner of computation of debt – the most notable being the dramatic increases in the PAYE and PRSI arrears categories.

4.3 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 audit settlements were reviewed with satisfactory results. The outcome of the 2001 programme of Revenue audits is summarised in Table 7, which also includes 40 audits arising from investigation and anti-avoidance activity.

Table 7 - Revenue Audit Programme

Audit Type	2001		2000	
	No. of audits completed	**Yield €m**	No. of audits completed	Yield €m
Comprehensive	**2,200**	**74.4**	2,270	68.3
Value Added Tax	**4,223**	**61.2**	4,409	35.0
PAYE Employers	**1,443**	**10.3**	2,104	11.9
Relevant Contracts Tax (RCT)	**383**	**3.0**	352	1.7
Combined Fiduciary (VAT, PAYE and RCT)	**626**	**11.8**	670	6.0
Capital Acquisitions Tax	**334**	**6.3**	388	3.7
Verification Audits and Desk Reviews	**7,107**	**37.2**	6,126	10.2
Investigation Branch	**30**	**0.4**	4	0.3
Anti-Avoidance	**10**	**3.9**	7	2.4
'Pick-Me-Ups'	**-**	**-**	21	0.1
DIRT	**47**	**-**	37	220.0
Total	**16,403**	**208.5**	16,388	359.6

Comprehensive Audits

The selection of cases for comprehensive audit 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 2,200 comprehensive audits completed in 2001 is detailed in Table 8. The highest individual settlements were €1,490,990 for Income Tax and €5,966,902 for Corporation Tax. The overall yield of €74.4m includes interest charges of €13.1m and penalties of €7.9m.

Table 8 - Yield from Comprehensive Audits

	Income Tax		Corporation Tax	
	Number	Yield	Number	Yield
Agreed Settlements		€'000		€'000
€1 to €12,697	561	4,325	176	1,563
€12,698 to €63,487	300	8,407	109	3,205
€63,488 to €126,974	59	5,353	34	2,905
Over €126,974	56	16,439	49	27,893
Other Settlement Activity				
Returns accepted – no additional tax payable	577	-	236	-
Settled by restriction of losses carried forward to future years	25	104	9	3,422
Referred to Collector General for enforcement action	8	711	1	15
Totals	**1,586**	**35,339**	**614**	**39,003**

Random Audits

It is Revenue policy that 6% of cases selected for audit as part of the comprehensive, VAT and PAYE/PRSI audit programmes are selected randomly. The 6% policy would indicate a target of approximately 472 random audits for completion in 2001. In the event, 740 random audits were completed in 2001 consisting of 443 comprehensive (20%), 165 VAT (4%) and 132 PAYE/PRSI (9%). The returns of 510 taxpayers were accepted as originally submitted while additional liabilities of €3,381,890, including €1,033,281 in interest and penalties, were assessed in the other 230 cases.

4.4 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. Convictions were obtained in all 4 of the cases decided in Court in 2001

- An accountant who was a director of a company which provided payroll services to film production companies, was convicted of submitting false PAYE returns and sentenced to twelve months imprisonment.
- An individual whose company provided security services was convicted of submitting incorrect Income Tax returns, delivering incorrect information and failing to keep proper records. A sentence of six months imprisonment and a fine of €1,905 was imposed. On appeal, the prison sentence was suspended and a further fine of €1,270 imposed.
- A construction company director was convicted of submitting incorrect VAT and PAYE returns and received a six months suspended sentence and was fined €2,750. The company was fined €7,618.
- An individual providing plumbing and heating services was convicted of submitting false VAT returns, obtaining VAT repayments by false pretences and failing to keep proper records. A three months prison sentence was imposed.

Of a total of 31 cases on hands at the end of 2001, 17 are still under investigation, 4 cases have been submitted to the DPP for consideration for prosecution, 6 are proceeding to prosecution and 4 cases have been closed. In one further case, the defendant pleaded guilty in the District Court in 2001. However, when the case came up for sentencing in April 2002, the District Justice refused jurisdiction and sent the case for trial in the Circuit Criminal Court. In June 2002, the Circuit Criminal Court gave leave to apply for a judicial review of the District Court decision.

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 2001, 11,656 warning letters were issued and 1,101 cases (1,050 Income Tax and 51 Corporation Tax) were successfully prosecuted with fines totalling €1,045,354. Court orders were obtained in 40 of these cases which required the convicted person to submit all outstanding returns.

Penalties of €1,148,085 were imposed by Revenue on 476 employers who failed to make P35 employer returns on time. €372,255 of these penalties have been paid by 158 employers. Revenue are seeking to recover penalties of €347,220 from 139 cases by means of court proceedings. Penalties of €413,400 imposed on 173 cases have been withdrawn. The remaining six cases where penalties of €15,210 were imposed are under review as payment of the penalty is being offset from overpaid taxes.

4.5 Special Investigations

DIRT

In 2000, Revenue completed the DIRT 'look-back' audits of financial institutions and reported the results to the Committee of Public Accounts. Audits of all of the institutions have been completed with the exception of IIB Bank Limited and Guinness and Mahon (Ireland) Limited. Final liability in respect of these may depend on the outcome of investigations into the Ansbacher Accounts. Payments on account have been received from the two institutions. In 2001, 47 audits of financial institutions were completed to ensure continuing compliance with DIRT regulations.

Also in 2001, Revenue began to address the issue of the underlying tax on funds deposited in bogus non-resident accounts. The approach adopted by Revenue involved a deadline of 15 November 2001 for depositors to voluntarily disclose and pay any tax, interest and penalties. For those who availed of this, interest and penalties were capped at 100%, no prosecutions were taken and settlement details were not published. Under this arrangement, €227m was paid by 3,675 account holders in respect of 8,380 accounts. Of these, 599 account holders declared a nil liability. All returns are being checked for basic eligibility. In addition, samples have been selected both by the Underlying Tax Project Team and the various Tax Districts for review of the amounts disclosed.

Revenue are now seeking to identify bogus non-resident account holders who did not avail of the voluntary disclose and pay arrangements. Some 1,800 depositors identified during the DIRT look back audits have been referred to tax districts for investigation. The status of these cases at June 2002 is

- 108 have been settled with no liability
- 7 have settled with total liability of €352,724
- 166 have made submissions to Revenue and payments on account of €148,304 have been received

from some of these

- 5 cases are being considered for prosecution
- the remaining cases are being researched further.

Revenue have applied for 18 High Court orders to obtain information from financial institutions relevant to a person's tax liability and 17 orders have been granted. It is expected that this investigation will continue for a number of years.

Offshore Investments via National Irish Bank

The investigation into individuals who invested in an offshore investment scheme operated by National Irish Bank is continuing. By August 2002, settlements were reached in 342 cases totalling €31m including interest and penalties of €17m. Of these cases, 90 were settled with no liability. In addition, payments on account totalling €7m have been received in respect of other unresolved cases. Seven cases have been referred for criminal investigation with a view to prosecution through the courts.

In 2001, National Irish Bank submitted to Revenue a list of 22 new cases. Of these, 15 involve relatively small sums and are thought unlikely to involve substantial tax evasion. Revenue have committed to investigate all additional cases as appropriate.

Ansbacher (Cayman) Limited

A special project team of eight investigators together with support staff is investigating the Ansbacher accounts. The team is investigating cases directly involving Ansbacher type arrangements as well as other cases involving offshore funds and deposits. At August 2002, a total of 300 cases were under investigation.

Investigations into five cases have been concluded as follows

- One case was settled with no liability
- One Ansbacher case was settled for €330,971, including interest and penalties of €190,461
- One case involving Ansbacher type arrangements was settled for €292,040, including interest and penalties of €169,580
- Two other cases involving offshore funds or deposits were settled for €279,342 (interest and penalties €144,996) and €250,138 (interest and penalties €177,399)

Payments on account totalling €17.23m have been received to date in 51 cases as follows

- €11.24m from 44 cases involving Anshbacher-type arrangements
- €5.99m from 7 cases involving offshore funds and deposits.

In July 2002, the report of the High Court Inspectors into Ansbacher (Cayman) Limited was published. Revenue are examining the report and comparing the information in it with the results to date of their own investigations. Revenue have also applied to the High Court for additional documents gathered by the Inspectors but not published in their report. This application is expected to be heard in November 2002.

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. There were a total of 71 cases that apparently avoided tax by engaging in 'picking up' expenses which were proper to political parties. Of these, 15 have been mentioned at either the Flood or Moriarity tribunals and payments on account have been received from six of these. Of the remaining 56 cases, 42 have been settled. In 36 of these, no settlement exceeded €12,697, the total amount of such settlements being €144,233 including €79,913 in interest and penalties. Six of the settled cases involved payments of amounts greater than €12,697. The total yield from these was €326,491 including interest and penalties of €202,158.

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.

4.6 Write Offs

The Revenue Commissioners have furnished me with details of taxes written off during the year ended 31 December 2001. Details of the total amount written off and the distribution according to the grounds of write-off are shown in Table 9 and Table 10.

Table 9 - Taxes Written Off

Tax	2001 €'000	2000 €'000
Value Added Tax	**29,476**	42,895
PAYE	**12,790**	16,763
Corporation Tax	**11,270**	6,914
Income Tax	**68,092**	19,163
Other Taxes	**6,401**	2,232
PRSI	**12,263**	16,292
Total	**140,292**	104,259

Table 10 - Grounds of Write Off

Grounds of write-off	2001 No. of Cases	2001 €'000	2000 No. of cases	2000 €'000
Liquidation/Receivership/Bankruptcy	**382**	**26,942**	397	24,834
Ceased trading – no assets	**578**	**16,945**	1,432	41,875
Deceased and Estate Insolvent	**52**	**1,631**	144	3,275
Uneconomic to pursue	**35,173**	**82,552**	1,196	15,486
Unfounded Liability	**37**	**830**	34	582
Cannot be traced / Outside Jurisdiction	**117**	**4,096**	297	5,984
Compassionate Grounds	**70**	**1,545**	89	1,503
Uncollectable due to financial circumstances of taxpayer	**243**	**5,660**	382	10,114
Examinership	**2**	**91**	4	606
Totals	**36,654**	**140,292**	3,975	104,259

The write off in 2001 included the write off on an automated basis of 33,791 cases totalling €67m in respect of Income Tax, Corporation Tax and Capital Gains Tax. The larger cases were manually checked to confirm that the write off was justified. All amounts were pre 1991 and no amount was greater than €32,000. Cases under the control of the Criminal Assets Bureau, cases under investigation and potential Ansbacher cases were excluded from write off.

The Internal Audit Branch in Revenue undertakes an annual examination of a sample of cases written -off. The internal audit of 2001 write-offs in which 163 cases were examined has recently been completed. The audit did not include the automated write off. The results of the audit were generally satisfactory and no instances were found where tax was improperly written off.

I have examined a sample of cases representing over 4% 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 completed the detailed examination of a sample of cases which I referred to in my Report for 2000. The results of that examination are reported in the following section of the Report.

4.7 In Depth Examination of Tax Written Off

Introduction

In 2000, Revenue wrote off outstanding taxes to a total amount of €104m under the care and management provisions of the Taxes Acts. It was considered by Revenue that the taxes due in each case had become uncollectable for various reasons. The write offs were subject to internal control procedures, and some 4% of cases were examined by Internal Audit to ensure that procedures were followed and that tax was not improperly written off. My staff also reviewed a sample of cases which indicated that procedures had been followed. However, as a separate exercise, they commenced a more in depth examination of a sample of cases in some write off categories in order to establish the extent and adequacy of Revenue activity over the years prior to write off and whether the relevant lessons had been learned from such cases. This report sets out the findings of that examination.

Background

An analysis by Revenue of outstanding taxes at the end of 1996 concluded that there was no realistic chance of recovering much of the book debt of €1,817m for tax years up to 1994/95 due to a number of factors:

- €745m of the arrears related to periods prior to self assessment, was more than 10 years old and remained uncollected at the end of the collection and enforcement cycle
- the overall debt included estimated assessments of €620m, many of which were regarded as speculative and overestimated
- €509m was due from cases cancelled by the Inspector of Taxes, usually on the basis of having ceased trading, and
- the rate of recovery of the €312m arrears amassed in the early years of self assessment was extremely low; even the very favourable terms of the 1993 tax amnesty had made little impression.

Revenue write-off procedures were revised in early 1997 so that much of the old uncollectable debt would be deleted from the records through the use of automation to write off small amounts, an enhanced effort to review doubtful debt, and the write off of cases involving company liquidations at the beginning rather than the end of the company liquidation process. It was hoped that the measures would result in a significant reduction in the level of old book arrears and a greater focus on the collection of current taxes and collectable arrears, and lead to a more planned approach to debt management. Write off remained an internal management matter and decisions to write off are not notified to taxpayers or other interested parties. Revenue considers that the strategy has been successful on the basis of a fall of 11% in the level of recorded tax debt between 1997 and 2001, as against increases of 64% in the gross tax collection and 50% in the number of taxpayers in the same period.

At that time, the Revenue Commissioners sought my views on their proposals and I stated that I was in broad agreement but pointed out that:

- control procedures needed to be designed to minimize the risk of writing-off collectable debt
- the Revenue policy of reinstituting collection action on written off arrears should continue where circumstances change to an extent that the debt can be satisfied
- the revised write-off procedures should not be seen as giving the message that if Revenue demands are ignored for long enough they will go away.

Table 11 details the overall amounts of tax written off in the five years 1997 – 2001, and the amounts for two of the main categories - 'liquidation/receivership/bankruptcy', and 'ceased trading – no assets' which account for 40% and 20% respectively of the total.

Table 11 - Tax Written Off

	Overall Total Written Off		**Liquidations etc.**		**Ceased Trading – No Assets**	
Year	No. of Cases	€m	No.	€m	No.	€m
1997	-*	357	-	193	-	27
1998	-*	274	-	118	-	67
1999	4,501	112	475	36	2,347	42
2000	3,975	104	397	25	1,432	42
2001	**36,654	140	382	27	578	17
Total		987		399		195

* Number of cases written off in 1997 and 1998 are not available.
** Includes automatic write off of small amounts totalling €67m.

Objectives and Scope of the Audit

The objective of the audit was to go beyond the standard write off papers, and to examine the role of the relevant divisions and processes within Revenue in managing and pursuing a sample of significant write off cases in the years prior to reaching write off stage in order to fully assess the appropriateness of the write off decision and to identify any lessons which might be learned from the loss, and whether Revenue had actually made the necessary adjustments to procedures and practice.

The expectation was that only the selected write-off cases would require to be examined. It was anticipated that the entity/person/ business had ceased and was no longer involved in any economic activity. However, it became apparent from an early stage in the examination of a number of cases that the people and their businesses had not ceased but often had multiple ongoing business involvements which gave every indication of deliberate abuse of the tax system. In the light of this preliminary finding, the examination was reoriented towards identifying the extent of these activities, the relationships between various business entities, the methods used to escape the tax system and the overall lessons for the tax collection system.

The original sample on which the audit was based was a selection of 50 cases in which an amount greater than €125,000 was written off during 2000. It comprised 34 companies, 14 individuals and 2 other institutions. The cases were selected to cover the various write off categories e.g. 'liquidations' and 'ceased trading – no assets', and the different units in Revenue which had been involved in the authorisation of the write offs. However, due to the extent of the work involved and the approximately 300 related cases which were also fully examined, the number of cases from the original sample on which a full review was possible was reduced to 25 with only a brief review of the remainder.

In each full review, the liquidation and write off files were examined. Case histories were reviewed on the Revenue computer systems i.e. Central Registration System, Integrated Taxation Processing and Active Intervention Management (in some cases). Additional data from other sources was also examined in certain cases as follows:

- tax assessment files
- Revenue property database
- excise licence databases
- Companies Registration Office system (available on Revenue computer systems from Sept. 2000).

The CRO system was particularly useful for identifying directorships, relationships and the status and activities of businesses. The various information sources were utilized to build up a comprehensive tax history of cases, which gave a more complete picture than that provided by any of the stand alone Revenue systems, or by the write off summary and backing papers. While all of these information sources were available to Revenue staff at the time of write off, some e.g. access to the new Companies Registration Office system and Revenue's Integrated Taxation Processing are relatively recent developments and were not available to Revenue staff when the sample cases were originally worked.

In addition to this report and analysis of the audit findings, with its focus on the performance of the overall system, detailed reports were forwarded to Revenue on an ongoing basis outlining all information which came to light in each case in order that any tax implications could be established and investigated.

Audit Findings

The audit findings fall into two main categories i.e. audit concern relating to the appropriateness of each write off, and the weaknesses in the Revenue collection system which might be indicated by the details of the cases. The weaknesses and possible lessons are considered in areas such as registration, compliance, enforcement and audit. In addition, the implications of particular aspects of abuse noted in two business sectors – property development and the licensed trade – and the difficult area of the abuse of limited liability for tax evasion are also considered. At times, there may be some overlap between points which is unavoidable as many occur together and are closely related e.g.

- inadequate pursuit earlier in the case
- a narrow 'case-based' approach
- inadequate information on and understanding of the overall business and tax context of the case
- lack of awareness of previous write off record
- strong evidence of extended tax abuse.

However, it is necessary to attempt to isolate and categorise each issue in so far as that is possible in order that it may receive full consideration within the context of the overall tax collection system.

While much of this report's content relates to systems and procedures, the write offs were processed on an individual case by case basis. Therefore, for illustration purposes, outlines are included of some details in relation to a sample of three cases which came to light during the audit as a result of following the information trail back from the write off of amounts of €442,000, €146,000 and €170,000. In my opinion, these serve to underline the main points made in the report, and also show the extent of Revenue's task when such activities are concealed within the millions of transactions of the taxes systems.

Appropriateness of Write Off

Reports on the write off cases examined were forwarded to Revenue including comments on the issues coming to audit attention which raised questions on aspects of the write off decision in 2000. Essentially these can be summarised into two main issues – the inadequately informed 'case-based' approach, and the policy of minimising the write off amount.

Write Off Decision based on Inadequate Information

Write off decisions were made on the very narrow basis of the recent collection history of a case treated in isolation, and without an examination of all of the information which was available to Revenue. It is clear from cases reviewed that such an examination would have revealed a far more complex tax history and, in particular, relationships to other tax cases and write-offs involving the same principals. Given the depth of information revealed in some cases, the Revenue write off review could only be considered to be superficial in nature. A comprehensive record of an individual and his/her businesses is vital to a decision on the appropriateness of write-off. A more comprehensive tax history could have resulted in a different conclusion and decision on the collectability of outstanding taxes in a number of cases reviewed.

There is still every possibility that a write off will ultimately be the only option in many cases due to the very limited options available to enforce the recovery of tax owed by a company with no remaining business or assets. However, in cases where a pattern of behaviour encompassing aspects of chronic non-compliance or even deliberate tax evasion activity is identified, a lesson will have been learned either regarding an individual taxpayer, or a system weakness. Appropriate action either through the close monitoring of all of an individual's future activities, or by addressing the weakness, should minimise future losses.

Full Extent of Loss Understated

When a write off is reported, the reasonable expectation is that the amount recorded faithfully represented the substance of the transaction i.e. in this context the extent of the loss to the Exchequer. Obviously, the amount of the recorded loss should not be distorted by inflated estimates but, equally, the extent of the actual loss should not be misrepresented by the exclusion of reasonable estimates likely to be acceptable for legal action in other circumstances e.g. estimates made under Section 23 of VAT Act. It was noted in many cases examined that the extent of the recorded loss may have been understated as:

- there was no assessment of the extent of non-compliance or the likely size of the full tax debt
- the write off was based purely on charges on record, even where these only equated to some payments from a failed fixed payment arrangement

- a number of undercharges identified on tax audits were excluded
- all interest and penalty charges were excluded.

Revenue has stated that it would be unproductive to apply scarce resources to the task of establishing the full liability in circumstances where such tax would, in any event, most likely be uncollectable. Such activity would add nothing to the Exchequer and would operate to the detriment of more productive work.

While the Revenue position is understandable, in the context of resource allocation, I believe that some effort should be made to present a complete and accurate picture with regard to write offs bearing in mind that

- the real scale of a write off is likely to have an impact on the decision taken
- it would be expected that efforts to establish the full extent of a tax liability should arise earlier in the collection process
- accounting and transparency requirements cannot be totally put aside.

Further Write Off Issues

Irrespective of how the write off process is carried out, there is a further issue relating to its timing. It is, or should be, the final in depth review of all aspects of a case in order to establish whether it should be 'written off' or excluded from all of the live stages of the tax collection system. However it is usually carried out at a stage, e.g. six years or more after tax due, when the conclusion will be that it is too late to take any meaningful action and the difficulty of tracing persons and records too great. In order to maximise the value of such a review, consideration should be given to performing this process, say as a third party review, at a much earlier stage e.g after 12 months/24 months without meaningful collection activity in order to get to the bottom of what has occurred in a case at a time where the chances of tax recovery may be much greater. Following the completion of this process cases could be moved to a 'pending write off' account for a further period, but would not be subject to routine collection activity unless new information of relationship comes to light. The current principle would not be affected whereby the debt does not totally disappear at any stage, but remains on taxpayer record for recovery should the opportunity arise, and any lessons for Revenue would be learned earlier. Revenue consider that a decision on whether to write-off or not should be taken at the time of review, as placing a case in a pending category to be re-examined again later would be wasteful of resources.

The weakness of the basis of the write off decisions in a number of the small sample of cases reviewed out of the €104m total written off in 2000 also raises the issue of the extent to which the 2000 write offs in total, and even earlier years, contain cases where the decision should be reviewed. Obviously, at this remove, any look back would require to be focused both with regard to size and type of cases. A further issue, and possibly of greater importance at this stage, may be the extent to which those write offs hide the successful efforts of tax evaders, allowing them the opportunity to repeat their undiscovered practices as instanced by the three sample outlined cases.

CASE No. 1 - Property Developer

- Developer entered the tax system through the 1988 tax amnesty with a payment of €79,000 for years 1970/71 – 1988/89; while that was considered inadequate by Revenue, no further payment was ultimately demanded;
- Write off of €442,000 CT from 1988 included in sample reviewed; demand returned undelivered 1990; no further collection action until write off in 2000 on basis that neither of the two directors could be contacted; Co. had failed to register issued share capital, directors, business address or any annual returns; no connection was made with the individual, the amnesty payment, or his other companies;
- Developer and his family were involved in at least 35 active million pound plus property development companies during 1990s including several major industrial estates, office blocks, apartment blocks, townhouse schemes and a shopping centre, with recent developments valued at over €125m.
- Dealings with Revenue:
  - 35 Co.s registered for CT, 25 for VAT, and none for PAYE/PRSI
  - while the core business was always property development, cases were spread over various tax districts due to a wide variation of declared activities
  - CT returns rarely filed for post-completion i.e. disposal periods; Co.s typically informally dissolved without formal wind-up of final statement of affairs providing information on the sale of property or disposal of cash and other assets which would allow assessment of tax liabilities
  - CT paid totalled €0.25m, while VAT Repayments exceeded VAT payments by €6m (however, portion of that difference is due to 'Section 4A' exemptions arising from sales to VAT registered purchasers)
  - An agent for one of the Co.s informed Revenue that Co. had always been dormant, and the certified accounts filed with CRO reflected this position; Co. had constructed two townhouse developments and an apartment block in early 1990s which sold for €10m
  - In response to a returned demand for €34,000 VAT arrears arising from four tax audits, a Revenue field officer called to the registered address of one of the Co.s and was informed that the Co. had transferred to another address, and that the whereabouts of the directors were unknown; at the second address it was stated that Co. no longer existed; both locations were owned by the developer's Co.s. The VAT arrears were written off. The Co. developed 36 houses to the value of €2.5m but no CT was paid.
  - In all, our examination noted four write offs of taxes totalling €0.6m.
- While the developer was registered for Residential Property Tax, he was not considered to have a liability when his residence was sold for €3.9m because his declared income was below the income threshold.

Revenue Response

Having examined the write off cases referred by my staff, Revenue is satisfied that the cases were worked in accordance with the instructions, guidelines and work practices prevailing at the time the write off was recommended. The write off decision, taking each case on its specific merits, was fully justified. The write off procedure requires each staff member to make a judgment bearing the following factors in mind – the size and age of the debt, previous collection history, whether the debt is well founded i.e. based on returns filed not estimates, feasibility of further collection or enforcement action. Each recommendation is submitted for approval by the Assistant Principal or Compliance Manager, or where the total write off exceeds €320,000, by the Principal Officer or Senior Inspector.

Having reviewed write off procedures in light of cases highlighted by my audit, Revenue has introduced additional checks, called 'commonality checks' which seek to identify and check on the principals behind companies with significant tax payment problems and is amending Write Off Guidelines to provide for:

- checks for linkages to be carried out where tax is being considered for write off
- a specific question for caseworkers to confirm that they have checked the Companies Registration Office for links to other companies in which directors may be involved
- a check on the write off position in respect of the director's personal tax together with the recording of a brief summary of those enquiries.

Revenue has stated that while an old Revenue system which collapsed in 1997 did allow for interrogation of Companies Registration Office records, it was not easy to use and the information was not up to date. The current system which was installed in September 2000 allows staff to create the links used by my staff during the course of this audit. In relation to use of information on the Revenue property file, property searches usually occur after a decision is made to pursue a debt e.g. in considering a judgment mortgage or forced sale. The property search is carried out using the more comprehensive and up to date on-line Land Registry database. The type of use to which the Special Enquiry Branch property file was put during our examination is usually reserved for audit cases. However, Revenue will give consideration to what further use can be made of that system in the context of write off operations. When the structured management system for Revenue's data being developed under the LINKS project is fully operational, it should be possible to obtain all information held by Revenue relevant to a particular taxpayer through one enquiry. This will greatly assist the working of audit and compliance cases by increasing efficiency and focusing on the risk in a particular case. The first part of this system will become operational towards the end of 2002.

With regard to the question of reviewing other write off cases, Revenue considered that the audit sample which was drawn from the larger write off decisions in 2000 would not be fully representative of all write off cases. The larger cases sampled would be more likely to involve cases where enforcement action had never been successful and where evasion would therefore be more likely than in the generality of cases. Revenue has indicated that the recently introduced 'commonality checks' should pick up evaders who attempt to repeat the stratagem and that all of the previous write offs would be reviewed and, where possible, overturned in such cases. That approach would provide the most efficient use of available resources.

In conclusion, Revenue is satisfied that while the write off decisions on each individual case were correct in accordance with the procedures and information systems available at the time, deficiencies in the systems identified in my examination have now been addressed. Revised structures and procedures have been put in place to ensure detection and follow through where case linkages of the type revealed by my examination are identified. An investigation has commenced as to how a comprehensive examination of the cases noted can be put in train. The write off of uncollectable tax will play an important role in the challenging programme of debt reduction set out in Revenue's Statement of Strategy 2001-2003, and Revenue is satisfied that the procedures and systems in place will ensure the appropriateness of its actions, taking all factors into account.

Weakness in Revenue Activity

This section of the report sets out a number of weaknesses in Revenue activity which were noted from the in depth examination of the sample of write off cases, and also from the many related cases which were sourced and reviewed in the course of that examination. The objective was to establish the extent to which such weaknesses, which had, in all likelihood, contributed to the failure of collection and to reaching the stage of write off, had been identified and rectified by Revenue. The items in this section are grouped under registration, compliance, enforcement, audit and other controls.

Registration

Points noted in this area included:

- individuals with multiple tax
- the incorporation of companies was not linked to tax registration; many other companies owned by directors involved in write off cases were not registered for tax purposes
- companies registered for one tax but not for the obviously appropriate tax: pubs registered for Corporation Tax but not for VAT, similarly services sector businesses not registered for PAYE
- discrepancies as between the registration details in Revenue and Companies Registration Office different directors or business addresses
- formal documentation in Companies Registration Office e.g. annual returns and registered charges, indicated that the companies traded before being registered for tax.

There would appear to be a need to synchronise the incorporation of companies and their registration for tax. The tax registration process should be tightened to ensure that all relevant tax heads are included, and that complete and accurate details regarding beneficial ownership and business address are provided. Consideration could be given to including the PPS No. of each director as the objective of limited liability is to facilitate the conduct of business investment as opposed to concealment from the tax system.

Compliance

The lack of monitoring and review of a number of cases which came to attention was indicative of weaknesses in the compliance area:

- companies found to be active had a 'dormant' status on the tax database
- Companies Registration Office indications of business activity e.g. annual returns, registration of charges, changes of business address, were not used to check compliance
- There was a pattern of registration for Corporation Tax and no other tax head, and of submitting no returns; from the check of several hundred companies registered for Corporation Tax, some with evidence of extensive trading activity, only a handful returned a liability, or any returns, for Corporation Tax
- Returned mail was a basis for a number of write off decisions; this should be seen as an early indicator of compliance or more serious problems – signalling the need for early action; in two cases, there were delays of many years before attempting to re-establish contact
- VAT returns are a valuable measure of business activity; this source did not appear to be used as a useful indicator of liability for other taxes
- The monitoring of Corporation Tax compliance appeared to have a low priority in the cases examined, particularly in comparison with the high yielding VAT and PAYE.

Enforcement

An aspect which stood out from the review was the necessity for prompt and decisive action when matters reach enforcement stage. The opportunities for effective enforcement of tax debt can be limited when dealing with private companies, and collection procedures should have the flexibility to respond appropriately in such cases. Particular weaknesses in write off cases included:

- allowing token action by the taxpayer to revert the whole enforcement process back to the beginning as opposed to picking up where it was suspended
- excessive caution and inordinate delays (sometimes over minor matters) in proceeding to enforcement.

<u>CASE No. 2 - Publican A & Publican B</u>

From the early 1990s Publican A has, through Co.s, been involved at different stages in the operation of three pubs owned by Publican B; each of the newly-formed Co.s registered for tax, obtained Tax Clearance Certificates (TCCs) and renewed the pub licence;

- Each then followed a behaviour pattern which outsmarted and rendered useless the normal Revenue procedures in this area:
  - Co.s were partly tax compliant (for VAT) during the first year
  - At the end of the year an instalment arrangement for a small amount i.e. €1,000 per month was agreed with Revenue for Year 1 arrears, and TCC was issued enabling licence renewal
  - The instalment arrangement was immediately abandoned and, by the third year, Co.s had large VAT arrears. These were mainly estimated because of failure to make returns.
  - At this point, Co.s ceased to trade and were dissolved (no annual returns were sent to the CRO). Licence was transferred to the owner, Publican B, who successfully obtains a TCC and renewal of the licence
  - An interim period follows during which the business is totally non-compliant: in one case VAT returns were not filed for an unbroken three years, and a return under any tax head for one year
  - The dissolved Co. is then replaced by another with Publican A as a director, and which has a 'clean' tax record to allow the cycle to recommence.
- In addition to the write off of €146,000 in the audit sample, a total of €100,000 was written off in two further cases relating to Publican A.
- Publican A's companies have not made any Corporation Tax returns to date.
- Publican B has declared only one of his ten directorships to Revenue; one of his Co.s acquired eight properties, mainly pubs and hotels, in the period 1987 to 1997 while deregistered for tax. On licence renewal application, three of the pubs declared annual turnover of between €1m and €2.5m.
- Twenty two Co.s which operated pubs owned by Publican B were dissolved without a formal wind up or statement of affairs; no Co. returns were made to the Companies Registration Office during the period of incorporation.

Revenue Response

In relation to the areas of registration, compliance and enforcement, Revenue has stated that procedures regarding registration have been significantly tightened up over the years, and that it should not now be possible to register more than once. Individuals wishing to register must use the PPS No. and provide information on date of birth and mother's maiden name. To the extent to which they could be identified, existing registrations were merged and consolidated with the advent of the Central Registration System, Integrated Taxation Processing and Active Intervention Management. Revenue also advised that a review of all aspects of registration is underway and will be completed in Autumn 2002, with proposed implementation of recommendations by early 2003. The findings and implications of the audit report would be incorporated in the review.

The bringing together of the various registrations within the Central Registration System has enabled caseworkers to get a better overall perspective, and thus ensure that more effective action can be taken against non-compliance. Another example is the recent legislation on offsetting that now allows Integrated Taxation Processing to automatically offset where a tax liability is due or to withhold a repayment until outstanding returns are submitted. The Companies Registration Office system installed in September 2000 is also relevant in this context. The Active Intervention Management system and cross taxhead caseworking approach to non-compliance has been in place for a number of years and the approach had been a significant success in ensuring that debt problems, whether highlighted through current compliance or arrears difficulties, were pursued promptly and efficiently.

A number of legislative changes introduced in recent years have resulted in closer cooperation between Revenue and the Companies Registration Office in policing newly incorporated companies and companies which have just commenced business. Revenue has also issued a form for completion by all dormant companies in order to ascertain their current business status. A company which does not reply may be struck off. Where the response indicated that business activity had not commenced, the matter would be followed up on a regular basis.

Some of the cases identified by the audit predated the caseworking era and Revenue was satisfied that pursuit of the cases would be radically different today. Expertise in pursuing tax debt had been steadily enhanced. Lessons had been learned and remedial changes had been introduced. For example, where the original caseworking guidelines had provided for a graduated customer service type approach to default, that had since given way to a more direct approach with early decision-making and a clear strategy in each case to ensure that default was effectively dealt with at the earliest possible date. Revenue stated that a more critical view was taken of instalment arrangements, especially repeat arrangements, with the taxpayer having to justify an instalment in all cases. Those aspects had been emphasised by training. There had also been considerable enhancement of Revenue's enforcement capability with the employment of six firms of solicitors to ensure the effectiveness of Revenue's enforcement capability through the Courts.

Because of those developments, Revenue was confident that many of the collection shortcomings identified by my examination could no longer arise. However, Revenue also accepted that the cases brought to attention from the examination demonstrated that some further developments would improve effectiveness and that a number of new measures are in the course of introduction to try and ensure that the problems highlighted can be overcome. Some of the changes were procedural and had been introduced straightaway. Others (referred to under later sections) required more detailed consideration, including possible legal changes, and would take a little longer to introduce.

Revenue Audit

Points in relation to Revenue audit which arose from the examination of selected write off cases were as follows:

- there was no facility for input to the audit selection process by anybody outside of the inspectorate e.g. cases being caseworked due to poor payment record were not referred for audit consideration despite the risk to the correctness of returns
- information sources which were critical to our examination viz. CRO, Revenue property file and excise licence database, did not appear to be used by Revenue to identify possible tax abuse
- there was little evidence of audits in the cases examined, apart from regular VAT audits up the early 1990s. These audits did result in the detection of a high incidence of under-declared liabilities and some instances categorised as evasion. However all cases were not assessed or pursued for the shortfall, action did not appear to be taken against those categorised as evaders, and there was no evidence of specific monitoring of risk cases identified from audit
- an audit was initiated in one case when returns were considered too low; the audit revealed substantial underdeclaration of tax due.

Revenue Response

Revenue stated that the compliance and collection programmes are designed to address the failure to comply with payment and filing requirements with direct action, and that an approach to poor payment record cases that involved considering them for audit would not be the most productive use of resources. However, Revenue will consider the inclusion of poor payment compliance as one of the risk factors in the planned computerised risk analysis and risk scoring system which will be used to identify suitable cases for audit. It is intended that an automated process will calculate a risk score by applying rules and weighting to available data such as audit results, third party information, accounts, data from tax returns, intelligence information and trade classification codes. This process will be helped by the current links to the Companies Registration Office database and future linking of all Revenue databases under the LINKS project.

As regards the VAT audits of the sample which were carried out in the early 1990s, Revenue stated that in most cases the undercharges had been dealt with either by restricting repayment or by subsequent submission of the return. Assessments to recover the VAT were not required.

There has been continuous development in the area of monitoring of risk for audit since the 1990s. After 1993, VAT audit programmes were subsumed into the Revenue Audit Programme, and the selection of cases for audit has been based on tax at risk under all tax heads. The computerised risk management system previously described is at contract stage. Other developments in the audit area since the cases dealt with in this report included the AIM case-tracking mechanism and a Code of Practice for Revenue auditors under which all audits go through a set procedure to finality.

As regards cases which were brought to Revenue's attention in the course of my examination, detailed profiling of the principals behind the companies had been undertaken and arrangements were underway to have audits carried out.

Direct Debit

The direct debit facility for payment of taxes allows taxpayers to pay a fixed amount each month by direct debit followed by a single annual return together with any balance due. When operated correctly, the system benefits both the taxpayer and the Revenue compliance workload. However, cases of abuse of this system were noted where traders deliberately underpaid the direct debit amounts giving rise to significant liabilities at annual return stage.

Revenue Response

Revenue is satisfied that measures introduced in the last two years provide an effective mechanism for tackling the problem of deliberate abuse of the direct debit facility viz.

- legal provisions to establish a minimum amount of direct debit payment, with back dated interest payments for breaches
- the facility is withdrawn from cases with compliance problems, including 'phoenix' cases
- a dedicated unit has been established to systematically pursue annual returns in direct debit cases, and apply interest where appropriate.

'No Case Size'

It was noted in a number of instances that a tax debt had accumulated from the early stages after registration without collection activity by Revenue. This arose because in the absence of tax returns or payments, the collection system was not able to determine an appropriate level of estimate, and a case was classified as 'no case size' and remained peripheral to the pursuit/enforcement process.

CASE 3. - Leisure Sector Operator

- Operator and family had interests over 12 years in 18 companies which ran 11 bars, nightclubs and hotels; 3 companies are currently 'live', while the others were dissolved or liquidated; Companies Registration Office registration or filing requirements were not fully met for any company.
- All of operator's companies were partly or totally non-compliant for taxes; some submitted tax returns but did not make payments; companies were registered for Corporation Tax but did not submit returns; a receiver of one of operator's companies generated and paid over substantial amounts of tax while running a business which had made no returns while controlled by the operator.
- VAT audits of a number of the operator's companies identified underpayments and evasion; each was treated on a single case basis, and not linked to the operator.
- Current nightclub business is run by a 'fourth generation' company, which received a Tax Clearance Certificate even though it is not registered for VAT or PAYE; previous owner was registered for these taxes.
- Excise licences have been issued to this operator up to one year after due date; companies conducting some of the businesses did not have any excise licence, but 'sheltered' under a licence held by unrelated operators of other bars in a complex.
- In addition to the write off of €170,000 which was included in the audit sample, there have been 5 other write offs totalling €520,000 in relation to this operator.

Revenue Response

Revenue indicated that the risks of the 'no case size' classification had been under review, and pointed out the complication that a new registration may not start trading immediately and that the issue of estimates could lead to unfounded debt. A solution is currently being implemented with the objective of ensuring that registrations will not remain in the 'no case size' category for longer than six months. All 'nil return' and permanent VAT repayment cases have been moved from 'no case size' to a new category. A computer program development will schedule a series of contacts with new registrations to encourage submission of returns. In the event that this step does not get a response, a visit to the premises will provide the basis for the issue of an informed estimate which will bring the case into the regular pursuit/enforcement process. Where it is established that no trading occurred, the registration will be cancelled.

Tax Issues arising in Particular Sectors

It was noted that a pattern of difficulties arose across a number of cases in two particular business sectors – property development and pubs – and some indication of the issues can be seen from the outline sketches presented in this report from each of the sectors. However it was considered that, side by side with the particular tax risks in each sector, Revenue also had particular risk control advantages in each of these areas through the requirement for formal legal transfers in all property transactions, and the requirement for an annual Excise licence and tax clearance in the licensed trade. General issues arising from limited liability and the corporate veil are considered elsewhere in this report.

Property Development

In the area of property development, there may be a complexity of company and financial arrangements and relationships. A separate legal entity may be established for each property development and, in some cases, a number of separate companies may be formed to deal with aspects of a development including property development, property holding, investment, and management of the completed building. During the course of the development a company can legitimately make VAT repayment claims, and no liability to Corporation Tax arises at that stage. The tax liability invariably arises when the development is complete and properties are being leased or sold. This creates a large VAT and Corporation Tax liability and Revenue is particularly vulnerable to the situation where the development company ceases to trade immediately after the properties are leased or sold without making tax returns or payment. Even if Revenue were monitoring the situation and reacted quickly to raise VAT assessments, it is likely that collection and enforcement activity would be fruitless where legal liability rested with a company which has ceased, leaving only the option of liquidation which is unlikely to recover any of the outstanding tax. With any delay recovery becomes virtually impossible.

Revenue Response

Revenue accepts that more needed to be done to combat the type of abuse of VAT and Corporation Tax identified in the write off cases examined, and a Working Group to recommend proposals in this regard has been established. It seemed clear that legislative changes would be needed to counteract the problem, and Revenue indicated that appropriate proposals would be developed in time for the next Finance Bill.

Pubs, Excise Licences and Tax Clearance

The issue of Tax Clearance Certificates (TCC) by Revenue only to persons who are tax compliant is a strong control. TCCs are required for many areas of business e.g. for public sector contracts, obtaining various licences, and state grants. The audit found that:

- companies had obtained TCCs without registering for any tax head
- companies obtained TCCs by registering for one tax e.g. Corporation Tax, but not for the taxes which would give rise to their main tax liabilities i.e. VAT and PAYE. In many instances, pubs had obtained TCCs without registering for those taxes
- chronic arrears cases subverted the regulations and obtained TCCs simply by changing the name of the business usually by the creation of another company. The tax histories of the company owners were not considered in the vetting of applications for tax clearance
- TCCs were issued in serious arrears cases on the foot of a pledge or arrangement to pay off arrears, leaving Revenue at a loss when the arrangement collapsed
- A known 'phoenix' case with over 60 employees filed a 'nil' return for PAYE but received a TCC.

Over generous operation of the TCC system undermines the purpose and effectiveness of this control, and misses an opportunity to ensure tax compliance.

Case No. 2 demonstrates how the controls based on the requirement for a Tax Clearance Certificate before obtaining or renewing an Excise Licence can be circumvented.

Revenue Response

Revenue has stated that the requirement for a Tax Clearance Certificate in this area makes a significant contribution to the tax collection effort but acknowledges that it is not foolproof. Efforts have been made over the years to tighten requirements, but difficulties had arisen because the type of action ideally required would conflict with limited liability. However, in light of the cases identified in this report, Revenue has set up a Working Group to prepare proposals which would link the tax clearance requirement with the actual operation of the pub. As the types of remedy envisaged would require legislative change, definite Revenue proposals would be formulated in sufficient time for the next Finance Bill.

Abuse of Limited Liability for Tax Evasion

The findings in this area are considered under the headings of abuse of limited liability, directorships, and 'phoenix' syndrome.

Abuse of Limited Liability

The concept of limited liability allows the formation of a legal entity for the purpose of stated business activities, and limits the possible loss of owners to the amounts which have been invested in the company. The purpose of limited liability is to facilitate the growth of business and investment. However the degree of redress available to any third party is also limited to the net assets of the company. The requirements for setting up and operating a company are set out in company law and policed by the Companies Registration Office, the Department of Enterprise Trade and Employment and, more recently, by the Office of the Director of Corporate Enforcement. Certain details relating to each company are in the Companies Registration Office including details of directors, company address, and annual returns relating to the operation and financial position as certified by a public auditor.

It is generally understood that the key to successful business dealings with limited companies is accurate information and a close understanding of its business and relationships. As companies can cease trading and wind up with the same ease with which they are formed, and given the limitation of pursuit, it would be considered imprudent to place full reliance on the items of information in the Companies Registration Office, or to await the filing of the minimalist annual returns. Those engaged in major business transactions with companies e.g. banks and main suppliers also ensure that their interests are protected by such facilities as liens and charges, personal guarantees, and the absolute insistence on meeting tight payment deadlines. When dealing with companies, whether with regard to Corporation Tax and Capital Gains Tax or PAYE and VAT, Revenue is operating in exactly the same business sphere, and is effectively competing with the other interests for the cash available to each company. Therefore it has little option but to operate at a similar level. Anything less will lead to a frequent experience of dealing with the remains of a business which has closed and moved on. There will be little left as many companies on the tax system are of the 'close' company type with an issued share capital of €2.50.

In the course of our examination of the tax records of the cases in the sample, related companies and other business interests of principals revealed substantial abuses of the tax system by individuals through abuse of the principle of limited liability or the 'corporate veil'. These individuals did not receive any particular interest from Revenue – even at write off stage. Clear patterns of abuse were identified as follows:

- there was extensive use of companies bought 'off-the-shelf' which were activated to operate a business activity for a short period (e.g. 1 – 5 years) and which then ceased trading, either having not registered for tax, or not made returns, or having run up substantial tax arrears
- individuals concealed their business interests under cover of the company veil. Directorships were not declared. Other family members and employees were registered as directors to conceal principal ownership. Concealment was aided by the declaration and registration of a plethora of home and business addresses
- in addition to such registration offences, all of the required Companies Registration Office registration information was not supplied. These were also accepted as companies by Revenue.

While there were few instances where Revenue cross checked information with the Companies Registration Office records, information at that source was less than complete for a number of cases reviewed:

- there were major information gaps with regard to directorships. A new number is allocated to each newly registered director, but the extent of individuals' directorships are concealed by inconsistent declarations of details such as name, address, and date of birth; this makes it impossible to police the limit of 25 directorships per individual
- instances were noted where no directors were listed, or less than the number legally required; there was no issued share capital, and the address of the formation office was listed as the address of the new company

- there was a low level of annual returns compliance among the companies reviewed; most have been dissolved without provision of the required special motion of dissolution or of a statement of affairs showing the distribution of the company assets.

The Companies Registration Office will only be effective as a general information source and protection for the general public and Revenue when it ensures that complete and correct information is registered in accordance with company law.

However there are further risks for Revenue should the Companies Registration Office embark on a strike-off programme in order to enforce annual returns compliance. This could seriously hinder tax collection as the directors can then walk away from the tax debts of the struck off company, or even choose to bring about such a situation by failing to file annual company returns.

In summary, it was clear that the requirements of incorporation were treated with disdain by the companies reviewed, and that limited liability was merely a device to be used to escape tax obligations. The registration deficiencies must raise questions as to whether the companies created have the legal status to allow them to avail of limited liability. In view of the extent of lost tax revenues, there may also be an onus on Revenue to challenge such status, and to attempt to look beyond the companies and seek out and pursue beneficial owners. However, in a few cases, Revenue has recently pursued a course of action with the objective of obtaining the disqualification of an individual to serve as a director.

Directorships

Points noted were as follows:

- individuals had extensive directorships which were not on the tax record
- individuals with directorships on the tax records were not monitored as directors
- there was little evidence of usage of this information for establishing relationships with other cases
- there was no evidence that the directors of companies which dissolved while solvent were pursued for drawings, where there was no indication of any other accountability for the company assets
- there was evidence of inter-company asset transfers without the establishment of final tax liability or ultimate beneficiary.

The narrow 'case-based' approach in these instances may have resulted in considerable tax loss.

Phoenix Syndrome

Phoenix syndrome describes a particular area of tax evasion where directors attempt to use the protection of limited liability for the deliberate avoidance of tax liabilities, essentially by ceasing activity under the guise of one company and transferring the assets and business to a 'new' company with a clean tax record. To counter this activity, Revenue monitors a list of approximately 300 companies. It was noted that:

- 'phoenix' monitoring was focused on companies and not on the individuals behind the companies. Companies created for separate projects by the same principal, and subsequently dissolved leaving substantial assessed and unassessed tax liabilities were not included in the Revenue monitoring programme
- the 'phoenix' programme monitored the 'new' company but no action appeared to be taken in relation to the past activities of companies and directors
- instances were noted where it appeared that Revenue identified and investigated classic cases of 'phoenix' activity but did not add them to the programme.

Revenue activity in this area can be frustrated where the owner of a business, through careful leasing arrangements, ensures that the former companies do not own any assets against which action can be taken.

Revenue Response

Revenue has indicated its awareness of the dangers that limited liability poses to tax collection, in particular where the principal of a company abuses limited liability by deliberately leaving tax debts unpaid and 'walking away' from insolvent companies. Revenue has stated that, because of the requirements of company law and limited liability, there were essentially only two remedies open to it in dealing with such individuals. Firstly, where such a practice is identified, to closely manage new cases associated with such persons from the start so that early and decisive action is taken where compliance problems develop. The phoenix monitoring programme demonstrated the success of that approach. Secondly, where such a practice was identified through a ceased business, to seek to have directors restricted or disqualified for fraudulent or reckless trading through the liquidation process.

It was also pointed out that the dangers posed by limited liability were not confined to Revenue and reference was made in that regard to the McDowell Report, the subsequent enactment of the Company Law Enforcement Act, 2001, and the establishment of the Office of the Director of Corporate Enforcement (ODCE). It was considered that the ODCE now had real teeth to take action against rogue directors using a 'scorched earth' policy to defraud creditors including Revenue. The ODCE and Revenue can exchange information, and the two agencies are cooperating closely with liaison procedures in place. The Company Law Review Group has also reported on ongoing issues in this area, such as mitigating the effects of strike off for Revenue and other creditors.

In recent years, Revenue had introduced a specific programme for phoenix companies aimed at stopping any build up of arrears in the current trading entity, and had been successful in minimising tax losses. Where the taxpayer's co-operation was not forthcoming, enforcement action was taken without delay, and where necessary the company was liquidated. The approach was constantly monitored, and further refinements introduced e.g. seeking earlier identification, and the use of bonding. However, as the modus operandi of the cases identified from our examination did not conform to the classic phoenix outline, revised operational guidelines have been issued to broaden the scope of operations by changing the emphasis from company succeeding company to business succeeding business whether company, partnership or sole trader. At end 2001, 400 companies were intensively monitored under the scheme.

Revenue has stated that the use of the liquidation process was primarily to deal with a situation where 'ordinary' enforcement was not successful and the debts of a company continued to rise. Apart from preventing the rise of debt, Revenue also pursued the possibility of directors being restricted or disqualified and made personally liable for the debts of the company insofar as it was appropriate and possible. However, decisions in those areas were outside of Revenue's control and the difficulty arose from the necessity for convincing evidence to be presented to the Court. Liquidators could be reluctant to pursue such possibilities in view of the legal costs involved, although where appropriate Revenue can guarantee funding for liquidators in that regard. A further problem arose in instances where the principal of a company 'resists' turning over the books and records of the company to the liquidator. While recent changes in company law made it more likely that errant directors would be restricted or disqualified, evidence of the impact of the change in practice was awaited.

Many of the companies identified by our examination had long since ceased trading, and the only course of action for Revenue to pursue the companies at this stage would be to apply to the High Court for the appointment of a liquidator on a just and equitable basis. The liquidator would then pursue the directors on the basis that there was a probable debt outstanding from the directors of the company. It was doubtful whether such a course of action would be successful or cost effective based on the age of the debt, the limited and circumstantial information available and the costs involved. Revenue's experience would suggest that such a course would not be successful.

Notwithstanding the success of Revenue actions whether in relation to phoenix monitoring or caseworking generally, Revenue considered that it was clear from the cases emanating from our examination that further measures were needed to tackle the problem of people using limited liability as a vehicle for deliberate and sustained non-payment of tax liabilities. The effective elements of the measures which have now been introduced provide for

- mandatory checks to identify related cases where there was a history of non-compliance. These checks would be carried out at (a) registration stage (b) where the company had a significant tax debt problem and (c) prior to a write off decision of any significant level of debt
- systematic and vigorous pursuit of related cases by a Dedicated Pursuit Unit in the Collector General's Office. Such pursuit will include the principal plus all related companies, and will be supported where necessary by a co-ordinated cross-Revenue approach ensuring audits in appropriate cases.

The arrangements have already been introduced and the Unit has commenced work in pursuing the cases identified by our examination. Further cases would be brought into the programme as they are identified by caseworkers. Revenue is confident that the particular measures now being implemented provided an appropriate and effective remedy in the identification and subsequent pursuit of people using limited liability for the deliberate non-payment of tax liabilities.

Response of the Department of Enterprise, Trade and Employment

With regard to the role of the CRO the Department of Enterprise, Trade and Employment accepted that there had been abuses of company law, and indicated that the recognition of such abuses had led to the establishment of the McDowell Group with a mandate to review the compliance and enforcement regimes for company law and to make recommendations to address those issues. The Group's recommendations which sought to strengthen registration-type compliance, to properly enforce company law generally and to provide for the updating of company law on an ongoing basis were given effect by the Company Law Enforcement Act 2001 following which the ODCE was established and resourced to fully and effectively ensure the enforcement of the Companies Acts.

The Department also adverted to combined provisions enacted in company and tax law in 1999 to counter tax abuse in the area of Irish registered non-resident companies. The provisions strengthened Revenue's hand by introducing a requirement for newly formed companies to give details of proposed activity, and the ability for a company to be struck off the register for failure to provide information to the Revenue Commissioners. These provisions were specifically designed to enable the Revenue to immediately interact with newly incorporated companies and obtain any necessary information. A failure to supply the information requested can result in the company in question being struck off.

Particular areas covered by the Department's response included the concealment of directorships through the provision of inconsistent information to the Companies Registration Office, the low compliance rate in filing annual returns with the Companies Registration Office and the impact of the strike-off process on Revenue's ability to collect outstanding tax liabilities.

The Department stated that the question of the identification of directors had been considered in the First Report of the Company Law Review Group in December 2001. The Group concluded that while a formal identification procedure such as is found in certain civil law countries ought not be initiated, consideration should be given to requiring the pre-registration of directors who would at all times subsequently identify themselves on CRO filings by reference to their PPS number with parallel provisions for non Irish-resident directors. The Government had accepted that recommendation and the legislation to give it effect was currently being drafted.

The Department indicated that while there had, historically, been a low level of compliance with annual filing requirements, that had been one of the issues which the McDowell group had sought to address. By 2001 the compliance rate of 85% showed a considerable improvement over the 1997 level of 36%, and further improvement is needed. The initial improvement in compliance followed an extensive strike-off campaign carried out by the CRO. With effect from October 2001, a severe late filing penalty provided for in the Company Law Enforcement Act, 2001, was introduced and the strike off campaign was rolled back. The CRO is keeping under review the success of the late filing penalty in bringing about a satisfactory level of compliance and will use other enforcement processes as necessary.

The Act also provides for on-the-spot fines as an additional instrument for encouraging compliance and as an alternative to the more resource demanding court prosecutions. While it is open to the Registrar of Companies to prosecute companies and their directors (and that is regularly done), it is difficult to deal with the large numbers involved through that mechanism.

The Department also stated that the strike-off process, which had now been relegated to use as an instrument of last resort for dealing with non-compliant companies, had no effect on Revenue's ability to collect outstanding tax liabilities. Where there were sufficient assets to recover, the company could be easily restored to the register at the time of the appointment of a liquidator. If directors had deliberately disposed of their assets to avoid taxation (or other debts) the continuing existence or non-existence of the company was not the material issue. The Company Law Enforcement Act, 2001, established for the first time a real distinction in law between "Voluntary" and "Involuntary" strike off of a company. Where a company is struck off the register as part of the enforcement process, it is now open to the Director of Corporate Enforcement to seek the disqualification of the directors pursuant to the Companies Act 1990. Where a company itself requests strike off, the registrar will only agree to the request provided that the company files all outstanding returns and accounts, places an advertisement in a newspaper and secures the agreement of the Revenue Commissioners. No companies have been struck off compulsorily since these changes have come into effect but the registrar reserves the right to use this process as provided for by law where absolutely necessary.

Conclusions

The task of Revenue is to collect due taxes from the assessed activities of more than two million taxpaying entities. By and large this is achieved through the acceptance of key procedures e.g. PAYE, tax returns, and the co-operation of the taxpaying public with the minimum contact. The process could hardly operate in any other way given the scale of the numbers involved. However, there is an ongoing risk that persons will attempt to evade tax liabilities through a recognition of the pressure under which the system operates, and by either attempting to hide within the great number of taxpayers and taxpayer activity or, should the attention of the system fall on them, by maximising the extent of Revenue action necessary thereby making the cost to the system so high that Revenue will 'go away'.

In undertaking this in depth examination of some of the largest write off cases in 2000, one might have expected to find one or two 'bad eggs' among a selection of cases which just ended up as write offs for a variety of mundane reasons e.g. genuine business collapse, unfortunate change in personal circumstances. However, there must be considerable concern regarding the number of cases in the sample, involving the use of private limited companies that confirm at least elements of the 'hide or frustrate' approach. This raises questions not only about the adequacy of write off procedures but also, more importantly, about the extent to which Revenue is geared to deal with those attempting extensive tax evasion under cover of limited liability.

Revenue's debt reduction policy incorporating the write-off strategy has proved to be an efficient and effective means of tackling the problem of long outstanding tax arrears as well as allowing resources to be diverted to the prevention of new debt arising. Notwithstanding the success of that policy Revenue's response to the findings of this report recognises that improvements have to be made to its procedures in order to ensure that the risk of tax being inappropriately written off is minimised.

There is a strong message from the findings of this report that write offs, or at least certain categories of write off, must be subjected to a sharper review in the knowledge of what might have transpired in each case. Consideration must also be given to the issue of what may have been included in other significant write offs in recent years. A more time-consuming review of proposed write off cases over a predetermined monetary value, including cross checking with related registrations and principals and other information sources, should pay dividends in the management and control of future cases. Pursuit, even through the legal system, cannot only be on the basis of rate of return, and Revenue's recent use of liquidations to seek restriction and disqualification of directors are valuable steps along this road. There must be possibilities also of using the failure of companies to meet many Companies Registration Office and Revenue requirements to persuade the Courts to withdraw the protection of limited liability and render the directors liable for outstanding taxes.

A considerable portion of the report is devoted to the tax evasion issues arising from limited liability as this would appear to provide serious problems for Revenue. This is hardly surprising given the reality of the figures for 2001 - about 146,000 live companies and 1,200 being formed and 600 struck off each month - together with the possibility of a lack of complete or accurate information and time lags before a problem would become known to Revenue. The evader pays lip service to the requirements of Companies Registration Office and Revenue registration and returns but uses the concept of limited liability to avoid pursuit. Revenue's weapons are time-consuming liquidation and future monitoring where the connections have been identified.

In the business world, the institutions financing such private companies and their main suppliers prevent the possibility of similar losses by successfully penetrating the company veil by way of such facilities as liens and charges in advance, personal guarantees, and the absolute insistence on meeting tight payment deadlines, backed up by the threat of refusing future facility. Revenue in contrast cannot as easily choose its customers, although this is partially countered by the ability to propose amendments to rules and legislation when such a requirement is identified. The message from the practices of the business world is that the focus must be on prevention.

On the basis of the findings of the report, consideration should be given to implementing whatever changes are required to bring about closer co-operation between the Revenue and the Companies Registration Office to prevent a prospective tax evader from playing one institution against the other, and from using the facility of the limited liability of a private company to hide the identity and ultimately the tax liability of the directors from Revenue. The improved enforcement of company law, and the general application of the proposed identification of all directors by PPS Number will be of major benefit.

Revenue has already addressed some of the shortcomings identified by my examination by changing certain procedures and through the development and implementation of new technologies to enable it to adopt a more integrated approach to the collection of tax arrears. Increased application of sophisticated technology tools by Revenue should gradually improve performance in identifying and collecting outstanding tax. But these developments on their own will not have optimum effect without changes in the law to strengthen Revenue's hand in a number of specific areas highlighted in this report. In this regard, Revenue has reacted positively to the report by implementing administrative changes and preparing legislative proposals to give effect to the necessary countermeasures.

4.8 Repayments of Value Added Tax to Registered Traders

Background

Value Added Tax (VAT) is an indirect tax on consumer expenditure that is charged on the value added at each stage of the production and distribution cycle. VAT is chargeable when a taxable person supplies goods or services within the State in the course or furtherance of business. Effectively, VAT is paid by a customer or consumer who is supplied goods or services for his or her own personal use. The supplier (i.e. the registered trader) is charging and collecting the tax on behalf of the Revenue Commissioners. There are currently over 200,000 traders registered for VAT. The gross amount of VAT collected by Revenue in 2001 was €10.5 billion.

A registered trader is charged VAT on the taxable goods and services it purchases for its business. A registered trader in turn charges VAT on the taxable goods and services it supplies. The trader is entitled to deduct the VAT charged on its purchases from the VAT it has charged on its sales. A trader accounts for VAT on his/her sales and purchases by means of a return to Revenue (normally every two months). In most periods, VAT charged on sales exceeds VAT charged on purchases and the trader pays the difference to Revenue. However, in certain circumstances the VAT on purchases exceeds the VAT on sales and the trader is due a repayment of VAT. For instance, if a trader increases stock or purchases an expensive item of equipment, a repayment can arise. Some businesses (e.g. food businesses) are in a permanent repayment situation because their sales are zero-rated but they are being charged VAT on some or all of their purchases. The total amount of VAT repayments by Revenue in 2001 was €2.6 billion. This includes refunds which arise where a trader has overpaid VAT and the overpayment is repaid by Revenue.

VAT is a self assessed tax and registered traders are required to maintain proper records of all transactions that affect their VAT liability. Revenue carry out a programme of audits which includes audits of traders' VAT records to ensure they are complying with the regulations and to check the accuracy of VAT returns including repayable returns. VAT audit activity may be dedicated or form part of general audit programmes. The VAT yield from audits in 2001 was €61.2m mostly arising from underpayment of tax but would also include an element of overstatement of VAT repayment claims.

In recent years, a number of taxpayers have been convicted and received prison sentences for obtaining payment by making false VAT repayment claims. In addition, a former official of the Revenue Commissioners received a prison sentence for conspiring with others to defraud the Revenue Commissioners of €4.8m by means of a false VAT repayment claim.

Revenue's customer service standards aim to repay 85% of VAT claims within 10 working days of receipt of claim with the balance being repaid within a further 20 working days. In 2001, figures supplied by Revenue showed that 80% were refunded within 10 days and 94% within 30 days.

Objectives and Scope of the Audit

The objectives of the audit were

- To ensure that the system for repayment of VAT to registered traders is such that
  - Repayments are only made where properly due
  - All repayments are supported by valid and complete documentation
  - All payments are correctly made and recorded in the accounting records.
- To establish if appropriate arrangements are in place for setting repayment limits and for the approval of repayment claims which exceed those limits.
- To establish whether appropriate management information relating to repayments is produced and utilised to improve the efficiency and effectiveness of the system and its controls.

The examination of the VAT repayments system was based on a review of documentation and discussions with the Accountant General's Office and the Collector General's Office. The role of the Inspectorate in controlling VAT repayments was established by means of discussions with officials in the Office of the Chief Inspector of Taxes. A random sample of VAT repayments and refunds made in 2001 was selected and checked against the prevailing system validation rules. Where repayments in the sample were referred to the relevant tax district for certification the action taken in the district was reviewed.

System for Repaying VAT

In recent years Revenue has been developing its systems so that each taxpayer will be treated as a single customer for all taxes. The Integrated Taxation Processing System (ITP) is a key element in moving to this approach. ITP is a system for issuing and processing returns, payments, repayments and refunds. VAT was incorporated into ITP in April 2000 and since then all claims for VAT repayments to registered traders are processed through the ITP system and payments are made from that system.

VAT returns when received by Revenue are scanned into electronic format and processed through the ITP returns reception sub-system. When the VAT return has been successfully processed through returns reception it will create an amount due from or to the taxpayer for the period depending on whether the return is payable or repayable. Each day the Debits/Credits sub-system of ITP is run which identifies credits on a taxpayer's record and instigates the processing of a repayment. The system checks each repayment claim against a series of validation rules which includes examining the taxpayer's record for outstanding taxes or returns. If a claim fails a validation rule the processing of the claim by the system ceases and a 'work item' is created which is delivered electronically to an official within Revenue to process. If the taxpayer has outstanding taxes the system will, in certain circumstances, automatically set the repayment claim against those taxes. In other situations where there are outstanding taxes, a work item will be created and the repayment claim may be offset against the outstanding taxes manually. The processing of a claim or 'credit' automatically by the computer or manually by an official can result in

- The full amount of the credit being approved and payment being issued.
- The full amount of the credit being disapproved. The credit will remain on the customer's account but there will be a stop to prevent the credit being processed.
- Issuing payment for part of the credit and disapproving the remainder.
- Offsetting the full amount of the credit to outstanding taxes.
- Offsetting some of the credit to outstanding taxes and payment being issued for the balance.
- Offsetting some of the credit and disapproving the balance.

The Debits/Credits system processes the credit through 3 stages

- Credit validation – confirming that the credit is valid and can be released for offsetting and/or repayment.
- Offset validation – offsetting the credit to outstanding taxes.
- Repayment validation – repaying the credit.

Work items created in relation to VAT repayments are referred to the relevant tax district of the taxpayer, to the VAT Repayments Section of the Accountant General's Office or to the Collector General's Office. The official to whom the work item is referred takes the appropriate action depending on the nature of the work item. For instance, if a work item is created because the taxpayer has outstanding returns, the taxpayer will be contacted and asked to submit the returns and informed that payment will be withheld pending their receipt. If a claim fails a particular validation rule and is referred to an official, it is the responsibility of the official to check the claim against the remaining system validation rules, as the claim does not re-enter the sequence of validation checks at the point it failed. The exception to this is a work item referred to the tax district which if approved re-enters the sequence of validation checks at a pre-defined point in the system. An official to whom a work item is assigned can use the comments box provided to indicate what action is being/was taken. The insertion of such comments is optional. When an official has processed a work item to his satisfaction, he electronically approves it and it is then referred to his supervisor for approval. In certain circumstances, for example high value repayment claims, a third level of approval is required.

Audit Findings

Returns

As part of the examination a sample of 40 repayments and refunds made in 2001 were scrutinised. Each payment was checked against the original VAT return submitted by the taxpayer. Prior to scanning, all returns are reviewed to ensure all information appears to be in order. In certain circumstances, for example, if the taxpayer has not signed the return, it will be returned to the taxpayer. Correctly completed returns which have been damaged or which are considered to be uninterpretible to the scanner, are re-written by Revenue staff prior to scanning. In these cases, the original return is attached to the re-written version. This was the case for two of the claims examined both of which were for amounts in excess of €1m.

In seven of the 40 cases examined, the taxpayer submitted a second return for the same period after the original repayment claim had been processed. Each of these cases was a designated 'repayment only case' where the taxpayer is permitted to submit two claims for a period. For other cases, the system will accept a second repayable return for a period and will automatically treat it as supplementary to the first return and not as a replacement for it unless the second return is greater than the original in which case a work item will be created and customer confirmation sought. Revenue should consider introducing procedures to extend the confirmation process to all instances where second repayable returns are received. Alternatively, the VAT return could be revised to allow the taxpayer signify the nature of second returns. The exception to this is where the taxpayer clearly marks the second return as a replacement and this fact is noted by the Collector General's staff prior to scanning. In these cases, the system will substitute the amounts on the second return for those on the first and adjust the taxpayer's record accordingly. This can be problematic if the second return is for less than the first and repayment has already issued based on the first. The taxpayer's record will show an amount due from the taxpayer for the relevant period but this fact is not flagged by the system and recoupment of the amount already repaid will have to await normal collection activities. Revenue has indicated that the possible enhancement of ITP to facilitate the confirmation of all second repayable returns is being examined.

System Validation Checks

The validation checks carried out by the system involve checking against the information held on the taxpayer's record in the Revenue computer. In the main the checks relate to whether the amount of the claim exceeds monetary limits which are set for each taxpayer by the Inspector, whether the taxpayer has outstanding taxes, whether his returns are up to date and whether there are any stops or other markers on the taxpayer's record which would prevent repayment. For the sample of 40 repayments examined, it was found that the system was carrying out all the checks specified.

While staff did receive training and introductory training manuals when VAT was first introduced into ITP, there is a lack of user documentation to inform officials how to deal with work items that arise when claims fail validation checks. However, VAT Repayments Section are currently drafting a user manual. It should be borne in mind that with each new release of ITP, changes can be made to the system that affect the VAT repayments element of the system so that user documentation could become outdated. Nevertheless, it should be possible to maintain an up to date user manual to which staff could refer. Revenue has confirmed that the manual is expected to be completed in October 2002, following which it will be updated regularly.

The VAT Repayments Section is established in such a way that the each taxpayer deals with the same staff member and Revenue's view was that the advantage of this in terms of staff members becoming familiar with the case outweighed the obvious control weakness. Following the audit, Revenue decided to change this policy and will shortly implement the conventional control device of regular rotation of team members. For the sample examined, work items which were referred to officials in the VAT Repayments Section, were dealt with in an appropriate manner. Repayment claims which fail validation rules do not re-enter the sequence of checks at the point which they failed and the onus is on the user to check the claim against the remaining validation rules. Revenue should assess the risk that this gives rise to against the delay in repayment that would occur by subjecting approved work items to re-checking by the system. Revenue has stated that claims which fail validation rules are subject to at least two levels of approval before repayment and that the rechecking of such claims by the system would duplicate work already done and delay the repayment. They are also of the view that even in the unlikely event that the user releases the payment in circumstances where it would fail system checks, the risk is negligible as normal compliance activity would be initiated in due course.

Offsetting Repayments against Outstanding Taxes

The Finance Act, 2000 gave Revenue the power to introduce regulations to allow them to offset repayments due to a taxpayer under one taxhead against outstanding taxes in other taxheads. Previously, this was not possible without the permission of the taxpayer. Revenue introduced these regulations in August 2001. These regulations and the extension of ITP in September 2001 to incorporate almost all taxes with the exception of Relevant Contracts Tax (RCT) and some capital taxes will allow automatic offsetting of repayments due in most instances. The random sample examined showed that repayments and refunds were made in five cases where the taxpayer's record showed amounts outstanding in respect of RCT ranging from €1,825 to €108,146. Two cases were also noted where the taxpayer's record showed Capital Gains Tax outstanding of €14,349 and €21,527. While each of these cases pre-dated the regulations allowing automatic offsetting of repayment against unpaid taxes, they underline the need for the taxpayer's position as a whole to be examined prior to repayment being issued. These cases also highlight the need for Revenue to complete the introduction of all taxes into ITP to allow the system to automatically offset repayments against unpaid taxes. Until this is done, offsetting of unpaid taxes which have not yet been incorporated into ITP can only be done manually and there is the possibility that outstanding non-ITP taxes will be overlooked when repayment is being issued. Repayment claims which do not fail system validation checks and therefore are automatically approved by the system are by definition not brought to the attention of an official. Therefore, it is not possible to carry out manual checks for outstanding non-ITP taxes. It is understood that RCT will be incorporated into ITP before the end of 2002 which will allow greater use to be made of the offset provisions. Capital Gains Tax is now incorporated into ITP and subject to the full offset provisions.

Referrals to Inspectors

The main risk based control of VAT repayments is the system of monetary limits set by the Inspector for each taxpayer. If a repayment claim is received which exceeds these limits the claim requires the approval of the Inspector before payment is made. The main objectives of this system of referral to Inspectors are

- To provide an improved service to compliant taxpayers.
- To assist in the detection of fraudulent or incorrect claims.

In addition, a small proportion of all claims are randomly selected and referred to the relevant Inspector for review prior to repayment.

The setting of these monetary limits is at the discretion of the relevant Inspector. Minimum levels have been prescribed centrally and criteria are set to identify high risk cases in this context, including

- 'Phoenix' type operations or cases with poor Revenue history.
- Traders registering with no fixed place of business.
- Non-resident companies.
- Liquidator/receiver cases.
- Cases where trading records are poorly maintained.

While these criteria are good indicators of potential risks it is essential that cases are constantly reviewed to ensure that all such high-risk cases are promptly identified and the limits adjusted accordingly as necessary.

When a claim is referred to the Inspector it is at the discretion of the Inspector what action should be taken. In essence, the decision has to be taken as to whether the claim can be certified with or without an audit. Instructions to inspectors require that in general all first claims in excess of a specified amount require an audit but that the Inspector has discretion in deciding the degree of checking required. The Inspector may decide that there is sufficient information available to certify the claim otherwise than by way of audit. Factors which the Inspector takes into account in making this judgment include

- Whether the case had previously been audited and what is the compliance history.
- What is the nature of the trade and whether it involves highly technical business transactions.
- The degree of understanding by the trader of his/her VAT obligations.
- The agent and his/her level of involvement.
- Are there exempt transactions involved?
- Is there a large volume or value of trade in goods in which the trader does not normally trade or is there a trade in high value goods to registered traders in other EU countries?

Revenue are currently examining the feasibility of establishing VAT Verification Units to deal with the checking of repayment claims. Planning is underway to establish one such unit on a pilot basis. The intention is to review the operation of this unit to establish whether similar units should be set up in all regions.

Of the 40 claims examined during this audit, 17 had been referred to the relevant Inspector for certification because the monetary limits had been exceeded. These claims were certified by the districts on the basis of one or more of the following

- Requesting from the taxpayer supporting invoices, explanation for the claim or other information deemed necessary.
- Knowledge of the taxpayer and their tax history (including knowledge from any on-going audit).
- For single large transactions, checking that the vendor had paid to Revenue the VAT that the taxpayer is seeking repayment of.
- Carry out an audit of the taxpayer.
- Examination of latest accounts.
- Consideration of nature of the business.

In one case where a claim for €1.21m was certified by the Inspector, the comments box on the ITP system in relation to the work item notes that the claim was not checked due to lack of resources. Revenue has since stated that the basis for the decision to approve the claim also included knowledge of the company including a recent audit and the compliance record of the company.

Risk Assessment

In recent years, due to the growth in the economy, the number of claims being referred to Inspectors increased to such a level as to be unmanageable and it became necessary to universally increase the monetary limits for all but the most high-risk traders. In fact, two such general increases have been made in recent years in the level of these monetary limits. These increases were deemed necessary because the level of resources available in tax districts could not deal with the number of claims being referred to them for approval. Nevertheless, the identification of particular risk type cases and the setting of appropriate limits based on the identified risk would be more appropriate than general increases designed principally to reduce the number of claims being referred. The monetary limits are trader specific and therefore are only reviewed if the case is re-examined by the Inspector either because it is the subject of some type of audit or because the Inspector is required to certify a repayment claim. More research and information is required to identify the type of cases that may give rise to the risk of fraudulent or incorrect repayment claims and to apply this knowledge in setting appropriate monetary limits for particular types of cases.

Revenue has recently appointed contractors to develop a computerised risk analysis and risk scoring system to identify customers who are most likely to fail to meet their obligations in respect of the various taxes and duties. The intention is that an automated process of applying rules to available data such as audit results, third party information, accounts, data from tax returns, intelligence information and trade classification (NACE) codes will be implemented to assist Revenue in its audit and investigation activities. This will allow the degree of risk to be determined by the calculation of a risk score. The opportunity should be taken when this system is being introduced to incorporate risk factors in relation to VAT repayments and adjust the system of repaying VAT accordingly. Revenue has stated that the new system will be effective for all taxes and all areas of Revenue business including VAT repayments.

Revenue has estimated that approximately 50% of repayments and refunds are automatically approved by the system for payment. In many cases, a number of years can elapse between audits of traders and therefore it may be some time before the validity of repayments which have not been referred to the Inspector can be checked. Also, when an audit is carried out it does not examine all periods since the previous audit so some repayments may never be examined. In 2001, repayments and refunds of almost €63m were made to traders who registered for VAT in that year. Over €51m of these payments were to companies who according to data on the ITP system have not been audited. Repayments and refunds of over €571m were made in 2001 to traders who have not been audited since before 1990.

Revenue has stated that total reliance cannot be placed on the audit data on ITP as not all districts record audit details on that system. The Active Intervention Management System (AIM) provides a more comprehensive record of audit activity. However, the interface between AIM and ITP systems does not update the record of audit activity. The AIM system is currently under review and the issue of consistent and comprehensive recording of audit activity will be addressed as part of the review. Revenue has also pointed out that some of the companies who received repayments in 2001 with no apparent recent audit were in a group relationship with other companies. While no audit details were recorded in respect of the company that received the repayment, audit activity did in fact take place and was recorded on the computer record of another company within the group. In relation to new registrations, Revenue has stated that they are aware of the risks involved and have procedures in place to minimise that risk. These procedures include checking the PPS numbers of the principals involved in the business, examining the compliance record of associated businesses and in certain cases conducting pre-registration visits.

In relation to VAT risk analysis, Revenue stated that

- The increase in the referral limits followed a review in 2000 by a working group in the Chief Inspector's Office. It was a necessary stop gap measure to alleviate an unacceptably high level of non-productive referrals and to provide a breathing space in which to develop a real risk based selection model.
- Various options for the development of a more scientific method of case selection had been examined in recent years including
  - Flexible risk ratings based on industry sector, case size, compliance record, etc
  - Differentiating between 'payment' and 'repayment' traders so that different targeting rules could be applied to each category
  - The use of audit dates so that traders who had been satisfactorily audited could be given higher referral limits.
- In the absence of an overriding risk analysis system, the Chief Inspector's Office has centrally identified and issued to selected tax districts lists of VAT cases which posed a possible revenue risk. These were based on factors such as repayment only cases, cases in an overall repayment position and cases that had received two repayments in excess of the monetary limits in a calendar year.

Revenue has also stated that risk, in the context of Revenue operations, focuses on the potential loss of revenue arising from non-compliance with obligations under legislation with the purpose of identifying those who pose the greatest risk of tax default. In this context risk is not confined to repayments only.

Management Information

Possible risk based checking of claims is of course limited by the amount of information that is available. As the VAT return shows the amount of VAT on sales and purchases for the period but not the amount of sales and purchases themselves, it would not be possible to review ratios. Registered traders are required to submit each year a return of trading details showing the total of their sales and purchases for the year broken down by VAT rate. These returns are required to be submitted to the Collector General's Office but due to a lack of resources the information on returns submitted is not being captured on the taxpayer's record. This limits the ability to check the credibility of repayment claims against known trading levels. It is understood that proposals to resolve the matter are currently under consideration.

Each taxpayer registered with Revenue is given a trade classification code known as a NACE code. Proper classification of traders by type of business would help in assessing the validity of repayment claims. However, the current system of NACE codes is apparently not suitable for this due to a lack of definition in the code. A project is underway to review and revise the NACE codes.

Other than information in relation to the number and value of repayments made and performance in relation to customer service standards, very little management information is routinely produced in relation to VAT repayments. The production and review of relevant management information would provide a valuable tool in monitoring and controlling VAT repayments. Examples of the type of management information that could be obtained include

- Analysis of claims disapproved or partially approved by Inspectors. This could provide indicators of possible fraudulent claims and inform checks on future claims. Further analysis could be conducted by trade class to identify types of traders whose claims are adjusted most often.
- The random selection of claims for review by the relevant Inspector is capable of providing a valuable indicator as to whether the system is operating satisfactorily. However, unless the results of the Inspectors' reviews of these claims are collated and analysed, an assessment of the system based on this test can not be made.
- Details of claims from recently registered traders.
- The yield in terms of payment or offsetting of outstanding taxes from checking claims should be recorded.

Revenue has stated that the review of the NACE codes and the new computerised risk analysis system will allow greater analysis of available information for management information purposes.

Conclusions

The administration of VAT differs significantly from that of other tax heads by virtue of the fact that almost one quarter of the gross amount collected is subsequently repaid. This is innate to the nature of the tax but it requires Revenue to continually reassess its strategies for striking the correct balance between legitimate demands for improved customer service in making VAT repayments with the equally important objectives of only making correct repayments and minimisation of the likelihood of fraud.

The consolidation of VAT, including repayments, with the integrated taxation processing system in April 2000 provided the opportunity for significant benefits both in the areas of customer service and internal control. However, the relative newness of these arrangements requires ongoing strategic and operational review to ensure that the full possibilities of the system are achieved and that where necessary it is modified to address any weaknesses detected.

The system now in operation puts a premium on the implementation and regular review of a comprehensive risk control strategy, together with full operation of the procedures designed to achieve the desired level of control. The findings of my examination indicate that there is scope for improving both the strategy and the application of controls. Revenue is now at an advanced stage in obtaining a comprehensive computerised risk management system for all taxes and all areas of Revenue business including VAT repayments.

There is an increased level of risk associated with the issue of substantial repayments to newly formed companies and to older companies which have not been audited for some time. Revenue has confirmed that with 25,000 new VAT registrations annually, risk analysis and risk management must be central to the control process. The tax history of the individuals behind each new business are checked in detail and further action such as new business visits and later audits are based on the on going assessment of risk. However, my examination noted low utilisation of management information for control purposes in an area where the volume of transactions would suggest that it could be a valuable control tool.

Potential weaknesses at the point where manual intervention necessarily allows for system checks to be overridden should be carefully managed, for example where there is a break in the sequence of validation tests. Clarity in the handling of second returns for a period, the better use of comments fields, improved user documentation, a more refined use of business codes together with the implementation of the staff rotation policy should help to further improve the control environment.

4.9 Dividend Withholding Tax

Background

The scheme of Dividend Withholding Tax (DWT) was introduced in the Finance Act, 1999, and requires companies resident in the State to make a deduction at the standard rate of income tax from dividends paid or other profit distributions made after 6 April 1999, subject to certain exemptions. Recipients such as companies resident in Ireland, investment funds, charities and pension funds are specifically excluded. Others, including most non-resident individuals and companies, may qualify for an exemption by making the appropriate declaration and supplying adequate supporting documentation either directly to Revenue or to approved dividend paying companies or agents acting for the company (Authorised Withholding Agents). A financial institution or stockbroker which has registered with Revenue as a Qualifying Intermediary may receive distributions without deduction of DWT in respect of clients who have provided the intermediary with appropriate declarations of exemption. The Qualifying Intermediary takes responsibility for administering the DWT, must retain declarations and other relevant documentation for inspection for six years, and provide an auditors report of compliance with the scheme in its first year of operation and subsequently on request.

A company or Authorised Withholding Agent which makes a distribution is required to submit a return containing details of distributions made and DWT deducted to the DWT Section of the Customs and Residence Division of Revenue by the 14th day of the following month, together with payment of the full DWT liability. A return is required even where no DWT deduction is made from the distribution. An Inspector of Taxes may make an assessment for any unremitted tax or in cases where s/he considers that the return understates the full amount due. While the recipient of the distribution is required to declare the gross amount received for income tax purposes, credit may be claimed in respect of the DWT deducted at the standard rate. Where the DWT amount exceeds final tax liability, or where a valid exemption entitlement had not been sought, a refund of DWT may be claimed.

DWT receipts for 1999-2001 are shown in Table 12.

Table 12 - DWT Receipts and Returns 1999 - 2001

	Gross Receipts	Refunds*	Net Receipts	Total No. of Returns	No. of 'Nil' Returns
1999	€46m	€8m	€38m	1,003	378
2000	€203m	€18m	€185m	3,301	1,429
2001	€189m	€46m	€143m	4,010	1,628

** The table shows the overall DWT position, taking account of direct refunds by DWT Section and tax districts, and subsequent refunds on the basis of approved claims from non-residents etc.*

The low figures for 1999 reflect the nine month period, and special transitional arrangements for some non-resident persons. It was also likely that some distribution dates may have been brought forward to avoid the necessity for a DWT deduction. Revenue expectation was that DWT would yield in the region of €100m in a full year.

Objectives and Scope of the Audit

The objective of the audit was to examine the extent to which procedures currently operated by Revenue provide adequate assurance as to the assessment and collection of revenues due in respect of DWT. Audit work mainly focused on the operation of the DWT Section. Information and papers were also received from the Office of the Chief Inspector of Taxes. From an examination of records, a sample of recipients of distributions were selected and cross-checked to their IT returns. A sample of companies was selected from those which had previously made distributions for Advanced Corporation Tax purposes and failed to submit a DWT return. The sampled cases were cross-checked to Corporation Tax returns and company accounts for evidence of distributions. Procedures for granting exemption status from the payment of DWT, and for the issue of refund payments, were also examined.

This report also includes reference to a number of findings from a 2001 report by Revenue's Internal Audit Division on the procedures governing the administration of DWT.

Audit Findings

Declaration of Distributions by Companies

DWT operates on the basis of self-declaration by companies. Companies are not required to register for DWT, and the Revenue returns compliance programme is not applied to company distributions. There were no comprehensive procedures operated to ensure that all liable companies submitted returns for DWT. Corporation Tax returns and supporting annual financial statements were not systematically monitored for distributions which would indicate a liability for DWT returns and possibly deductions. Revenue has however stated that an enhancement is in the process of being developed whereby the response to the panel on the Corporation Tax return indicating whether a distribution had been paid will be captured by the Tax Districts and made available electronically to the DWT Section.

The level of returns received in 2000 and 2001 of 3,301 and 4,010 respectively (relating to some 2,300 companies) represents under 4% of companies classified as live for Corporation Tax purposes. For the same periods, DWT returns were submitted by only 50% of those companies which had returned Advanced Corporation Tax in 1997/98. Revenue have pointed out that the corresponding figure for 1998/99 rose to 57%. While it considers that these statistics in themselves do not indicate a DWT compliance problem, Revenue accepts the need to crosscheck former Advanced Corporation Tax filers against DWT filers and the DWT compliance programme now provides for this.

A review by my staff of 21 companies which had filed returns in respect of Advanced Corporation Tax but which appeared not to have submitted DWT returns revealed that

- 13 companies had not made distributions; however in five cases, distributions may have been made by other companies in the group
- 5 of the companies had, in fact, made returns in respect of the distributions identified. One of the companies filed a return in 2000 but had omitted to file a return in 1999. The liability was €7,807 and the return has since been received
- 3 companies had made distributions totalling €1.4m without completing a DWT return. Two of the companies had no liability and are now in the process of preparing 'nil' returns. In the other case, confirmation is awaited as to whether a proposed distribution was made.

Internal Audit noted that 439 or 25% of companies which had made a DWT return in 1999/2000 did not submit a return in 2000/01. Revenue stated that there may not be a compliance problem as a company which makes a distribution in one year may not do so in the following year. However, in June 2002, 79 companies which had previously filed a return in 1999 and 2000 showing a DWT liability in excess of €1,000 but did not file a return in 2001 or early 2002 were contacted. To date, 38 companies had responded and only 2 had a DWT liability which amounted to €11,000 in total.

Internal Audit found that 25 of a sample of 79 companies which had made Corporation Tax payments greater than €125,000 had failed to submit DWT returns. The formal response to Internal Audit stated that, of the 25 cases,

- 16 companies should have submitted 'Nil' returns
- 1 company had a DWT liability and subsequently filed a return
- 1 company had made the distribution prior to the introduction of DWT
- 2 companies which had provided for distributions in their accounts did not make the distributions
- Investigations were under way into the remaining 5 companies.

Revenue has pointed out that 92% of DWT yield comes from stock exchange quoted companies plus a handful of others (111 companies in all) – and these are very tightly controlled. In the case of companies quoted on the Dublin Stock Exchange, a weekly list of companies, who are due to make distributions is provided by the Dublin Stock Exchange to DWT Section. These companies are monitored to ensure that returns and payments are received on time. The compliance level has been excellent and ensures that the bulk of DWT is collected in full.

Revenue stated that the introduction of a comprehensive compliance programme for smaller companies was postponed until 2002 as it was considered that any loss of revenue would be very small, and that the initial focus had to be on customer service and on establishing a system to administer the tax. Revenue also stated that DWT Section has commenced a compliance programme to gauge the level of compliance of the smaller private companies, and that the only evidence of a compliance problem to date related to companies which did not have a DWT liability but which failed to file the required 'nil' return.

Claims for Exemption Status

A sample of exemption cases was examined by my staff and all appeared to be in order and were supported by appropriate declarations from the beneficiary. Variations were noted in the level of assurance provided in the audit certificates supplied by Qualifying Intermediaries. In this regard, it is noted that, following a consultation process with the accountancy profession, DWT Section had agreed a standard certificate with the objective of achieving a consistency in the audit work to be performed and the extent of the assurance to be provided. In addition, the Section has drawn up a set of audit checks for the examination of Qualifying Intermediary records, and a programme of Revenue visits to these agents commenced recently.

Regular Distribution Patterns

There are strong indications that salary payments and other remuneration are being made by companies in the form of distributions which initially only attract deductions at the standard rate of tax, and which also avoid the requirement for payment of PRSI contributions. The Internal Audit report noted 32 companies which had made monthly distributions of similar amounts to the same beneficiaries. The DWT Section has since identified 139 companies making regular distributions. The matter was initially referred to Special Enquiry Branch for investigation but Revenue has since referred the cases in question to its Anti-Avoidance Unit which will handle such cases in future.

Declaration of Dividend Income on Income Tax Returns

While DWT is deducted at the standard rate from the proceeds of distributions received, a taxpayer has an Income Tax liability at the marginal rate. However, while the name and address of recipients must be shown, there is no requirement to record the Personal Public Service (PPS) No. of dividend recipients on DWT returns. Even in the absence of this common reference, it is still possible to perform a manual matching between DWT and Income Tax returns for individual cases but an overall systematic check on the return of dividends for Income Tax, possibly through the selection and sampling of high value cases, is not feasible.

Revenue stated that, at the time the DWT legislation was enacted, it was considered that imposing a requirement on registrars of quoted companies and qualifying intermediaries to obtain the PPS numbers was a disproportionate compliance burden which could interfere with the efficient workings of the stock market. Revenue said that a recent report recommended undertaking a study to establish the benefits accruing and costs associated with the quoting of third party reference numbers on all forms, including the DWT form. The results of this study will inform the debate prior to requesting any legislative changes to implement the quoting of such PPS Nos. Revenue also stated that a prototype system for better matching and risk profiling of dividend recipients has been developed and will be made available shortly to Tax Districts.

A sample of 50 recipients of dividend income to the value of €1.6m was extracted by my staff from DWT returns and matched with individual Income Tax returns with the following results:

- 33 returned the dividend
- 5 returned an amount less than the dividend paid on DWT return
- a PPS No. could not be traced in 4 cases
- 2 did not submit an Income Tax return
- in 6 cases the submitted Income Tax returns were not traced by Revenue; a computer check has established that the relevant Income Tax returns have been processed in 5 cases, assessments have issued and that each has returned dividend income. The remaining case is under enquire by the tax district.

Internal Audit found that, of 17 Income Tax returns examined, 5 individuals had not returned their dividend. Revised returns and tax payments were subsequently received from 3 individuals. A further case, while not returned by a minors' trustee, was returned on the minors' returns. The final case was resolved by a repayment of the DWT.

Conclusions

One of the lessons from the DIRT investigations was that, even in a self-assessment system, it would be inadvisable to rely totally on self-declarations by companies, or any other clients of the tax system. There are clear indications both from the findings of this audit and from the Internal Audit report that compliance by companies with the DWT scheme is not being monitored by Revenue in a systematic way.

The DWT Section is now becoming more proactive, for example by launching a programme of checking of recipients' agents. It is likely that this process will be accelerated by the Internal Audit report. Nevertheless, up to recently, DWT was less than fully established in the tax system, with the level of compliance unclear. It is considered that further improvement in this situation would be achieved with actions on two fronts:

- setting DWT compliance targets and implementing a clear strategy to achieve them, and
- putting structures in place to facilitate full exchange of data with other areas of Revenue.

Part of the administration of DWT is delegated to companies, to Authorised Withholding Agents and to Qualifying Intermediaries. While this makes a substantial contribution to the efficient operation of the scheme, Revenue should formally consider the risks inherent in a delegated approach. An appropriate programme of monitoring of this aspect of the scheme should then be implemented which is commensurate with the level of risk and the efficient utilisation of resources.

In response to the report, Revenue has stated that since the introduction of the scheme, much of the emphasis was on legislative, customer and information technology development issues. As priority was now switching away from those issues, greater emphasis and resources were being assigned to scheme compliance issues. Revenue has indicated that actions now under way or proposed include:

- 14 reviews are currently in progress under a programme for reviewing and checking the activities of paying companies and intermediaries. It is envisaged that there will be a significant expansion in this aspect of work in the future
- since September 2001, DWT is in the Integrated Taxation Processing system and, since May 2002, returns and payments can be filed through the Revenue On-line System. A comprehensive DWT database containing details of DWT payments and related shareholder information has been developed and is available to DWT section and is being rolled out to tax districts
- DWT Section intend to compile, on an ongoing basis, a register of companies with a potential DWT liability. Previous filers will be recorded and any who have not made a return in the previous 18 months will be contacted
- as part of the compilation of a DWT register, former Advanced Corporation Tax filers will be cross checked against DWT filers, and the position of all companies who have not made DWT returns will be checked
- electronic transfer of data from the Corporation Tax returns to DWT Section
- Corporation Tax filers who had a tax liability greater than €125,000 and who did not make a DWT return will be identified, and the accounts submitted to tax districts in these cases will be inspected.

4.10 Forecasting of Tax Receipts

Under Article 28 of Bunreacht na hÉireann, a White Paper setting out Estimates of Receipts and Expenditure for the coming year is presented to Dáil Éireann prior to the annual Budget statement of the Minister for Finance. The estimated tax receipts in this statement are subsequently adjusted to take account of Budget changes, and the resulting 'Post-Budget Estimate' becomes the tax collection target for the coming year, and the main funding basis for the expenditure side of the Budget statement. While the final estimates of tax receipts are decided and formally presented by the Department of Finance, and while the estimates at all stages are prepared on the basis of economic forecasts from the Department, Revenue plays a major advisory role through the preparation of estimates of tax receipts and costing of options and proposals. Tax receipts are reported through the monthly Exchequer Statement, the annual Finance Accounts and my Annual Report (which differs from the other sources in showing the actual net receipts as opposed to the amounts paid into the Exchequer).

Table 13 - Variation between Forecast Tax Receipts and Exchequer Outturn 2001

Tax Head	2001 Post-Budget Estimate	2001 Outturn	Actual Shortfall	Shortfall As Percentage of Estimate
	€m	€m	€m	%
Customs	230	165	-65	-28
Excise	4,774	4,050	-724	-15
Capital Taxes	1,196	1,051	-145	-12

Stamp Duty	1,276	1,227	-49	-4
Income Tax	9,879	9,347	-532*	-5
Corporation Tax	4,302	4,156	-146	-3
VAT	8,792	7,920	-872	-10
Other	12	9	-3	
Total	30,461	27,925	-2,536	-8

* includes PAYE shortfall of €762m

The considerable variances which occurred in 2001 between the final forecast of tax receipts for that year and the actual amounts collected for each tax head and paid into the Exchequer are detailed in Table 13. The overall outturn for 2001 was 8% less than predicted, and there were notable shortfalls in VAT, Income Tax and Excise. The outturn for Excise for 2001 was €213m lower than the 2000 total in a year when the preliminary estimate for GDP economic growth was just under 6%.

In the current year, the end-March 2002 Exchequer returns noted that year on year tax receipts were 2.8% lower in the first quarter of 2002 than for the equivalent period in 2001, as compared with a predicted increase of 8.6% for all of 2002 over 2001. Internal Revenue statistics for 2002 Income Tax for the period from 1 January to 31 May 2002, which are analysed in Table 14, indicate a shortfall of €295m (7.7%) over expected receipts in the period. The cumulative shortfall in PAYE, which is the major component of the Income Tax total, was €182m (5.8%).

Table 14 - Income Tax: Projected and Actual Receipts to end May 2002

	Projected* to end May 2002	Actual Receipts** To end May 2002	Shortfall
	€m	€m	€m
Income Tax (PAYE)	3,126	2,944	182
Income Tax (Non-PAYE)	695	582	113
Income Tax (Total)	3,821	3,526	295

* For management information purposes, the Post-Budget Estimate for each tax head for the year is apportioned by Revenue over each of the months on the basis of the established payment patterns for that tax head.

** Internal Revenue collection figures are not directly comparable with Exchequer lodgments.

Having regard to the serious implications for the economy of inaccurate revenue forecasting, I asked the Accounting Officer

- whether specific analysis has been undertaken with a view to establishing the factors which have given rise to the 2001 shortfalls in VAT (€872m), Capital Taxes (€145m) and Excise (€724m) and, if so, the results of such analysis
- the reasons for the continuing trend of shortfalls in the PAYE take, and if these shortfalls are mirrored in the PRSI take for 2001 and 2002 to date.

In addition, I sought the observations of the Accounting Officer as to the extent to which the recent variances in revenue collected as against that forecast, and in particular those outlined above, are indicative of

- a weakness in Revenue forecast data, calculations or methodology
- a weakness in Department of Finance forecast data, calculations or methodology, or
- a reduction in the efficiency and effectiveness of revenue collection.

I also invited the observations of the Accounting Officer at the Department of Finance.

Since I received the observations of the Accounting Officers the shortfall between projected and actual income tax receipts has grown further as shown in Table 15.

Table 15 - Income Tax: Projected and Actual Receipt to end August 2002

	Projected to end August 2002	Actual Receipts To end August 2002	Shortfall
	€m	€m	€m
Income Tax (PAYE)	4,929	4,566	363
Income Tax (Non-PAYE)	863	729	134
Income Tax (Total)	**5,792**	**5,295**	**497**

Revenue Response

In response the Accounting Officer of Revenue pointed out that the role of Revenue in forecasting tax revenue receipts was a supporting one to the work of the Department of Finance. He stated that each year Revenue was formally asked by the Department of Finance for preliminary forecasts of tax revenue. The forecasts for some taxes such as PAYE, VAT, Capital Gains Tax, Customs, and the VRT element of Excise Duties were normally derived by Revenue from applying the percentage growth rate projected by the Department for certain macro-economic indicators to the expected tax outturn of the preceding year. Appropriate specific macro-economic indicators were not available for other taxes such as Corporation Tax, Income Tax (non-PAYE) and Excise (other than VRT) and forecasts for these were based on alternative growth indicators derived from local or other sources. While the specific macro-economic indicator used for VAT, namely Personal Consumer expenditure, could also be used as a basis for forecasting Excise, other than VRT, it was considered much less appropriate because the Excise base was significantly narrower than VAT. Accordingly the prevailing method for forecasting Excise was by way of a trend-based analysis of the yields from the various dutiable commodities over a number of years. The forecast figures thus provided by Revenue were taken into account by the Department of Finance in their deliberative process leading up to publication of the Pre-Budget forecasts (the "White Paper" Estimates) and the Post-Budget forecasts. The latter reflected the projected impact of Budget changes on the economy as well as on tax revenues.

Specific Analysis

As regards specific analysis, the Accounting Officer informed me that in 2001 the collection performances of all taxes were monitored as usual on a monthly basis and that the forecasts were continually revised where appropriate until year end. A number of special enquiries were also undertaken during the year into the collection performances of VAT, Excise and PAYE which were significantly under-performing against Budget forecast.

With regard to the factors giving rise to the shortfalls in VAT, Capital Taxes and Excise the Accounting Officer stated that, of the total shortfall of €872m for VAT against Budget target, VAT on Imports accounted for €233m with the main causes of the undershoot being a significant drop-off in imports of motor vehicles, fuels and computer parts from outside the EU. While falling significantly short of Budget forecast, the yield in 2001 from VAT Internal grew by over 8% compared with the outturn for 2000. That was a marked fall in the growth rate of 18% achieved in the year 2000 over 1999. Revenue was satisfied that the reasons for the fall in the rate of growth in 2001 was directly related to the level of activity in the economy reflecting a general slowdown in consumption, exacerbated by the Foot and Mouth crisis and influenced in the last quarter by the attacks in the USA on 11 September. Because of the general fall in growth rate throughout 2001, it was not possible to place monetary values on each of these effects.

The Accounting Officer said that Capital Taxes were more difficult to forecast than other taxes generally because of their nature. Capital Gains Tax and Capital Acquisitions Tax were driven by events (mainly disposals of assets), and were not as closely related to general economic activity as VAT or Excise. Of the total shortfall of €145m for all Capital Taxes against Budget target, Capital Gains Tax accounted for €113m. He said that firm reasons for that shortfall were not available but that, while an element of it could have been attributed to some slowdown in the economy in early 2001, it may also have been an indication that the release of pent up investment funds which generated the acquisition of further capital assets in the years following the reduction of the Capital Gains Tax rate to 20% in the 1998 Budget had slowed down. The shortfall of €32m in yield from Capital Acquisitions Tax was accounted for principally by a reduction in the yield from Inheritance Tax.

The Accounting Officer also stated that receipts from Excise were down on target for all excisible commodities. An examination of the net receipt in 2001 indicated the following breakdown of the €724m shortfall as identified at commodity level in Table 16:

Table 16 - Excise: Analysis of 2001 Shortfall by Commodity

Commodity	Shortfall (€m)	Commodity	Shortfall (€m)
Beer	63	Tobacco	188
Spirits	57	Light Oils	66
Wine	14	Other Oils	56
Cider & Perry	3	VRT	276

The total of these figures emerges at €1m less than the total shown in Table 14 because of rounding in the constituent items.

While collection performance in general reflected a fall in consumer spending on excisable items, he added that some specific factors were also identifiable such as:

- the provision in the 2001 Finance Act to abolish the end-year payment catch-up for alcohols was not included in the Budget arithmetic - the cash flow cost of this factor at end 2001 was estimated at €39m for Beer, €33m for Spirits and €16m for Wine
- the negative effects on yields arising from the Foot and Mouth crisis, particularly in the tobacco and oils sectors (these were down on target by €188 million and €122 million respectively)
- the yield from VRT was affected by a drop of more than 66,000 new car registrations in 2001 compared with 2000 and with a 2001 Budget forecast which was based on an assumed "no change" year-on-year in the volume of car registrations (this was down on target by €276m).

The Accounting Officer informed me that the shortfalls in PAYE in 2001 and in 2002 to date were the subject of ongoing research. Various aspects of Income Tax forecasting and collection, particularly in regard to PAYE, were analysed on an ongoing basis by a technical group chaired by the Department of Finance and involving personnel from Finance, Revenue, Social and Family Affairs and the Central Bank. He indicated that some specific contributory factors towards the €762m shortfall in 2001 PAYE collection as against Budget forecast had been identified, such as an over-estimate of €67m in the 2000 outturn base when compiling the 2001 forecast, an underestimate by €203m in the cost of the 2001 Budget package in 2001 and the cost of the Special Savings Incentive Scheme, which was introduced in the 2001 Finance Act and not factored into the Budget arithmetic. The cost of the Savings Scheme in terms of PAYE tax forgone in 2001 was €55m but when that was offset by a reduction in the expected cost of Medical Insurance relief under the new Tax Relief at Source system the net cost was reduced to €27m. In the wider economy, the lower than expected growth in GDP in 2001 allied to a reduced growth in employment numbers (lower at 49,000 than the 60,000 estimated at Budget time) would also have affected income tax.

The Accounting Officer considered that most taxes were performing reasonably well in 2002 apart from Income Tax. As regards the negative collection performance by PAYE in 2002 to date, Revenue was confident that part of the variation was explained by issues of timing which could not be accurately predicted because of changing the tax year to the calendar year, and the difficulty of predicting exactly when budget changes would take effect. Also, the monthly targets for PAYE collection in 2002 were broadly based on the monthly collection pattern over the 12 months of 2001. PAYE collection in 2001 was at its strongest in the first half of the year and using this as a basis for the corresponding target in 2002 may have had the effect of front-loading the target for the first half of 2002 to an unrealistic level. The 2002 forecast for PAYE was based on a projected growth over 2001 allied to an expected recovery in the economy. If this recovery takes place, PAYE receipts should recover over the remainder of the year in line with the general pattern in the economy.

While Revenue did not monitor PRSI collection against monthly targets, the Accounting Officer understood that PRSI outturn had come in ahead of targets set by the Department of Social and Family Affairs in 2001 and to date in 2002. As regards the comparison between PRSI and PAYE collection performance there were certain systemic differences in the way PAYE and PRSI operate which can account for different effects in the respective outturns. For example, if earnings were reduced (short-time working, less overtime or job loss) there was no refund of PRSI contributions already paid but there could be tax repayments due. Furthermore, any reduction in earned income for individuals who had already exceeded the PRSI ceiling (€35,870 in 2001 and €38,740 in 2002) had no effect on the individual's contribution to PRSI but it would reduce the tax yield.

Quality of Revenue Forecast Data, Calculations and Methodology

The Accounting Officer informed me that the forecasting of tax revenue could not be an exact science as it was necessarily based on a number of key factors which were themselves forecasts. Tax revenue forecasts were usually based on a combination of forecast yield figures for the outgoing year (or for a future year, where forecasts for more than one year were being prepared) and on projected annual trends in economic growth. Frequently it was also necessary to factor in an estimated carryover cost or yield impact of significant budgetary changes, which impact had itself been compiled on the basis of historical data projected forward using extensions of the same projected trends in economic growth. In summary, forecasts of tax revenue would be as sound or as weak as the variables on which the process depended and that while every effort was made to have reliable basic data there would also be scope for some margin of error. Tax receipts performance in 2002 was being kept under review by the technical group.

Possibility of Reduction in Efficiency and Effectiveness of Revenue Collection

The Accounting Officer assured me that Revenue had examined in considerable detail the question of whether the extensive shortfalls were indicative of a reduction in the efficiency and effectiveness of collection, and was fully satisfied that there was no such reduction. The pattern of return and payment compliance for PAYE is shown in Table 17. Similar patterns pertained to VAT and other taxes.

Table 17 - PAYE Compliance: Number of Employers paying PAYE on time

Year	Number of monthly returns issued to employers	Number of monthly returns/payments on time	*Percentage compliance
1999	1,373,321	702,069	51.12%
2000	1,534,609	805,224	52.47%
2001	1,676,013	896,963	53.52%
2002 (to end-May)	718,785	404,992	**56.34%

* The figures shown related to returns received within the due month. For example in 2002 by the end of the following month, 74% of all cases which had a known liability had made returns.

**Although percentage compliance appeared to be low (56% in 2002 to end May) the proportion of monthly liability represented was much higher as it included the big cases and most medium sized payers.

Another measure of compliance was the level of arrears outstanding. He stated that there had been no exceptional rise in the level of arrears at December 2001. Arrears of €351m at that date represented a rise of 1.4% over December 2000, while collection rose by 2.7%. The final possible area in which there might have been a reduction in compliance would be the area of underdeclaration and, in particular, whether the extent of undeclared employment increased in 2001. Any significant rise would be visible as a divergence in trend between the number of employees and employments reported to Revenue, and the general employment statistics. The Quarterly Labour Force Estimates for 2001 showed a year-on-year rise in the number of persons in full-time employment of 3.6% at the start of 2001, falling to 2.5% in the final Quarter. Returns received by Revenue in 2002 (in respect of 2001) showed an increase of 7% in the number of employments. While the significance of the larger increase in the number of employments was under investigation, Revenue was satisfied that there had been no widespread failure to declare employment. In conclusion, the Accounting Officer indicated that Revenue was fully satisfied that taxpayer compliance and Revenue efficiency had been maintained or enhanced since the beginning of 2001, and had made no contribution to the relatively poor performance of that year.

Response of Department of Finance

Economic Growth Lower than Anticipated

In response to my request for observations, the Accounting Officer at the Department of Finance informed me that the shortfall in tax receipts was mainly due to overall economic growth being lower than expected on Budget day. Budget 2001 was predicated on a forecast of 8.8% for real GDP growth for the year 2001. That economic forecast was based on the latest national and international data available to the Department at that time and was broadly in line with what was widely believed as the likely growth scenario for the economy. The EU Commission Autumn 2000 forecasts expected real GDP growth of the order of 8.25%, the OECD and the Central Bank about 8% and market commentators' forecasts did not differ substantially from that level.

However, the outturn for economic growth was much lower than anticipated, with the preliminary estimate for GDP growth for 2001 at 5.9%. That lower growth was due to the outbreak of Foot and Mouth disease and related restrictions which also affected the pattern of growth (depressing cross-border and domestic spending on petrol, for example), as well as to the effect of the slowdown in the United States economy, exacerbated by the events of 11 September. That lower economic growth and changed patterns of personal consumption generated less tax receipts than expected, especially in the areas of Income Tax, Value Added Tax and Excise. In the case of excise receipts €88 million of the shortfall was due to an oversight, as the cost of deferment of the payment of excise duty on alcohol was not included in the Budget arithmetic.

Tax Forecasting Methodology

The Accounting Officer stated that the tax forecasting methodology used by the Department was set out in a report published by the Department in 1999. Basically, the process of forecasting involves collaboration between the Revenue Commissioners and the Department. In the run up to the Budget, the Revenue Commissioners provide estimates of likely tax revenue for the Budget year in question and the subsequent years. In doing so, the Revenue Commissioners rely in certain cases (e.g. income tax) on macroeconomic forecasts supplied by the Department of Finance on earnings, employment and consumption growth. In assessing the overall tax revenue forecast the methodology involves relating that forecast to expected economic growth in nominal terms. The relationship is of the order of 1:1 with variation to be expected, depending on whether growth is mainly domestic or externally driven, and on whether budget tax measures are less or more generous. If growth is mainly externally driven or tax concessions are more substantial then when nominal GDP increased by 1%, taxes would be expected to increase by less than that.

In the period 1996 to 2000 the ratio (or elasticity) of the increase in taxes compared to nominal GDP averaged close to 1:1 i.e. every 1% increase in actual GDP resulted in an increase in taxes of 1%. The 2001 Budget elasticity based on the 2000 forecast out-turn for taxes was 0.84 and 0.91 based on the actual 2000 outturn. The forecast for the increase in tax revenue in the Budget for 2001 was 11.6%, which became 12.5%

as the tax out-turn for 2000 came in €216m below the Budget forecast.

Factors which Impacted on Income Tax Yield in 2001

The Accounting Officer considered that at the time of the Budget for 2001 the forecast increase in tax revenue appeared reasonable and consistent with previous experience. He said, however, that the experience in 2001 had turned out much differently. One relevant factor had been the decrease in average hours worked in the economy in 2001, which in the industrial and construction sector amounted to one hour or more. That in itself could have been expected to have a significant effect on the rate of growth in income tax receipts.

In the case of income tax, the forecast tax yield was further affected by an upward revision in the cost of the Income Tax reductions in the Budget for 2001 on the basis of subsequently available data. The annual update of the tax base completed in summer 2001 led to an upward revision in the cost of the tax package which had been announced in the Budget. The revised tax base reflected the fact that economic growth in 2000 was higher than expected in late 1999, leading to higher employment and incomes in 2000. For example, the Department of Finance forecast for GDP and GNP in the 2000 Economic Review and Outlook was 10.3% and 8.3% respectively. The eventual figures published by the CSO for the year 2000 were 11.5% and 10.4%. The revised tax base reflected the fact that the estimated number of PAYE income earners on Revenue's books in 2001 increased by 76,000 compared with the corresponding figure used in the Budget for 2001. The tax base revised on the basis of these figures caused the cost of the 2001 tax package to be revised upwards by €300 million in a full year (€200 million in 2001, i.e. April to December tax year).

A further consideration was that tax system changes (e.g. the widening of the spouse tax band, broadening of tax relief on pension contributions) could affect behavioural patterns, with the potential to affect tax yield in ways in which there was no "history" on which to ground estimates of impact. He said that substantial changes in the tax regime of recent years may have generated effects of that kind, the impact of which would only be determinable as later years' tax data became available for analysis.

Factors Impacting on Tax Yield in 2002

In relation to 2002, the Accounting Officer reported that tax receipts to end-June were down 7.1% compared with receipts during the same period last year. However, he pointed out that the due date for June Corporation Tax had fallen on Friday 28 June, and that payments of the order of €1 billion had been received on 1 July in relation to the June period. An adjustment for that timing factor left tax revenue at roughly the same level as 2001.

He indicated that tax receipts for the first half of 2002 had been affected by a number of factors:

- The tax reductions in the budget for 2001 came into effect on 6 April 2001 and there was a carry over cost of the full year effect of those reductions in the first four months of 2002. That cost was estimated at €540m in the first four months of 2001.
- The start of the income tax year had been brought back from 6 April to 1 January. As a result, the tax reductions announced in the Budget for 2002 were payable with effect from 1 January 2002, and not from 6 April as was the case in 2001. The additional cost of that was approximately €120m.
- Refunds of income tax of €170m were made in respect of Special Savings Investment Accounts (SSIAs) in the first six months of 2002 compared with €2m in the same period in 2001. SSIAs were introduced with effect from 1 May 2001.

Income tax receipts at the end of June 2002 were €630m below receipts at the end of June 2001, whereas the total of the foregoing measures was €830 million. He pointed out that this year's yield was also affected by increases in income over the levels obtaining in 2001 – the size of which was conjectural at this point.

He also noted that the economy was growing at a much faster rate in the first half of 2001 compared to what was expected for the first half of 2002. That was a result of the sharp slowdown in growth in the economy in the second half of 2001. The Central Statistics Office provisional estimates showed that the economy grew on an annual basis by 12% in the first quarter of 2001 but had slowed to zero by the fourth quarter of 2001. As a result, income tax receipts in the first six months of 2001 grew at a rate of almost 9% but fell by over 3% in the second half of 2001 compared to the year 2000. It would have been expected on that basis alone that income tax receipts in the first half of 2002 would have performed poorly in comparison to the first six months of 2001.

Looking forward to the second half of the year, the Department of Finance expected revenue to improve in response to a stronger economy. Nevertheless, it was expected that tax revenue for the year as a whole would be of the order of €500 million less than the Budget estimate, due for the most part to lower than expected economic growth and higher than expected SSIA costs given the unexpectedly large number of accounts opened as the "window" came to a close in April 2002.

In Depth Examination of the Income Tax Base

The Accounting Officer informed me that the Department, in consultation with Revenue, is examining the income tax base in more depth based on the up-dating of the income tax file to 1999-2000, supplemented by estimates based on latest PAYE returns to end-2001 and an examination of trends in PAYE payments by a sample of larger employers. That examination was ongoing. It was considered that the major changes made to the tax system in the 1999 and 2000 Budgets in relation to tax credits and widening of the standard rate band may have affected the income tax base and the projections that could be made on that basis. Furthermore, the elasticity of tax receipts at a time when GDP was increasing was likely to differ significantly from that experienced when economic growth slowed sharply, especially if overtime, bonuses or commissions were being cut as growth slows. Such income was more likely to be taxed at the higher rate. He stated that the issue was one of concern to the Department and was being carefully examined and monitored closely in preparation for the next Budget in December.