

Chapter 2

Office of the Revenue Commissioners

2.1 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. Sections 2.2 to 2.9 refer to matters arising from this examination.

Revenue Collected

Revenue collected under its main headings in 2004 is shown in Table 2.

Table 2 Revenue Collected^a

	Gross Receipts €m	Repayments €m	Net Receipts €m	2003 Net Receipts €m
Income Tax	13,189	2,494	10,695	9,156
Value Added Tax	13,635	2,918	10,717	9,716
Excise	5,242	176	5,066	4,736
Corporation Tax	5,707	372	5,335	5,155
Stamps	2,106	36	2,070	1,664
Customs	178	4	174	137
Capital Acquisitions Tax	200	10	190	213
Capital Gains Tax	1,548	20	1,528	1,436
Residential Property Tax	—	—	—	1
Total	41,805	6,030	35,775	32,214

^a Total gross collection amounted to €48.7 billion as levies and fees such as PRSI (€6.7 billion), Health Levy (€129m) and Environmental Levy (€14m) are collected for other Departments.

Of the net receipts of €35,775m, a total of €168m was paid during 2004 under Section 3 of the Appropriation Act, 1999 from the proceeds of tobacco excise to the Vote for Health and Children. €35,572m was paid into the Exchequer which represented a prepayment of €333m. The amount prepaid at the end of 2003 was €368m. Most of the prepayment is due to the transfer into the Exchequer of moneys received from taxpayers as deposits and payments on account pending final settlement of tax liability. Such amounts are rarely repaid to the taxpayer and will subsequently be included in the relevant tax receipts figures as and when liability is finalised. An enhancement to Revenue's systems during 2004, introduced procedures which will allow most payments on account to be allocated and processed as tax receipts.

2.2 Tax Written Off

The Revenue Commissioners have furnished me with details of the €173m of taxes written off during the year ended 31 December 2004. Details of the total amount written off and the distribution according to the grounds of write-off are shown in Table 3 and Table 4.

Table 3 Taxes Written Off

Tax	2004 €000	2003 €000
Value Added Tax	72,369	41,792
PAYE	36,862	17,505
Corporation Tax	8,326	5,895
Income Tax	16,385	34,683
Capital Gains Tax	868	977
Other Taxes	1,120	1,986
PRSI	36,618	16,607
Total	172,548	119,445

Table 4 Grounds of Write Off

Grounds of write-off	2004 No. of Cases	2004 €000	2003 No. of cases	2003 €000
Liquidation/Receivership/Bankruptcy	2,097	88,519	337	29,442
Ceased trading – no assets	2,760	40,447	2,277	32,390
Deceased and Estate Insolvent	176	1,350	200	2,022
Uneconomic to pursue	19,359	23,162	38,844	39,322
Unfounded Liability	209	1,983	151	1,688
Cannot be traced / Outside Jurisdiction	586	9,615	331	5,978
Compassionate Grounds	248	2,322	81	926
Uncollectable due to financial circumstances of taxpayer	706	5,150	520	7,677
Totals	26,141	172,548	42,741	119,445

The increase of €53m in the amount written off is mainly due to a review and write off of old insolvency debt on record (this category of write off increased by almost €60m over 2003). In 2004, €3.3m was written off on an automated basis consisting of cases with small balances (less than €500) which were uneconomic to pursue. Cases under general investigation, potential Ansbacher cases, and cases under the control of the Criminal Assets Bureau are excluded from all write off procedures.

The Internal Audit Branch in Revenue undertakes an annual examination of tax write offs. The 2004 audit examined a sample of 171 cases representing 22% (€37m) of the value of non-automated write offs (€169m). The results of the ten automated write off runs were also examined and the application of the authorised selection criteria was confirmed. Commonality checks are designed to establish, prior to tax being written off, whether related entities have outstanding tax liabilities. Write off procedures provide that where a commonality check identifies related entities with tax liabilities greater than €250,000, the case should be referred to the Collector General's Dedicated Pursuit Unit for review prior to any write

off. Of the cases sampled by Internal Audit, 92 met the criteria for commonality checks but the check was not recorded as being carried out in 29 of those cases. Internal Audit carried out a commonality check on the 92 cases and identified 7 that should have been referred to the Dedicated Pursuit Unit but were not. It was also considered that one of the 171 cases sampled should not have been written off (as there was an overpayment on record that equalled the amount of the outstanding tax but had not been offset) and that another was written off prematurely (before all appropriate avenues of collection had been exhausted). The total amount involved in these two cases was some €76,000 (€25,000 and €51,000 respectively). In the first case the overpayment has been offset against the amount owing and the write off has been reversed. In the second case, the original debt has been reduced by €23,000 following adjustment of estimates incorrectly raised and a further attempt to collect the debt is being made.

2.3 Outstanding Taxes and PRSI

Table 5 reflects the activities and transactions in the twelve-month period ended 31 March 2005. Table 6 sets out an aged analysis of the balance outstanding at 31 March 2005. The tables were prepared on the basis of information furnished by the Revenue Commissioners.

Table 5 Outstanding Taxes and PRSI

Balance at 31 March 2004	Tax or Levy	Net Charges Raised	Paid	Written Off	Balance at 31 March 2005	Analysis of Balance at 31 March 2005	
						Under Appeal	Available for Collection
€m		€m	€m	€m	€m	€m	€m
346	VAT	9,984	9,985	56	289	64	225
186	PAYE	9,513	9,510	28	161	4	157
198	PRSI	6,579	6,573	28	176	2	174
306	Income Tax (Excluding PAYE)	2,488	2,485	17	292	64	228
—	DIRT	163	163	—	—	—	—
157	Corporation Tax	4,448	4,387	78	140	56	84
150	Capital Gains Tax	1,542	1,544	—	148	88	60
12	Capital Acquisitions Tax	1	10	—	3	—	3
8	Abolished Taxes	—	—	—	8	—	8
1,363	Total	34,718	34,657	207	1,217	278	939
3.1%	Debt as a % of gross collection^a				2.5%	0.6%	1.9%

^a Gross collection in 2003 was €43,968m and in 2004 was €48,705m.

Table 6 Aged Analysis of Debt at 31 March 2005

Tax	Total tax outstanding at 31 March 2005	Amounts outstanding for 2004	Amounts outstanding for 2003	Due for periods 1990/91 to 2002	Due for earlier periods
	€m	€m	€m	€m	€m
VAT	289	49	83	157	—
PAYE	161	88	21	51	1
PRSI	176	99	27	49	1
Income Tax	292	2	69	212	9
Corporation Tax	140	27	25	84	4
Capital Gains Tax	148	3	32	112	1
Capital Acquisitions Tax	3	—	—	3	—
Abolished Taxes	8	—	—	8	—
Total	1,217	268	257	676	16

2.4 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 outcome of the 2004 programme of Revenue audits is summarised in Table 7.

Table 7 Revenue Audit Programme

Audit Type	2004		2003	
	No. of audits completed	Yield €m	No. of audits completed	Yield €m
Comprehensive	4,058	382.3	4,359	226.3
Value Added Tax	2,776	50.0	3,951	76.4
PAYE Employers	517	5.1	874	18.1
Relevant Contracts Tax (RCT)	439	7.0	231	1.6
Combined Fiduciary (VAT, PAYE and RCT)	848	18.4	544	13.2
Capital Acquisitions Tax	677	6.3	112	5.6
Verification Audits and Desk Reviews	6,750	76.4	5,695	86.8
Customs Audits ^a	162	2.4	214	0.5
Excise Audits ^a	25	—	45	—
Environmental Levy Audits ^a	59	0.1	13	—
Powers of Inspection Audits ^a	10	1.6	—	—
Investigation Branch	—	—	1	0.4
Anti-Avoidance	—	—	3	0.3
DIRT	—	—	8	0.8
Total	16,321	549.6	16,050	430.0

^a Details of these audit types are included for the first time, 2003 details have been restated.

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. For 2003 and 2004, selection was also based on information relating to bogus non-resident accounts obtained from financial institutions under High Court orders — 1,690 comprehensive audits were completed in bogus non-resident account cases in 2004 (2,460 in 2003). 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 4,058 comprehensive audits completed in 2004 is detailed in Table 8. The overall yield of €382.3m includes interest charges of €110.5m and penalties of €39.3m.

Table 8 Yield from Comprehensive Audits

	Income Tax		Corporation Tax	
	Number	Yield	Number	Yield
Agreed Settlements:				
€1 to €12,700	1,792	€3.5m	65	€0.8m
€12,701 to €100,000	992	€39.2m	110	€4.8m
€100,001 to €500,000	347	€73.1m	49	€12m
€500,001 to €1m	63	€44.7m	11	€8m
Over €1m	27	€145.5m	10	€31.5m
Other Settlement Activity:				
Returns accepted – no additional tax payable	264	—	308	—
Settled by restriction of losses carried forward to future years	6	€0.2m	3	€18.5m
Referred to Collector General for enforcement action	11	€0.5m	—	—
Totals	3,502	€306.7m	556	€75.6m

Random Audits

The traditional random audit programme was not carried out for 2004 due to a change in Revenue strategy as a result of a review of the programme. However, 25 cases selected under the programme for previous years were completed in 2004, 13 of which yielded €155,153 in tax, interest and penalties.

For 2005, Revenue introduced a Taxpayer Compliance Testing Programme. The programme has two primary functions

- To measure and track compliance with all tax legislation, and
- To ensure that all tax payers run the risk of being selected for audit.

The programme selected 400 cases on which full comprehensive audits are being carried out. The cases were selected from those that had a live registration for any of the following taxes — Income Tax, Corporation Tax, VAT, Employer's PAYE/PRSI and Relevant Contracts Tax. Selection was pro rata for each of the regions and the Large Cases Division. The target date for completion of the programme is September 2005 and evaluation of the programme is planned for December 2005.

2.5 Prosecutions

Under Revenue prosecution strategy, Regions and Divisions forward cases to Investigation and Prosecutions Division 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 Division before commencement of the resource intensive criminal investigation work which can take several years before reaching the Courts. In 2004, 57 cases were referred to the Division for consideration and 31 were accepted for investigation with a view to prosecution. In the one case decided in Court in 2004, an individual was convicted of submitting incorrect Capital Gains Tax returns and a three month sentence was imposed but was suspended on condition that 180 hours community service was served. The individual was also fined €5,000.

The status at July 2005 of the 66 tax cases on hands at the end of 2004 is

- 34 are still under investigation
- 13 have been submitted to the DPP
- The DPP has issued directions to prosecute in 4 cases
- Bench warrants have been issued in 2 cases
- 5 cases are before the court
- Convictions have been obtained in 6 cases and a guilty plea has been entered in 1 further case
- 1 case has been closed.

In addition to prosecutions for serious tax offences, there were 91 convictions for Customs and Excise and Vehicle Registration Tax offences including tobacco smuggling and customs frauds involving counterfeit spirits. Custodial sentences were imposed in 7 of these cases. There were also 180 convictions for unlicensed trading and 149 for marked oil offences.

2.6 Special Investigations

Table 9 sets out the payments made to the end of July 2005 in relation to cases being examined as part of the Revenue Special Investigations. A short summary of progress to date in the investigations follows.

Table 9 Payments arising from Special Investigations

Investigation	Cases Involved	Payments to Date
DIRT — Look Back Audits (financial institutions)	37	€225m
DIRT — Underlying Tax		
Voluntary Disclosure Scheme	3,675	€227m
Post Voluntary Disclosure Investigations	c. 8,300	€362m
NIB	465	€55m
Ansbacher	289	€51m
Pick Me Up Schemes	71	€0.7m
Mahon Tribunal	27	€28m
Moriarty Tribunal	18	€8m
Offshore Assets	c.13,200	€754m
Undisclosed Funds – Life Assurance Products	c.4,600	€329m
Total		€2,039.7m

Underlying Tax on Bogus Non-Resident Accounts

A total of 3,675¹ taxpayers paid €227m¹ under the Voluntary Disclose and Pay Scheme whereby the underlying tax relating to funds deposited in bogus non-resident accounts was required to be paid by 15 November 2001. I referred in my 2003 Report to Revenue's liability reviews of a sample of cases. 37 of the 268 liability reviews have still to be completed. The total yield from the 231 liability reviews completed is €4.3m. 17 cases have been deemed ineligible and 8 of these have paid additional amounts of €0.8m. The remaining ineligible cases are at various stages of investigation.

Revenue obtained information on taxpayers who held bogus non-resident accounts but who did not avail of the Voluntary Disclose and Pay Scheme from financial institutions on foot of High Court orders under Section 908 of the Taxes Consolidation Act, 1997. At July 2005, payments of €362m had been received from such taxpayers.

Offshore Investments via National Irish Bank

In 2005, investigations began into an additional 13 cases that invested in an offshore investment scheme operated by National Irish Bank to bring the total number of cases involved to 465. Investigations have concluded in 416 of the cases. 299 cases have settled with total liabilities of €48.2m and 117 cases had no liability. Investigations are continuing in the remaining 49 cases and payments on account of €4.2m have been received from 16 of these. NIB has paid €2.4m in respect of Capital Gains Tax on compensation it paid to certain investors.

¹ 3,675 taxpayers paid €227m by the deadline of 15 November 2001. In total, 3,754 taxpayers availed of the Scheme and paid €232m.

Ansbacher Investigation

Cases directly involving Ansbacher type arrangements as well as other cases involving offshore funds and deposits are being investigated. There are 289 cases comprising 179 cases on the High Court Inspectors' Report and 110 similar cases discovered by Revenue or listed in the Authorised Officer's Report.

High Court orders have been used to gain access to books, records and other documentation relevant to the investigation. The High Court granted access to documents and information obtained by the Inspectors in relation to Ansbacher clients and persons who failed to co-operate with the Inspectors and Revenue has applied for such access in a number of cases.

136 cases have been settled to date, 71 of which had total liabilities of €42.3m, including a settlement of €7.5m with a Cayman Islands based bank. The other 65 cases settled had no liability and include 43 non-resident cases covered by the provisions of Double Taxation Agreements as well as 4 cases covered by the 1993 Amnesty provisions. In addition, payments on account of €8.7m have been received in 29 of the 153 on-going cases.

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 found a total of 71 cases that apparently avoided tax by engaging in 'picking up' expenses which were proper to political parties. 42 cases have been settled for a total of €470,724 including interest and penalties. Revenue has decided not to settle 15 cases that have been mentioned at the Mahon and Moriarty Tribunals until those bodies have reported. €158,157 has been received on account from 6 of those cases. 14 cases are still under investigation some of which relate to payments in the 1980s or early 1990s and for which records are no longer available. As a result it is proving difficult to confirm liability. Payments on account of €90,340 have been received in 5 of these cases. These figures have not changed in the last two years.

Tribunals

Matters disclosed at the Moriarty and Mahon Tribunals that suggest that tax evasion may have occurred are being investigated as they come to notice. Currently, 18 cases are being investigated as a result of the Moriarty Tribunal and two have been settled for a total of €6.3m. Payments on account of €1.4m have also been received. 27 cases are being investigated as a result of the Mahon Tribunal. None of these cases have been settled but payments on account of €28.5m have been received in 14 cases.

Offshore Assets

In 2001 Revenue established an Offshore Assets Group to examine the tax status of assets held offshore by Irish residents. Following inquiries into taxpayers who invested funds in offshore subsidiaries of two Irish financial institutions, Revenue announced in February 2004 the commencement of an investigation into unpaid tax on funds in offshore accounts and investments. Account holders were encouraged to give Revenue notice of their intention to make a qualifying disclosure by 29 March 2004. They were then required to submit a statement of disclosure and any payment due by 28 May 2004 (subsequently extended to 10 June). The benefits to account holders of meeting these deadlines were mitigation of penalties, settlement details would not be published and there would be no investigation with a view to prosecution. Revenue intend to seek High Court orders to identify those who have not made a voluntary disclosure and

one order has been obtained. A total of €754m has been received to the end of July from some 13,200 cases as a result of the work of the Offshore Assets Group.

Undisclosed Funds – Life Assurance Products

Investigations began in 2004 into the use of single premium life assurance products to hide income or gains not previously disclosed for tax purposes. The first stage of the investigation involved a deadline of 23 May 2005 for taxpayers who invested undeclared funds in life assurance products to give notice to Revenue of their intention to make a voluntary disclosure. The disclosure scheme does not apply to anyone currently under investigation and the benefits to taxpayers of availing of the scheme are that

- the disclosure will be treated as a voluntary disclosure and therefore, settlement details will not be published
- Revenue will not initiate a prosecution
- penalties will be mitigated in accordance with the Code of Practice for Revenue Auditors

Some 10,000 such notifications were received and these had until 22 July 2005 to pay their outstanding liabilities. Payments of €329m had been received by the end of July 2005 from some 4,600 cases. The second stage of the investigation will identify taxpayers who have not availed of this voluntary disclosure scheme and Revenue will use the powers obtained in the Finance Act, 2005 (section 140) to inspect information held by life assurance companies to assist in making an application for a High Court order.

2.7 Special Savings Incentive Account Scheme

Introduction

The Special Savings Incentive Accounts (SSIA) Scheme was introduced by the Finance Act, 2001, to encourage individuals to provide for the future by saving regularly. The essence of the scheme was that the Exchequer would effectively pay a tax-free bonus of 25% on amounts saved monthly by individuals over a five-year period. The estimated annual full year Exchequer cost of £100m (€127m) indicated a tentative estimate for annual subscriptions of £400m (€508m). It was considered that the scheme would also help reduce inflation by taking money out of the economy but the gross amount (€635m p.a. – subscriptions and Exchequer contribution) was considered too small to have any measurable effect.

Administration of the Scheme

The administration of the SSIA Scheme was provided for under the Special Savings Incentive Accounts Regulations, 2001 (S.I. No. 176 of 2001). In essence, the Regulations required the financial institutions to operate and ensure compliance with all of the terms of the Scheme. Revenue were given a policing role that included the power to audit financial institutions' compliance with the Scheme. The main features of the Scheme are

- The Scheme commenced on 1 May 2001 with the first subscription to an account to be made before 30 April 2002. The Exchequer contributes a tax credit equal to 25% of the amounts saved each month for 60 months. The maximum savings permitted in a month are €254 per account and a minimum of €12.50 was required to be saved in each of the first 12 months.
- Only individuals over 18 years of age and resident for tax purposes could open an account. An account holder must remain resident or ordinarily resident throughout the period the account is held. Each individual is allowed only one account and is required to produce evidence of their PPS number to the account manager and complete a declaration when opening the account.
- Each account must be funded from the account holder's own resources (except in the case of married couples) and sums cannot be borrowed or repayments of borrowings deferred in order to fund savings to the account.
- SSIA accounts are managed by Qualifying Savings Managers (financial institutions) which are required to register with Revenue. There are 330 financial institutions registered consisting of banks (9), building societies (3), credit unions (302), insurance companies (15) and the Post Office Savings Bank. Funds in SSIA accounts can be invested by financial institutions in deposits, shares, government securities or life assurance products. Individuals can transfer accounts from one financial institution to another. On maturity², tax at the rate of 23% is deducted from the income or gain arising from the investment of the funds in the account i.e. tax is applied to the difference between the total value of the account on maturity less the total subscriptions and tax credits that were lodged to the account. However, if there is a withdrawal at any time before the account matures, tax at 23% is deducted from the full amount of the withdrawal i.e. the subscriptions and tax credits as well as any income or gain.
- Revenue makes monthly payments to financial institutions based on claims from them for the net amount due i.e. the tax credit due less tax on gains. Financial institutions must make annual returns by 28 February giving details of all SSIA's.

² An account matures if it runs its full 5 year term or if the account holder dies

Outturn of the Scheme to date

Total subscriptions to 31 March 2005 amounted to €7.26 billion and the net amount claimed from Revenue to that date was €1.776 billion. Details are shown in Table 10.

Table 10 Accounts, Subscriptions and Tax Credits

	No. of Accounts	Total Subscriptions	Net Amount Claimed from Revenue ^a
2001	398,214	€356,565,983	€88,790,617
2002	1,143,418	€1,859,321,585	€459,664,728
2003	1,113,880	€2,187,421,507	€532,623,415
2004	1,094,294	€2,264,832,004	€550,244,518
2005 (to March)	^b	€591,814,025	€144,605,547
Total		€7,259,955,104	€1,775,928,825^c

^aThe financial institutions receive the tax credit one month in arrears.

^b Not available until 2005 Annual Return submitted.

^cTotal tax credits claimed were €1,815,533,212 less total tax on gains of €39,604,387.

Statistical data compiled by Revenue (Table 11) shows the distribution of income levels for SSIA holders for the years 2002 to 2004. That distribution closely reflects the overall distribution of taxpayers' incomes as reported by Revenue³.

Table 11 Distribution of Income Levels for SSIA Holders 2002 to 2004

Income Category	Income Range (2002 levels)	% of account holders 2004	% of account holders 2003	% of account holders 2002
Low	<€20,000	27.7%	28.1%	28.8%
Medium	€20,000-€50,000	49.1%	49.0%	48.8%
High	>€50,000	23.2%	22.9%	22.4%

Scheme Issues

In light of the unexpected extent of the uptake of the Scheme, I sought the views of the Accounting Officer of the Department of Finance on

- the original estimate of the cost to the Exchequer
- the factors supporting the setting of the Exchequer inducement of 25%
- the extent to which existing savings were switched into SSIA's
- the impact of the Scheme on inflation.

Given the benefit conferred on the financial institutions by the scale of the response to the Scheme, I also asked if any consideration had been given to seeking contributions towards the cost of the Scheme from them.

³ Revenue Statistical Report 2003, Table IDS1

The Accounting Officer of the Department of Finance pointed out that the Government, on the recommendation of the Minister for Finance, decided to introduce the Special Savings Incentive Scheme to encourage individuals to provide for the future by a regular pattern of savings and as a means of taking demand out of the economy. The Minister provided a tentative estimate to the Dáil and Seanad of an Exchequer cost of €127m per annum indicating a level of savings of over €500m per annum. The Accounting Officer stated that these figures were not targets for the amount of savings the Scheme might attract and that the Minister made it clear during the Dáil and Seanad debates that he would be happy to see the Scheme maximised resulting in significantly more savings and therefore a greater cost. He also informed me that there is no target level for retention of savings as such.

The Accounting Officer explained that the Scheme arose out of consideration by the Minister and the Department early in 2001 of various suggestions for tax relief to encourage consumers to save rather than spend. The basis of the 25% Exchequer contribution to amounts saved was simply the 20% standard rate income tax relief expressed in terms of the net cost of the contribution i.e. tax relief at the standard rate on the grossed up amount of the contribution. The contribution was conceived in this way, as a bonus via the financial institutions, largely to keep administration costs down.

In relation to switching of savings, the Accounting Officer said that the Scheme was designed in as much as possible to reduce switching but it was clearly understood when the decision was being made that such switching could not be ruled out. However, the evidence from the annual returns to Revenue from the SSIA providers indicates that the scheme was successful in attracting a significant number of younger savers and people on lower incomes.

As regards the effect of the scheme on inflation, he said that the position is that in general terms, goods price inflation in Ireland is determined by international prices and exchange rate changes while services sector inflation is largely determined by the strength of domestic demand, the amount of slack in the labour market (i.e. wage pressures) and the level of competition across the different services sectors. Therefore, it is reasonable to expect that reducing domestic demand has a favourable impact on services sector inflation and therefore on the overall level of consumer price inflation. It is extremely difficult to isolate the impact of this factor from other factors driving inflation at the time. The gap between Irish and Euro area inflation has by now been effectively eliminated but clearly there were many other factors at work here. It is important to note however that economic theory strongly suggests that relationships in this area are not stable over time.

As for the likely impact of the scheme on inflation when funds are released, this will depend on a series of factors including the level of retention of savings, the amount of the remainder spent or invested, whether spending will be on domestic output (e.g. services) and assets or on imports, (e.g. cars, foreign holidays or foreign assets), the amount of slack in the economy when the money is spent and the extent to which the savings habit fostered by the scheme is persisted with. Estimates vary widely as to the influence of these factors. Information on intentions to spend or save is of necessity based on surveys and the output from these are very difficult to assess. What the money will be spent on is difficult to gauge. There is little or no previous experience in the economic literature to go on and in any event decisions are likely to be strongly influenced by the economic environment at that time. He said that the Department of Finance approach is to develop a range of scenarios and factor these into their current economic forecasts and accompanying variability analysis.

The Accounting Officer stated that the decision to introduce the scheme was a policy decision, taken for the stated reasons and that no contribution was ever envisaged from financial institutions. He noted that interest rate competition between institutions seeking to attract investors to the SSIA scheme provided some very competitive rates of interest (in addition to the 25% bonus) for those who shopped around between institutions.

Control of the Scheme by Revenue

Revenue operate direct control over the Scheme through processing and approval of claims for monthly payments from financial institutions as well as validation and reconciliation of annual returns. Responsibility for ensuring individual savers comply with the terms of the Scheme has to a large extent been entrusted to the financial institutions. Revenue carry out inspection visits to financial institutions to monitor their operation of controls in this regard and to ensure that the financial institutions themselves are in accord with the terms of the Scheme. My staff reviewed Revenue's checks on the Scheme with generally satisfactory results. In response, the Accounting Officer of Revenue informed me that

- there were no instances of invalid monthly claims from financial institutions
- discrepancies mainly relating to PPS numbers and dates of birth arising from the validation of annual returns were followed up and have either been resolved or will be before the end of 2005
- a programme of inspections in the financial institutions shows that they have fulfilled their administrative responsibilities adequately
- some 700 cases were reported for non-compliance and 450 cases have been disqualified since the Scheme commenced.

In response to my query as to whether Revenue has established the number of instances where payments are being made by Revenue under the SSIA Scheme in respect of individuals who owe money to Revenue, have had outstanding taxes written off or have not submitted tax returns due, the Accounting Officer for Revenue stated that while tax compliance as such is not one of the conditions attaching to the SSIA Scheme, Revenue's approach to non compliance is to identify the non compliant at an early stage and casework the case as appropriate. This may include enforcement or indeed attachment. It is Revenue policy that where appropriate, all suitable creditors will be examined for the purposes of attachment, including SSIA accounts. This approach has been successfully used in the recent past. He pointed out that SSIA account holders must be individuals, the majority of whom are PAYE employees and as such would not generally feature on the Revenue non-compliant listings.

2.8 Relevant Contracts Tax

Background

The Relevant Contracts Tax (RCT) tax deduction system was introduced in 1970 to counter tax avoidance in sub contracting in the construction industry and was subsequently extended to forestry and meat processing operations. The number of contractors and sub contractors engaged in these industries is set out in Table 12.

Table 12 Contractors and Sub Contractors in Construction, Forestry and Meat Processing Industries

	2000	2005
Principal Contractors	22,000	33,801
Registered Sub Contractors (C2 Holders)	27,000	40,329
Unregistered Sub Contractors	36,000	56,580

For 2005, 18,640 contractors act as principals and registered sub-contractors and are included in both categories (11,000 in 2000).

RCT only applies where the principal contractor and the sub contractor operate in the same industry. A principal contractor must establish, for each job, whether a worker is a sub contractor or an employee. It is not always obvious whether an individual is employed or self employed and there is no absolute definition covering all cases. The category a person falls into depends on what they actually do, the way they do it and the terms and conditions under which they are engaged.

Under the RCT system, a principal contractor must deduct tax at 35% from payments to sub contractors unless the principal has a relevant payments card issued by Revenue for that sub contractor. Where a principal has a relevant payments card for a sub contractor, payments are made without deduction of RCT and recorded on the payments card. Relevant payments cards are only issued by Revenue in respect of sub contractors who hold certificates of authorisation (C2s). C2s are issued by Revenue to sub contractors on application provided their tax affairs are in order and the applicant is deemed to be a bona fide sub contractor. Where RCT is deducted from a payment, the principal gives the sub contractor a deduction certificate showing the gross amount of the payment and the tax deducted. After the end of the month in which the payment is made, the sub contractor can submit the deduction certificate to Revenue and claim repayment or offset of the RCT deducted.

Principal contractors must maintain a record of payments to all sub contractors and submit monthly returns (RCT30) together with remittance of the tax deducted. An annual return (RCT35) must also be made showing the total payments to each sub contractor (paid with and without deduction of RCT) and the total RCT deducted (if any) from each. The amount of RCT collected and repaid for the years 2001 to 2004 is shown in Table 13.

Table 13 RCT Collected and Repaid or Offset 2001 to 2004

	2001 €m	2002 €m	2003 €m	2004 €m	Total €m
Collected	422	394	477	612	1,905
Repaid/Offset	365	365	403	522	1,655
Not Allocated	57	29	74	90	250

Changes Introduced Since 2000

Since my 2000 Report on the systems and procedures for administration of RCT several operational changes have been introduced.

- RCT has been incorporated into Revenue's Integrated Taxation Services (ITS) system.
- RCT was introduced into Revenue's Active Intervention Management (AIM) caseworking collection system in a limited way in 2002 thus allowing monitoring of the larger principal contractors. RCT has recently been fully integrated into the AIM caseworking system.
- Monetary limits can now be applied to payments cards issued. For payments over that amount, RCT must be deducted or a new payments card applied for.
- The Finance Act 2004 empowers Revenue to maintain a register of principal contractors.
- A risk evaluation of RCT has recently been carried out by Revenue.

I sought the observations of the Accounting Officer on the extent to which the changes introduced have addressed the issues identified in my 2000 Report and in particular

- the progress made in pursuing the €38m - €44m arrears of RCT highlighted in my 2000 Report
- when electronic processing of the annual return data is likely to be implemented and the benefits it will give to the administration of the tax
- when the recommendations of the risk report will be available for consideration and implementation
- whether it is intended to seek a legislative basis for the payment card monetary limit.

The Accounting Officer stated that in recognition of the potential risk associated with RCT, Revenue had committed a large proportion of its information technology resources to incorporating the tax into the ITS system. This necessitated assigning a higher priority to RCT than the development of the PAYE system for employees. He said that this decision was taken on the basis that it was necessary to move RCT into ITS before the administrative problems identified could be properly addressed. Its inclusion in ITS means that a full audit trail of all RCT processing activity is now available. Further benefits are system checking

- of the tax compliance of sub contractors prior to C2 issue
- that contracts limits are not exceeded prior to Payments Card issue
- of deduction certificates and tax compliance status of sub contractors claiming refunds or offsets. ITS automatically offsets refund claims against outstanding taxes.
- for principals who are not up to date with returns and payments when sub contractors claim refunds or offsets
- of cumulative monthly payments by a principal against total deductions from sub contractors per annual return and issue of estimate as necessary.

Revenue's recent restructuring has included the establishment of Special Compliance Districts in each of the Revenue Regions. These Districts have commenced a number of projects and initiatives with a particular focus on the construction industry and major infrastructural projects which have produced information and intelligence that has increased Revenue's understanding of the RCT sector as well as identifying and profiling cases that present risks. The intelligence from such projects provides a base from which Revenue can evaluate the effectiveness of its current programmes and develop new strategies on how to tackle fraud and evasion. These developments coupled with the introduction of a new computerised risk assessment system will facilitate the development of new policies and compliance programmes to actively pursue appropriate cases. He regards these measures as a significant step towards ensuring the efficient administration of RCT, the identification of compliance risks and addressing any weaknesses in RCT administration.

In relation to the cases with arrears of €38m to €44m, the Accounting Officer stated that when RCT was introduced into ITS in November 2002, all balances for the years 2000/2001 and later were included in ITS. Balances for prior years were not automatically transferred to ITS due to the uncertainty of the charges under the old system. Where the older charges were confirmed as valid, they were manually input to ITS for full collection case working. The majority of cases have been examined at this stage and where necessary, the liabilities have been included in ITS. Some of the cases have to be rechecked to confirm the status of the charges. This requires access to files stored "off site" and it is taking some time to retrieve the files and confirm the position. Examination of all cases is expected to be completed by the autumn.

The Accounting Officer also informed me that the facility to capture the data on the annual returns is currently being developed and is scheduled for completion in December 2005. Annual returns for 2004 and subsequent years will be processed. He stated that the capture of this data will allow Revenue to

- Match data already being captured from refund/offset claims with the principal's returns.
- Check the validity of payment card numbers quoted.
- Identify subcontractors who are not reclaiming RCT deducted.
- Identify patterns where principal contractors engage uncertified subcontractors only (increased cash flow), C2 holders only (less administration) and subcontractors who do not provide a tax reference number (possible shadow economy issues).
- Identify principal contractors where compliance with RCT legislation and regulations may be an issue (payments card numbers not quoted and no tax deducted, payments card number quoted not issued to that principal).
- Use the annual return data in the risk assessment system to profile cases where tax might be at risk across all taxheads.

The Accounting Officer also stated that Revenue was in discussions with the Department of Social and Family Affairs as to the extent of information they would require from the annual returns to assist in identifying instances of sub contractors working while claiming social welfare benefits.

The Accounting Officer said that Revenue management have not yet considered the report of the risk evaluation of RCT which has just recently been completed. Some of its proposals and developments could be introduced quickly while others will require information technology developments.

The Accounting Officer informed me that the monetary limit on payments cards was introduced on an administrative basis in 2004 under the care and management provisions of the Taxes Consolidation Act, 1997. It was introduced to reduce some of the risks associated with the tax including cases where sub contractors who held C2s on the basis of a small contract were being used to channel significant payments to large operators in the shadow economy who would not have met the criteria to obtain a C2. The limit also provides a degree of protection to Revenue against the possibility of small, labour only contractors building up significant tax debts. Revenue consider that the monetary limit is a pragmatic response to these risks and is appropriate and desirable in the long term and is therefore best placed on a statutory footing. Revenue are considering this and other changes required to the RCT legislation with a view to putting forward proposals to the Department of Finance for consideration for inclusion in the Finance Bill, 2006.

Current Audit Issues

In the light of the findings of my previous audit and the changes introduced since, I examined the operation of RCT in the Fingal District, the Cavan/Monaghan District and the Construction Business Unit of the Large Cases Division. The system operated in each of these was examined. Sample checks were made of principal contractors and their annual returns, the validity of payments cards and tax reference numbers supplied on annual returns and the compliance record of sub contractors listed on the annual returns. In addition, a sample of Revenue audits in the construction sector was examined and internal audit activity in the RCT area was reviewed. The findings of my audit together with the responses of the Accounting Officer are set out below.

Submission of Annual Returns by Principal Contractors

32 of 65 annual returns examined were submitted from 1 to 10 months after the due date. A penalty for late submission was not imposed in any case.

The Accounting Officer stated that based on the experience of the use of penalty proceedings in relation to other taxheads, Revenue are of the view that the automatic taking of penalty proceedings alone for late submission of returns will not be effective in changing the compliance behaviour in RCT cases. Since Revenue restructuring, a more whole case approach to tackling non-compliers is being followed. This means that instead of dealing with individual instances of non compliance (such as the failure to file a particular tax return) in isolation, account is taken of the total risks across all taxheads. Decisions on the type of action to be taken are made based on what is considered to be the most appropriate intervention to change the behaviour of the taxpayer. The introduction of the computerised risk assessment system will greatly facilitate this new approach. It may be that in some cases, penalty proceedings will be the most appropriate action to take. However, this new approach is at an early stage.

Completion of Annual Returns

- 8 of the 65 annual returns included entries for 38 sub contractors without a payments card number but no RCT was recorded as deducted.
- Entries on annual returns for 3 sub contractors showed negative amounts.
- There were some 6,533 sub contractors on the annual returns examined. Tax reference numbers were not supplied for 457 of these.
- Addresses were not provided in all cases.

The Accounting Officer informed me that it is Revenue policy that annual returns are examined to check for deficiencies but due to pressure of other work programmes some were not fully examined. Where problems are identified, cases are considered for audit as part of a District's annual audit programme and the decision to initiate an audit will take into account factors such as the degree of the deficiency (the tax at risk), the tax history of the case and resources. Where a decision is made not to proceed with a formal audit other options and contacts need to be considered. To ensure that there is consistency in RCT administration across all Regions, Revenue proposes to issue comprehensive instructions on the best practice to be applied in working annual returns. The instructions will also address other issues such as the quality of information provided on RCT return forms.

In relation to cases where no payments card number was quoted but no tax was deducted he said it may be the case that the principal omitted the number from the annual return in error. Where this is not the case, the matter is generally referred for audit. Where the audit shows that tax should have been deducted payment is required unless, in exceptional circumstances, where there is no neglect, all parties are fully compliant and nothing would be gained by processing a payment through the system. Also, payment is not required in group cases, as provided by the Code of Practice for Revenue Audit, where the group is compliant.

Enquiries into the cases where there were negative amounts on the annual return show that the principals' own internal systems led to these amounts being recorded on the RCT 35s. Any tax implications arising are being followed up.

In relation to the absence of tax reference numbers on the annual return, he said that as the return may be submitted a year or more after the subcontractor was engaged, possibly on a short term contract, a difficulty arises in that the principal contractor may not have the means of getting this information. The subcontractor must however provide their date of birth in all cases. The address should also be supplied in all cases, but in practice it is often omitted where the subcontractor has provided a tax reference number or has a C2 certificate. In any event the subcontractor's address is available on Revenue's computer records.

He stated that the electronic capture of annual return data will automate the detection of discrepancies but that until that process is complete, processing of forms would be extremely costly in terms of resources and has to be assessed in terms of the benefit to be gained and the opportunity costs involved. Revenue has other strategies in place to detect non-compliance and tax at risk with new dedicated teams in its restructured organisation. The work of the Special Compliance Districts means that those who are not in the tax system are now being detected on a current basis and not after the fact when an annual return form has been submitted and the subcontractor cannot be traced.

Sub Contractors' Tax Reference/Registration Status

The validity of the reference details and the tax registration status of a sample of sub contractors recorded on the principals' annual returns were checked as part of my audit. In most cases the outcome was satisfactory but there were difficulties with some cases which I raised with the Accounting Officer.

The Accounting Officer stated that in light of the large amount of information relating to subcontractors on annual returns, coupled with the practical difficulty of interrogating this data outside of a management information system, no specific check has been carried out to date on the validity of tax reference numbers. However, this difficulty will be addressed by the electronic data capture of information on annual returns. The approach to using this development to ensure that taxpayers who supply inaccurate data can be detected is being examined.

Comprehensive instructions issued in October 2004 to all staff outlining procedures in the registration process with the main emphasis on the ongoing maintenance and accuracy of taxpayers' data. The instructions address the question of registration for other taxes by directing that where staff processing registration applications consider that the taxpayer should be registered for other taxes, the taxpayer or their agent should be contacted. In relation to unregistered subcontractors, the Accounting Officer said that such taxpayers generally apply to Revenue for a tax refund. When processing the refund, checks are made to ensure the subcontractor is registered for all relevant taxes and compliance checks are made where this is not the case. These compliance checks have resulted in the detection of taxpayers who do not submit tax returns or who underpay their liabilities. Procedures are also in place to ensure that non-resident sub-contractors are registered for all appropriate taxes.

Employee/Sub Contractor Status

My examination reviewed files relating to Revenue audits in the construction industry finalised in 2004 with particular reference to the classification of workers as between employees and sub contractors and found some evidence of principal contractors being advised by Revenue auditors to reclassify sub contractors as employees. In 1998, a programme of site visits to principal contractors had been undertaken to check whether any persons treated as sub contractors should be reclassified as employees. The status of some 63,000 sub contractors was examined and as a result some 20% were reclassified as employees. A similar special programme commenced in 2001.

I sought the observations of the Accounting Officer as to

- whether he was satisfied with the level of checking of the classification of workers as between employees and sub contractors
- whether the special programme of site visits commenced in 2001 was completed or is planned to be completed
- the extent of the contribution of work of the Joint Investigation Units⁴ to the control of RCT, including the classification issue.

The Accounting Officer stated that Revenue have responsibility for administering the operation of all taxes in the construction industry and ensuring that all operators within that sector comply with all their taxation obligations, and not just RCT. Revenue carry out a range of checks in relation to the status of those engaged in the construction sector and also monitor activity in the sector through the issue and processing of RCT forms. He said that Revenue auditors examine the employee/sub-contractor status as a routine part of audits. Approximately 1,500 audits (about 10% of all audits) were conducted on building contractors in 2004. The auditors would have examined the forms that a principal contractor and a sub-contractor complete in respect of each contract (RCT1) which contain details of the duration and type of contracts and a statement that the contracts are not contracts of employment. He pointed out that recent computer enhancements make it easier to identify cases where an employment arrangement rather than a contract arrangement may exist e.g. where sub-contractors are receiving regular payments under deduction of tax from one principal contractor.

The Accounting Officer informed me that in 2004, Special Compliance Districts initiated a number of key projects to tackle tax evasion and in the construction sector concentrated on major infrastructure projects. Surveillance of construction sites allowed Revenue to develop a profile of those engaged on sites and to

⁴ Revenue and the Department of Social and Family Affairs carry out joint investigations through Joint Investigation Units which are staffed by officials from both departments.

use this information to carry out site visits where risks were identified. These site visits have led to cases being referred for possible prosecution and informed the selection of cases for future audits. Investigations into the construction and property development sectors focusing on all taxes and duties are continuing in 2005.

The special programme of site visits, which commenced in 2001, was suspended in September 2002 to allow Revenue to provide audit staff with Health and Safety training to enable them to move around the sites. The programme was not resumed following an analysis of the degree of misclassification uncovered (of the 984 subcontractors examined only 65, i.e. 7% were misclassified). However, officials who are engaged on construction site visits have now been provided with the recognised training courses to enable them to move around the sites.

The Accounting Officer informed me that the focus of the Joint Investigation Units crosses all taxheads and all areas of business activity. While no specific RCT projects were undertaken, the Joint Investigation Units have regularly examined taxpayers operating in the construction, forestry and meat industries and have dealt with RCT compliance and classification issues as they arose. Their compliance interventions also focus on other tax heads and duties including the operation of PAYE, VAT and Income Tax. No separate statistics are kept of RCT classification issues as the classification issue has not presented itself as a significant risk and the main focus of these Units is on areas where persons are working and claiming social welfare allowances.

Internal Audit

The Revenue Internal Audit Section examined RCT repayments and offsets to sub-contractors and refunds to principals who had overpaid RCT in June 2004 as part of a general audit of repayments. A sample of 55 repayments and offsets to sub contractors were examined with satisfactory results. Since the introduction of RCT into the ITS system, the volume of refunds to principals had increased dramatically from an annual level of about 30 to about 4,000 per annum. Previously, the principal had to apply to have the amount refunded or included in the balancing of the annual return. In the ITS system a refund is automatically triggered for all taxes where the amount received is greater than the charge on record. The Internal Audit found one case where refunds were incorrectly made to a principal as a result of a supplementary payment of RCT, correctly due, being treated by the ITS system as an overpayment, and automatically refunded. In light of the identification of that problem, the Collector General's Office temporarily suspended the automatic refund facility for RCT. A subsequent review found 399 cases where improper refunds totalling €912,000 had been made. All refunds to principals greater than €10 are now blocked by the system and must be manually processed. 388 of the cases found have been resolved and the moneys recovered, and 11 cases, which received refunds totalling €14,000, are still to be resolved.

I asked the Accounting Officer whether he was satisfied that incorrect repayment had not occurred in respect of any other taxhead in ITS.

The Accounting Officer stated that he was satisfied that the issues that resulted in incorrect automatic repayments of RCT were generally related to the migration of RCT to the new ITS environment. Steps have been taken to specifically address the issues identified in relation to RCT and additional validation procedures have been implemented. In relation to taxheads other than RCT, situations where taxpayers do not use the returns provided or do not clearly indicate the circumstances of the payment give rise to some potential for incorrect repayments. The validation systems in place and the maturity of the other taxheads within the ITS environment provide assurance that similar issues to those identified in relation to RCT are not a significant concern.

General Management

In relation to management of RCT generally, I also asked the Accounting Officer

- what action was planned to improve the compliance rates for monthly and annual RCT returns
- the extent of frauds in relation to RCT and the action taken in response
- whether he was satisfied with the operation, control and administration of RCT and that it is achieving its objectives.

The Accounting Officer informed me that it has only proved possible to accurately and reliably compute compliance for the monthly return commencing in January 2005. The compliance rate within one month of the due date is 52%. The Accounting Officer informed me that compliance rates for monthly returns are currently significantly below PAYE/PRSI (P30) compliance rates. This is to be expected, as compliance case working for PAYE/PRSI has been a core element of Revenue's compliance programmes for a number of years. As case working has been extended to include RCT since the beginning of 2005, Revenue anticipates that compliance rates will improve considerably for RCT in the coming years. For 2005, the Collector-General's division has introduced specific compliance targets for RCT in its business plans. The computerised risk analysis system will form a significant part of Revenue's continuing focus on improving compliance behaviour across all taxheads.

Establishing compliance rates for annual returns prior to 2003 has also proven to be unreliable. Since 2003, formal compliance campaigns have been introduced. The compliance rate for the 2003 return at the time of issue of the compliance programme in August 2004 was 60%. This has now risen to 81%. The compliance rate for the 2004 return at the time of issue of the compliance programme in May 2005 was 57%. Matching annual return data processed electronically with sub contractor deduction certificates will help identify principals who have engaged sub contractors but not submitted annual returns.

The Accounting Officer informed me that twelve cases of RCT fraud were investigated by Revenue in recent years. Two cases involved collusion among large numbers of individuals and companies (97 in one case and 24 in the other) including principal contractors and these cases were referred to the Gardaí whose enquiries are ongoing. The remaining ten cases where serious suspected abuse of the RCT system were identified were referred for investigation by Revenue's Investigation and Prosecutions Division (IPD) with a view to prosecution. To date one of these cases has resulted in a Court conviction and the defendant was sentenced to 240 hours of Community Service. In two other cases, the defendants failed to appear in Court and bench warrants were issued for their arrest. The remaining seven cases are under active investigation by IPD.

He said that the main weakness identified in these frauds, was the fraudulent issue by principals of deduction certificates in respect of work never carried out and payments that were never made. The tax shown as deducted on these certificates was bogus and not remitted to Revenue. He said that the functionality of the ITS system allowed Revenue to respond quickly to these fraud cases and identify the deduction certificates that were being used in the fraud. An analysis of the alleged frauds identified six common traits in these cases and a development was introduced to the ITS system to identify potentially bogus claims and principals who were not returning adequate amounts of RCT deducted. A risk evaluation was carried out to make recommendations to counter such frauds.

In relation to the operation of RCT generally, the Accounting Officer stated that the serious compliance problems that RCT was introduced to tackle still exist today and are compounded by the highly

competitive nature of the industry where non-payment of tax debts is seen by some as a way to gain a competitive advantage. He said that Revenue faced new challenges arising from the increased level of activity in the construction sector and the increase in the number of non-resident contractors. The difficulties in tackling non-compliance in the construction sector are recognised internationally and different jurisdictions have come up with their own responses to the problem. The main focus and purpose of the RCT system is to secure payment of tax by subcontractors who might not otherwise pay. Most operators in the construction, forestry and meat processing industries are relatively tax compliant in terms of returns and payments. Revenue's compliance programmes monitor the returns and payments made by principal contractors. Registered subcontractors are subjected to a returns and payments compliance regime that annually reviews their entitlement to hold a C2. Unregistered subcontractors suffer a tax deduction of 35% and their compliance is monitored when they apply for a refund or offset of this tax. While the unregistered subcontractor who does not apply for a refund or offset is not being monitored at this point in time, they have suffered a deduction of tax at 35%, which might not otherwise be achievable. With the capture of the data from the annual return, Revenue will be in a better position to analyse and profile these cases and put in place a comprehensive and efficient response.

The Accounting Officer stated that Revenue's new structure has increased its capability to respond more quickly to this complex and changing environment. Initiatives already started by the regions have increased Revenue's understanding of the RCT sector and its risks and these projects will continue. While the RCT system is still mainly paper based, ITS and AIM have streamlined processes and allowed Revenue to monitor compliance more effectively than heretofore. As a result of the tightening up of procedures and the enhancements that have been made to the underlying computer systems, Revenue is satisfied that the RCT system is still achieving the objectives for which it was put in place. He said that the computerised risk analysis system will increase Revenue's effectiveness at tackling non-compliance in the sector.

2.9 Stamp Duty on Electronic Share Transactions

Background

The introduction of a new electronic system (CREST) operated by a UK company for the settlement of transactions arising from the sale or transfer of shares in UK and Irish registered companies was noted in my 1996 Report. Under Section 105 of the Finance Act, 1996, Revenue entered into an agreement with the operating company for the collection and payment to Revenue of Irish stamp duty. Before the CREST system went live Revenue tested a range of individual transactions to ensure that the amount of stamp duty due would be correctly calculated by the system.

Operation of the CREST System

Under the agreement the stamp duty collected is lodged by the operating company to designated bank accounts in trust for Revenue and is transmitted weekly, three weeks in arrears, to the Central Bank. Prior to the transfer of funds a daily breakdown of stamp duty payments collected is forwarded to Revenue by the operating company. The weekly receipt of funds is confirmed to Revenue by the Central Bank. My 1996 report also noted that a direct link with the new system was under development that would download further transaction details to Revenue. That data would facilitate verification that the correct amount of duty was paid over by the operating company, and also facilitate audit procedures. Under the agreement with the operating company Revenue was given the right to undertake a system audit of the company.

In order to participate in the CREST settlement system, brokers are required to become members of the system and put in place guaranteed payment arrangements. The system matches the details input by both parties to a sale and completes the transaction, the respective bank accounts are debited and credited with the agreed amount and, where applicable, the stamp duty liability of 1% is also collected from the account of the purchasing broker. €220m was collected by Revenue through the CREST system in 2004. Table 14 shows the total stamp duty on share transactions for the years 2000 to 2004 and the CREST payments and refunds for each year.

Table 14 Electronic Share Transactions and Stamp Duty 2000 - 2004

Year	Collected through CREST System	CREST Refunds	Paper Based Transactions	Total Stamp Duty on Share Transactions
2000	€212m	€25m	€44m	€231m
2001	€306m	€25m	€65m	€346m
2002	€272m	€32m	€63m	€303m
2003	€250m	€28m	€34m	€256m
2004	€255m	€35m	€40m	€260m

Exemptions and Section 75 Returns

Legislation provides for exemption or relief from stamp duty on share transactions in certain circumstances. The main instances are outlined in Table 15. Closings relief is provided only on a 'pay and refund' basis, while the other three exemptions are obtained on a self-assessment basis by brokers inputting the relevant exemption code to the CREST system. Stamp duty is not deducted by the system from exempt coded transactions. However, data subsequently provided in electronic form by the system

to Revenue includes the unique identifier number of each transaction, date of transaction, whether shares are Irish, broker identity, number and identity of shares, value of transaction, broker self assessment code in relation to exemptions or relief, and the amount of stamp duty assessed and charged by the system.

Table 15 Exemptions/Reliefs under Stamp Duties Consolidation Act, 1999

Exemption/Relief	Criteria	Stamp Duty
Beneficial Ownership did not change	<ul style="list-style-type: none"> • Broker is acting in an agency capacity • Legal title only is transferred • By Electronic Transfer only 	Stamp Duty not payable
Closings Relief	<ul style="list-style-type: none"> • Broker is acting in an agency capacity • Both contracts due for completion on the same day • Both purchases are closed within 25 days • By Electronic Transfer only 	Stamp Duty payable but refundable
Market Maker	<ul style="list-style-type: none"> • Broker registered by the Stock Exchange to trade in the relevant securities • Electronic and Paper Transfers 	Stamp Duty not payable
Broker/Dealer	<ul style="list-style-type: none"> • Broker acting in a principal capacity • Securities purchased must be sold on within a calendar month • Electronic and paper transfers 	Stamp Duty not initially payable, but due if no resale within a calendar month

Member firms that have claimed broker/dealer exemption through the CREST system must submit a report to Revenue on a six monthly basis (Section 75 Report) containing details of the actual outcome of each purchase that had been initially coded as a Section 75 exemption on the expectation of resale within a calendar month and of the amount of duty which may subsequently have become due. A certified declaration is also required from the broker/dealer to the effect that the shares transferred under the Section 75 exemption, and in respect of which stamp duty has not been paid, were transferred on sale to a bona fide purchaser within the permitted period of one calendar month⁵. Refund claims for closings relief must include details of each transaction and a declaration as to why the refund is warranted.

Internal Audit 2001

An internal audit of the payment of Stamp Duty through the CREST system was carried out by the Revenue Internal Audit Section in November 2001. The audit findings noted that

- A number of brokers had not complied with Section 75 return requirements for the previous six monthly period, and had not been pursued by Revenue
- Desk-based audits of Section 75 returns are mainly carried out where errors have been discovered in the course of processing refund applications
- It was not possible to identify all members trading in CREST as the members' identification numbers were not known to Revenue
- No Revenue audit of a CREST participant had been carried out since the system was introduced in 1996.

⁵ 'Traditional' paper share transactions deemed exempt by brokers will be accepted unstamped by a Company Registrar. There is no record of subsequent receipt of Section 75 returns by Revenue in such cases.

Current Audit Concerns

It was noted in the course of an audit by my staff in February 2005 that those weaknesses still existed. It was also noted that an unsolicited payment of €1.1m was received by Revenue from a broker in November 2003 in respect of stamp duty on 516 share transactions through the CREST system in the period April 2001 to March 2003. The transactions had been coded exempt by the broker at time of purchase under broker/dealer relief (Section 75) but had not been sold on within the required period of one month of purchase thereby negating the relief and incurring a liability to stamp duty. In October 2004 Revenue informed the broker that a further €3.3m comprising interest of €0.1m and penalties of €3.2m was due to Revenue in respect of the late payment of the stamp duty.

As the €1.1m underpayment underlined the significant risk of underpayment of stamp duty which may arise in relation to exemptions, and as the failure to obtain Section 75 returns and declarations deprived Revenue of a key tool to police compliance in that area, I sought information from the Accounting Officer as to

- whether the systems and procedures operated by Revenue were adequate to ensure that all of the stamp duty due to the Exchequer from transactions on the CREST system was promptly identified and collected
- the circumstances and outcome of the case in which interest and penalties totalling €3.3m had been demanded by Revenue in October 2004
- whether a Revenue stamp duty audit had been carried out on the books and records of any CREST member since 1996 and, if so, the outcome of such audit
- whether Revenue had exercised its right under the 1996 agreement to undertake a system audit of the CREST operating company.

Revenue Response

Adequacy of Systems and Procedures

The Accounting Officer informed me that the operation of CREST had since its introduction in 1996, been the subject of many meetings and correspondence between the Revenue Crest Unit and both the Irish and London Stock Exchanges, individual Member Firms and other interested parties with the objective of educating them in Revenue's requirements for submitting refund claims and returns in relation to stamp duty exemptions. Reclaims sought on the basis of inputting errors by CREST participants had a draining effect on the Revenue resources available to administer the system.

Revenue's approach has been to tackle the deficiencies in reporting through a two-streamed approach – education and compliance leveraging. The relationship-based business model had sought to address the non-compliance in this area and had been successful in assisting brokers in understanding and meeting their obligations. Revenue has also been working to improve audit case selection using business intelligence. A number of meetings to outline compliance issues had been held with the Irish Stock Exchange. A Technical Group consisting of Revenue and Irish Stock Exchange representatives had been established to review difficulties in complying with CREST obligations and it was hoped that this Group would be shortly able to agree a guidelines (Market Norms) document which would outline details of Revenue requirements. Brokers were given an opportunity to get their affairs up to date and had confirmed that there would be full and timely compliance with their obligations from December 2004.

The UK Stamp Duty Reserve Tax exemptions in CREST differ from those in relation to Irish stamp duty and had resulted in confusion for UK brokers in regard to their Irish stamp duty obligations. Having regard to this, there had been a series of discussions and meetings since September 2000 to educate them and to improve the level of compliance and the accuracy of their returns.

The recommendations of the 2001 Internal Audit report had been implemented where considered feasible. It had also been decided that management of the compliance of the CREST activities of the main brokers would be transferred to the Large Cases Division. The transfer would release resources within the Crest Unit to concentrate on the remaining brokers.

The CREST system to date had grown significantly both in terms of the volume of transactions effected and data flows since its inception. For example, the 1996 net stamp duty collected through CREST was €6m (some 12% of the total collected for shares) and in 2004 had risen to €220m (84.5% of the total for shares). Revenue had responded to the increase in the level of business by moving to upgrade its computer system. When implemented, the upgraded system would increase user capability and solve a number of existing performance problems.

The securities market had also evolved over the past few years and that had resulted in a different trading environment from that which obtained at the commencement of CREST. In light of this, the Irish Stock Exchange had approached the Department of Finance with proposals to replace the existing legislative stamp duty exemptions for CREST transactions by a Single Intermediary Relief (the simplified exemption used for UK securities). If such a relief were introduced, it would reduce the present administrative burden both for CREST participants and for Revenue.

Non-Compliance with Broker Reporting Requirements

The Accounting Officer indicated that the main issue of ongoing concern for Revenue had been the failure of brokers to comply with the Section 75 reporting requirements. Due to resource constraints, there had not been a formal procedure in place in Revenue to identify brokers dealing in Irish shares. Additional resources had been allocated to the Crest Unit in the latter half of 2004 to deal with compliance issues. The Business Plan for 2005 included an activity to identify brokers dealing with Irish shares on the CREST system. However, it is difficult to accurately quantify the number of brokers with returns outstanding as the indicator flag used on the CREST system for Section 75 relief is the same as that used for Market Maker relief (see Table 15) for which no return is required. Table 16 sets out the total number of brokers dealing in Irish shares and the outcome of Revenue's exercise to identify the potential number of brokers with returns outstanding for the six monthly periods ending March 2000 to March 2005.

Table 16 Section 75 Returns Outstanding 2000 - 2005

Period ended	Total Number of Brokers Trading in Irish Shares	Potential number of Brokers availing of S.75 Relief	Number of Brokers who submitted six-monthly returns	Potential number of Brokers with returns outstanding
March 2000	191	44	28	16
September 2000	211	51	27	24
March 2001	242	59	23	36
September 2001	235	61	18	43
March 2002	219	76	23	53
September 2002	242	72	12	60
March 2003	220	82	38	44
September 2003	224	87	45	42
March 2004	227	96	46	50

September 2004	238	101	46	55
March 2005	235	104	34	70

In outlining the steps taken by Revenue since 2000 to obtain the outstanding returns together with all stamp duty due, the Accounting Officer reported that where non-compliant brokers were identified, they were advised of their obligations and given the opportunity to bring their affairs up-to-date. Furthermore, where a broker submitted reclaims on foot of the Section 75 exemption, these were withheld if their appropriate returns⁶ were outstanding. Those actions had resulted in more brokers becoming compliant and in the collection of outstanding stamp duty where appropriate. The exercise also indicated that as 45%-50% of brokers with a potential obligation to submit a Section 75 return had less than 100 trades exempted in the period, the extent of potential underpayments from these brokers is small. Having analysed the year 2004, only 10 brokers had in excess of 10,000 trades in the six-monthly periods and there were no issues regarding their understanding of their Section 75 obligations.

Reconciliation of CREST Payments Received

The weekly payments notified to Revenue by the operating company are checked against the weekly amounts of stamp duty charged on the CREST computer, and subsequently with the Central Bank confirmation of payments lodged. However, due to the design of the CREST computer system, checks of weekly payments made by the operating company against relevant underlying transactions can only be carried out on behalf of the Crest Unit by expert Revenue computer personnel. Such checks, which were carried out in 2001 and again in early 2005, consisted of examining the data-feed from the operating company to identify the transactions on a specific date, the stamp duty paid on each transaction and the total yield for that date. Crest Unit then compared that data with the payment advice for that date. In the context of the proposed upgrading of the computer system, a request had been made for that facility to be directly available to the Crest Unit users. Differences arising from the checks are rare, with only two instances in the past six months. The previous discrepancy prior to that was in November 2003.

Underpayment of €1.1m

Following a desk-based audit in May 2003, it appeared to Revenue that the firm in question was availing of Section 75 exemption but had failed to submit six monthly returns. The firm was advised that all reclaims would be suspended and was requested to examine the position. After further contacts, a payment of €1.1m was received in November 2003. Outstanding Section 75 returns for the period May 2001 to April 2003 were subsequently submitted in June 2004. The formal Section 75 declaration by the broker was not received but had recently been sought. Revenue assessed interest at €104,809 and penalties at €3,254,940. Following correspondence, the penalties were mitigated to €281,443 in June 2005 in line with Revenue policy and in recognition of the cooperation received from the firm in question as well as the level of neglect involved. There was no mitigation of the interest. A reminder subsequently issued in July 2005 requesting payment of the interest and the mitigated penalty.

Revenue Audit of Brokers

The Accounting Officer stated that the Crest Unit regularly undertook desk-based audits to confirm the bona fides of exemptions claimed. In any case where desk-based audits detected an underpayment of stamp duty, the underpayment was pursued and collected. Regular field visits were made to brokers to discuss record keeping and compliance issues with them. Although an external Revenue CREST audit had not to date been carried out on any brokers participating in the CREST system, the desirability of such audits was identified during 2004. Accordingly, computer based audits of a number of CREST

⁶ i.e. covering the 6 month period in which the related transactions occurred.

brokers were planned for later in 2005. A team had now been put together to carry out these audits with the Crest Unit providing the technical expertise in the development of the audit plan and the audit itself being facilitated by officers outside the Crest Unit with the appropriate level of audit and computer skills.

Revenue Audit of CREST System

Arrangements had been made with the operating company to conduct a system audit in London before the end of 2005. The audit will be carried out by the same team including assistance from the Revenue Computer Audit Services Unit. It was anticipated that the results would also be of benefit during audits of individual brokers.

General

In conclusion, the Accounting Officer noted that while the existing systems and procedures in place were not designed to accommodate the level of business presently generated through the CREST system, he was confident that, as with all self-assessed taxes, where underpayments of stamp duty were identified they were pursued and collected. The existing CREST computer system was being upgraded to offer the necessary response to present day demands. It was expected that the features of the upgraded system would in turn require management to adopt new practices and procedures in the manner of identifying and collecting stamp duty. In all, the additional measures currently being taken (including the audit of the operating company and some of the broker members) would increase Revenue's effectiveness in improving compliance.