

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 2.4, 2.5 and 2.8 to 2.10 refer to matters arising from this examination.

Revenue Collected

Revenue collected under its main headings in 2002 is shown in Table 2.1.

Table 2.1 Revenue Collected

	Gross Receipts €m	Repayments €m	Net Receipts €m	2001 Net Receipts €m
Income Tax	10,983	2,004	8,979	9,318
Value Added Tax	11,375	2,531	8,844	7,907
Excise	4,734	139	4,595	4,213
Corporation Tax	5,129	325	4,804	4,144
Stamps	1,177	38	1,139	1,223
Customs	154	20	134	165
Capital Acquisitions Tax	157	7	150	168
Capital Gains Tax	636	17	619	876
Residential Property Tax	1	-	1	1
Total	34,346	5,081	29,265	28,015

Of the net receipts of €29,265m, a total of €167m was paid during 2002 under Section 3 of the Appropriation Act, 1999 from the proceeds of tobacco excise to the Vote for Health and Children. €29,283m was paid into the Exchequer which represented a prepayment of €316m. The amount prepaid at the end of 2001 was €131m. 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. From 2004, payments on account will be recorded and processed as tax receipts.

2.2 Tax Written Off

The Revenue Commissioners have furnished me with details of taxes written off during the year ended 31 December 2002. Details of the total amount written off and the distribution according to the grounds of write-off are shown in Table 2.2 and Table 2.3.

Table 2.2 Taxes Written Off

Tax	2002 €'000	2001 €'000
Value Added Tax	80,197	29,476
PAYE ⁹	42,657	12,790
Corporation Tax	6,094	11,270
Income Tax	23,707	68,092
Other Taxes	2,600	6,401
PRSI	22,843	12,263
Total	178,098	140,292

Table 2.3 Grounds of Write Off

Grounds of write-off	2002 No. of Cases	2002 €'000	2001 No. of Cases	2001 €'000
Liquidation/Receivership/Bankruptcy	360	31,137	382	26,942
Ceased trading – no assets	2,236	42,765	578	16,945
Deceased and Estate Insolvent	251	2,813	52	1,631
Uneconomic to pursue	152,543	75,047	35,173	82,552
Unfounded Liability	167	2,547	37	830
Cannot be traced / Outside Jurisdiction	510	7,427	117	4,096
Compassionate Grounds	234	2,185	70	1,545
Uncollectible due to financial circumstances of taxpayer	954	14,177	243	5,660
Examinership	—	—	2	91
Totals	157,255	178,098	36,654	140,292

The write off in 2002 included the write off on an automated basis of 145,797 cases totalling €51m in respect of VAT, PAYE, PRSI, Income Tax, Corporation Tax and Capital Gains Tax. 117,000 of these cases were from periods back to 1966 and the amounts involved were less than €100. The remaining cases were pre-1993 and no amount was greater than €32,000. 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. Its 2002 audit examined file papers and computer records for a sample of 153 cases, representing approximately 17% of the value of non-automated write offs. In addition, the computer files relating to each of the sixteen automated write off runs were examined to confirm that the authorised selection criteria were applied. The internal audit found no instance where tax was improperly written off under the current instructions, procedures and guidelines.

2.3 Outstanding Taxes and PRSI

Table 2.4 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 2003 - the latest date for which data was available at the time of finalising my Report. Table 2.5 sets out an aged analysis of the balance outstanding at 31 May 2003.

⁹ Includes some PRSI written off.

Table 2.4 Outstanding Taxes and Levies

Balance at 31 May 2002 €m	Tax or Levy	Charges/ Estimates Raised €m	Paid €m	Balance at 31 May 2003 €m	Estimate of amount likely to be collected €m
119	VAT (Declared Liabilities Net of Repayments)	8,322	8,315	126	101
207	VAT (Estimates)	53	54	206	166
169	PAYE (Declared Liabilities)	7,159	7,182	146	117
27	PAYE (Estimates)	747	759	15	12
198	PRSI (Declared Liabilities)	5,259	5,292	165	133
19	PRSI (Estimates)	464	472	11	8
443	Income Tax (Excluding PAYE)	1,511	1,627	327	263
-	DIRT	199	199	-	-
189	Corporation Tax	3,765	3,807	147	118
111	Capital Gains Tax	674	633	152	123
18	Capital Acquisitions Tax	158	157	19	13
8	Abolished Taxes	1	1	8	-
1,508	Total	28,312	28,498	1,322	1,054

Table 2.5 Aged Analysis of Debt at 31 May 2003

Tax	Total tax outstanding at 31 May 2003 €m	Amounts outstanding for 2002 €m	Amounts outstanding period for 30/4/01-31/12/01 €m	Due for periods 1990/91 to 2000/01 €m	Due for earlier periods €m
VAT	332	122	68	140	2
PAYE	161	67	23	65	6
PRSI	176	82	25	64	5
Income Tax	327	10	53	246	18
Corporation Tax	147	31	10	86	20
Capital Gains Tax	152	11	14	125	2
Capital Acquisitions Tax	19	1	1	17	-
Abolished Taxes	8	-	-	8	-
Total	1,322	324	194	751	53

The balance outstanding at 31 May 2003 of €1,322m is €186m less than at the same point in 2002. It is estimated by Revenue that €1,054m or 80 % of the total outstanding is likely to be eventually collected. This compares with an estimated collection ratio of 71% at May 2002. 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.

2.4 DIRT Investigations

There are two distinct aspects to Revenue activity in the area of DIRT investigations. The first relates to the Look-Back Audits of the operation of non-resident accounts by financial institutions which were completed in 2000. Following on from that investigation of the institutions, Revenue commenced a further investigation in 2001 that focused on the issue of the 'underlying tax' which may be due by individuals in respect of the funds deposited in the bogus non-resident accounts.

DIRT 'Look-Back' Audit of Financial Institutions

As a result of the original DIRT 'look-back' audit of 37 financial institutions completed in October 2000, a total of €220m was collected in tax, interest and penalties for the years of assessment 1986/87 to 1998/99. Further audits were finalised in 2002 at 10 of those financial institutions in respect of the later tax years of 1999/00 and 2000/01 which resulted in an overall yield of just over €1m.¹⁰ In 2001, DIRT 'look-back' audits resulting in an overall 'nil' yield were carried out on 47 other financial institutions, none of which had a retail branch network.

Underlying Tax on Bogus Non-Resident Accounts

The approach adopted by Revenue to the issue of moneys deposited in bogus non-resident accounts which may not have been declared for tax purposes involved setting a deadline of 15 November 2001 for depositors to make a voluntary disclosure and pay tax, interest and penalties. Under the 'voluntary disclosure' scheme, interest and penalty charges were capped at 100% of the tax due, a credit was allowed for DIRT paid by the depositor's bank, prosecutions would not be taken and settlement details would not be published. 3,675 bogus account holders availed of voluntary disclosure and paid €227m in respect of 8,380 accounts. Of these, 599 account holders declared a nil liability. All returns were checked by tax districts for basic eligibility. 30 cases were deemed ineligible as they were already under enquiry or came within the scope of the Ansbacher enquiry or other tribunals of investigation. The underlying tax project team selected 140 cases randomly for liability review by tax districts. Tax districts selected a further 115 cases based on risk. A nationwide report of the eligibility assessment and liability review has not yet been completed. I have carried out some audit work on the voluntary disclosure phase and my examination will be completed when the overall Revenue check on this first phase of the DIRT underlying tax project is finalised.

In February 2002, investigations commenced into the bogus non-resident account holders that had been identified in the look-back audits of financial institutions and who had failed to avail of the voluntary disclosure scheme. Details on 1,800 cases were passed to tax districts for investigation in March and August 2002. Information on non-resident account holders was sought from 26 deposit takers on foot of High Court orders¹¹. The information received under the orders was examined and enquiry letters were issued to 30,000 individuals in October 2002. Those who cooperated were liable to full penalties and interest and publication of the settlement but would not be prosecuted. Those who failed to respond to the enquiry letter are being examined for follow up and some are under investigation with a view to prosecution. A further 90,000 enquiry letters (see Table 2.6) have issued as information under the court orders is received and examined.

Table 2.6 Underlying Tax Enquiry - Letters Issued

Date	Number of Account Holders	Number of Accounts
October 2002	30,000	13,500
January 2003	40,000	21,500
May 2003	10,000	6,000
July 2003	40,000	20,000

€220m has been received to-date from bogus non-resident account holders who failed to avail of the voluntary disclosure scheme. Information is continuing to be received as a result of the court orders and it is expected that investigations will continue for several years.

¹⁰ Total Yield €1,030,800 – DIRT €848,900, Statutory Interest €171,800 and Penalties €10,100.

¹¹ The High Court orders were obtained under Section 908 of the Taxes Consolidation Act 1997 as amended by the Finance Act 1999.

2.5 Understatement of DIRT Liability

Arising from an examination by my staff in September 2001 of Revenue's DIRT Look-Back audits of financial institutions, I enquired at the time about the nature and extent of the Revenue audit carried out in a particular financial institution. In reply, the then Accounting Officer outlined the justification for the type of audit undertaken and affirmed that Revenue staff were fully satisfied that the 400 non-resident accounts examined were authentic and belonged to genuine non-residents. He stated that the financial institution in question had produced evidence in relation to the genuine non-resident status of the sampled cases to the Revenue team, including those accounts where there were declaration deficiencies. As a result of that Revenue audit, the Revenue report on the DIRT Look-Back audits to the Committee of Public Accounts had concluded that no amount of tax was due from the financial institution in question.

It was subsequently noted in June 2003 during a review by my staff of the pre-15 November 2001 "voluntary disclosure" phase of Revenue's pursuit of the underlying tax due in respect of funds deposited in bogus non-resident accounts that declarations were received from 62 persons which admitted to a total of 230 bogus non-resident accounts of which 102 were stated to be held in the financial institution in question. The payments to Revenue which accompanied the 62 declarations totalled €8.7m.

In regard to the reconciliation of Look-Back Audit information with the bogus non-resident declarations received, it was also noted that:

- The 62 voluntary disclosures included five individuals who had their accounts examined during the Look-Back Audit
- A listing of all non-resident accounts held with the financial institution as at October 1998 was supplied by the financial institution to Revenue at the time of the Look-Back Audit. The audit sample was selected from this list. Excluding the five selected in the sample, the list only included a further eight of the 62 individuals who subsequently made voluntary disclosures.

As this information raised renewed concerns about the quality of the Revenue Look-Back audit in the financial institution in question and the possible implications for the Look-Back audits generally I sought the views of the Accounting Officer.

He informed me that officers from the Underlying Tax Project office met with representatives from the financial institution on the 12 February 2002 to discuss the implications for the institution and its customers, of the application for a High Court Order under Section 908 Taxes Consolidation Act, 1997. The fact that some of its customers had come forward during the 15 November 2001 incentive scheme and disclosed bogus non-resident accounts, which they held with the financial institution was also made known to them. The Order was obtained in March 2003 and the financial institution is supplying information on foot of it on a phased basis over the period 30 June 2003 to 31 October 2003.

Until all of this information is received and reviewed, it will not be possible to form a clear view on the reliability of the DIRT Look Back Audit findings for the financial institution in regard to DIRT and the related interest and penalties.

As regards the wider implications for the Look-Back audits he stated that the methodology used in the course of the particular audit was based on the special circumstances encountered in the financial institution – no previous reclassification or redesignation exercise, no internal or external auditor evidence of bogusness, an October 1998 sample date and post 1994 growth in retail banking involvement. He also stated that there was no evidence at this point to suggest that the issues that arise in relation to the financial institution have implications in relation to any other DIRT Look Back audit settlements.

2.6 Special Investigations

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 June 2003, settlements were reached in 373 cases totalling €40m including interest and penalties of €22m. Of these cases, 97 were settled with no liability. In addition, payments on account totalling €5m have been received in respect of other unresolved cases. Payments totalling €1m in respect of Capital Gains Tax have been received in 52 cases where National Irish Bank paid compensation to the investor.

Three cases have been prosecuted. In two of these the defendants pleaded guilty, one was fined €1,750 in the District Court and the other was fined €6,000 in the Circuit Court. Both cases settled their tax liabilities for €882,610 and €804,592 respectively, these figures are included in the overall settlement figures. In the case of the defendant who settled his liability for €882,610 an additional €767,898 settlement was received from his company as a result of the same investigation. In the third case the defendant also pleaded guilty and received a suspended sentence subject to the taxpayer being fully compliant for the next five years. The taxpayer settled his liability for €448,827. One other case is being investigated with a view to prosecution.

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. None of these cases have been finalised to date.

Ansbacher (Cayman) Limited

A special project team 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. There are 289 cases comprising 179 cases on the High Court Inspectors' Report and 110 similar cases discovered by Revenue or listed on the Authorised Officer's Report. Taking account of spouses and connected companies, these cases consist of 300 names. The number of connected entities in relation to cases under investigation is nearly 700.

To date, 44 cases have been settled including 25 cases named in the High Court Inspectors' report which are non-resident and covered by the provisions of Double Taxation Agreements and are regarded as closed. Settlements of €2.8m, including interest and penalties of €1.7m have been agreed in the other 19 cases settled. These 19 cases include five cases with no additional liability and two cases covered by the 1993 Amnesty provisions.

In addition, payments on account totalling €22m have been received to date in 64 cases as follows:

- €15m from 56 cases involving Ansbacher-type arrangements
- €7m from 8 cases involving offshore funds and deposits.

Revenue's application to the High Court to obtain unpublished documents gathered by the Inspectors was heard in November 2002. Judgment is expected shortly.

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 Flood (now 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 eighties or early nineties 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 the cases still under investigation.

Tribunals

Matters disclosed at the Moriarty and Flood (now Mahon) Tribunals that suggest that tax evasion may have occurred are being investigated as they come to notice and a considerable number have been looked at to date. Currently 17 cases are being investigated as a result of the Moriarty Tribunal. One case has been settled for €6,292,506 and a payment on account of €14,876 has been received in respect of one other case. Currently 22 cases are being investigated as a result of the Flood (now Mahon) Tribunal and payments on account of €17,572,640 have been received in respect of eight cases.

2.7 Prosecutions for Serious Tax Evasion

Under Revenue prosecution strategy, audit districts are required to 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 very resource intensive criminal investigation work which can take several years before reaching the Courts. Convictions were obtained in all 3 of the cases decided in Court in 2002.

- A cattle dealer/haulier was convicted of failing to submit Income Tax returns and was fined €3,000.
- An individual was convicted of delivering incorrect VAT returns and information. A six month prison sentence was imposed but was suspended on payment of a €12,000 fine.
- A house builder was convicted of delivering an incorrect Income Tax return and incorrect VAT returns. A fine of €2,540 was imposed.

Of a total of 27 cases on hands at the end of 2002, convictions have been obtained in five cases, 17 are still under investigation, bench warrants issued in two cases and three cases have been closed.

2.8 Prosecution of Non-filers of Income Tax Returns

Background

The self assessment system requires every chargeable person to submit a return of income, profits or gains for each chargeable period by a specified filing date. As the timely filing of properly completed returns is the bedrock of self assessment, it is Revenue policy to bring criminal prosecutions under Section 1078 of the Taxes Consolidation Act, 1997 against those who ignore their filing responsibilities. Non-filer prosecutions are taken by way of summary proceedings in the name of the Director of Public Prosecutions in the District Courts. Prosecutions in Dublin are taken by the Revenue Solicitor, while outside Dublin the State Solicitors perform this work.

In 1998 Revenue decided to substantially increase the number of cases being referred for criminal prosecution for non-filing offences. This decision was based on the view that criminal prosecution would be:

- The best method for obtaining outstanding returns
- A deterrent against future non-submission.

The prosecution results for Income Tax non-filers for the past six years, which indicate the growth in convictions from 1998, are summarised in Table 2.7 below.

Table 2.7 Results of Prosecution of Income Tax Non-Filers 1997 to 2002

	1997	1998	1999	2000	2001	2002
Warning letters (Rev. Solicitor)	1,917	5,450	5,399	6,457	9,818	9,348
Cases referred for issue of summons	853	1,968	2,369	1,951	2,401	1,839
Number of taxpayers convicted	223	659	1,159	936	1,050	972
Total Fines¹²	€0.2m	€0.9m	€1.5m	€0.9m	€1m	€1m

Objectives and Scope of the audit

The objective of the audit was to examine, in relation to Income Tax returns, the effectiveness of the prosecution approach

- As a method to ensure submission of outstanding returns
- As a deterrent against future non-submission.

The audit work included interviews, the issuing and review of questionnaires and the examination of internal reviews, correspondence and operational instructions. While Revenue has adopted various approaches to non-filers under other taxheads, these areas were not covered by this audit.

The role in the prosecution process of the central Compliance Policy Unit, four selected tax districts (Dublin, Cork, Letterkenny and Limerick) and the Revenue Solicitors Office was examined, together with recording and tracking databases in those offices. The reported results of the prosecution work in the four tax districts were reviewed and analysed.

An examination was also carried out on a sample of 99 Income Tax cases with 275 outstanding returns that were referred for prosecution by the four tax districts. The sample was selected on a generally random basis with the intention of achieving an even split between cases where convictions were actually obtained (in the event 56 fell into that category), and cases which did not reach that stage (43). Computer records, tax returns and correspondence relating to each case were examined and analysed.

The findings set out in the report reflect this approach to the audit, and fall into two sections that relate to:

- The general review of the operation and administration of the prosecution process both centrally and in the districts
- The more specific findings arising from the review of the sample of cases.

Operation of the Prosecution programme

A bulk issue of the standard income tax return form is made annually to all taxpayers required to make a return. Reminders are issued to those who fail to file a return by the due date i.e. 10 months following the end of the tax year. After a further 3 months, lists of cases with annual returns still outstanding are forwarded to tax districts for further investigation and, if necessary, prosecution.

¹² Includes fines for Corporation Tax.

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Table 2.8 provides details of the number of Income Tax return forms issued for the tax years 1999/00 and 2000/01, and of the number of cases with a return outstanding referred on to tax districts.

Table 2.8 Tax Return Forms Issues and Non-Return Cases Referred to Tax Districts

	1999/00		2000/01	
	General Issue of Income Tax Return Forms	Non-Filer Cases referred to Tax Districts ¹³	General Issue of Income Tax Return Forms	Non-Filer Cases referred to Tax Districts ¹³
All Areas	321,398	67,102	328,887	72,273
Dublin	72,434	16,846	75,942	22,412
Cork	40,129	7,845	40,719	8,410
Letterkenny	11,022	2,162	11,206	2,604
Limerick	27,290	6,033	29,494	6,510

Cases are categorised by the number of outstanding returns - most cases are persistent non-filers. The tax status of each case is checked on the Revenue databases prior to a visit and cases which should not be pursued are excluded. A programme of visits to assess the extent of tax at risk is organised for cases which have still failed to submit returns and are deemed possibly suitable for prosecution. A visit report is subsequently completed by the Field Officer with a final recommendation as to suitability for prosecution. Lists of cases deemed suitable for prosecution are forwarded by the tax districts to the Revenue Solicitor who then issues a 21 day warning letter to the non-filer. Cases that fail to respond to the warning letter are forwarded for summons. A separate summons is instituted for each outstanding return. Court times are arranged and summonses are served by the Gardaí. The Gardaí require at least 6 weeks to serve a summons. Each offence is liable to a fine of €1,900 (which can be mitigated by a maximum of 75%) and/or committal to prison for up to 12 months. The fine was increased to €3,000 by the 2003 Finance Act. A provision to allow Revenue to apply for a Court order compelling convicted defendants to submit the outstanding returns of income was included in the 1999 Finance Act. The powers available to Revenue in dealing with Court orders were further extended by the 2002 Finance Act which created an additional offence of non-compliance with the Court order, with the same fine or committal provisions as those for non-filing. Fines are collected by the Fines Office administered by the Department of Justice and paid over quarterly to the Revenue Commissioners. Revenue is obliged by law to publish details of convictions of non-filers.

While Table 2.8 indicated the annual flow of non-filing case referrals to the four tax districts under review, Table 2.9 details the disposal of that workload for 2001 and 2002, including by summons, conviction and Court order.

Table 2.9 Results of Prosecution Activity in Four Districts in 2001 and 2002

	Dublin		Cork		Letterkenny		Limerick	
	2001	2002	2001	2002	2001	2002	2001	2002
Warning Letters	992	802	717	553	366	361	835	688
Referred for issue of summons	448	320	380	344	155	186	92	174
Convictions	373	371	256	301 ¹⁴	112	99	88	64
Court orders	5	72	1	5	-	-	3	6
Returns submitted	4,182	3,471	3,564	2,436	1,120	519	3,399	2,534
No returns needed	3,562	2,977	461	619	101	30	393	719
Unsettled Cases	9,102	15,964	3,820	5,355	941	2,055	2,241	3,257
Total Caseload	16,846	22,412	7,845	8,410	2,162	2,604	6,033	6,510

¹³ The general issue relates to returns due for that year whereas cases referred to tax districts includes returns not submitted during the previous 5 years.

¹⁴ Includes 54 struck out cases.

An analysis of cases handled by Dublin tax district in 2002 revealed that nearly one third of referred cases were 'settled', with 15% submitting returns while the remainder were deemed not due to make returns. Within that figure, the rate of returns submitted ranged from 24% of those with only 1 outstanding return to as little as 4% for persistent non-filers. 4% of cases were referred for prosecution with the emphasis on persistent non-filers; half of those proceeded to summons stage.

Findings from General Review

Deterioration in Compliance Behaviour

There were indications of a hardcore of non-compliant individuals and their numbers have increased substantially in recent years:

- The number of cases referred to Dublin and Limerick tax districts increased by 60% in two years;
- While a prosecution can only be taken once for an outstanding return some individuals have several convictions for non-filing (one case had seven convictions). Up to 10% of those convicted are repeat offenders. The Dublin prosecution database had 891 (13%) cases with previous convictions, with the bulk coming from persistent non-filers. In 2002 Letterkenny fast tracked the prosecution process for 152 repeat offenders whose current returns were outstanding.

Revenue Response

Compliance trends show that timely filing rates are holding and for the most recent year have improved from 74% to 75%. This figure is significant in the context of the 2002 change to the calendar-year basis of return, which meant that taxpayers and their agents had to deal with two income tax returns in one year. Specific compliance programmes viewed in isolation may not provide the best yardstick by which to measure compliance trends. There are other strategies besides prosecution to encourage timely compliance. Late filers are subject to 10% tax surcharge and interest on late payment of tax due. More importantly, to minimise tax at risk Revenue may raise assessments to tax in the absence of a return and pursue the liability to enforcement if necessary.

System and Resources Under Pressure

The holding back of distributions to districts, the emphasis on the multiple non-filer, the extended period before issue of summons and the serious backlog in Dublin district and in the Revenue Solicitor's Office suggest a system under pressure to cope:

- The 2002 download of cases of outstanding returns was not distributed to tax districts until August of that year. There was insufficient time in the tax districts to work these cases and outdoor visits were reduced from previous years. The bulk of cases heard by the courts in 2002 were taken from the download for 2001
- The larger tax districts are unable to work the full download. Priority is given to categories of cases, mainly the persistent non-filers with returns outstanding for all 5 years. Due to the workload in Cork a distinction on the degree of suitability for prosecution is made following the outdoor visit with the result that some suitable cases are dropped from the programme. Cases which are excluded may be worked from future downloads
- The recommended interval of 4 weeks to referral for summons from the date of warning letter was generally followed by Limerick, Cork and Letterkenny while Dublin allowed up to 6 months to elapse prior to referral for summons. 1,050 Dublin cases referred for summons are held in the Revenue Solicitors Office. In consequence of that backlog, a further 1,382 cases are held in the tax district ready for summons

- Limerick tax district initiates their compliance programme with a telephone campaign followed by a warning letter from the district and then a visit for those who fail to submit returns. Other districts limit their telephone campaigns to agents.

Revenue Response

Technical developments taking place in Revenue's computerised taxpayer ledger system delayed the distribution of the 2002 download of non-filer cases to tax districts. By contrast the 2003 download was issued in March. Some tax districts did not work all 2002 cases because of the impending second return date in October. With regard to tackling non-filers at district level, it is not expected that all districts will do exactly the same thing. Districts are allowed to take account of local factors and to try different approaches if they feel this will achieve a better outcome.

Delays in Processing Cases

The maximum impact on the Non-Filer arises from a prompt and firm Revenue response to each outstanding return of income. That may not always be achieved:

- The prosecution process is lengthened in some cases by delays in serving summonses, arranging court times, and numerous adjournments to facilitate requests for more time to submit returns. The length of time from the warning letter to getting a case to court varies from 3 months to over 2 years;
- Up to 2001 the annual 'download' extracted cases which had outstanding returns in any of the previous 5 years. In 2002 the application of a different programme identified and downloaded additional cases outstanding for more than 5 years and up to 10 years. In effect, prior to 2002, these latter 'hard' cases were not included in the compliance and prosecution programme. Dublin received 400 such cases. Revenue have pointed out that these cases were previously subject to the debt management programme, which pursued both the tax due and the return.

Court Hearings

The course of the hearings in Court does not always run smoothly from the Revenue viewpoint. Instances include mitigation and a high level of adjournments.

- Judges generally mitigate fines by or near the maximum limit of 75% when returns have been filed. The level of mitigation varies from court to court. In some courts fines were mitigated even though the returns were not filed. Other courts impose maximum fines in cases where the defendant fails to attend or submit outstanding returns. In other instances the benefit of mitigation was applied to repeat offenders. Revenue estimate that the average level of mitigation of fines is 62%.
- Finalisation of cases is delayed by the high level of adjournments allowed by the Courts. There are many instances of cases with up to 5 or 6 adjournments. Revenue estimate that 37% of all cases brought to court were granted adjournments.
- In cases of individuals with several offences before the Court, Revenue withdraw 50% of charges when returns are submitted in time for the court hearing and the defendant is in attendance. Only one charge is pursued in hardship cases. Judges have expressed reservations about convicting individuals who have filed returns.
- Prosecution costs are awarded by some Courts to the State Solicitor. There is no evidence of subsequent transfer of costs to Revenue even though State Solicitors are remunerated by the State for this work. Revenue is not opposed to State Solicitors seeking costs provided such costs are transferred to Revenue on behalf of the DPP. However, Revenue have pointed out that neither the DPP nor Revenue have any contractual relationship presently with the State Solicitors whose contracts are with the Chief State Solicitor.

Fines and Court Orders

The tasks following conviction are fine collection and, in cases where the defendant has not already submitted returns, obtaining and enforcing an order of the Court for all outstanding returns of income. Performance is less than satisfactory in both areas:

- The collection of fines imposed by the courts is not monitored by Revenue. The quarterly payover from the Fines Office does not provide a breakdown by case. A comparison of fines received by Revenue with fines imposed by the courts indicates that one third are not collected. There is little point in having fines imposed by the courts if there is no follow-up to ensure the fines are paid. Revenue has pointed out that the collection of fines is a matter for the Court Service.
- Instructions to State Solicitors to apply for court orders in respect of outstanding returns did not issue from the Revenue Solicitor until 15 months after the provision became law in the 1999 Finance Act.
- There is a lack of consistency in the approach adopted to the use of court orders. In Dublin and Limerick, court orders are sought in all cases where returns are not submitted on conviction. In Cork, court orders are sought in larger cases and/or cases with previous convictions where despite the conviction returns remain outstanding. In these cases following the application of the State Solicitor the decision on the imposition of fines is deferred to an adjourned court hearing as an encouragement to the defendant to influence the level of fines through the submission of the returns. In Letterkenny, court orders have not been sought but will be sought where it is deemed appropriate.
- In all, 31 court orders were obtained nationally in 2000 while a further 40 were obtained in 2001. 19 non filers in Dublin and 14 in Cork have failed to comply with court orders.
- As at June 2003 the offence of non-compliance with court orders, created in March 2002, has not been utilised by Revenue in any case to-date.

Revenue Response

The Revenue Solicitor's Office is in the process of advising State Solicitors to actively pursue appropriate cases to prosecution for failure to obey the court order to file the outstanding return.

Audit of Non-Filer Cases

The selection of cases for criminal prosecution for failure to file returns follows the refusal of the taxpayer to respond to Revenue contacts, and a case review and visit to establish the likelihood of a reasonable level of tax at risk. It would be expected that such cases would receive strong consideration for selection for audit. The extent to which such cases are audited is unclear:

- Dublin referred 20 cases to Dublin audit districts in 2002 as specifically suitable for audit. Dublin also forwards all late returns received from prosecution cases to audit with a recommendation that they be included in the next screening programme for audit selection. Cork forwarded 21 cases and Limerick forwarded 14 cases in 2002 as suitable for audit. There was no feedback on any cases referred to audit.
- Letterkenny do not forward returns obtained through the prosecution programme to audit.

Revenue Response

It does not follow that a case considered suitable for prosecution is necessarily suitable for audit. In many cases it may be more efficient to deal with risk to Revenue through the assessment and debt management programmes. However, all late filers are included as part of the screening programme used to select cases for audit. Cases are selected for audit purposes by tax districts, including Letterkenny, based on risk assessment criteria. The Revenue audit programme selects some 200 non-filers for audit each year. A

computerised risk analysis system currently being developed is likely to bring more convergence to the prosecution and audit selection criteria.

Findings from Audit Sample

The results of the examination of a sample of 99 cases with 275 outstanding returns which were referred by the four selected districts for prosecution are analysed in this section. Features noted include the difficulty of obtaining returns in all cases even following conviction by the Court, the extent to which those who had been pursued by legal means for outstanding returns again failed to file a return for the current year, and the surprisingly low level of tax liability which was accepted without audit in respect of many of the cases which had gone to such lengths to avoid making a return of income.

Returns Obtained

Of the 99 cases, 79 submitted the outstanding returns, returns were not needed in 8 cases and 12 were still not resolved at 30 June 2003. In 5 of the unresolved cases returns have not been made despite a court order. Of 79 cases which ultimately submitted outstanding returns due to the prosecution programme, 33 have again not submitted returns for the most recent year – 2001.

Assessment and Collection of Tax Due

An analysis of the liabilities set out in 194 returns received from the 79 recalcitrant filers is shown in Table 2.10 and indicates that 50% of returns had a declared tax liability of less than €500 for the year under review. That the individuals appeared to require Revenue to utilise the full extent of its compliance procedures to establish that fact must raise questions as to the completeness of such returns. Revenue initiated an audit of the returns of two of the recalcitrant filer cases. Notwithstanding the extent of the delay in making a return and payment, computer files did not record interest charges in any cases. The self assessed amounts due totalled €371,615 but €63,134 remains unpaid by 21 individuals. The Field Officer report on outdoor visits generally did not record an assessment of the materiality of tax liabilities.

Table 2.10 Tax Liabilities Declared on Non-Filer Returns of Income Obtained under the Prosecution Programme

Total Tax Liability Declared	No. of Returns	% of Returns
Nil	55	28
€1 - €500	43	22
€501 – €2,000	49	25
€2,001 – €5,000	25	13
€5,001 – €10,000	15	8
Over €10,000	7	4
Total	194	100

The business status of the self-employed individuals whose returns are included in Table 2.10 covered a wide range of occupations including company directors, accountants, small manufacturers, publicans, builders, farmers, tradesmen, taxi drivers and hairdressers.

Revenue Response

Officers are instructed to make every effort to determine and record customers' circumstances as well as their general disposition towards compliance and capacity to pay. A reminder drawing compliance officers' attention to these instructions is being prepared. Comprehensive audits are ongoing in 2 of the sampled cases. Interest was charged on four late filers and collected from one to date. There have also been two VAT and one Relevant Contracts Tax audit relating to taxpayers in the sample.

Pre-Prosecution Activity

Analysis of the sample indicated the time intervals which elapse at the different stages of the process, and the extent to which cases can be resolved before a Court hearing

- The time intervals which elapsed between outdoor visits and issue of the 21 day warning letter were
 - Dublin 3 – 12 months
 - Cork 4 – 6 months
- The time intervals from issue of the warning letter to referral for summons were
 - Dublin 6 – 12 months
 - Cork 5 – 6 weeks
 - Letterkenny 2 – 3 months
 - Limerick 2 – 3 months
- 37 of the sampled cases were settled and not brought to court, of which 27 were settled without the necessity for referral for summons.

Prosecutions and Convictions

The sample confirmed the findings of the general review in relation to number of charges, repeat offenders, mitigation of fines, and multiple adjournments. It also raises a question as to whether all convictions in the sample were published.

- Seven cases had previous convictions.
- Fines were mitigated in all but 3 of the 56 convictions.
- Of the 20 Dublin cases sampled, adjournments ranging from 1 to 6 occasions were noted in 10 cases.
- A sample of 15 convicted Dublin cases were checked to the published quarterly list of defaulters. However, 8 of the cases could not be traced.

Conclusions

In its Annual Report for 2002 Revenue notes that as a result of a major project to introduce the Pay and File procedure, together with coordination with tax practitioners and An Post and a public information campaign, 80% of the 2001 returns issued had been returned within a few weeks of the due date together with €1.7bn. The focus of this report was on a later phase of compliance activity when cases which had failed to respond to the promptings of the central compliance programme are distributed to tax districts for local investigation and, in particular, the use of the prosecution option to ensure that a return is finally filed. Dealing on a case-by-case basis with a hard core of cases for which prosecution is considered the only suitable method of obtaining a return of income is in strong contrast with the annual high profile compliance campaign. Equally the final tax yield will be insignificant in comparison, and the overheads will be greater. However that phase is of equal importance as it ensures that the equity of the income tax system is preserved, and ultimately that the success of the mainstream tax system is maintained.

For these reasons, Revenue has increased the use of prosecution as a method of obtaining outstanding returns and the results of the revised approach can be seen from the annual statistics of convictions of non-filers which show an increase from just over 200 in 1997 to an average of over 1,000 per annum in the period 1999-2002. In addition there have been two amendments to the law to strengthen the power of Revenue to obtain the outstanding return as well as a fine in conviction cases. However the audit findings raise the question as to whether the policy as implemented is achieving its maximum impact.

The system would appear to be under pressure to meet the demands of full implementation of the non-filer prosecution policy as indicated by:

- The late distribution of 2002 cases to districts, the focus on the persistent non-filer as opposed to hitting all initial instances, and the large backlogs in Dublin district and with the Revenue Solicitor
- The length of time from warning letter stage to getting the case into court can be up to two years

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- Instructions to State Solicitors to apply for Court orders for returns of income did not issue until fifteen months after the provision became law under the 1999 Finance Act
- Lack of consistency between districts in the approach adopted to the use of such Court orders
- The offence of non-compliance with Court orders, created by the 2002 Finance Act has not been implemented to date.

A review may be necessary to establish how the various bottlenecks can be addressed in order to ensure that the prospective non-filer can have a strong expectation of being subject to an early firm response for each offence.

While the annual number of convictions and the imposition of over €1m in fines undoubtedly makes a significant contribution towards improved compliance levels, a closer examination gives rise to concern that the overall impact at case level is not as clear cut as might have been expected. There were inconclusive outcomes to many prosecution cases:

- One third of the total fines imposed may not be collected
- Returns remain outstanding in all of the five cases in the audit sample where Court orders had been obtained
- The tax due remained unpaid in 25% of a sample of 79 cases in which returns had been obtained as a result of prosecution activity
- Only seven cases from a sample of fifteen convicted cases were traced to the published quarterly list of defaulters.

Only full implementation of available penalties including the enforcement of court orders will change the behaviour of persistent non-filers. This is confirmed by data from the report indicating that at present up to 10% of those convicted are repeat offenders, and that of a sample of 79 cases settled through prosecution activity returns for the latest year are outstanding in 33 cases.

194 returns were submitted in 79 cases only after an extensive compliance effort by Revenue, and a commensurate degree of reluctance on the part of the taxpayer. It was noted however that 50% of these returns declared annual tax liabilities of less than €500. Most of the 194 returns were accepted by Revenue without audit.

In general, the prosecution of non-filers is established as an effective method for extracting returns and is a vital part of the compliance programme. The shortcomings identified, when addressed, should improve the effectiveness of an extensive and costly but very necessary process.

Revenue Response

Compliance levels for the most recent year, as they relate to timely filing, continue to improve with 75% of all returns received on the due date rising to 80% within a few weeks. Initiatives to assist taxpayers through electronic filing via Revenue Online Service (ROS), streamlining of processes, the introduction of the calendar year basis of return and Pay and File in 2002 will facilitate improvement in this area.

Revenue's programme of prosecution of non-filers is one of the measures used to address taxpayers who fail to meet their obligation to file a return. As can be seen from analysis provided in the report at Table 2.9, a percentage of cases with an outstanding return will, on examination, be reclassified as no return needed. This may arise where an individual has ceased to operate a business, moved into PAYE employment or the source of income giving rise to the return e.g. investments rental income, no longer exists.

The remaining hard core of cases who fail to lodge a return are pursued through criminal prosecution by Revenue. Notwithstanding the success of the prosecution of non-filers programme in securing outstanding returns, prosecution has done little to change behaviour amongst hard-core non-filers. The Revenue response throughout this report highlights how Revenue will target such cases using improved audit selection, greater knowledge of the taxpayer and their business through “whole case management” which will lead to the raising of accurate assessments which will be pursued through the debt management programmes to enforcement where necessary. Furthermore this whole case management approach will be fundamental to addressing the relationship between returns compliance and audit as raised by the report.

The shortcoming highlighted in the report relating to the timeliness of non-filers programmes and backlogs throughout 2002 have been addressed by Revenue in detail. 2002 was an atypical year given that:

- The change from the tax year basis to the calendar year meant that uniquely two tax returns were due in 2002 at end January and end October respectively.
- IT developments used to extract cases for the year 2002 led to a more comprehensive but later issue of cases to the tax districts i.e. August 2002 as opposed to May/June 2001 for the previous years returns.

As part of the Revenue’s current development of a New Compliance Strategy all operations will be reviewed with a view to ensuring that the most efficient and effective systems are in place so as to maximise the use of resources towards targeting the non-compliant. The main findings of an internal Revenue review of non-filers prosecutions, taken by way of summary conviction, were:

- The threat of criminal prosecution, i.e. the Revenue Solicitor’s pre prosecution warning letter, has a success rate of some 70% in securing outstanding returns but there is little evidence that it changes future compliance behaviour for the better.
- Criminal prosecution is -
 - a slow process,
 - reasonably, though not 100%, effective in securing outstanding tax returns,
 - not effective in changing future returns compliance behaviour in all cases.

Amongst other recommendations the review concluded that the threat of prosecution is a useful tool in securing outstanding returns and should continue as one of the compliance options for dealing with non-filers.

Issues relating to the pursuit of outstanding fines, court adjournments and mitigation of penalties, even in the case of repeat offenders, remain a matter for the Courts. The Revenue Solicitor’s office is in the process of advising State Solicitors to actively pursue appropriate cases to prosecution for failure to obey the court order to file the outstanding return.

2.9 Random Audit

Background

Self-Assessment

Since 1988, Revenue has increasingly used systems of self-assessment as a means of administering the various taxes and duties. In essence, such a system places the onus on taxpayers to file returns and pay taxes correctly and on time without any prompting from Revenue. The corollary of this from Revenue’s point of view is that returns are processed and assessments made on a non-judgmental basis. While it is a feature of a self-assessment system that the majority of returns are accepted by Revenue with limited or no checking being carried out, a key control in such a system is the detailed checking of selected returns by

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means of Revenue audits. Revenue's programme of audits of selected taxpayers is central to its efforts to deter tax evasion and maximise compliance with tax law.

Revenue audits in relation to income tax, corporation tax, capital gains tax and value added tax can range from desk checking specific aspects of a tax return to comprehensive audits where all aspects of tax returns for all taxes are examined during a visit to the taxpayer's premises. The length of time taken to complete the audit depends both on the type of audit carried out and the nature and size of the taxpayer's business. Table 2.11 sets out, for each of the last five years, the number and type of audits completed under Revenue's main audit programme. Audit activity in a year is not confined to audits completed. At any point in time a large number of audits are at varying stages of the audit process. In addition to audits under the main audit programme, audits are also carried out as a result of special investigations, anti avoidance schemes and in relation to other taxes and duties such as Capital Acquisitions Tax and Customs and Excise.

Table 2.11 Audits Completed 1998 to 2002

	Number of Audits Completed				
	2002	2001	2000	1999	1998
Comprehensive	2,424	2,200	2,270	2,512	2,844
VAT	4,300	4,223	4,409	5,101	6,886
PAYE Employers	862	1,443	2,104	2,768	2,824
RCT	169	383	352	384	261
Combined Fiduciary	582	626	670	892	735
Verification	7,594	7,107	6,126	5,248	4,314
Total	15,931	15,982	15,931	16,905	17,864

Principles and Code of Practice

Revenue's audit programme is an important part of its strategy for deterring and detecting evasion and maximising compliance with tax laws. The principles underpinning the conduct of Revenue audits are set out in the "Code of Practice for Revenue Auditors", a revised version of which was published in August 2002. The revised Code defines a Revenue audit as an examination of:

- A return of Income Tax (including DIRT and other fiduciary taxes), Corporation Tax, Capital Gains Tax or Capital Acquisitions Tax (either in whole or in part)
- A declaration of liability or a repayment claim, for VAT, PAYE/PRSI or Relevant Contracts Tax
- A statement of liability to Stamp Duties.

It may also include an examination of an individual's or a company's books, records and tax obligations so as to establish the correct level of liability, and collect arrears of tax. The Code guides Revenue auditors on how audits should be conducted. It outlines taxpayers' rights and addresses issues such as location of audits, access to taxpayers' records, periods to be audited, review procedures, audit settlements, penalties and disclosures by the taxpayer.

Objectives and Scope of this Audit

The majority of audits are selected from cases with identified tax at risk. A proportion of audits are, however, selected at random each year. The objective of this examination was to review Revenue's programme of random audits. It specifically set out to

- Establish the objectives set for the random audit programme and their measurement, monitoring and achievement
- Establish the extent to which the results from random audits can be used to assess the level of compliance in the tax system generally

- Examine Revenue's approach to random audits including selection, process, finalisation and review of audits.

Documentation was reviewed and discussions were held with the Audit Policy Branch of the Operations Policy and Evaluation Division. The database of completed audits maintained by that Branch was also examined. Discussions were held with Statistics Branch of the Revenue Commissioners on how random audits were selected. The random audit process was examined in three tax districts by means of discussions with District Inspectors, Audit Managers and individual Inspectors as well as examination of a sample of completed audit cases.

Revenue Audit System

General Objectives and Targets

Over the period 2001 to 2003 Revenue sought to develop its audit and investigation programmes by increasing the use of risk analysis techniques. The introduction of a computer based risk assessment and case selection system for audit and investigation was identified as a means of achieving this. Revenue's latest Statement of Strategy (2003 – 2005) re-asserts the importance of a risk based audit programme to achieving its goal of maximising compliance with tax legislation.

The overall objective of the audit programme is to ensure maximum compliance with relevant legislation. Revenue's annual business plans set targets for the audit programme in terms of the number of audits to be completed and expected yield. Targets compiled by each district underpin these overall targets.

Selection of Cases for Audit

At present, Revenue's risk based approach to the selection of audits involves:

- Screening of taxpayers' returns
- Intelligence gathering by each tax district
- Knowledge of industry practices affecting tax at risk
- Extracting information from Revenue records such as returns compliance and payment patterns
- Interaction with other areas of Revenue such as Revenue Mobile Service and Customs Audit Units
- Sectoral projects
- Cases previously audited.

The Steering Group on the Review of the Office of the Revenue Commissioners (2000) recommended that case selection for audit be based on computerised risk assessment procedures and that all relevant information available to Revenue be fully exploited to inform the selection. In 2001, Revenue sought information by way of a Request for Information (RFI) on how it might develop more sophisticated approaches to risk assessment for selection of cases for audit. The responses to the RFI were reviewed and evaluated and it was decided that tenders should be sought for a 'rules based' solution to risk analysis. In 2002, contractors were appointed to provide such a system for audit and investigation as well as an associated system to support Revenue's management information requirements in the area.

The risk analysis software was commissioned in March 2003 and the process of implementing a risk based approach to Revenue audit has commenced. A team is training in the use of the software and is collecting and formalising rules for the system. Tools for selecting cases and for facilitating auditors in managing their caseloads are also in development. It is intended to run a pilot programme in October 2003 but the first major programme will be in the first quarter of 2004 when Income Tax and Corporation Tax risk

profiles will be prepared. An important factor in when this risk analysis program is run will be the capture of certain data, such as financial accounts information, from the 2002 tax returns when submitted.

The objective of the risk analysis program is to analyse taxpayers across a number of profiles by applying 'rules' to all data available. Taxpayers will then be scored with regard to their risk to Revenue: i.e. evasion, non-payment, failure to file returns, etc. Revenue sees the benefits of this approach as enabling them:

- To highlight cases with most risk
- To anticipate cases which are becoming a risk
- To target risk cases in a timely fashion
- To free resources to tackle evasion by switching to electronic analysis
- To demonstrate the fair application of processes across the entire taxpayer base as for the first time all taxpayers will be screened
- To minimise contact with the compliant taxpayer by identifying risky cases.

A key part of the process will be the feedback cycle. In its first iteration, the risk analysis system will be driven by rules collected from auditors which will be tested by the rules team and validated by an expert group. However, this is a subjective process. When the profiles generated are used on audit and the results analysed, the rules will be reviewed and re-written or dropped as deemed necessary. While Revenue are reasonably confident that the new system will produce results from commencement, there is a possibility that the full potential of the new system will not be realised until it incorporates any amendments which may be deemed necessary as a result of the testing of the rules in a live environment.

Audit Results

Table 2.11 set out the number of audits completed for the last five years under Revenue's main audit programme. Table 2.12 below shows for the last three years the targets set in Revenue's Business Plans and the actual outturn for audit activity. The average yield and the percentage of audits where the yield is nil are also shown for each category. In each of the last three years, the target yield from audits has been exceeded even though the target number of audits was reached only in 2002. The large increase in the number of verification audits in 2002 and to a lesser extent in 2001 and the very significant yield from those audits is related to a particular focus on taxpayers exercising share options. As can be seen from the table, the comprehensive audit programme seems to be more successful than the other audit programmes in terms of targeting tax at risk. The average yield per comprehensive audit, rising from €30,387 in 2000 to €36,542 in 2002, is considerably higher than the average yield in any of the other audit programmes or the overall average yield for the audit programme as a whole. Also, the percentage of comprehensive audits which produce nil yields (between 34% and 39% over the three years) is lower than for the other audit programmes. The relative success of the comprehensive audit programme is hardly surprising given that the majority of audit resources are devoted to comprehensive audits and that such audits examine all taxes and are therefore more detailed and in general take longer to complete. Nevertheless, Revenue should consider what factors are contributing to the better return from comprehensive audits. Possible factors could include better risk selection procedures, more detailed examination during the audit and greater use of more experienced auditors on such audits. Revenue has stated that the new computerised risk analysis system will focus the audit resources more effectively on cases with more risk and may result in a change in the balance between comprehensive and fiduciary audit programmes.

Table 2.12 Audit Results 2000 to 2002

	Target Number	Actual Number	Target Yield	Actual Yield	Average Actual Yield	% with Nil Yield
2000						
Comprehensive	2,587	2,270	€56m	€68m	€30,387	34%
VAT	5,218	4,409	€34m	€35m	€7,955	58%
PAYE	2,205	2,104	€14m	€12m	€5,721	63%
RCT	270	352	€5m	€2m	€4,767	49%
Combined Fiduciary	677	670	€2m	€6m	€8,846	50%
Verification	5,543	6,126	€5m	€10m	€1,633	
Total	16,500	15,931	€116m	€133m	€8,392	53%
2001						
Comprehensive	2,916	2,200	€57m	€74m	€33,792	37%
VAT	4,843	4,223	€32m	€61m	€14,490	55%
PAYE	2,016	1,443	€13m	€10m	€7,138	62%
RCT	429	383	€3m	€3m	€7,726	58%
Combined Fiduciary	917	626	€6m	€12m	€18,834	42%
Verification	5,450	7,107	€11m	€37m	€5,206	
Total	16,571	15,982	€122m	€197m	€12,363	51%
2002						
Comprehensive	3,000	2,424	€67m	€89m	€36,542	39%
VAT	5,510	4,300	€50m	€61m	€14,207	58%
PAYE	1,248	862	€7m	€6m	€7,320	52%
RCT	560	169	€3m	€2m	€10,296	50%
Combined Fiduciary	901	582	€10m	€10m	€16,993	42%
Verification	3,000	7,594	€14m	€88m	€11,650	
Total	14,219	15,931	€151m	€256m	€16,074	51%

In the current programmes it is not considered unusual that the returns from the comprehensive programme exceed the returns from the single taxhead and joint fiduciary programmes, bearing in mind the screening process for the comprehensive programme, the time and resources involved in it and the method of case selection. Revenue has indicated that many cases, particularly in the VAT programme, are selected to check repayment claims. This policy, in particular, will be reviewed when the risk analysis system is operational. Revenue has also pointed out that the extensive training programme for new auditors results in a significant number of single taxhead audits being selected initially for new trainees.

Random Audits

Each year a number of comprehensive, VAT and PAYE/PRSI audits are carried out for cases which have been selected at random from those taxpayers who have submitted returns. The purpose of the random audit programme is to maintain and improve levels of voluntary compliance by giving all taxpayers at least some chance of being selected for audit and to create among the taxpaying public the perception of Revenue as active within all sectors and at all levels of economic activity. Random audits are conducted in the same manner as targeted audits and the principles as set out in the Code of Practice apply equally to random audits.

Selection of Cases

Each year the Statistics Branch of Revenue selects a random sample of cases for possible audit. Generally, a specified number of cases are selected for each Tax District and therefore the selection is not random across the entire taxpayer base but only within each district. This was considered an appropriate method of ensuring that each district partook in the programme. It ensured a wide geographic and sectoral spread of random cases. The central selection of cases ensured that the district had no input into the selection of cases. The cases are selected from those taxpayers who have submitted returns for the most recent tax year. Up to 1998 the random audit programme was applied to comprehensive audits only. The objective was that 2% of comprehensive audits undertaken would be selected at random. In 1998, random audits were extended to the VAT and PAYE/PRSI audits with the 2% target remaining in place. In 1999, the selection criteria were further refined so that only cases where the aggregate income was less than €127,000 were included. The reason stated for this was that larger cases would be subject to regular screening and would be selected for audit if necessary but the exclusion has resulted in the selection being less random.

For 2001, it was decided to increase the number of random audits to 6% of total audits which would mean about 1,000 audits would be selected randomly. As random selection up to 2001 had produced many very low income cases due to the high number of such registered taxpayers, it was decided to select cases using parameters for income levels. These parameters were set to make more effective use of the skilled audit resources available. The selection criteria for 2001 were therefore:

- For Corporation Tax, 20 cases were selected for each district from those companies who were showing profits on their latest tax return
- For Income Tax
 - 20 cases for each district where income did not exceed €25,395
 - 20 cases for each district where income was greater than €25,395 but less than €1.27m
 - 20 cases for proprietary directors
- For PAYE/PRSI, 10 cases per district
- For VAT, 10 cases per district.

For each year, the Audit Policy Branch of the Operations Policy and Evaluation Division allocates cases to districts from those selected by the Statistics Branch using the current criteria in order to achieve the desired number of audits. For 2002, cases allocated to each district were to be screened by the district and the tax at risk under each taxhead identified. One half of the cases were to be audited on the basis for which they were selected and the other half were to be audited on the basis of perceived tax at risk from the screening process i.e. if the screening of the tax at risk of a case selected for comprehensive audit indicated that VAT was the tax at risk then a VAT audit would be carried out rather than a comprehensive audit.

The policy of selecting cases based on income levels has not been repeated for 2003. Instead a specific number of cases were selected at random for each District (1,000 nationally) and these were to be thoroughly screened by each district. The intention was that as a result of the screening a total of 500 cases would be selected for audit (250 for comprehensive audit and 250 for fiduciary taxes audits). The objective was that the screening would reduce the number that were producing a nil yield thereby reducing the amount of unproductive work for Revenue and the associated cost to the taxpayer. These were some of the concerns that district managers and Revenue staff associations had expressed in relation to random audits. A further consideration was the necessity to free up resources to deal with the DIRT Bogus Non Resident programme. The effect of this will also be to reduce the level of random audits to approximately 3% of all audits.

These amendments to the selection of random audits each year indicate that Revenue are reviewing and adjusting the programme. However, with each adjustment the selection moves further away from being random. The focus has shifted from selecting cases at random to ensuring that the random audit programme produces a yield. If the purpose of random audits is to create the prospect that any taxpayer can be audited then any system other than pure random selection will not achieve this objective. The resultant yield should not be important in deciding which cases to audit. In the absence of a random audit programme based on pure random selection it is difficult to see how an indication of the overall level of compliance among taxpayers can be obtained. Revenue has stated that the random audit programme was not designed to measure, in a statistical sense, general levels of compliance among taxpayers. Revenue also stated that the selection criteria had changed in recent years, and that it could be argued that in 2003 an attempt was being made to revert to initial random selection with a screening process kicking in after the random selection. Revenue is conscious of the limited audit resources available and considers that damage can be done to the credibility of the audit programme (both externally and internally) if Revenue is seen to be auditing large numbers of small businesses with little yield. Revenue indicated that the random audit programme will be reviewed during 2003 and one of the issues which will arise is the question of whether the programme can be used as a measure of the general level of tax compliance. If this is accepted it will mean changes in how the programme is conducted.

Random Audit Process

Audits carried out under the random audit programme are no different from audits based on targeted selection. The Revenue auditors carry out the audits in accordance with the relevant legislation and the Code of Practice. As part of this examination the audit files for a sample of 40 completed audits were examined — 28 random audits (carried out under the old Code of Practice) and 12 targeted audits (carried out under the revised Code) — and issues arising are noted below.

- In two of the audits examined there were considerable delays by the taxpayers or their agent in supplying information required to finalise the audit. These audits were not finalised until 13 months and 21 months after the notice of audit was issued. The option of reducing the mitigation of penalties for lack of co-operation was not considered. Revenue stated that in the first case the auditor considered that there had been no attempt to obstruct or hold up completion of a complicated audit, while in the second a reason proffered for the lack of cooperation was accepted as genuine.
- The Code states that auditors require payment of all unpaid tax on record as well as the amount due under the audit settlement. In one of the cases examined the taxpayer paid the audit settlement but was unable to pay the other arrears on record. The taxpayer was instructed to enter into an instalment arrangement with the Collector General but this was not done and the arrears are still outstanding. Revenue has indicated that arrangements are now being made to set up an instalment arrangement in this case to ensure that the arrears are collected.
- Under the new Code where a taxpayer makes a full disclosure accompanied by payment – a qualifying disclosure – there is significant mitigation of penalties. For a disclosure to be a qualifying disclosure it must be in writing, state the full liability for tax, interest and penalties and be accompanied by payment of the total liability. In two of the cases examined where settlements totalled €20,000, the disclosures were treated as qualifying disclosures but did not seem to satisfy the criteria. Disclosures were deficient because they were not accompanied by payment and they did not include calculation of interest and penalties. Revenue has pointed out that there is a learning curve for auditors due to the significant changes in the Code of Practice.
- In one case, the auditor did not open for audit, periods other than those being audited even though the audit findings indicated that earlier periods merited review. The auditor noted that the taxpayer would not have had the resources to pay any liability arising. Revenue indicated that the absence of any unexplained build up of assets and the time required for an extended audit were also factors in the decision.

In cases where earlier periods are not opened, any liability is not computed and put on record. This effectively means that tax is being written off without going through Revenue's write off procedures. Revenue has stated that as it was decided not to open earlier years, there was no question of computing a liability and putting it on record. The opening of earlier periods in audit cases would not necessarily lead to increased tax liabilities for those periods.

- Under the Value Added Tax Act there is a fixed amount penalty for failure to register and for non-submission of returns. In one case examined, the taxpayer was not registered for VAT for a year in which he should have been. The auditor assessed the liability to VAT in the relevant year as €15,237 but the only penalty that could be charged was the fixed sum of €1,523. This seems relatively lenient when compared with a taxpayer who understated his return where the penalty could be as much as 100% of the amount of the understatement. This issue has been addressed in the Finance Act, 2003 which provides for tax geared penalties for failure to file VAT returns.

Results of Random Audits

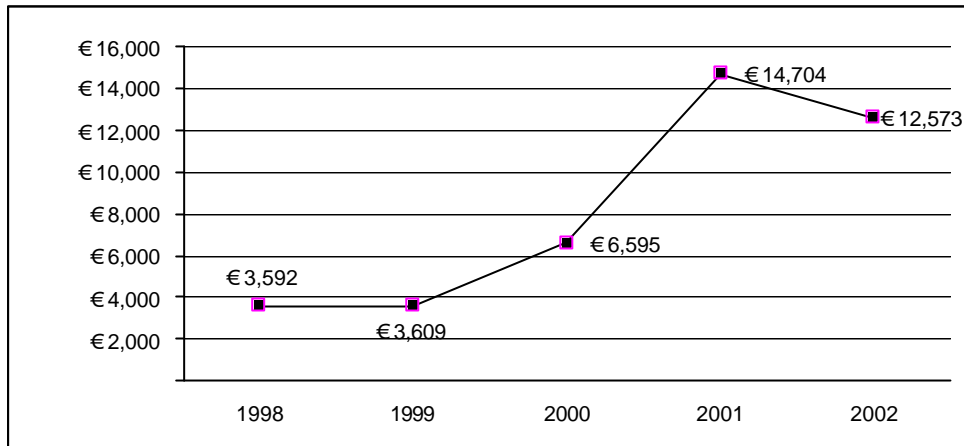
The total number of random audits completed in each of the last five years is shown in Table 2.13 together with the total yield each year and the average yield per random audit completed. The increase in the number of random audits completed since 1998 can be seen from the figures in the table. Although, 20 less audits were completed in 2002 than in 2001, the total of 720 completed is still significantly higher than in earlier years. The target of completing 1,000 random audits, introduced in 2001, has not been achieved to date. The average yield has increased significantly in recent years from €771 per audit in 1999 to a high of €4,570 per audit in 2001. The significant increase in average yield in 2001 and 2002 over earlier years could be due to the selection of cases from within specified income bands thus reducing the number of lower income cases selected. The system of screening of audits in 2002 prior to deciding what type of audit to carry out did not result in an increase in the average yield, which has fallen in 2002 compared to 2001, or in a change in the percentage of nil yielding audits. However, it should be borne in mind that more than one third of random audits completed in 2002 were selected under the programme for earlier years. As was seen in

Table 2.12, around 50% of targeted audits produce no yield. Table 2.13 shows that between 68-70% of random audits have nil yields. The difference in the proportion of nil yields between targeted and random audits is not as large as might be expected. Revenue is confident that if the cases were selected totally at random the average yield would be reduced and the number of nil yields would significantly increase.

Table 2.13 Random Audit Results 1998 to 2002

	Total	Nil	Yielding	Total Yield	Average Yield Including Interest and Penalties	Average Yield Tax Only
	Number of Audits			€	€	€
1998	243	182 (75%)	61	219,086	902	728
1999	192	151 (79%)	41	147,975	771	577
2000	437	342 (78%)	95	626,564	1,434	1,127
2001	740	510 (69%)	230	3,381,890	4,570	3,174
2002	720	491 (68%)	229	2,879,121	3,999	2,879

The average yield figures shown in Table 2.13 are based on the total number of random audits completed — both those that yield additional taxes and those that don't. The increase in the average yield is more dramatic if the average yield for each random audit where underpayments are found is calculated. This is represented in Figure 1 and shows an increase from €3,592 in 1998 to €14,704 in 2001 reducing to €12,573 in 2002.

Figure 1 Average Yield per Yielding Random Audit 1998 to 2002

An analysis of the annual results of the random audit programme would be expected to provide a means of assessing the overall level of compliance by taxpayers that had submitted returns i.e. the extent to which reliance can be placed on the 'self assessment' of tax liability. Key performance indicators might be: the % of audits with no yield (returns accepted as originally submitted), the average tax yield in other cases (the extent to which taxpayers are under-declaring tax due), and an estimate of the possible total tax underpayment in relation to returns submitted. However the possibility of deriving an accurate extrapolation from recent programme results has been damaged by the ongoing changes to the methods of selection. Such changes were made by Revenue in an effort to maximise yield from this relatively minor component of the overall audit programme.

Table 2.14 attempts to show how such an extrapolation might be done. It also notes the yield-focused refinements introduced by Revenue in recent years which have moved the process further away from simple random statistical selection.

Table 2.14 Attempted Extrapolation of 'Random' Audit Results 1998 to 2002

Year	Average Yield per Audit (Tax Only)	Total Returns	Possible Tax Underpayment Indicated	Refinements which may distort Statistical Results
1998	€728	340,000	€248m	— Random Audits Extended to VAT and PAYE/PRSI
1999	€577	349,635	€202m	— Only cases with aggregate income <€127,000 included
2000	€1,127	360,323	€406m	
2001	€3,174	367,395	€1,166m	— No. of audits increased, and income parameters introduced
2002	€2,879	400,407	€1,153m	— Screening at district level, to focus on tax at risk

However, it is clear that the availability and application of statistically sound data would provide a realistic and significant indication of the performance of the self-assessment system. Revenue has pointed out that the current random audit programme was not designed to measure, in a statistical sense, general levels of compliance and non-compliance among taxpayers, and it would have difficulties with any extrapolation exercise based on programme results. A review of the random audit programme was underway and these issues would be taken on board in that review.

Review and Quality Control

It is the responsibility of each auditor to agree the amount of the audit settlement with the taxpayer/agent. All settlements require further approval and in this regard the District Manager or Audit Manager can approve settlements up to €50,000. An Assistant Secretary may approve settlements up to €100,000 and any amounts over that require the approval of a Revenue Commissioner. A short one page report setting out the results of the audit and the details of the settlement forms the basis for these approvals. Audit files are not reviewed in each case. Consideration should be given to including on the audit unit report the category of penalty which has been applied in each case. Revenue has indicated that this is being provided for in the audit case management system which is being updated. Such information could provide a useful insight into trends in compliance by different taxpayers or classes of taxpayers and could feed into Revenue's risk selection system. Revenue ensures quality control in the conduct of audits by the requirement that 5% of audits are reviewed within the district and 25 are reviewed each year by the relevant Regional Director.

One of the aims of the audit programme is to ensure that as a result of the audit the taxpayer becomes compliant in the future. Revenue seeks to assess this by re-auditing a number of cases. The re-audit programme is not of course confined to random audits but includes all audits which yielded €6,349 or more. These cases are then reviewed four years after the original audit and the aim is to re-audit 10% of such cases based on the districts' assessment of the tax at risk. Summary results of re-audits for 1999, 2000 and 2001 are in Table 2.15 below. These results would appear to indicate that up to one half of taxpayers may remain non-compliant following an audit. It should be borne in mind that the selection of cases for re-audit is subject to some risk assessment so that possible non-compliance is identified prior to the re-audit. Nevertheless, with more than one fifth of these audits yielding more than on the original audit, the success of audit as a means of ensuring long term compliance needs to be assessed. This significant level of taxpayers who remain non-compliant even after an audit may also be an indication that the penalties imposed did not act as a deterrent. Revenue has stated that in addition to monitoring the compliance records of previously audited taxpayers, an important aspect of the re-audit programme is also to ensure that taxpayers are aware that Revenue has not gone away just because the audit is finalised.

Table 2.15 Re-Audit Programme Results

	1999	2000	2001
Number re-audited	226	194	118
Nil Yield	86 (38%)	79 (41%)	51 (43%)
Yielding	140 (62%)	115 (59%)	67 (57%)
Lower yield on re-audit	89 (39%)	75 (39%)	n.a
Higher yield on re-audit	51 (23%)	40 (20%)	n.a
Original Yield	€8,291,743	€7,468,587	€3,466,700
Yield from re-audit	€4,926,565	€3,459,220	€1,678,644
Re-audit yield as % of original	59%	46%	48%
Average original yield	€36,689	€38,498	€29,379
Average re-audit yield	€21,799	€17,831	€14,226

Conclusions

The Audit Programme is a key component of Revenue's policy of deterring evasion and maximising compliance with tax law. The programme is targeted at areas of perceived revenue risk. Nearly 16,000 audits were completed during 2002 with a total yield of €256m. In approximately one half of these cases, the taxpayer's return was accepted as submitted. The total number of audits included 720 which were selected under a Random Audit Programme which is intended to improve compliance by giving every taxpayer a chance of audit selection, and to indicate that Revenue was active within all sectors and levels

of economic activity. The random audits yielded €2.9m including interest and penalties, while returns were accepted as submitted in two thirds of the cases reviewed.

While an average tax yield per audit of €2,879 for the 2002 Random Audit Programme may appear on extrapolation to indicate a potential overall tax yield of about €1,000m, such a conclusion is not sustainable at this stage as the final case selection is not made on a purely random basis. Under the current approach there are distortions arising from the exclusion of high value cases which are already subject to a screening programme, adjustments to ensure a geographical spread, and efforts to increase yield by a focus on higher income bands and indications of risk.

While the increasing yield from the overall Audit Programme (2000 €133m, 2001 €197m, 2002 €256m) is no doubt welcome from a collection viewpoint, it must also give rise to some concern as an indicator of the extent to which tax returns may be understated and of the extent of the overall tax shortfall to the Exchequer without giving any clear picture of the level of overall non-compliance. That key management information, which would allow benchmarking of the impact of compliance initiatives and of the overall Audit Programme, would be provided by the random audit segment of the programme if cases were selected and examined from each year's returns on a purely random basis. Any reduction in random audit yield would have little impact on the overall yield from the Audit Programme (random audit provided only 1% of the total yield in 2002). A possible preponderance of small cases would underline the current objective of the universality of audit check. Equally, it is not unknown for sizeable tax evaders to submit minimal level income returns. In response to this report, Revenue has stated that the use of the random audit programme as a measure of the general level of tax compliance will be examined during 2003.

The results of the re-audit programme of taxpayers that had significant liabilities on the original audit four years previously may indicate a requirement for an ongoing monitoring procedure of such cases during the years immediately following the original audit. The number of taxpayers that remain non-compliant would also appear to indicate that the original Revenue audit and settlement did not provide sufficient deterrence to make future non-compliance an unattractive proposition.

2.10 Environmental Levy

The Waste Management (Amendment) Act, 2001 amended the Waste Management Act, 1996 and provided for the introduction of an environmental levy on plastic shopping bags. The Act gave the Minister for the Environment and Local Government the power to make regulations to specify matters in relation to the collection of the levy and other administrative matters. These regulations – Waste Management (Environmental Levy) (Plastic Bag) Regulations 2001 - were made in December 2001. They provided for the introduction on 4 March 2002 of a 15 cent levy on each plastic bag supplied by retailers to customers. The levy is imposed at the point of sale. Certain types of bag are exempt – re-usable bags sold for 70 cent or more, bags used to contain fresh meat, fish, poultry, cooked food or ice and bags used to contain loose fruit and vegetables and other foods that are not otherwise packaged. Under the regulations the Revenue Commissioners are the collection agency for the levy and returns must be made to them by the 19th of the month following the end of each accounting period — each calendar quarter is an accounting period. The amount due is deducted by Revenue directly from the retailer's bank account. The regulations require the retailer to authorise Revenue to debit the amount payable. Retailers are required to maintain stock records of their plastic bags. Revenue officials are empowered to inspect the books and premises of retailers.

In preparation for the introduction of the levy, Revenue scanned the records of those who were registered for VAT and whose trade classification (NACE) code indicated retail activity that could involve the supply of plastic bags. This produced a database of some 36,000 retailers. A manual examination of these cases was then carried out to remove cases where it was obvious that there was no potential liability to the levy.

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This reduced the database to 29,000 cases and these were issued with returns for the first period of the levy. In the period 4 March to 31 December 2002, Revenue collected €7,188,973 on foot of the levy.

As the levy was only introduced during the year of account, my objective was to establish the extent to which assessment and collection procedures had been put in place, and how they were operating. An examination of a random sample of 100 traders¹⁵ known from audit records to have been registered for VAT indicated that approximately 80% of the VAT registrations which were still 'live' were registered for the levy. Returns had been submitted by 60% of cases registered, of which two thirds were 'nil' returns. I asked the Accounting Officer for Revenue's assessment of the current level of compliance with the Environment Levy regulations. I also sought information as to when audits and inspections would commence.

The Accounting Officer supplied details of the returns compliance rates as measured at 15 August 2003 for the first five accounting periods, and these are set out in Table 2.16. He stated that while the database of 29,000 for the first issue had since been reduced to approximately 23,000 cases, Revenue's assessment was that the 'true' compliance rates were significantly higher than shown in Table 2.16 as the database, on which the percentages are based, still contained many cases that had no liability to the tax. That was supported by the result of a limited campaign of telephone contact by Revenue with non-compliant cases which indicated that approximately 80% of non-filers had no liability to the levy. The tax registration process was currently being examined with a view to identifying and registering any new cases that may be liable for the plastic bag levy at the time of general tax registration.

Table 2.16 Environmental Levy Compliance Rates

Period	Number of Returns		% Compliance
	Issued	Accounted For	
30 June 2002	29,307	23,039	79%
30 September 2002	26,520	19,844	75%
31 December 2002	24,850	17,751	71%
31 March 2003	23,094	14,696	64%
30 June 2003	22,688	12,073	53%

The collection system now had the capacity to issue estimates for levy cases that fail to file returns. The issue of estimates would commence in September 2003 and it was expected both to improve compliance and to identify cases that had no liability to the levy. Revenue has stated that the charging of interest on late payment of the levy, which was provided for in the Protection of the Environment Act, 2003¹⁶, should also improve compliance.

The Accounting Officer indicated that a Service Level Agreement entered into between Revenue and the Department of Environment and Local Government provided that Revenue was responsible, inter alia, for:

- Carrying out verification checks relating to the accuracy of returns
- Pursuing accountable persons who failed to deliver returns and payments within the statutory time limits.

Revenue had not carried out any audits or inspections in relation to the levy to date, but intended to carry out audits in conjunction with the existing programme of audits under other taxheads once the relevant

¹⁵ Only traders whose NACE code indicated retail activity which could involve the supply of plastic bags were included. The sample was reduced to 46 'live' VAT registrations as 54 of the sample of 100 had ceased trading.

¹⁶ Implementation of this provision is subject to the signing of a commencement order by the Minister for the Environment and Local Government.

Revenue staff have been duly authorised, as required, under the Levy regulations. Audits were expected to commence in the final quarter of 2003.

Revenue expected that the additional measures would improve compliance and clean up the register and considered that, as the levy had only been in existence for little over a year, that a compliance rate ranging up to 79% was satisfactory particularly in light of indications that the vast majority of non-compliant filers did not appear to have any liability to the levy.