

27 Tax Audit Settlements

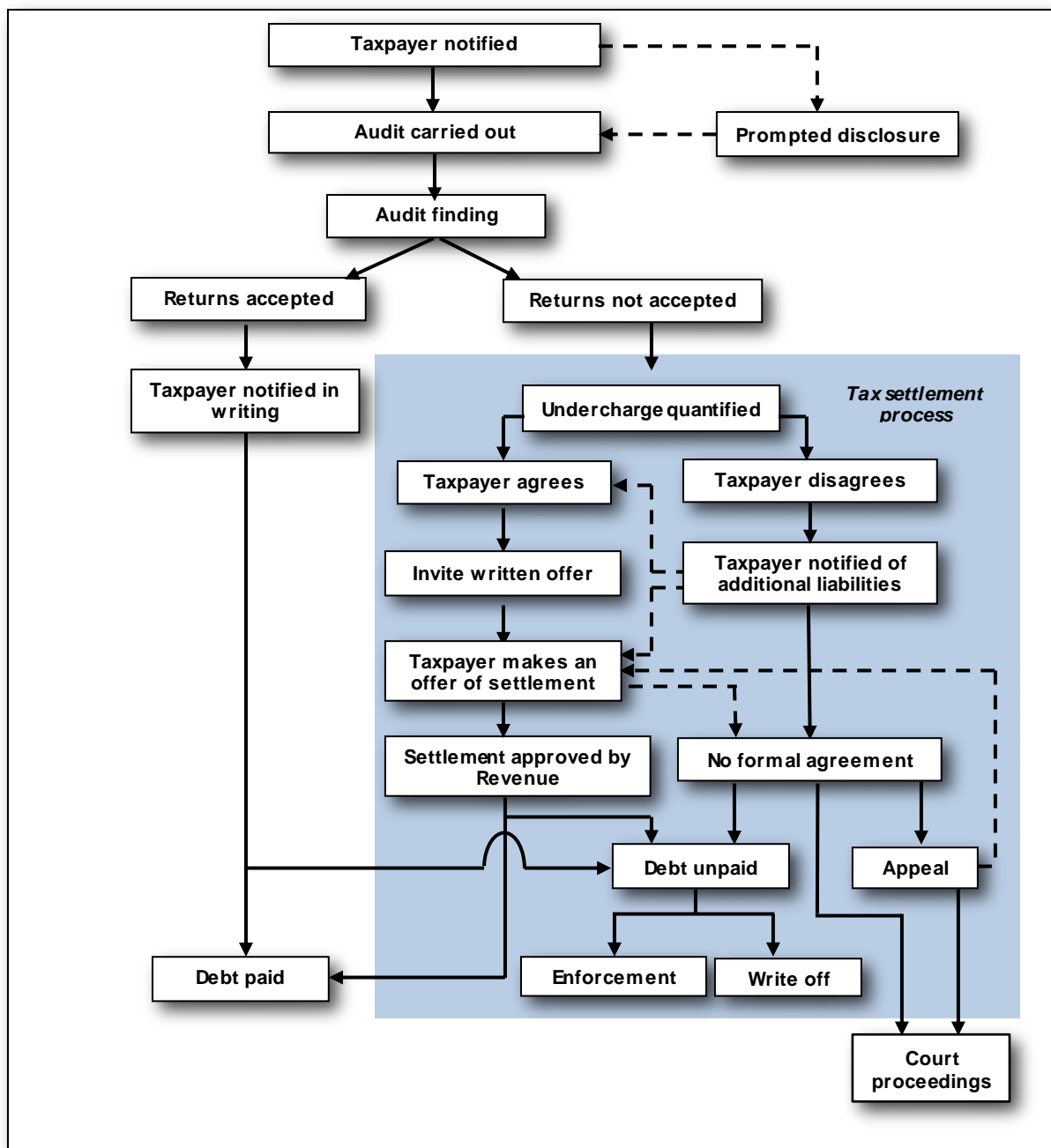
- 27.1** Self assessment of tax liabilities by individuals and companies is an essential part of the operation of tax and duties administration in Ireland. Taxpayers are required to file complete and accurate returns and to make associated tax payments in accordance with statutory deadlines. Taxpayers may also claim tax repayments on a self-assessed basis.
- 27.2** As part of its approach to promote voluntary compliance with tax and duty obligations and to detect and deter non-compliance, Revenue operates two audit programmes
- targeted audits where cases are selected on the basis of risk profiling and
 - audits of cases selected randomly.
- 27.3** The Revenue audit process is summarised in Figure 27.1.
- 27.4** Revenue audits are carried out in accordance with the requirements of legislation, principally the Taxes Consolidation Act, 1997, and Revenue's Code of Practice for Revenue Audit (Code of Practice).

Focus of the Examination

- 27.5** The focus of this examination is on audit settlements.¹ In the course of planning and carrying out audits, Revenue officials are required to exercise judgment in a number of areas. These include the estimation of the liability (if any) due and the amount of interest and penalties to be applied in settlements reached with taxpayers following a Revenue audit. Taxpayers are entitled to equitable and even-handed treatment by Revenue and Revenue audit files should include appropriate evidence to support judgments made.
- 27.6** The objectives of the review were to
- review audit settlements reached to determine whether the basis for settlements is clear and that the settlements have been approved at the appropriate level in Revenue
 - assess the extent to which interest and penalties were applied to audit settlements completed in 2012
 - review the extent to which taxpayers meet payment obligations following audit settlements.

¹ The term settlement includes liabilities, agreed between Revenue and taxpayers, and liabilities determined by the Appeal Commissioners or the courts.

Figure 27.1 Revenue audit process



1 Audits are classified as completed when the audit file is closed and the liability arising from the audit has been paid or passed to the Collector General for collection.

2 Revenue district managers have authority to approve settlements up to €50,000; Assistant Secretaries up to €100,000; and the approval of a Revenue Commissioner is required for settlements in excess of €100,000.

Sample of cases examined

27.7 Revenue reported that it completed 9,066 audit cases in 2012 with a total yield of €359 million and an average yield per case of €39,600.¹

27.8 As part of this examination, 45 audit cases closed by Revenue in 2012 were reviewed. The cases selected comprised the four cases with the highest audit settlements in 2012 and 41 cases selected at random with some from each of the settlement approval levels.²

- 27.9** Review of the files showed that nine cases (20% of the sample), including one of the four largest cases, had been incorrectly recorded as audit interventions. The 36 audit cases had a yield of €41.4 million, or 11.5% of the total reported audit yield in 2012. The outcomes of the 36 audits are summarised in Figure 27.2.

Figure 27.2 Outcomes from sample of audit cases, 2012

Outcome	Number	Proportion of cases	Audit yield € m
Audit resulted in settlement	28	78%	39.9
Repayment claim disallowed	1	3%	1.5
No liability	7	19%	—
Total	36		41.4

Source: Revenue audit files.

Quantifying the Liability

- 27.10** Revenue's procedures require that the Revenue auditor should, at the completion of an audit, quantify the amount of tax, interest and penalties due by a taxpayer.

Prompted disclosure

- 27.11** Following notification by Revenue of an audit, taxpayers may take steps to correct their tax returns by making a 'prompted disclosure' to Revenue. Where a prompted disclosure: is a disclosure of complete information relating to a tax liability; is made in writing; and is accompanied by payment in full of the tax or duty and any interest due on the late payment or an agreed phased payment arrangement that complies with Revenue's instalment arrangement procedures, it is considered to be a 'qualifying disclosure'.¹ One of the effects of a valid qualifying disclosure is to reduce penalties that are applied for tax default, including avoidance of publication of settlement details.
- 27.12** The review of the 36 files found that prompted disclosures had been made in 11 cases. Only four cases were valid qualifying disclosures with full payment including interest. Seven of the 11 cases did not satisfy the qualifying disclosure criteria, mainly because the liability was not paid at, or around, the time the disclosure was made or an instalment arrangement had not been put in place.

Calculating the tax liability

- 27.13** At the completion of an audit, the auditor quantifies liability in respect of tax, interest and penalties (if any) and the taxpayer is invited to make a settlement offer in writing.² If no settlement is reached, the Revenue auditor raises a formal assessment for the liability due. The taxpayer has the option of appealing this assessment. Typically, the auditor raises a formal assessment for tax only at this point, on the basis that the taxpayer has a right of appeal.³ Revenue considers that it would be premature to raise an interest or penalty charge until the final tax charge is determined at appeal.
- 27.14** In seven of the 36 audit files reviewed, the Revenue audit found that no additional tax liability was due. The examination reviewed the files and found that the Revenue conclusions were appropriate based on the evidence on the files.

¹ Section 1077E(I) of the Taxes Consolidation Act 1997.

² The Code of Practice requires that in circumstances where a tax liability has been quantified in a qualifying disclosure, the auditor should check the taxpayer's calculation.

³ A notice of opinion is issued by Revenue in cases where no agreement can be reached with the taxpayer about the level of penalties payable. It also covers any case where a penalty is agreed but not paid. In these circumstances, the Revenue auditor formally expresses the opinion that the penalty is due and gives notice of that opinion to the taxpayer and the taxpayer's agent. A notice of opinion must be issued before a penalty can be pursued through the courts.

- 27.15** Another case concerned a claim for repayment by a taxpayer. The claim for €1.5 million was disallowed by Revenue following an audit and the examination found that this was appropriate.
- 27.16** The remaining 28 cases were reviewed for evidence that audit settlements reached appeared reasonable based on the evidence on the files and that the settlement amounts were agreed on the basis of a calculation by the Revenue auditor of the taxpayer's liability, including appropriate application of interest and penalties.
- 27.17** The files indicated that the Revenue auditors had recorded an assessment of the liability in four out of five cases. Assessments had not usually been recorded in lower value cases (see Figure 27.3).

Figure 27.3 Revenue quantification of tax liability

	Proportion of cases	Proportion of settlement values
Revenue auditor calculated liability ^a	82%	98%
Taxpayer's calculation not verified by Revenue	11%	1%
No evidence of liability calculation	7%	1%

Source: Revenue audit files

Note: a Including cases where the Revenue auditor validated taxpayers' calculations.

Charging of Interest and Penalties

- 27.18** The Taxes Consolidation Act, 1997 provides for the application of interest for the late payment of tax and there is no provision for it to be mitigated even after qualifying disclosure.¹ The rates of interest to be applied are set out in various Finance Acts.
- 27.19** Penalties may be payable where tax returns are incomplete or inaccurate and associated payments have not been made on time. In cases where penalties apply, the Code of Practice states that the amount of the penalty is generally calculated by the Revenue auditor and agreed with the taxpayer. In circumstances where agreement is not reached or where the taxpayer does not pay an agreed penalty, the applicable penalty is determined by the relevant court.² A number of factors determine the level of penalties, if any, including
- whether the tax default occurred before or after 24 December 2008
 - whether the taxpayer made a qualifying disclosure (including payment of due amounts)
 - the category of default e.g. careless or deliberate behaviour
 - whether a taxpayer co-operates with Revenue in the course of an audit.

¹ Taxes Consolidation Act 1997, sections 1080 to 1084.

² For amounts up to €6,350, the District Court is the relevant court. The Circuit Court has jurisdiction for amounts up to €38,092 and the High Court for amounts above that.

Revenue has the discretion to mitigate penalties by up to a maximum of 50%. Penalties are not due in circumstances where additional tax is due to a technical adjustment or an innocent error that is corrected at the first opportunity. In some circumstances, penalties may not be applied where a taxpayer claims that their failure to comply with a requirement of the tax code results in no loss of revenue to the State.

Further details are set out in Annex A.

27.20 The examination reviewed the extent to which interest and penalties were applied in respect of all audits finalised in 2012. The results are set out in Figure 27.4.

Figure 27.4 Proportion of yielding cases in 2012 where interest and penalties were applied, by region

	Number of cases	Interest and penalties applied	No interest and penalties applied	Total yield including interest and penalties € 000	Average yield including interest and penalties € 000	Interest and penalties as a proportion of the total yield
Special Units						
Large Cases Division	127	55%	45%	57,771	455	6%
Investigations and Prosecutions Division	192	95%	5%	17,688	92	55%
Regions						
Border Midlands West	1,940	78%	22%	83,024	43	20%
Dublin	1,262	79%	21%	71,667	57	22%
East South East	1,141	79%	21%	57,685	51	25%
South West	1,456	73%	27%	69,853	48	22%
Total	6,118			357,688	58	21%

Source: Analysis by the Office of the Comptroller and Auditor General

Note: a Figure does not include around 120 audits that are not recorded in Revenue's audit case management system. These are mainly Stamp Duty and Capital Acquisitions Tax audits. All other cases classified by Revenue as yielding audits are included.

27.21 The level of interest and penalties applied was significantly lower for the Large Cases Division than for the other units. Interest and penalties were applied to fewer large cases and represented only 6% of the yield.¹ This compares to 21% for audits at regional level.

Interest and penalties in sample cases

27.22 The examination also reviewed the application of interest and penalties in the 28 audit cases where settlements had been made.

Charging of Interest

27.23 The interest applied in 24 cases amounted to around €1.1 million. The interest was recalculated to determine whether the amounts charged were correct, based on the period when the tax should have been paid and the applicable interest rates. The results showed that

- The interest charged in 21 cases was correct.
- In three cases, the interest amounts charged by Revenue were, on average, two-thirds of the amount estimated to be chargeable by the examination team. The estimated total interest undercharge for these cases was around €21,000.

27.24 In two cases, round settlement amounts had been agreed with taxpayers. This included the two largest cases examined.

- In one case, the settlement amount of €8 million was stated to include an unspecified amount in respect of interest (see Case Study A).

¹ Revenue defines large cases as companies with turnover of €162 million or more or tax payments greater than €16 million annually. For individuals, the Large Cases Division manages those with net assets greater than €50 million, non-residents with substantial interests in Ireland and partners in large accountancy and legal practices.

- In the other case, Revenue arbitrarily split the round settlement amount of €15 million between tax due (€9.7 million) and interest (€5.3 million) in its records (see Case Study B).

27.25 The Revenue files recorded that interest had not been applied in two cases

- In one case, the settlement amount was €7.3 million but no interest was applied. The examination calculated that interest due in this case was of the order of €570,000 (see Case Study C).
- The second case was a settlement for almost €690,000. The interest due, but not charged, for late payment in this case was estimated at around €63,000.

Imposition of Penalties

27.26 Penalties were not applied in eight of the 28 cases. The examination found that the non-application of penalties was appropriate in three of these cases.

27.27 In the remaining five cases, the examination team concluded that penalties could have been applied but were not. This included three of the four case studies outlined below. In the other two cases, where the tax liabilities amounted to €385,000 and €343,000, the examination team estimated that the penalties not levied amounted to around €390,000.

27.28 The examination found that penalties had been applied in 20 cases (71%). The level of penalties applied was in accordance with the legislative requirements and the Code of Practice in thirteen of these cases.

27.29 For the remaining seven cases where penalties were applied, the examination found that the penalties applied were lower than what the documentation on the files indicated should have been charged

- In three cases, taxpayers were given the benefit of reduced penalties because they had made qualifying disclosures prior to the Revenue audit commencing, but the examination found that the disclosures were not valid mainly due to non-payment of the liability when the disclosure was made.
- In three cases, the documentation on the file did not support the reasons cited for mitigating penalties e.g. mitigation of penalties because the taxpayer had cooperated with Revenue was not supported by the documentation.
- In the seventh case, the taxpayer's agent had calculated the penalty but the calculation, which was incorrect, had not been checked by Revenue.

27.30 The total tax liability in these seven cases was €862,000 and Revenue charged €266,000 in respect of penalties. The examination estimated that the appropriate level of penalties based on the evidence on the files was of the order of €478,000. On that basis, around 44% of the penalty liability was foregone.

Negotiation of Settlements

- 27.31** The review found that in most cases, the settlement amount was the same as the liability that had been calculated including interest and penalties where these had been applied. However, in two cases there was a significant difference between the liability calculated by Revenue and the settlement amount.
- One case was settled for €8 million just prior to a court hearing. See Case Study A for further details.
 - The largest settlement made in 2012 of €15 million in respect of Capital Gains Tax, was significantly less than the Revenue estimate of the taxpayer's liability. Details are set out in Case Study B.
- 27.32** In a further four cases, there were smaller differences between the Revenue calculation of the liability and the settlement amount. The differences ranged from €13,000 to €30,000 and from less than 1% to 32% of the Revenue estimate of the liability.

Case Study A

- 27.33** Revenue identified two associated companies that made Corporation Tax payments in 2005 for the year ended December 2004. On investigation, Revenue found that the companies had been in operation for a number of years prior to that but that no Corporation Tax had been paid.
- 27.34** The companies were subsidiaries of a non-Irish parent company. The parent company invested significant sums in each of the subsidiary companies and the subsidiaries then lent this money back to the parent company. Income reported in the Irish companies' accounts was in respect of interest due, but not paid, by the parent company on the loans.
- 27.35** The Irish subsidiaries asserted that their interest income was not liable to tax in Ireland as the subsidiaries had not received the interest. From 2004, following changes in the tax regime in the parent company's home country, the Irish subsidiaries received payment of the interest income and paid Corporation Tax in Ireland.
- 27.36** At an early stage, in mid-2005, the case was referred within Revenue to its anti-avoidance unit which handled the case from then on. An audit of the two companies, focused on 2001, was carried out in late 2005. Ireland has a double tax treaty with the parent company's home country and in the course of this case, Revenue engaged with the tax authorities in that country.
- 27.37** Revenue subsequently raised tax assessments and notified the taxpayer and the taxpayer's agent that it estimated the liability including interest and maximum possible penalties at between €10 million to €16 million, depending on how the income for 2004 was classified for taxation purposes.
- 27.38** The taxpayer lodged an appeal and made a payment of €11.1 million on account without prejudice to the outcome of its appeal. The Appeal Commissioners found in favour of the taxpayer, and tax was assessed at nil. Revenue indicated it would appeal to the High Court.
- 27.39** In 2008, Revenue raised further assessments (second set of assessments) for the periods to end 2003 for a total amount of €11.8 million.

- 27.40** The taxpayer appealed. The Appeal Commissioners confirmed the second set of assessments. The taxpayer appealed to have the case re-heard in the Circuit Court
- 27.41** Just prior to the case being heard in the Circuit Court, there were extensive negotiations between Revenue and the taxpayer. A settlement of €8 million was agreed and €3.1 million of the €11.1 million the taxpayer had paid on account was returned to the taxpayer.
- 27.42** The settlement amount was not separated between tax and interest. Revenue's estimate of the total due by the taxpayer if Revenue had been successful in the court case was around €14 million of which around €3.3 million (24%) would have been interest. On a pro-rata basis, the settlement represented around €6.1 million tax and €1.9 million interest.
- 27.43** The settlement was approved by a Revenue Commissioner. No penalties were applied. The settlement details were not published.
- 27.44** Some points of note about the case were
- The case was technically complex and involved the interpretation and application of tax law. Revenue referred the case to its anti-avoidance unit at an early stage. The Revenue audit file showed a significant degree of challenge of the case put forward by the taxpayer's agent including argument based on case law.
 - The taxpayer was notified at an early stage of the potential liability including interest and maximum possible penalties. The file also includes detailed notes on the negotiations conducted between the two sets of legal counsel on behalf of Revenue and the taxpayer. In the final negotiations, Revenue put forward a settlement figure that included interest.

Comments of the Accounting Officer

- 27.45** The Accounting Officer pointed out that that the opinion of senior counsel was sought by Revenue before making a decision regarding the settlement amount. Factoring in the ultimate chance of success and the further time, expense and resources that would be involved in bringing the case to conclusion, counsel's recommendation was to accept the settlement proposed. Following consideration of this opinion, Revenue decided to accept the settlement.

Case Study B

- 27.46** In the course of an audit in 2011, Revenue identified a transaction in which the taxpayer had transferred company ownership in exchange for another company which had a significant cash balance and no other assets. The taxpayer's agent asserted (subsequently) that the share exchange did not constitute a disposal and that the taxpayer qualified for relief from Capital Gains Tax under provisions of the Taxes Consolidation Act, 1997.
- 27.47** Following the audit, Revenue took the view that the taxpayer had made a taxable capital gain and raised an assessment for €22 million.

- 27.48** Revenue did not notify the taxpayer of interest due or possible penalties. The examination team has calculated that interest amounting to around €10.3 million had accrued at the time the assessment was raised. In addition, penalties could range from 15% to 100% of the tax liability depending on the view Revenue took of the category of tax default involved and the extent to which the taxpayer had co-operated with Revenue. Based on Revenue's assessment of €22 million in respect of Capital Gains Tax, the taxpayer's total liability inclusive of interest and penalties could have been in the range €36 million to €54 million.
- 27.49** Revenue was not satisfied that the transaction qualified for relief under the terms of the Taxes Consolidation Act, 1997. This would have required the share exchange to be for bona fide commercial reasons and not form part of any arrangement or scheme of which the main purpose (or one of the main purposes) is avoidance of liability to tax.
- 27.50** At a subsequent meeting between Revenue and the agent, the agent stated that the taxpayer was interested in bringing the matter to an end. A Revenue file note states that both sides accepted that if the matter went through the appeals process, it could take around eight years for the case to be processed through the High Court. The agent offered an amount of €15 million to settle the case.
- 27.51** An internal Revenue document following the meeting stated that if the case was settled for €15 million, it would be closed expeditiously and a substantial payment received, the time and cost associated with an appeal would be avoided and there would be no concession of the principle involved. The risk that there might be nothing left to collect at the end of a legal case was also raised. On the other hand, it was noted, there was the possibility of a larger settlement if the appeals process was allowed to take its course.
- 27.52** The terms of the settlement, as set out in the taxpayer's letter of offer, were
- payment of €15 million in full and final settlement of the Capital Gains Tax liability
 - any liquidation of the taxpayer's assets to extract funds to meet the settlement would not give rise to a capital loss which could be offset against any future gains.
- 27.53** The taxpayer made a payment of €15 million. The settlement was approved by a Revenue Commissioner on 21 December 2012. No penalties were applied and the settlement details were not published.
- 27.54** Some matters of concern in relation to the settlement are
- The taxpayer's agent put forward arguments that the case involved a technical issue and that the taxpayer's position was supported by case law. There was no evidence on the Revenue audit file that the Revenue team managing the case sought advice in relation to the technical issues from either Revenue's anti-avoidance unit or from other specialist staff within Revenue e.g. from within its large cases division. Neither was there any evidence on the file of Revenue having put forward detailed arguments (e.g. based on precedent) to rebut those of the taxpayer's agent. There is reference on file to the issues of the cases having been highlighted to the National Anti Avoidance Network and discussed at a meeting of the network in September 2012 but there is no evidence of any recommendation being made or action being taken arising from the meeting.¹

¹ The Revenue National Anti-Avoidance Network comprises liaison officers from each of the Revenue districts and from the anti-avoidance unit who meet quarterly to discuss issues identified by the regions.

- The case was one where it appears there were just two possible outcomes - either the transaction was liable to Capital Gains Tax and the taxpayer would have been liable to pay the full amount of tax plus interest and penalties or it was not liable to tax and the taxpayer's liability would have been nil. A file note makes reference to some benefits for settling and some risks for Revenue if the case were to go to appeal, for example the time and cost involved. However, there is no detailed analysis, based on specialist knowledge or advice, of the likely outcome of litigation and of the costs involved. This type of analysis could have informed Revenue in its negotiations with the taxpayer and the taxpayer's agent.
- The Revenue audit file does not show that Revenue, at any point, made a claim for interest or penalties for the Capital Gains Tax due. Therefore, from the taxpayer's perspective, €22 million was the amount that Revenue was seeking.
- There was no evidence that Revenue, in the course of the settlement negotiations, put forward a figure higher than the €15 million offered by the taxpayer. The taxpayer's offer was proposed for approval within Revenue without any commentary on what alternative figure might have been proposed in negotiations or what the taxpayer's liability might be if Revenue were successful in a court action.
- The settlement was approved appropriately within Revenue's settlement approval thresholds which require amounts over €100,000 to be approved by a Revenue Commissioner. However, cases which involve significant differences between Revenue's estimate of a liability and the amount put forward for approval, or that may have elements of technical complexity or risk, could benefit from formal consideration by a number of people, for example a settlements approval committee, before final approval is given.

Comments of the Accounting Officer

- 27.55** In regard to the application of interest and penalties, the Accounting Officer pointed out that the assessment to Capital Gains Tax was an amount that would arise if Revenue's concerns about the non applicability of the section of the Taxes Consolidation Act, 1997 proved correct. The taxpayer had a right in law to appeal against the assessment. It would thus be incorrect to raise an interest charge in advance of the assessment becoming final and conclusive and the ultimate liability being determined. The Accounting Officer noted that a similar situation arose in relation to penalties. Furthermore, she stated that the point at issue in the case centred on an interpretation of the Taxes Consolidation Act, 1997 and the Code of Practice provides that a penalty will not apply in relation to technical adjustments. Technical adjustments are adjustments to liability that arise from differences in the interpretation or the application of legislation. The Accounting Officer pointed out that it is difficult to envisage that a claim for penalties at any level could have been sustained in the case and that Revenue considered it inappropriate to seek a penalty in these circumstances. Revenue accepted the settlement as being a compromise to include an element of tax and interest.
- 27.56** In relation to the technical aspects of the case and the use of specialist advice, the Accounting Officer stated that the team dealing with the case had considerable operational tax experience and professional and technical qualifications and that this was used to analyse both the issue and case law and precedent. Furthermore, she stated that the issues of the case were placed before the anti-avoidance unit of Revenue's Large Cases Division and discussed at a meeting of the National Anti-Avoidance Network in early September 2012. There was no consensus within Revenue on the likely success of Revenue in pursuing the case in the courts. Indeed, success was considered unlikely.

- 27.57** The Accounting Officer said that, given possible outcomes in a spectrum ranging from tax plus interest at one end, to zero at the other end, it was incumbent on Revenue to consider a settlement offer because of the possibility of the zero outcome. As the appeals procedure, including the courts, is always protracted and as the amount initially obtained by the taxpayer was rapidly dissipating, it could never be guaranteed that if Revenue ultimately won the arguments there would be any funds from which to collect the tax. She pointed out that there was, within the taxpayer's structure, two offshore registered companies and a concern existed that it would have been impossible to properly monitor any leakage of funds through those companies. Revenue personnel involved in the case were strongly of the view that a better offer would not be forthcoming, and that the taxpayer would take his/her chances in the courts if the offer of €15 million was not accepted. The Accounting Officer said that it was not possible to make a precise evaluation of the probabilities involved and thus there was a large element of value judgement involved. In reaching a settlement, she noted, Revenue did not concede any point of law.
- 27.58** In regard to the payment of €15 million, the Accounting Officer said that Revenue had always recognised that to discharge the tax it would be necessary to extract funds from the investment holding company and that this would be done by way of liquidation. If Revenue was to win on principle, and prove that the relieving sections governing share for share exchange did not apply, then the base cost of shares for that liquidation would become the initial amount. As the company's net asset value had fallen significantly, liquidation would have crystallised an allowable capital loss of this amount. The potential tax value, in the future, to the taxpayer of such a loss at a 30% Capital Gains Tax rate would also have been significant. Revenue prevented this by requiring the agent's letter of offer to include a statement to the effect that any necessary liquidation to extract funds would not give rise to a loss arising from the fall in value of the company that could be used to offset other liabilities.

Case Study C

- 27.59** A taxpayer queried the correct treatment of a series of transactions in relation to Value Added Tax. The transactions concerned interim payments on a long-term contract.
- 27.60** The taxpayer's enquiry triggered an audit. The Revenue finding was that the taxpayer owed €7.3 million in VAT which the taxpayer paid. Around half of the payment was a year late, while the remainder was between two and ten months late.
- 27.61** The Code of Practice states that statutory interest should be applied in circumstances where there is a technical tax issue under consideration and the payment is late. Notwithstanding this, Revenue did not apply interest. The examination calculated that interest due for late payment in this case was of the order of €570,000.
- 27.62** The matter of concern in relation to this case is the failure to apply interest despite the clear requirement to do so.

Comments of the Accounting Officer

- 27.63** The Accounting Officer stated that the imposition of an interest charge was considered by Revenue prior to settlement in this case. However, it was accepted that the undercharges arose as part of a 'current' contract, in that the goods were under construction at the time of the audit and were not scheduled for delivery for some time. The payments giving rise to the undercharges were a small number of high value stage payments relating to a single transaction. In addition, when the taxpayer was satisfied that the technical position as outlined by Revenue was correct, a full and immediate payment was made. Interest would have been charged if the acquisition of the goods and the completion of the contract had occurred prior to the audit.

Authorisation and Approval of Audit Settlements

- 27.64** Settlement offers are subject to approval by a Revenue Commissioner or, below certain thresholds, by regional and district staff. The Revenue auditor's report on the audit should contain a clear recommendation on whether the settlement proposed should be approved.
- 27.65** The review found that all settlements had been approved in accordance with Revenue's approval thresholds.
- 27.66** The thresholds are set by reference to the total settlement reached with the taxpayer. However, in cases where there is a difference between the Revenue estimate of the liability and the settlement amount proposed, approval may have been required at a higher level if the threshold was based on the estimate of liability.

Publication of Settlements

- 27.67** Settlement details must be published where a penalty has been applied except where the taxpayer has made a valid qualifying disclosure before an audit commenced or the settlement is less than €33,000 or the penalties are less than 15% of the tax due.¹ Revenue may also refer cases to the Director of Public Prosecutions whose decision it is whether or not to prosecute.

Collection of Settlements

- 27.68** Taxpayers do not always immediately pay the amount due when audit settlements are reached. The extent to which settlement amounts had been paid was examined in the 28 cases reviewed in the course of the examination and a review of a further sample of 25 settlements for each year from 2007 to 2012. The results are set out in Figure 27.5.

¹ The threshold for liabilities relating to the years 2005 to 2009 was €30,000. From 2010, the threshold increased to €33,000.

Figure 27.5 Payment of audit settlements

Year of settlement	Number of cases	Total settlement amount	Status per Revenue records			
			Paid	Written off	Outstanding	Not known ^a
		€m	€m	€m	€m	€m
2012	46 ^{bc}	63	45	1	6	11
2011	25	86	58	—	2	26
2010	25	67	39	—	10	18
2009	21 ^c	73	71	1	—	1
2008	25	87	80	6	—	1
2007	25	136	135	—	—	1
Totals	167	512	428	8	18	58

Source: Revenue audit files and taxpayer records maintained by Revenue.

Notes: a The cases concerned are currently being reviewed by Revenue (September 2013).

b The 2012 cases include six cases that are common to both the sample of 28 cases reviewed in detail and, also, the sample of 25 reviewed for evidence of payment only.

c Cases where the audit yield was the disallowance of a repayment claim or a restriction of losses have been excluded.

27.69 Figure 27.5 shows that of the yield of €512 million for the cases reviewed, around 84% of the settlement amounts were paid by March 2012, around 1.6% of the tax had been written off while the balance remained outstanding.

Case Study D – Appeal and Non-Payment

27.70 In 2004, Revenue undertook an audit of Company D which operated in a sector in which Revenue was carrying out a series of sector-specific audits.

27.71 Following the audit, Revenue found, in September 2005, that there was an undeclared tax liability of €1 million for the years 2003 and 2004 in respect of VAT, PAYE and Corporation Tax, penalties of the same amount and interest of €100,000 due, bringing the total amount due to €2.2 million. The subsequent key events in the case were

- In January 2006, the taxpayer appealed the findings to Revenue.
- In February 2008, Revenue requested a date for a hearing from the Appeal Commissioners.
- A hearing was scheduled by the Appeal Commissioners for October 2008 but this was postponed at the request of both parties (Revenue and the taxpayer). Hearings were held in March and October 2009.
- The company subsequently went into creditors' voluntary liquidation.
- On 25 November 2009, the Appeal Commissioners issued their determination in favour of Revenue.
- The taxpayer appealed the case to the Circuit Court. The hearing took place in 2010. The Court found in Revenue's favour.
- In November 2012, the audit was closed and the tax was written off. The file stated that although the assessments had been confirmed, the company was gone and the Collector General could not collect the amounts due.

27.72 The audit yield recorded by Revenue for the case was €1 million and this is the amount included in the 2012 audit yield.

27.73 Some points of note about the case were

- the very significant lapse of time in progressing the case
- the taxpayer's record did not show the interest and penalties that had been calculated as due by Revenue and the amount referred to the Collector General for collection was €1 million (the tax only).

Comments of the Accounting Officer

27.74 The Accounting Officer pointed out that a matter of relevance to this case was the fact that Revenue was aware that a VAT issue of importance to the case in question had been referred on 11 February 2009 by another Member State to the European Court of Justice for decision. This issue was eventually adjudicated upon in June 2010.

Tax Audit Files

27.75 Revenue audits should be carried out in accordance with the Code of Practice and audit files should provide clear evidence of this. Revenue auditors should produce audit reports that set out clearly the issues involved in the audit and provide clear recommendations about proposed settlements.

27.76 Audit files should contain, at least

- a letter of notification to the taxpayer setting out what Revenue intends to examine and the periods to be covered by the proposed audit (audit scope)
- a note of an initial interview carried out with the client at which the scope of the audit is explained and the taxpayer is given an opportunity to disclose matters to Revenue
- evidence to show how the Revenue auditor addressed the issues in the audit scope and any other issues that arose in the course of the interview with the taxpayer or the conduct of the audit
- evidence to show how the audit assessment, including interest and penalties, was calculated by the Revenue auditor or where the taxpayer made a qualifying disclosure, evidence that the taxpayer's calculation had been checked by Revenue and penalties applied, where appropriate
- a written offer of settlement from the taxpayer.

27.77 The examination found significant variability in the quality of the files for the cases that were reviewed. A number of files were of a high standard and contained clear evidence of the audit having been conducted fully in accordance with the Code of Practice, including notification of audit and interview with the taxpayer, how the audit was conducted and the basis for the audit settlement reached. However, in many cases, it was difficult to ascertain from the file what the audit issues were and what was the basis for the audit settlement proposed. Figure 27.6 summarises the findings from the file reviews.

Figure 27.6 Revenue audit files

Element	Standard met
Audits carried out (36 cases)	
Letter of notification to taxpayer	89%
Note of initial interview	61%
Evidence to show that key audit issues were addressed	67%
Settlement agreed (28 cases)	
Adequate evidence of calculation of settlement amount	86%
Written offer of settlement from taxpayer	43%

Source: Revenue audit files

- 27.78** Revenue has taken some steps in the course of 2013 to address audit quality issues. In May 2013, it issued a document 'Quality Compliance Intervention Standards' setting out quality assurance procedures for the Revenue audit and risk management intervention process. In June 2013, it issued a 'Mandatory Items Report' document setting out items that must be addressed when an audit or other intervention is being finalised.

Comments of the Accounting Officer

- 27.79** In relation to written offers of settlement from taxpayers, the Accounting Officer pointed out that settlement details can sometimes be agreed orally and followed up in writing by the Revenue auditor.
- 27.80** She also stated that the new Quality Compliance Interventions Standards were published by Revenue to highlight, inter alia, what is expected from auditors in terms of quality audit files and that one of the standards, the planning standard, addresses some issues raised here. As part of the Performance Management Development System cycle for 2013, audit managers and auditors discuss the auditor's compliance with the quality standards in the context of interim and annual reviews. It is also proposed that a programme of quality assurance checks, on cases selected randomly, will be implemented by the Planning Division by 2014. High quality audit files are used to some extent in compliance training programmes and this will be reinforced as examples of best practice.

Misclassification of Interventions

- 27.81** As part of this examination, 45 reported audit cases closed by Revenue in 2012 were selected for review. The cases had a combined audit yield of €51.4 million, or 14.3% of the total reported audit yield in 2012.

27.82 Review of the files showed that nine cases (20%) had been incorrectly recorded as audit interventions.

- One of the four cases with the highest settlements was for an amount of €7.4 million. However, the payment did not arise from an audit but from an expression of doubt notified to Revenue by the taxpayer in advance of making the Corporation Tax return for 2011.¹ Following review by Revenue and discussions with the taxpayer, the appropriate tax treatment of the transaction was agreed and payment was made of the tax due.
- In a further six cases, taxpayers had made payments following either the correction of an error made in a tax return or an unprompted voluntary disclosure.² No audits were carried out in these cases. The payments totalled €2.6 million and ranged from €7,000 to €2.3 million.
- In two further cases where no audit was carried out, there were no additional liabilities.

27.83 The cases that were incorrectly classified as audits are summarised in Figure 27.7.

Figure 27.7 Revenue interventions incorrectly classified as audits

Basis of selection for review	Number of cases	Yield value €m	Incorrectly classified	
			Number	Yield as a % of total
Large settlements	4	37.7	1	20%
Randomly selected settlements	41	13.7	8	19%
Total cases examined	45	51.4	9	20%

Source: Revenue audit files

Conclusions and Recommendations

27.84 In 2012, Revenue reported that just over 9,000 audits were carried out under its two audit programmes and that the yield from audits amounted to €359 million.

27.85 Nine of the sample cases selected for the examination had been incorrectly classified as audit interventions by Revenue. Exclusion of these cases reduces the audit yield for the sample cases by around 20%. The fall in yield was broadly the same for cases selected at random as for the large cases, which were selected on the basis of size. While the revenue was collected, in the misclassified cases it is likely based on the sample results that Revenue's reported overall audit yield of €359 million for 2012 is materially overstated.

Recommendation 27.1: Revenue should review the manner in which its interventions with taxpayers are recorded in order to ensure that the nature of an intervention is accurately recorded and that the yields from the different intervention types are appropriately classified in order to ensure more accurate targeting of scarce audit and investigation resources.

¹ An expression of doubt arises when a taxpayer is uncertain about the correct tax treatment of a transaction and seeks Revenue's view.

² An unprompted voluntary disclosure occurs where the taxpayer makes a disclosure before a letter notifying the taxpayer of an audit issues or, in the case of an investigation, prior to commencement of the investigation.

Accounting Officer Response: Agreed. Improvements are in place since July 2012. With the assistance of new case management tools, Revenue has been refining the classification of interventions beginning in 2012. It is important to point out that while the appropriate classification of a tax intervention is important it has no effect on the quantum of tax paid over to the Exchequer.

- 27.86** For most of the sample cases reviewed, the examination found that the taxpayers' liabilities had been either calculated by Revenue or Revenue had validated calculations by a taxpayer's agent and that interest and penalties had been applied in accordance with legislation. However,
- In 18% of cases reviewed there was insufficient documentation on file to show how the tax liability had been quantified.
 - Interest was applied in 93% of cases reviewed, including two cases where round sum settlements were made. No interest was applied in two cases and the interest charged in a further three other cases was not the full amount due.
 - The examination found that, where they were applied, the level of penalties was lower than the files indicated should have been charged in a third of cases. No penalties were applied in two cases reviewed although the evidence on files indicated that penalties would have been appropriate.
- 27.87** Analysis of all audit settlements reached in 2012 showed that for those cases managed by the Large Cases Division, the proportion of settlements to which interest and penalties were applied was significantly lower than the cases managed in the regions.
- 27.88** The Accounting Officer stated that interest and penalties in the cases managed by the Large Cases Division are applied in line with legislation and the Code of Practice, and there are legitimate reasons why both are lower than those in the regions. For example, the nature of the case base in the Large Cases Division, mainly large corporates, means that the issues identified in audits can often relate to technical adjustments which do not result in a penalty. Where a penalty is applied, it is applied at the appropriate rate per the Code of Practice.

Recommendation 27.2: Revenue should review the mechanisms it has in place to ensure that interest and penalties are quantified in accordance with legislation and its Code of Practice. It should consider putting in place a quality assurance system whereby a sample of files are reviewed and shortcomings that are identified are addressed. This could help to ensure consistency of interpretation and application of the legislation and the Code of Practice and provide assurance to Revenue that taxpayers are treated equitably.

Accounting Officer Response: Agreed. The nature of an audit, in particular when it comes to negotiating the audit settlement, varies significantly from case to case and while the legislation and the Code of Practice provide the auditor with a structure within which to operate, the auditor must use judgment to weigh up all of the facts and circumstances in a case to come to a fair and workable settlement. Several initiatives have been introduced since July 2012 to enhance the quality of the compliance intervention process. Enhancing the quality of our interventions will continue to be high on our agenda. The referral of audit settlements to Revenue's top management, on a random basis, introduced in July 2013, will considerably enhance our capacity to identify shortcomings in the process. In addition, a programme of quality assurance checks of cases selected randomly will be implemented by the Planning Division by 2014 and will help to underpin this.

- 27.89** The highest audit settlement in 2012 was for €15 million in Case B. Notwithstanding the technical complexity of the case and the amount involved, the case was not referred within Revenue to its anti-avoidance unit. The evidence around negotiating the settlement indicated that Revenue could have added rigour and transparency to its approach through making the taxpayer aware of the potential liability, and clearly documenting internally Revenue's assessment of the probable outcomes of litigation.
- 27.90** The approach taken in the case with the second highest settlement of €8 million in Case A contrasted with the approach taken in Case B. In Case A, Revenue involved its anti-avoidance unit from an early stage and the taxpayer was made aware of the total potential liability in the course of negotiations while the case also showed that Revenue considered the likely outcome of litigation in the course of the settlement negotiations.

Recommendation 27.3: Revenue should

- review its approval process and consider setting up a settlement approvals committee for specified types of cases e.g. cases of high value, cases of technical complexity and cases with a high degree of risk
- where there is a difference between the estimate of liability and the settlement amount proposed, consider requiring approval at the level of the original Revenue assessment (including appropriate interest and penalties) in order to ensure the potential tax foregone is reviewed at the appropriate level.

Accounting Officer Response: Agreed. Further consideration will be given to these recommendations. Revenue has in place a robust approval system requiring at least one approver at management level. Depending on the size of the settlement, approval at District Manager, Assistant Secretary and Commissioner level may be required. The standard conduct of a settlement negotiation involves regular internal consultation, as well as attendance by managers at meetings with taxpayers. In addition there are monthly management meetings chaired at Assistant Secretary level, or at the four-monthly results review meetings of the Assistant Secretaries, chaired by a Commissioner, where the level of sanctions applied to audit settlements is discussed in detail.

In July 2013, the case management systems have been modified to remind the approver to satisfy him/herself that the quality standards have been met in relation to the recording of the audit. Furthermore the systems also allow for the referral of a percentage of audit settlements, irrespective of the amount of that settlement (including nil settlements), to Assistant Secretaries and members of the Board, for approval. These initiatives are designed to raise the awareness of the importance of quality case working. In the same vein, the programme of checks referred to above will help to reinforce the quality intervention message.

Recommendation 27.4: Where cases may be settled for materially less than the Revenue estimate of a taxpayer's liability, Revenue should consider (and document) the alternative outcomes that might be expected from litigation where this is the alternative course of action. It is acknowledged that significant judgment may be required and settlements may be complex. Matters to be considered include uncertainties about the possible outcome as well as the time, costs and risks involved in litigation. Decisions, and the rationale for them, should be fully and clearly documented before the file is submitted for approval.

Accounting Officer Response: Agreed. The Quality Compliance Intervention Standards launched in May 2013 will support implementation of this recommendation and of that of 28.6 below.

Recommendation 27.5: Where cases involve technical complexity, specialist staff within Revenue (and externally where this is considered necessary) should be consulted and their opinions documented and recorded on the file.

Accounting Officer Response: Agreed. It is agreed that where it is necessary for an auditor to consult internally or externally, the specialist opinions should be documented and recorded on file.

Recommendation 27.6: In regard to the negotiation of audit settlements, Revenue should consider

- putting in place detailed guidance and procedures for the conduct of settlement negotiations
- requiring those negotiating the settlements to put forward Revenue's highest estimate of the taxpayer's liability including the appropriate interest and penalties
- setting up an experienced negotiating team which would be available to all units in circumstances where significant sums are at stake.

Accounting Officer Response: Agreed. All staff who participate in the audit training programme receive a module on settlement negotiations, where techniques are taught through a mixture of formal training, role plays and case studies. While the development of detailed guidance and procedures for conducting settlement negotiations will be considered, a strong emphasis is already placed on mentoring less experienced auditors through this phase of the audit process by having them attend meetings with senior staff where settlement negotiations are taking place. In addition, where particular technical issues are involved or large amounts are under discussion, the audit manager, and in larger cases the District Manager, as well as technical support, attend meetings with taxpayers and agents. Further consideration, however, will be given to the proposals in this recommendation.

Annex A - Penalties Rates for Defaults on or after 24 December 2008

Qualifying disclosure and taxpayers co-operation	Category of default	Prompted disclosure	Unprompted disclosure
All qualifying disclosures in this category	Careless behaviour without significant consequences	10%	3%
First qualifying disclosure in these categories	Careless behaviour with significant consequences	20%	5%
	Deliberate behaviour	50%	10%
Second qualifying disclosure in these categories	Careless behaviour with significant consequences	30%	20%
	Deliberate behaviour	75%	55%
Third or subsequent qualifying disclosure in these categories	Careless behaviour with significant consequences	40%	40%
	Deliberate behaviour	100%	100%

No qualifying disclosure	Category of default	No co-operation	Co-operation only
All defaults where there is no qualifying disclosure	Careless behaviour without significant consequences	20%	15%
	Careless behaviour with significant consequences	40%	30%
	Deliberate behaviour	100%	75%

Note: This table refers to defaults that occurred on or after 24 December 2008 (Finance No. 2 Act 2008), where the taxpayer makes a qualifying disclosure and also to defaults where no qualifying disclosure is made. The tax geared penalty is a percentage of the underpaid tax.