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"AN INTEGRAL APPROACH IN PREVENTING AND COMBATING TAX EVASION"

Topic 2.1

THE USE OF INFORMATION IN COMBATING EVASION

South African Revenue Service

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Case study

TOPIC 2.1 **THE USE OF INFORMATION IN COMBATING EVASION**

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EXECUTIVE SUMMARY

The purpose of this paper is to analyse the use of information in combating tax evasion by the South African Revenue Service (SARS). The analysis takes cognisance of both the internal and external environmental factors and in doing so fine tune the strategy. The strategy must support the vision, mission and higher purpose of the organisation within the legislative framework imposed upon SARS.

The point of departure is an understanding of the current situation faced by SARS. The history of taxpayers' behaviour is depicted by taking the turbulent political situation of the past. This is further expounded upon in more detail in the external and internal environmental analysis with specific emphasis being placed on the sources and use of information in combating tax evasion. This analysis reveals that the industry is very attractive, with globalisation having a major impact on SARS.

It is evident that both internal and external sources of information should be utilised optimally in order to effectively combat tax evasion. Various initiatives have been undertaken to obtain information, understand the environment and to combat tax evasion. This includes, inter alia, offering a tax amnesty to small business and building relationships with various bodies. Crucial in doing so are the development of relationships with governmental and non-governmental agencies both locally and internationally. By adopting this approach, historical factors affecting compliance levels will be addressed.

Information technology tools can be used to assimilate the data, develop trends and identify specific risks. This can assist with targeted campaigns in order to combat tax evasion. These campaigns may include taxpayer education initiatives to hardcore criminal investigations. It may be industry-specific or based on a specific hypothesis of non-compliance. It is thus imperative that the correct tools are available to

optimise the use of this information. Various opportunities for improvement are highlighted in the following analysis.

The changing environment creates challenges and opportunities to curb tax evasion. In order to reach the organisation's strategic intent, management is required to address certain critical issues, such as expanded electronic services; customised approach to compliance; strengthening partnerships and co-operation; transparency, clarity and simplification and workforce development.

The strategy deployed by SARS is aimed at making major in-roads in striving towards its vision and higher purpose. It is essential that the factors impacting on SARS be reviewed continually in order to ascertain the impact that it has on the environment. This will allow SARS to fine tune its strategy to any environmental changes.

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1. INTRODUCTION

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It is evident that both internal and external sources of information should be utilised optimally in order to effectively combat tax evasion. Various initiatives have been undertaken to obtain information, understand the environment and to combat tax evasion. This includes, inter alia, offering tax amnesty to small business and building relationships with various bodies. Crucial to doing so are the development of relationships with governmental and non-governmental agencies both locally and internationally. By adopting this approach historical factors affecting compliance levels will be addressed.

The changing environment creates challenges and opportunities to curb tax evasion. In order to reach the organisation's strategic intent, management must address certain issues. These issues include expanded electronic services; a customised approach to compliance; strengthening partnerships and co-operation; transparency, clarity and simplification and workforce development.

In the Information Age, 'knowing your client' is a maxim that affects government agencies as vitally as it does their private enterprise counterparts.

2. SOUTH AFRICAN CONTEXT

2.1. SARS Mandate.

The South African Revenue Service Act No. 34 of 1997 gives the entity the mandate to perform the following tasks:

- collect all revenues that are due;
- ensure maximum compliance with the legislation; and
- provide a customs service that will maximize revenue collection, protect the borders as well as facilitate trade.

The money raised by SARS through the imposition of taxes, duties and levies account for the bulk of the funds required by government. The funds are used by government to provide basic services such as education, health, welfare, maintaining national security and ensuring law and order. In addition, government invests in the infrastructure of the country for sustainable development e.g. roads, railways and telecommunications. If SARS is unable to fund government spending, basic service delivery to South Africans may be compromised. SARS therefore plays a pivotal role in developing the country and the economy and exists to improve the quality of life for all South Africans through the taxes raised and trade facilitated. The effectiveness of SARS is dependent on a variety of external factors such as the state of the economy, public support for the priorities of the government and the willingness of taxpayers to comply with tax rules.

2.2. The South African Reality.

Since the inception of a new democratic government in 1994, South Africa has undergone enormous change on all levels of society and the economy. South Africa's political past has played a significant role in the country's history of non-compliance with tax laws. Since the start of change in 1994, as more previously disadvantaged people became economically active and eligible for tax, no incentive existed to attract them into the tax base. Many eligible taxpayers also are uneducated and/or ignorant when it comes to tax obligations and the importance and value of all paying tax.

The following factors also contribute to the general climate of non-compliance in South Africa:

Historical factors

- Tax and duty evasion is not generally considered as serious a crime as the more conventional types of crimes where victims are affected directly;
- Certain "facilitators of revenue-related crimes" (e.g. lawyers, accountants, financial advisors, and consultants) have managed to create a base for their services to non-compliant taxpayers whereby they assist them to evade taxes or duties;

- Since 1994, criminals have increasingly abused the birth of democracy and increased opportunities resulting from an increase in trade, relaxed exchange controls and non-restrictive movement across borders. Criminals tend not to declare their income derived from illicit activities;
- Within the informal economy, which is substantial in South Africa, an element of criminal opportunism will always be found; and
- Sanctions imposed on South Africa pre-1994 resulted in the circumvention of customs-controls to facilitate sanction-busting. Over time, the existence of weak customs-controls provided opportunities to defraud Customs which led to the expansion of irregular trends and habits in different sectors of the economy, and the strengthening of criminal elements.

Other factors

- The opportunities provided by globalization as well as rising unemployment have contributed to an increase in the informal sector and cash economy. This has directly influenced the South African compliance landscape in that the country is characterized by a dual economy; that is, a sophisticated industrialized economy operating alongside an undeveloped informal economy that also includes elements of a cash economy and shadow economy of crime syndicates.

  Global trends affecting SARS include:

  a) Advanced passenger and cargo information;
  b) Automated data collection – e.g. Smartcards;
  c) Legislation to address privacy concerns;
  d) Extending the borders and implementation of a secure supply chain;
  e) Innovative sourcing of support and non-essential functions;
  f) Global terrorism threat; and
  g) Money laundering activities.

  Specific regional trends that need to be addressed include:

  a) Political and economic developments in the Southern African Development Community (SADC), Southern African Customs Union (SACU) and African Union (AU) regional co-operation; and
  b) Meeting objectives as set out in the New Partnership for Africa's Development (NEPAD).

- The efforts of government and the changing environment also impact on the compliance climate in the country in the following ways:

  a) The shift of focus and change in general in the State has weakened its ability to function optimally. This is further compounded by the change in the legislative environment;

  b) Opportunism and expectations of entitlement by some citizens in general;

c) While the State is able to define those aspects that are not considered favourable for growth and development and similarly what is envisioned as desirable for the future, the road to the developed state is still wrought with obstacles;

d) The risk of the State being "captured" in particular scenarios by different market forces or stakeholders has diminished. Previously the State and business were very closely aligned – as SARS changes/adapts, increasing resistance by business is experienced; and

e) Black empowerment presents unique challenges to SARS, when considering the intention of empowerment and weighing that against accountability and governance.

- In 1998 just over 5.8m taxpayers were liable for income tax. Those with taxable incomes of less than R40 000 constituted 50 percent of the number and contributed to 8% of the total taxes paid. Taxpayers with taxable incomes of R100 001 and higher represented approximately 10% of the total number of individuals but contributed 46% of the total taxes paid. Estimates for corporate income tax revealed that the overall effective rate may have been as low as 9% compared to a statutory rate in excess of 30 %;
- Substantial opportunities for evasion and tax abuse are linked to corporates and high net worth individuals because of the potential for tax arbitrage and the fact that high net worth individuals have access to significant resources to engage in aggressive tax planning and non-disclosure of off-shore investments. Consequently there are huge disparities between the statutory and effective tax rates of these groups;
- The more regulated industries boast higher compliance levels. A sector that assumed prominence in recent years is that of the financial services, the growth of which was accelerated by globalisation and the information age. The introduction of new financial instruments coupled with the difficulty of tracking these transactions offer significant opportunities for tax evasion; and
- With regard to customs, compliance levels are negatively impacted by the existence of a complex tariff regime and unwieldy, manually-driven procedures. Further, the system is vulnerable to fraud and collusion due to the necessarily close and frequent interaction between traders and customs officials coupled with the staggering amounts involved and their impact on business operations. For a customs official earning a nominal salary, this poses a high risk for corruption of varying degrees.

3. ENVIRONMENT

Ideally information should filter into the risk model from both external and internal sources. External environmental scanning should identify those factors which could prevent the organisation from achieving its objectives. This information should be consolidated and centralised in a database. A similar process should be adopted with internal risks identified through the internal environmental analysis. By applying intelligence to the risk assessment, non-compliance risks can be highlighted. A mechanism should be adopted (framework, processes and systems) that will produce risk ratings and prioritisation that will inform interventions for specific transactions / trends. These risks can be communicated so that relevant parts in the organisation can define appropriate measures to mitigate risk and implement the most appropriate risk response. Risk monitoring is not a once-off process. Changes in the environment need to be regularly. This will provide the organisation with the knowledge to improve business processes, responsiveness to their customers and adapt to changing economic conditions.

It is essential that targeted risk knowledge identifies and informs the organisation of risks at a strategic, tactical and operational level in order to achieve its objectives. The supply of strategic intelligence brings the appropriate focus, detail, attention and understanding of the key environmental risks to the organisation as a whole. The risk capability provides tactical and operational intelligence that, in turn, provides the relevant risk-related analysis for the prioritisation and increased effectiveness of compliance activities.

4. EXTERNAL ENVIRONMENT

4.1. Background.

Factors in the external environment that impact on an industry are defined in Thomson and Strickland (2001 : 93) as the driving forces, i.e. the major underlying causes of changing industry and competitive conditions. They argue that, whilst there may be many forces influencing an industry, there are usually only three or four which are likely to be the "… major determinants of how the industry evolves and operates" Thomson and Strickland (2001 : 99). It is therefore essential to identify those driving forces that are likely to dynamically influence the future trends of the industry.

Taxpayers and Government have a mutual interest in maintaining the integrity of the tax system, thereby ensuring that:

- it is convenient for taxpayers to comply with their obligations and secure their entitlements;
- compliance costs are kept to the minimum compatible with effective tax administration; and
- tax evasion is addressed so that (those) compliant taxpayers are not disadvantaged and public services can be adequately funded.

There will inevitably be those who will regard globalisation as an opportunity to evade taxes. For example, electronic trading provides opportunities for fraud similar to those that exist with cash. It, however, also has the potential to amplify significantly some existing areas of risk. Techniques for detecting and deterring those attempting to evade taxes must therefore keep pace with the development of technology.

Thus, in addition to being mindful of specific threats, law enforcement and revenue agencies should aim to gain an understanding of the specific characteristics of the emerging environment that, individually or in combination, may generate new types of crime. Countermeasures can then focus on these general characteristics, as well as specific identified known threats.

Had it not been for concurrent revolutions in globalization, deregulation of trade and related technologies such as telecom, computer networking, computing power and satellite systems, the impact of the internet might have been far less.

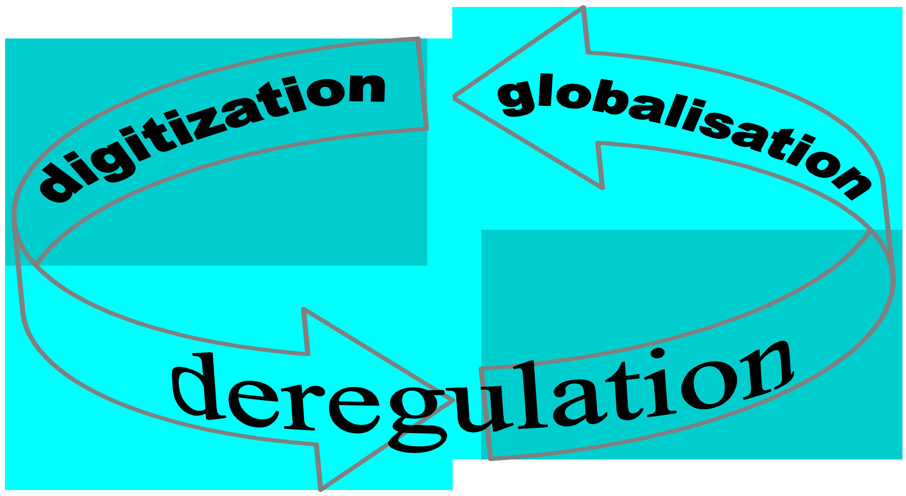

Figure 5.1: The trio of forces in the 'new economy'

Source: Downes and Mui, 2000.

These concurrent revolutions, according to Downes and Mui (2002), created a trio of new forces with digitization spurring on deregulation of industries and globalisation of markets. Global competitors are created where only local players previously mattered. These give power to customers, suppliers and new entrants, upsetting the previous careful cultivation of competitive advantages that were based on now-obsolete technology. The new technology undermines customer relationships, distribution networks, competitor behaviour and economies of size and scale.

With digitisation, information is being moved to computer systems and public networks where it can multiply in value. The more global the economy becomes, the more local regulations tend to restrain the industries they were enacted to protect, increasing the velocity of deregulation. Deregulation opens previously closed markets to competition, exposing chronic underinvestment in technology. And so the cycle continues.

These developments spurred the shaping of the 'new economy' in the following ways:

- <u>Computing devices</u>: Freeing people from mundane tasks and increased rate of work-flow. Increases in computer power and a reduction in size continue;

- Networks: one PC alone is a powerful tool, but two PC's are able to share information and resources and are clearly more powerful. As more computing devices are added, the network increases in power;
- Telecommunications: the growth in global telecommunications infrastructure continues. Today, fibre optics, satellites, mobile phones and other related devices drive this growth;
- Globalisation: in the past, the motor car and aeroplane played the most important role in bringing people from different nations or regions together. Today, television and telecommunications play a vital part in opening a window to other countries and cultures and to exploring new business opportunities;
- Internet: the internet supplies information and resources available through millions of connected networks around the world. It is a vast store of information, knowledge and ideas; and
- E-Business: E-Business is a holistic look at how the organisation can benefit from these new technologies. Companies need to progress towards being more flexible and agile to cope with the increased rate of change. The higher the degree of automation, the higher the ability to adapt to the environment.

These developments culminated in a shift in the world's economy from an industrial to an information base in just over a quarter of a century. It becomes ever more difficult to control tax evasion if there is no information available on economic events that have fully or partially taken place abroad, on individuals domiciled in other countries and on properties located abroad. Issues such as transfer pricing, tax havens, treaty shopping, under-capitalization, electronic commerce, among others, are recurring concerns in tax administrations throughout the world. Without mutual assistance among these administrations that may afford them the possibility of counting on reliable and timely information from abroad, their commitment to exercising control becomes a very difficult task.

4.2 E-commerce and Tax Compliance.

Government is encouraging and assisting taxpayers to comply with their tax obligations. This applies to those taxpayers engaged in e-commerce as it does to those trading by more traditional means. Taxpayers are more likely to comply if:

- they understand and have confidence in the laws they have to observe;
- it is easy to comply; and
- compliance is a positive move giving certainty and reflecting good citizenship.

Encouraging and improving compliance is achieved by respecting taxpayers' rights and helping them recognise their obligations under the law. Publicity, taxpayer education and support are all essential to achieving these goals.

Government is rewriting tax law to make them more transparent and simple to apply. E-commerce provides an opportunity for Government to interact with business in a direct way. It has the potential to provide access to structured information on demand as well as interactive services.

To assist in this process, the Government should:

- adapt the design of income and corporation tax returns to incorporate a request for a business to give its web site and e-mail address. This could, in the future, bring the advantages of speedier communication and enable SARS to target sector-related information or guidance;
- examine how developments in technology might be used to reduce compliance costs on business during the audit of electronic data, books and records, within acceptable risk parameters;
- encourage taxpayers to use e-filing;
- consider, in particular, what guidance small- and medium-sized enterprises (SMEs) that are starting to trade over the internet and, perhaps, internationally for the first time, need to help them comply with their obligations; and
- use the opportunities offered by technology to assist taxpayers to comply with the law and to help keep compliance costs for business down.

Information is the key to addressing the risks and maintaining the effective administration of both direct and indirect taxes. It should be accessible to SARS to the same extent as the case with more conventional means of commerce. Consultation with business is required to ensure that any measures considered necessary to deter, uncover or rectify non-compliance should have proper regard to the costs they may impose.

Confirming the integrity and authenticity of data provides a challenge in the electronic environment both for business and tax administrations. They have traditionally relied on paper-based audit trails - with its inherent look, feel and authenticity. Data held in electronic form does not at first glance provide these comforts. It can be corrupted unintentionally or otherwise manipulated before presentation.

Electronic audit methods are being developed to address these problems and to deliver the level of assurance that businesses and tax administrations need. Business will inevitably lead the way in developing secure systems. It is in their interest to maximise performance through reliable information systems whilst, at the same time, minimise the risk of fraud. Government will need to discuss its requirements with business and conclude on the adequacy of assurance for tax compliance purposes.

E-commerce is essentially a new means of trading. SARS needs to understand how it performs, the type of trade attracted to it and the ambit of activity. While the reasons for non-compliance will not be new, there will however be lessons to be learnt on the specific methodologies in use.

4.3 Use of Tax Havens.

Government is adopting legislation to prevent companies from avoiding tax by diverting profits to controlled foreign companies (CFCs). A CFC is a company that is resident in a low-tax territory and controlled from South Africa.

There are substantial similarities between the techniques used to commit tax crimes and those used to launder the proceeds of other crimes. The use of artificial arrangements and offshore financial centres is common to both money laundering and tax evasion, and various regulatory systems have been designed to facilitate the flow of information between tax and anti-money laundering authorities at the national level.

The most widely disseminated form of information exchange used in the past was through clauses included in the broad treaties to avoid international double taxation. At a very early stage, the agreements and model agreements on the subject included specific clauses regarding the exchange of information, initially for the exclusive application of the agreement itself and, progressively, expanding such purpose to also consider the struggle against tax evasion.

The international exchange of tax information is a key factor, acquiring ever greater importance so that the tax administration may effectively control compliance with tax obligations and, accordingly, ensure an equitable application of taxes in an international scenario.

Information exchange at the international level may take place informally, that is, without there being any conventional commitment and, merely as a result of an attitude of courtesy or solidarity among countries. However, no matter how useful it may be, this form of exchange faces such inconveniences as insufficient juridical support, the fact that it is sporadic, inarticulate and subject to all internal legal limitations of the informing country and its willingness as regards timeliness, extension and the way the information will be provided. In view of such circumstances, currently it is recognised that there is a need to enter into international agreements that would allow the contracting States access to information that could otherwise not be obtained through means and sources available internally. At present, South Africa has 57 fully ratified treaties, 9 comprehensive treaties and 3 sea and air treaties in place. Negotiations are currently underway to expand the number of treaties by a further 22.

A Large Business Centre (LBC) was launched in September 2004 as part of the overall strategy to become more taxpayer- and trader-oriented. The LBC was designed to provide a one-stop facility to meet the needs of an important group of taxpayers. Large business is a distinct community with sophisticated and wide-ranging tax issues, and the complexities of these issues are increasing with the advent of new technologies and globalisation. This has created the need for tax technical integrity, industrial specialisation and relationship building.

4.4 Money Laundering.

Money laundering is the movement of criminally-derived funds for the purpose of concealing the true source, ownership, or use of the funds. Laundering is a necessity for any profit-generating criminal activity. Without the ability to launder their illicit proceeds, criminals fail because money sustains them, motivates them, and gives them power. Narcotics traffickers, perpetrators of financial fraud, organized crime groups and others invest considerable effort into laundering their illicit proceeds.

Weak financial regulatory systems, lax enforcement, and corruption are key factors that make certain jurisdictions particularly attractive for laundering illicit proceeds by international drug trafficking and other criminal organizations, by terrorist groups financing their activities, and even by states undertaking financial transactions to evade international sanctions to acquire various technologies and components.

The global nature of the money laundering problem is clear. The world's financial markets are becoming increasingly intertwined, and free trade agreements and customs unions are increasing the movement of goods and people while blurring traditional borders. These new global systems, fuelled by technology, also allow criminals and their money to move easily from one jurisdiction to another, as they seek less regulated areas to hide.

The international community is responding: trans-governmental groups composed of financial, regulatory and judiciary specialists are working in a variety of ways to share information and expertise to fight money laundering and other crimes. Although they act internationally, they do so in their own national interest to improve enforcement of domestic laws and regulations, and to protect their financial systems from criminal abuse. Formidable challenges are posed by bank secrecy havens, alternative remittance systems, the development of new payment technologies, and the continuing evolution of the financial services industry. All nations must join the international community, working together to insure the stability and integrity of our financial systems, our economies and our governments.

South Africa has also adopted money laundering laws to help it comply with its international obligations to fight organised crime and terrorism. The latest and most comprehensive legislation detailing money laundering controls is the Financial Intelligence Centre Act (FICA), the focus of which is on control requirements.

FICA creates money laundering control obligations for banks and other institutions and professionals, such as estate agents, brokers, attorneys and insurance companies.

Customer identification is therefore a crucial element of any effective money laundering control system. Reasonable measures have been implemented to identify the customers and to prevent criminals from using false or stolen identities to gain access to services.

4.5 Tax Professionals.

The professional integrity and expertise of tax professionals and advisors also impact upon the compliance climate in South Africa. Rocked by the recent global scandals relating to accounting misrepresentation and fraud, the accounting profession needs urgent intervention to enhance its credibility. As many tax professionals come from this environment, this also impacts on the level and willingness to voluntarily comply with tax and customs legislation. Furthermore, because of the complexity of the tax environment and degree of literacy required, the opportunities for increased business make this a prime area for the proliferation of 'quasi' professionals who are not regulated. These factors create a tax-paying environment that is rife with aggressive tax planning schemes and outright evasion (underreporting of income and overstatement of deductions). “Facilitators of revenue-related crimes” (e.g. lawyers, accountants, financial advisors, and consultants) have managed to create a base for their service to non-compliant taxpayers whereby they assist them to actually evade taxes or duties.

SARS uses intelligence from compliance activities to ensure that a particular tax practitioner is not encouraging or facilitating taxpayer non-compliance. Tax practitioners are monitored for compliance with their own tax obligations, including filing of tax returns and payment of tax debts. Where there is evidence that tax practitioners are encouraging or facilitating non-compliance or have poor performance in their own tax compliance, they are investigated and, where appropriate, the matter referred to the relevant professional society or the practitioner is prosecuted.

4.6 Amnesty.

Exchange control and tax amnesty

According to the Minister of Finance in his National Budget Speech of 15th February 2006, a total of 42 672 applications for amnesty have been dealt with, and a total of R68,6 billion in foreign assets have been disclosed. The regularisation of the foreign asset holdings and tax obligations of the vast majority of applicants means that they can now manage their financial affairs without fear of criminal or civil prosecution. It also raises the declared income tax base by some R1,4 billion, and contributes to the statistical records of the Revenue Service and the Reserve Bank. The R2,9 billion in revenue raised through amnesty levies will be assigned to joint public-private partnership investments in community infrastructure and business development in low-income neighbourhoods.

Small Business Amnesty

Small businesses play a vital role in stimulating economic activity, job creation, poverty alleviation and the general upliftment of living standards. Many small businesses operated informally, were historically marginalized and were excluded from the economic mainstream, thus remaining outside of the tax system. These small businesses are now keen to regularize their tax affairs but their past non-compliance and the resultant potential tax liabilities, penalties and interest remains an obstacle. Recently, the exchange control and tax amnesty catered for the regularization of the more sophisticated and affluent taxpayer. There has been criticism that no similar opportunity has been made available for small businesses.

SARS efforts to broaden the tax-base and “walkabouts” in informal business areas have shown that numerous small businesses, though not registered, would like the opportunity for regularization without fear of tax liabilities arising from past non-compliance. Bringing people into the tax net is not always about immediate gains – it is also about future contributions and general improvement in the culture of compliance. This amnesty therefore enables both compliance and regularization. As businesses grow, they are able to see the benefits of moving into the formal economy. One part of this growth is about positively changing their relationship with government, as well as SARS as a revenue administration. It will also eliminate any uncertainties in respect of taxation that may exist among partially-compliant small businesses.

4.7 Sources of information within South Africa.

In order for SARS to effectively and efficiently carry out its mandate to the South African nation it is essential that relationships are developed in order to obtain and share information that supports its mandate to maximize its return on investment. To do this effectively, information sharing is crucial to the whole process. Working together and sharing information with other agencies and reliance on third-party co-operation will all assist in realising the mandate of SARS.

The following few examples will show how the above operates in practice:

- information gathered from Government Departments, for example the Department of Environmental Affairs and Tourism can assist SARS in evaluating and verifying whether total income or turnover of a particular taxpayer has been disclosed. Crucial information such as fishing quotas can be independently used in support of our case;
- independent opinions expressed by Public Accountants & Auditors also assist SARS in evaluating the risk of non-compliance by Taxpayers. Usually, a negative report will indicate that a risk may exist that a certain taxpayer is not complying. Relying on these professional reports and opinions is assisting SARS in its efforts to improve voluntary tax compliance. Accreditation of accountants for e-filing is another example of this type of relationship;
- relationships and information sharing with Trade Organisations, Local Authorities etc. assist SARS in obtaining information that may be generic to a large group of individuals or businesses and this can lead to a further broadening of the Tax base in registering those people for Vat, Income Tax and other taxes. This also may bring on board role players in the informal sector of the economy in the long run;
- government Agencies sharing information with SARS may result in additional revenue collections as income earned from an illegal source is still subject to Income Tax. Information to assist with anti - drug and smuggling campaigns can be shared with SARS by Law Enforcement Agencies;
- in order to complete the circle of compliance from the time an assessment has been raised until such time the book debt has been finally paid there can be various role players involved. The process of raising additional revenue for the state is only complete once the debt so created has been fully paid;
- in order to facilitate the effective collection of such debt, the Master of the Supreme Court, the Deeds Office, Executors of deceased Estates and Liquidators of Corporations and Companies all play an important role. The Credit Bureau is another source of information as to the creditworthiness of taxpayers. The Department of Home Affairs can also assist with the follow up of taxpayers especially where they are leaving or have left the RSA;

- Public Corporations, where major groups of individuals have assets, can be approach to support SARS in the collection process indirectly. An example is the Demutualization of Long Term Insurance Companies;
- Professional and Industrial Bodies can be a reliable source of information as certain professional occupations are subject to registration by law. Tax base broadening, compliance of members of such associations as well as the collections process can be enhanced by these sources; and
- information sharing within SARS between the Customs and Revenue arms can lead to increased compliance and improved revenue collections. Items of particular interest are Vat and the value of trading stock from an Income Tax perspective.

The above outlines but a few examples of reliable and accurate sources of information that can play a pivotal role in combating tax evasion. The dynamics of an integrated information network is the ideal in order to maximise revenue collection and combat tax evasion.

5. INTERNAL ENVIRONMENT

5.1 Background.

According to Thomson and Strickland (2001: 129), an organisation's value chain identifies the primary activities that create value for customers. Disaggregating an organisation's operations into strategically relevant activities and business processes exposes the major elements of the company's cost structure and determines its competitive advantage.

An organisation's value chain and the manner in which it performs each activity reflects that evolution of its own particular business and internal operations, its strategy, the approaches it is used to execute that strategy, and the underlying economics of the activities themselves.

5.2 Processes.

It is imperative to first analyse the value chain in order to determine how the organisation can become more effective and efficient. It is essential that SARS perform its value chain activities in ways that give the administration the capability to outmatch its rivals. This will lead to a competitive advantage for SARS.

<u>Multiple tax types and product silos that do not communicate well with each other</u>: in one way or another tax types are interlinked and can show up other areas of non–compliance. It is essential that the processes are interlinked where there are interdependencies between these silos. An example of this is a taxpayer that is registered for VAT but not for Income tax. This should not (and will not) continue if an integrated system is used.

Duplicated and disconnected business processes and IT systems: the core operational processes should be simplified by utilising the appropriate technology. SARS is developing a systems integration plan to ensure stability and provide the necessary infrastructure that will create a more effective and efficient operation.

Benefits of an integrated approach include the following:

- the customer-centric approach ensures an integrated service delivered with regard to all revenue products i.e. a "total business-solution";
- customer services of high quality form an integral part of the entire revenue product package and processes are holistically seen i.e. a "single view of SARS by the customer";
- due to the fact that the entire process is integrated, quality controls at all stages of the process will of necessity take place and are included in the manner in which the processes flow;
- performance of SARS officials, during all stages of the process, will be measurable;
- the processes will not be time-bound, as the performance thereof will not be bound to office hours and information can be received via various mediums and from various sources;
- the option/possibility of outsourcing certain parts of the processes can be investigated and/or considered;
- the processes relating to the various revenue products will be integrated, and compatible formats can/should be developed to ensure uniformity throughout; and
- quality control, service and engagement become inherent parts of each specific process and measurable in terms of each output and product for each process.

If SARS truly wants to aspire towards its strategic intent, it is essential that the value chain be analysed in terms of efficiency and effectiveness gains with the view of the taxpayer in mind. There are many areas of overlap between these value chain activities which lead to potential synergies being created once re-designed.

5.3 Technology.

Systems do not permit a single view of the taxpayer across tax types: as the various tax systems are not integrated, it is currently not possible to have a single view of the taxpayer. The Income Tax, VAT, Customs, Pay As You Earn (PAYE) and other systems are stand alone systems and are not integrated in any manner. This has huge disadvantages as the service provided to the taxpayer suffers. The taxpayer has more than one registration number and has to contact different offices to direct queries relating to the various tax types.

Outdated information technology systems that do not compliment each other: synergies between the systems are absent. An example could be someone who is being paid a VAT refund might actually owe SARS money for an Income Tax assessment. The money will be paid out in any event as the systems do not speak to each other.

The use of Information Technology has brought about a revolution in the manner in which business operations are carried out throughout the world. More and more operations are being carried out 'on-line', reducing the time taken and taking the world towards 'paperless' operations. Thus the use of 'Electronic Data Interchange'(EDI) has come to be accepted widely as the means of interface between business partners as also Government agencies.

<u>Encourage the automation of all processing activities</u>: a substantial percentage of human resources are also dedicated to this task that could probably be more productively used in compliance and taxpayer services initiatives. Most of this processing is formulaic and amenable to automation. Add sufficient value, give the system a user-friendly aspect, provide plenty of hyperlinked online help, make kiosks available for taxpayers who don’t have network access, and establish an intelligent well designed front-end for taxpayer data entry, feedback and interactivity and much of the processing workload will disappear.

<u>Encourage real-time rather than batched information processing</u>: customer service will be regarded as a more user-friendly process if taxpayer information can be checked and validated against other sources and assessments or bills are received in real time. Real time correlation between taxpayer information, and information provided by employers, other traders and enterprises up and down the transaction trail should also be possible.

<u>Integrate information technology systems</u>: the next generation Business to Business (B2B), Business to Government (B2G), Government to Government (G2G), Business to Client (B2C) and Government to Client (G2C) interactions will require that SARS systems are connected in real time, and can exchange and process information from each other relatively seamlessly before a third party is brought into the equation. The ideal would be to integrate all of the above under a single automated real-time infrastructure.

<u>Design SARS client systems and business processes effectively for the new environment</u>: at present, systems mirror their non-electronic counterparts, rather than capitalise on the advantage of the new environment. Electronic forms reflect their paper counterparts item for item and clients are requested to provide the same information in any number of different forms that may be required. If the systems are integrated, this should not occur. New business models, forms, customer relationship management techniques and client interaction models need to evolve if networks are used to their full potential.

<u>Tailor the electronic form to the taxpayer client</u>: most electronic forms are mirrors of their generic paper counterparts. The majority of advantages of electronic forms are overlooked. It should be possible for the taxpayer to log onto the related SARS system, enter the file number or other identifier, and have a return or e-form constructed immediately-that is, a form which is consistent with the entity being lodged, the industry, the location it falls under, the income sources and deductions

disclosed, and any other circumstances that are pertinent to that entity. This benefits both the taxpayer and SARS and results in relevant and timely information.

Build client relationship management systems that can automatically deal with the majority of taxpayer enquiries and contact: as much experience is available in various technical areas, thus it should be possible to build very sophisticated network-enabled databases from previous client contacts. Most of these databases, if properly assembled and indexed for search purposes, would forestall the need for many taxpayers to contact SARS in person on routine enquiries and contacts.

Encourage creative information validation and data matching: time and resources are mainly spent on collecting and processing dated information supplied by taxpayers in paper-based returns. A small proportion of information received is validated in audits against taxpayer records and records from a few third parties such as financial institutions, while a large part of the data is in need of ‘cleansing’. There are a vast number of third party sources for return validation data that could be used much more effectively than by current methods. These methods rely on intrusive ‘hit or miss’ audit methodologies which owe their existence to 1950’s accounting techniques.

Use real-time Business Intelligence systems, for risk management that continuously acquires and analyses information from a wide variety of sources: in the IT industry, these techniques are called ‘data-warehousing’, ‘data-mining’, ‘customer relationship management’, ‘online analytical processing’ and, in the networked age, are allied with ‘search engines’, ‘bots’ and ‘agents’ to continuously update the information. The main criticism is that of being reactive and procrastinating. Systems and information are relied upon and are constantly actioning business transactions and tax affairs and matters that occurred years before. However, SARS operations require different financial, market and industry indicators in real-time rather than relying on a database of returns that captured events long ago. There is no shortage of networked, publicly available information and data sources that can do this.

Use open rather than proprietary standards for networked client interactions: ever-growing client contact via the internet should be pursued as clients will be using of different platforms, networked devices and technologies that SARS will have no control over. Developing solutions using open standards ensures that all of these clients will be SARS-enabled, and that SARS does not have to replicate expensive system development for each new technology and device that appears over time.

Establish network access between revenue collection agencies in different countries: previously trans-national operations were the exclusive purvey of large corporations, but in the new environment SMEs can participate in huge numbers. As has become obvious from several forums, we share many of the same strategies, problems and opportunities, and information-sharing and consultation has proved very useful.

‘Big systems development is out, manageable fast incremental development is in: previously big mainframe-based processing systems were developed over a period of three or four years. In the new environment, neither the luxury of time nor money is available to do so. The client-server and peer-networked world of the internet mandates that systems be developed quickly in small incremental chunks, with added services and functionality being added in each new iteration.

Add value to clients: this is probably the most important facet of all when developing IT and particularly Web systems. Unless the IT system adds value for the client when compared with traditional ways of conducting transactions, it won't be marketable. It must be easier, faster, cheaper, more convenient, and more accessible than any other alternative.

6. UTILISATION OF INFORMATION

It is essential that targeted risk knowledge is used that identifies and informs the organisation of risks at a strategic, tactical and operational level in order to achieve its objectives. The supply of strategic intelligence brings the right focus, detail, attention and understanding of the key environmental risks to the organisation as a whole. The risk capability provides tactical and operational intelligence, which informs relevant risk-related analyses for the prioritisation and increased effectiveness of compliance activities.

It is imperative that clients are evaluated holistically through an improvement of overall levels of compliance while reducing the costs of compliance to business. SARS should place an emphasis on critical processes where the customer meets the revenue service, such as registration, receipt of payments, filing and assessing of returns. Good service and quality within these initial processes must balance stringent enforcement actions.

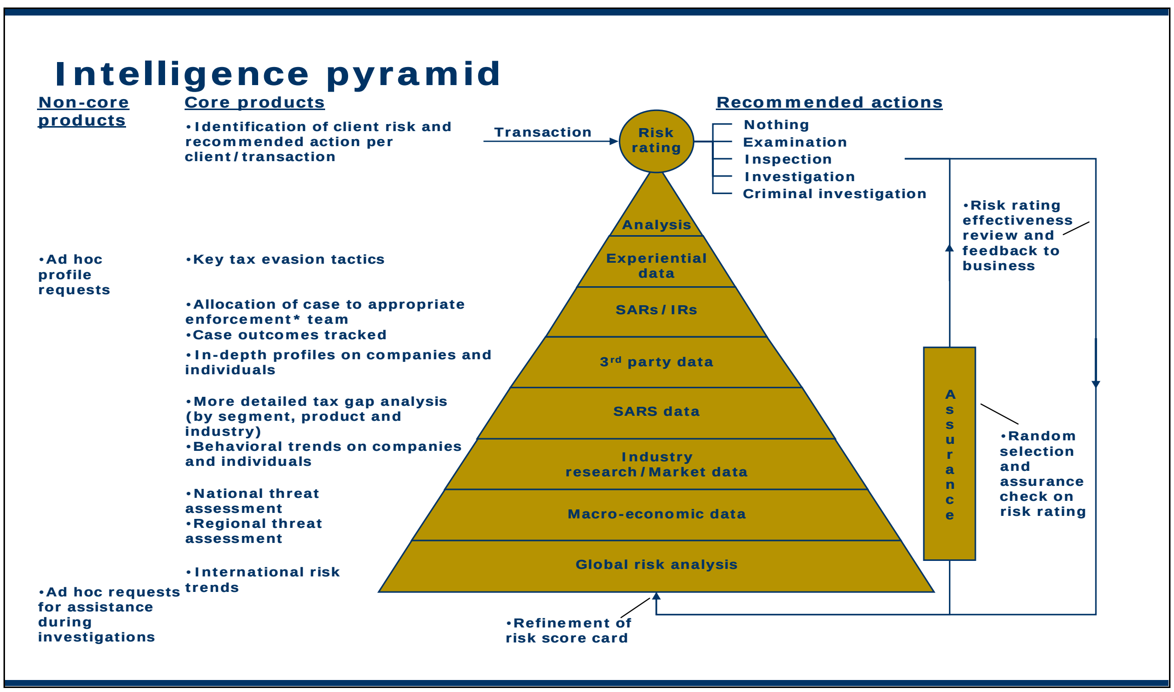

Figure 6.1: Risk Model

Source: SARS Intranet

This implies that Risk provides a supply of intelligence through the analysis of data and relevant information according to the requirements of the internal customers. The information processing capability will sort, analyse and refine raw data to prevent loss of valuable core activity time that currently is used to perform this function. It will provide timely and relevant knowledge to specific entities of the organisation. The intelligence will highlight external risks to SARS and trigger specific actions to mitigate non – compliance. It will provide an analysis of the taxpayer archetype in order to identify behavioural and market related trends that may increase the risk of non-compliance. In consultation with the other elements to continuously monitor changes in the environment that may pose a threat to the organisation and hinder the efforts of achieving SARS' strategic objectives. It monitors the environment to provide the organisation with the knowledge it needs to improve business processes, to be responsive to the needs of the other capabilities. Research products will enhance the understanding of the different risks, provide an in collaboration with Risk Control, Co-ordination and Framework & Internal Audit, to have developed and implemented a mechanism (framework, processes and systems) which will produce risk ratings that will inform interventions for specific transactions/trends.

The compliance model promotes the use of tailored responses to different taxpayer groups based upon their behaviour, compliance risk levels and history. A key theme continues to be the improvement of overall levels of compliance while reducing the actual costs of compliance to business. The model is intrinsic to the policy, legislative and administrative processes of the tax system and the manner in which SARS interacts with its customers. Good service and quality within these initial processes must balance stringent enforcement actions.

Taxation compliance behaviour is influenced by many factors - business, industry, sociological, economic and psychological - all of which influence whether an individual chooses to meet their obligations or not. The model shows a continuum of taxpayer attitudes towards compliance. At the base of the continuum, taxpayers have the desired attitude of actually being committed to compliance. At the other extreme, taxpayers have decided to engage in evasion.

The model also summarises the different sorts of support and interventions that may be needed to provide to collect the required revenue. The model suggests that SARS has the ability to influence taxpayer behaviour through timely response and interaction.

At one end of this continuum, they foster voluntary compliance through the timely provision of useful information and efficient, client-centred services. At the other end, they undertake responsible enforcement action to deter wilful non-compliance and promote the fairness and integrity of their border control, benefits payment, and tax systems. The right mix of services and enforcement across the entire continuum allows them to maximise compliance while minimising intervention and the burden on clients to fulfil their obligations.

Enforcement actions are reliant on the optimal functioning of these critical processes and draws on a broad suite of compliance tools compared to the compliance products upon which the organisation has relied in the past.

The strategy takes cognisance of the continuum between total compliance and total non-compliance. Taxpayers should be disincentivised from moving towards total non-compliance on the continuum, and encouraged moving further on the continuum towards total compliance. Compliance functions are part of all actions performed throughout SARS, and the strategy aims to address the different stages in the "life cycle" of a taxpayer.

Case selection is predominantly risk based, but is tempered with a degree of randomness, in order to cater for the requirements. However, where dictated by business-rules and legislative requirements, there will be a full coverage of compliance actions including maintenance actions. When customers de-register for particular products or in instances where credit balances inform refunds across the revenue-types, SARS will perform quality control in every instance. Risk profiling will recommend the ideal action based on the profile.

Information technology tools can be used to assimilate the data, develop trends and identify specific risks. This can assist with targeted campaigns in order to combat tax evasion. These campaigns may vary from taxpayer education initiatives through to hardcore criminal investigations. It may be industry specific or based on a specific hypothesis of non-compliance. It is thus imperative that the correct tools are available to optimise the use of this information.

7. CHALLENGES FACED IN THE 21ST CENTURY

In many ways tax administrations in the year 2000 are doing exactly what they did in the year 1970. Only the means and medium of doing so have changed. Tax laws that are administered trail social and scientific developments by a long margin and are often nightmarish in their complexity. A tremendous portion of our resources are devoted to processing information received from taxpayers in the form of tax returns. The taxpayer provides the data in a paper return, the information is re-transcribed onto various information systems, and this information is processed in batch mode, and that generates further paper that is sent to the taxpayer.

There is a reliance on information from the taxpaying clientele which is outdated and often unreliable. A significant portion of the resources are utilised to provide personal and person-to-person services to the taxpaying clientele. Work is concentrated at centralized offices and locations. Heavy reliance is placed on increasingly outdated accounting conventions and often-artificial geographical and jurisdictional limitations. Natural resources for example attract no value on the conventional company balance sheet, but most governments are attempting to conserve same. Most income taxes reward expenditure and discourage frugality and saving. Our tax regimes encourage personal, corporate and national debt, whilst our Treasuries bemoan the lack of national savings and funds. We encourage the artifice of trans-national corporate entities, and yet fail to associate those entities with actual productive, economic and trading activities in their supposed countries (often tax havens) of domicile. We are still coming to grips with phenomena like the multi-national corporation, profit shifting, corporate tax minimisation, tax competition and tax havens. And what had previously been the sole purvey of large corporations is now well within the capabilities of small to medium enterprises thanks to computers and the Internet. Many entities are allowed to hide behind legal and professional privilege.

We are redefining ourselves not solely as revenue collectors, but also as financial transaction monitors, economic observers and stock and financial market speculators. The major compliance problems that face us are still, broadly speaking, identity, evidence and jurisdiction although we are coming to grips with these questions in a multitude of different ways.

The information technology revolution is redefining our traditional focuses and boundaries and offering an increasing number of opportunities to expand our client services and increase our effectiveness as revenue collectors. It also offers a number of new threats to the revenue that we collect. At present we seem to be applying old business models, forms and methods to the new environment, but this will no doubt change as we refine our appreciation of electronic commerce, enterprise application integration and real-time automation, and integrate our IT systems better. Our personnel should be better educated, and far more conscious of the complexities of social, economic, technological and geo-political interactions than they have ever been. Broadly speaking they should be evolving into the valuable ‘knowledge workers’ we will need in the future.

We work in the context of a dynamic and changing world. Aside from the technological revolution, we also have social revolutions occurring, some due to environmental, some due to political and cultural, and others due to economic and geographical factors. With all this in mind, we must prepare ourselves for new demands and focuses in the next ten years. These will be generated by political, market, financial and economic, technological and environmental factors over which we have little control.

The next ten years offer a wealth of opportunities, in addition to the revenue threats that more often raise their head at an international level. ‘Master Plans’ or ‘Organisational Strategies’ in times of great flux such as now are probably not the most desirable alternative. More often than not such plans seem to waste away due to the exigencies of time and dynamic change which characterises the modern world. Rather, we should be making plans to become more responsive to that world and our clients. But, as a rule, bureaucracies are not good at this. We should be structuring our cultures, systems and business processes so that they are responsive and adaptable to change. We should not regard procedure, systems, law and regulation as something ‘written in stone’. We should not expect our client groups to adapt to us, we should be thinking about adapting to them. We should be value adding to our clients’ interactions and experiences with us.

The outstanding revenue agencies of 2010 will be those that have profited from the change. Those whose corporate culture and leadership have embraced change and the dynamics of the modern networked world.

8. WHAT DO WE INTEND TO DO

Responses to the various environmental changes will differ but a number of strategies will be useful in generating cost effective resource utilisation, more effective client service, and the reduction of compliance costs. To effectively contribute to Government's goals SARS will leverage its internal resources to instil a culture of compliance and enhancing citizen confidence in the tax and customs system. To sustain its performance while reaching higher thresholds SARS will focus on the following strategies:

- Creating a customer service culture which puts the needs of taxpayers, traders and the public first;
- A new business philosophy that defines a holistic and integrated approach to the management of people, processes, technology and organisational culture;
- Establishing an Enterprise Architecture that integrates revenue and customs where appropriate, and creates synergy between the core operating and support divisions at all levels of the organisation;
- Implementing a coherent approach to service, education and enforcement that is based on a segmentation model that assesses risk and responds to different needs and behaviour patterns among citizens;
- Integrated border management;
- Leveraging technology for electronic transactions, inspections and enforcement. Establish Accredited Client scheme to facilitate faster turn around in the Import and Export clearance process; and
- Develop Customs Transit Acquittal process to allow for greater control of goods being removed in transit and in bond.

These paradigm shifts require that SARS develops a sharper vision, a sophisticated and modern approach to work and the following portfolio of organisational capabilities that will enable us to achieve our goals. SARS will transform its culture and build organisational capabilities to:

- balance continuity (meeting targets through superior operational performance) with profound change (transformation);
- quantify the tax gap, profile and segment the tax base, and accurately predict future revenue streams;
- gather and analyse segment specific information to inform enforcement, service and education programmes;
- create a learning organisation that is equipped with knowledge management tools that create, archive and share knowledge across the organisation;
- investigate and audit to detect, measure, deter and correct areas of high risk;
- create and use meaningful information to guide executive decision making;
- develop a structured and systematic change management programme; and
- establish a strong base of people across the organisations that are passionate and enthused about serving taxpayers and stakeholders.

It is essential that SARS develops its strategies by taking the above factors into account. Should the proposed strategy be deployed, SARS will make major in-road striving towards it vision and higher purpose. It is essential that the factors impacting on SARS be analysed continually in order to ascertain the impact that they have on the current strategy. This will allow SARS to fine tune its strategy to these environmental changes.

The above risks are essentially common to the administration of tax systems throughout the world. Government recognises that a number of risks can best be addressed in co-operation with other countries. Where tax administrations have developed expertise, the aim should be to share best practice for application both domestically and internationally.

9. EXPECTED BENEFITS

SARS will be leveraging compliance and collections better by intelligently allying new technology with better administrative arrangements for collection. This will allow SARS to effectively reduce the cost of compliance dramatically. The information technology revolution will redefine traditional focuses and boundaries and offer an increasing number of opportunities to expand client services and increase effectiveness as revenue collectors. It also offers a number of new threats to the revenue collected. Personnel will be better educated, and far more conscious of the complexities of social, economic, technological and geo-political interactions than they have ever been.

The taxpayers will benefit as focus shifts from processing to compliance monitoring. This environment will be identified by improved taxpayer service that is professional and efficient and higher processing speeds that are accurate.

Resources and employees will be freed up to take a proactive role in revenue collection. They can regularly visit taxpayers and corporate clients to research their respective industries and enable early identification of new tax issues, compliance threats and opportunities for leveraging and timely client service. Servers and search engines can be used to monitor and gather data thereby regularly updating the Business Intelligence databases. Regularly meetings can be convened and forums held with different industries and taxpayer groups, to determine how best to resolve any outstanding issues. A real-time picture will develop of the economy and business environment, rather than dealing with an outdated view of it as was the case in the past.

Timely detection of a particular compliance threat and widely publicising it can become a compliance strategy that works in its own right. It also has the side effect of discouraging the migration of those compliance threats into the ‘widespread tax scheme’ arena. Public discussion with professional associations and other interested parties is encouraged with respect to these matters.

SARS can be a signatory to many OECD sponsored treaties and double tax agreements, and be diligent in extending agency cooperation with revenue agencies in other countries. Negotiations with various third parties, financial institutions, banks and electronic transaction facilitators will take place to ensure a high degree of cooperation and liaison between government and these sectors. These parties are efficiently and effectively used to leverage compliance freeing a large proportion of the tax base from any compliance obligations with respect to many taxes. The South African supply chains will be safe guarded which will also assist in safe guarding trade and investment potential. Emphasis will thus be placed on facilitating regional trade and economic development.

Each new business process, each new IT system, each new procedure or initiative, should be subject to stringent benchmarking against the current indices, and if it fails to improve on them is abandoned in favour of other alternatives. SARS will be a “Learning Organisation’. Encourage employees to train and educate themselves in an ongoing manner, to garner a wide range of experience, to do useful and creative research using the myriad of resources available to them, to investigate and report on various matters of ongoing concern. The ability to react quickly and responsively to their external environment should not be compromised

The networked age will be recognised, in which geographic boundaries have become even more intangible, they must bow to the inevitability of some multinational services being provided by others. SARS will be conscious that business competition is much more ferocious in the new environment, and that its actions, or failure to react, in given situations can often make or break a local business deal, a business, an industry sector or even an entire industry. For this reason it seeks to be a lot closer and more responsive to its client base than may have been considered proper or appropriate 10 years beforehand. In the Information Age, ‘know your client’ is a maxim that affects government agencies as vitally as it does their private enterprise counterparts.

10. CONCLUSION

SARS struggles with the legacy of an organisation, systems and culture that, like many South African organisations, is weak on service delivery and efficiency. In order to optimise the use of information to combat tax evasion it is essential that there is a detailed understanding of both the internal and external environment. It is evident that both internal and external sources of information should be utilised optimally in order to effectively combat tax evasion. Various initiatives have been undertaken to obtain information, understand the environment and to combat tax evasion. This includes offering tax amnesty to small business and building relationships with various bodies. Crucial to doing so are development of relationships with governmental and non-governmental agencies both locally and internationally. By adopting this approach historical factors affecting compliance levels will be addressed.

Information technology tools can be used to assimilate the data, develop trends and identify specific risks. This can assist with targeted campaigns in order to combat tax evasion. These campaigns may vary from taxpayer education initiatives through to hardcore criminal investigations. It may be industry specific or based on a specific hypothesis of non-compliance. It is thus imperative that the correct tools are available to optimise the use of this information.

The core business processes are inefficient as significant duplication exists between tax types and many of the processes are performed at sub-scale locations. The processes are not standardised across branches and as such efficiencies vary significantly between branches. The processes are fragmented, contain too many hand-offs and too many steps. There is also no prioritisation of work, resulting in a sub-optimal allocation of time and effort to high impact areas such as audit and collections.

The changing environment creates challenges and opportunities to curb tax evasion. In order to reach the organisation's strategic intent, management has addressed these critical issues. These issues include expanded electronic services; customised approach to compliance; strengthen partnerships and co-operation; transparency, clarity and simplification and workforce development.

The strategy deployed by SARS will make major in-roads in striving towards its vision and higher purpose. It is essential that the factors impacting on SARS be reviewed continually in order to ascertain the impact that it has on the environment. This will allow SARS to fine tune its strategy to any environmental changes.

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