

Intelligent Government – The Next Wave



## Network based transformation in **Tax** Systems



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# Introduction

**During recent years, government use of the Internet to provide services to citizens has grown significantly. The potential the Internet offers in terms of interaction between government authorities and citizens, information provision, transparency, and cost savings has led many European countries to begin to develop Internet-based services.**

One of the major priorities already identified by many officials charged with introducing electronic government is tax. Governments have quickly realized that electronic filing and taxation services could, if properly used, offer a way to greatly simplify the revenue collection process. In so doing, the hope is that this will lead to a closer relationship with taxpayers at a time when competition between tax authorities and the new challenges presented by the Internet and e-commerce are threatening traditional tax bases.



# Challenges Facing European Revenue Authorities and Governments

**Capital movements, the reduction and sometimes elimination of custom controls, and continuing innovations in information and communication technologies are all contributing to a growth in the mobility of tax bases worldwide. In Europe, the advent of the single currency is also a contributing factor to this development.**

For European governments, this state of flux presents them with a series of opportunities. For example, greater mobility between countries and regions has the potential to create major benefits for individuals and companies because it allows them to select as a residence the country or region that provides the best fiscal package, in terms of the provision of public goods and the associated tax burden, based on their circumstances. In addition, a greater exposure to international competition also creates a series of strong incentives for governments to raise public sector efficiency, resulting in a potentially exciting double dividend of lower taxation combined with improved public services.

However, greater mobility can also create serious problems and challenges to the tax base. The ability to move goods and services more freely between jurisdictions, combined with the differences that exist between different countries' tax systems and barriers to effective information exchanges, extends the scope for tax avoidance and evasion. Where this occurs, there will be pressure on governments either to decrease the expenditure on public services to a politically unpopular level or to lower the tax burden on highly mobile production factors, and apply higher tax pressure on the less mobile ones, in particular labour—another very unpopular move in political terms.

In the European Union (EU) there is no clear evidence of a race between countries to compete for investment by reducing taxes at the corporate level. So far, the general trend is for cuts made to statutory rates accompanied by measures that have the effect of broadening the tax base. However, there have been some recent developments in capital income taxation and preferential tax treatment as they relate to nonresidents by many EU countries and these may indicate that the pressure to lower taxes on highly mobile factors is now coming into play. Even though enhanced cooperation in certain areas of tax policy could curb pressures on tax base erosion, there are a series of economic and institutional issues that may limit the effectiveness of measures taken to do this. These include:

- At the economic level, both the size and type of public expenditure varies significantly throughout the EU. This is reflected in different financing needs. These in turn may demand significant differences in tax systems.
- At the institutional level, the requirement of unanimity for any decision on tax policy affecting all member states of the EU makes agreement on how to proceed difficult where countries have diverging interests.

The continuing trend towards globalisation of capital markets, as well as the rise of cheap and speedy electronic links to overseas financial markets, means it is becoming progressively harder to tax capital income effectively. The remaining restrictions on capital movements within the EU were completely abolished in the early 1990s. The single currency is also making cross-border investment an extremely attractive option. The single currency means there are no exchange risks or costs within the current 12-country euro zone and, as more countries sign up to the single currency, the possibilities of even greater cross-border investment opens up. At the same time, information flows between financial intermediaries and tax administrations, both within and across EU countries, remain limited, with the bank secrecy laws that apply in certain members' states proving to be major obstacles to greater transparency. In such a situation it is relatively easy to evade tax.

The consumption and corporate tax bases of EU member states, as well as other European countries, are also becoming more vulnerable to erosion. Cross-border shopping has received a huge boost since the adoption of the single currency. This has made cross-country price comparisons, and the use of e-commerce transactions, much easier.

### **Coping with e-commerce**

E-commerce is far less prevalent in Europe than it is in the United States. Although within the European Union there is wide disparity, with the Nordic countries—Sweden, Finland, and Denmark, as well as non-EU member Norway—being the most advanced in this area. Recent estimates show that e-commerce accounted for less than 0.5 percent of EU consumption in 1999, but its share is growing rapidly. The growing use of smart mobile phones, in addition to free Internet access and less expensive telecom tariffs, are expected to lead to far more private consumer e-commerce transactions in the future. This will mean even greater pressure on tax bases and could lead to an intensification of erosion pressures in certain fields.

It is arguable that in the context of business-to-consumer (B2C) transactions, countries such as Denmark and Finland that have a higher effective tax rate on consumption will be the most affected. This is because EU online providers of digital products currently apply their own country's VAT rates to intra-EU sales, while products delivered from a non-EU online source are tax free. New information and communication technologies also make the physical location of management and service activities much less significant, increasing the mobility of corporate income tax bases.

This all means that Europe, like the rest of the world, must deal with the specific tax challenges posed by the growing importance of e-commerce. Several questions stand out:



- How can a customer's country of residence be verified in an online transaction?  
Although there have been real improvements in tracing technology, tax administrations are still forced to focus on several criteria when making their decisions in this area. These include: the language in which the online transaction takes place, or its size—with smaller ones, such as the downloading of a few euros' worth of music, likely to be B2C rather than business-to-business (B2B).
- How to define a business establishment for the purposes of e-commerce. For example, multinational insurance companies that are unable to recoup their VAT are forced to pay tax on software they buy, and the simplest approach is to pay the tax in the country of their headquarters. In this case, what would stop these companies from establishing headquarters in low tax jurisdictions where they may have little or no business, just so they can declare their taxes there. While the dot.com crash affected mainly B2C e-commerce, B2B transactions have continued to develop because the Internet gives companies the ability to forge new relationships on a global basis through cooperative procurement procedures which enable them to reduce costs and inventory. One good example of this is Covisint, the company set up by several car manufacturers in the United States to pool procurement resources. New relationships of this kind will affect tax bases worldwide.

However, it would be wrong to think that B2C issues have disappeared. Efforts also need to be made to facilitate the collection of consumption taxes on cross-border trade for online delivery of products such as software, music, images, and the like. The OECD is now actively looking into the potential for the technology itself to assist tax administrations in this task. At the same time, new business models are beginning to appear in the telecommunications industry. Suppliers in this sector now frequently provide content as well as simple telecommunication connections through their mobile phones. In this way, a British resident who has mobile services provided by a United Kingdom-based operator may not be charged VAT on the phone calls made while traveling outside the country, but under a proposed EU directive currently being discussed, the user may be obliged to pay tax at the U.K. rate for downloading news content while on the same trip.

Clearly, if telecom services are going to be taxed at one rate in one country, and the text content is subject to a different rate in another jurisdiction, the complexities for tax accounting are going to be daunting. However, this is typical of the kinds of tax issues that will need to be addressed as innovations progress and the business world evolves.

The problems identified above, as well as many others, must be tackled by tax authorities on a collective basis. It is no longer possible for revenue services to exist in isolation. Perhaps the greatest challenge of all is for governments to understand this and to act accordingly.

At the same time, however, the growth of e-commerce and the increasing tendency of capital to flow from country to country means that new systems for the collection of taxes have to be developed. Countries are beginning to grapple with the issues and many, including a number in Europe, have made impressive progress.



# The Rise of Electronic Tax Solutions

**Over recent years, as customer expectations for quality service have increased and the potential of the Internet as a communications tool have become ever more apparent, the focus at many tax agencies across the globe has been centred on the necessity to improve the effectiveness of customer service systems, especially by means of alternative electronic channels. Such thinking comes about as authorities learn that improvements in the way in which customer services are organized can increase the potential for voluntary revenue collection.**

Likewise, electronic channels significantly enhance the ability of authorities to provide information to customers. An inherent part of any tax system is the obligation that tax agencies have to supply all the information necessary for taxpayers or their representatives to calculate and then deliver due taxes. Traditionally, revenue authorities have relied on printed publications to provide this information, along with the relevant instructions and forms, by means of person-to-person assistance either through meetings at local offices or over the telephone.

However, this way of operating presents a series of problems. First, tax codes are generally huge. The Internal Revenue code in the United States, for example, runs to nearly 1.4 million words, with another eight million words which help to interpret regulations and court cases based around the code. For cost reasons, most printed publications only provide general information and do not cover unusual situations or give complete information on relevant regulations and court cases. And, although in some countries telephone services do meet many of the needs taxpayers have for customised information, they do not provide all the solutions. Again in the United States, in 2000 the IRS's toll-free tax information staff failed to assist 22 million callers, or 40 percent of the total number of taxpayers who tried to make contact. And due to poor staff training, the information taxpayers receive over the telephone could well be wrong. In 2000, for example, the IRS estimated that its telephone tax law service provided incorrect information 26 percent of the time.

The tax world is complex. Tax agencies provide a service to a range of entities—from private individuals through businesses ranging in size from one-man start-ups to multi-national organizations—to tax professionals who represent clients in various matters, including the filing of returns and the defence of legal actions. What's more, tax is governed by multijurisdictional statutes and rules, all of which necessitate access to detailed specialist knowledge and processes. It is a world peopled by a broad range of customers, very few of whom would voluntarily conduct any business with tax agencies if they were not obliged by law to do so. And although it is clearly unlikely that tax agencies will gain new customers as a result of providing a better service, it is the case that there are potential revenue benefits in making it easier for so-called “willing” taxpayers to comply with their obligations.



## Cost savings

Aside from the services that electronic channels offer customers, there is also the potential for significant cost savings for the tax agencies themselves. Improved electronic data access, information distribution, and communication tools mean that it should be possible to minimize mistakes and reduce personnel numbers. Although this is an area that many authorities tend to play down, it is unlikely that such thinking has not entered into the minds of strategists, politicians, and civil servants. A white paper on electronic taxes produced by Digita, one of the United Kingdom's leading financial software development companies, makes the point nicely:

“At the heart of the e-economy is automation, the removal of human minds and hands from an organisation's most routine tasks and replacing them with computers and networks. This results in huge savings and vast improvements in speed and efficiency.

Think of it this way, a typical bank transaction costs 84p (approx \$1.20) when handled by a branch member of staff, 36p over the telephone, or 16p at a cashpoint (automatic teller machine [ATM]). But the same transaction processed over the Internet costs a fraction of a penny. Or to put it another way, a productivity improvement in excess of 97 percent, which is revolutionary.

The Inland Revenue employs 40,000 pairs of hands to type the contents of 150 million forms into their tax computer systems each year. Human error is typically 25 percent, which means up to 7.5million taxpayers could be receiving incorrect tax bills. The Inland Revenue annual report (year ending March 2000) revealed an accuracy target of just 77 percent and reports that it was “disappointed” to have missed its target by 5 percent.

In the United States, 35 million tax returns were filed last year. Working towards a goal of 80 percent electronic tax filing by 2007, the IRS has been aggressively promoting the advantages: 20 percent of tax returns received by the IRS contain a mistake; electronic filings produce an error rate of just 1 in every 200 returns.” (<http://www.digita.com/digita/home/whitepapers/whitepaper200102/default.asp>)

Considerable savings can be derived from instituting an electronic tax filing system. Based on a cost model of a government office handling 200,000 corporate files a year, Forrester Research Inc. has identified that savings fall into three areas:

- Automated data entry yields great savings. Government clerks need not reenter tax information once entered by the taxpayer and sent electronically to the relevant government database. As a result, the productivity of data entry and checking doubles to 10 tax files per day—reducing labour expenses for data handling personnel by 80 percent.
- Fewer errors lighten verification and correction burden. Accenture estimates that the Irish government logs average error rates of 25 percent for the corporate tax forms it processes, which Forrester estimates would cost the government Euros 2 million to amend. Intelligent data entry checks in electronic form, and the elimination of data re-entry, combine to bring the error rate down to 5 percent.
- Electronic data exchange cuts down printing and mailing costs. Typically, a tax department handling 200,000 corporate income tax returns may spend up to Euros 800,000 for subcontracting the printing and mailing of tax forms. (eFiling Kick-Starts eGovernment, Forrester Research Inc., August 2001)



Forrester claims that in the fifth year of a rolled-out electronic tax filing programme, governments stand to save up to 70 percent of their filing costs as a result of sending out and receiving corporate tax forms online.

### **Departmental interoperability**

In the longer term, the introduction of electronic tax systems will also help governments reengineer the ways departments work together and speak with each other. This will result in further cost savings and enhanced relationships between individual citizens and businesses and governments. This is stressed by the IBM Institute for Business Value in its March 2002 report on revenue and fiscal management:

“Tax departments can no longer serve as the hub for all tax interactions with customers. Increasingly, tax departments can act as a clearinghouse for ensuring that customers meet their tax obligations. Key intake, tax-processing and audit functions may not always flow through tax departments, but increasingly through intermediaries and other government departments. These entities can perform revenue department activities at a lower cost to the government. However, tax departments can monitor these activities to ensure that customers comply with tax obligations. As customers interact, tax departments can add value by enhancing economic development, facilitating effective decision-making and redefining community interactions. This transformation, enabled through Internet technology, can occur by focusing on improving voluntary compliance through access to information, becoming customer-centric, integrating throughout government departments and collaborating seamlessly with the private sector.”

(page 5, Revenue and Fiscal Management, IBM Institute for Business Value, March 2002)

Among many examples of inter-departmental collaboration, the IBM paper mentions one concerning an imagined bicycle business set up by a character named Susan:

“During one year of operations, Susan paid her store manager, Matt, a salary of US\$25,000. Matt files his income tax and does not declare any other income sources. Two months after filing his income tax, Matt purchases a US\$50,000 automobile that he registers with the Department of Motor Vehicles. A week after the car was registered, Matt receives a call from the Department of Revenue notifying him that he has been tagged for an audit. Before purchasing the automobile, Matt had not been selected for an audit.”

(page 4, Revenue and fiscal management, IBM Institute for Business Value, March 2002)

Key to the entire process is the understanding that for integration and coordination to work in practice, there must be a commitment to the sharing of knowledge:

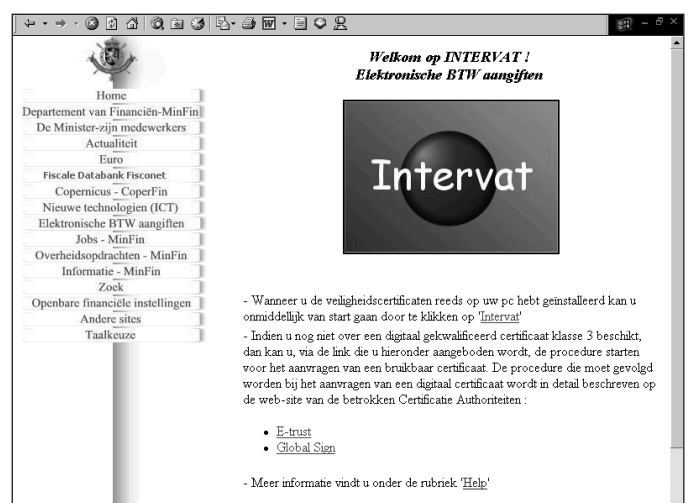
“The next-generation revenue department uses knowledge to form holistic views of a taxpayer within the department and across the government. Revenue departments know taxpayer needs, habits and tendencies. They use that information to improve compliance and aid other department goals. Leading nations have begun to share information with motor vehicle agencies to cross-check financial data of taxpayers. They can then use that information to tag audits and perform other compliance initiatives.” (page 9, Revenue and fiscal management, IBM Institute for Business Value, March 2002)

# Electronic Tax Initiatives

**Based on Forrester 2001 research, if properly implemented, the use of electronic tax systems by governments could lead to European revenue authorities saving up to 70 percent of the current costs involved in collecting taxes from individuals and businesses. It is no surprise, therefore, to learn that throughout the continent countries are initiating electronic tax programmes. Among these are the following:**

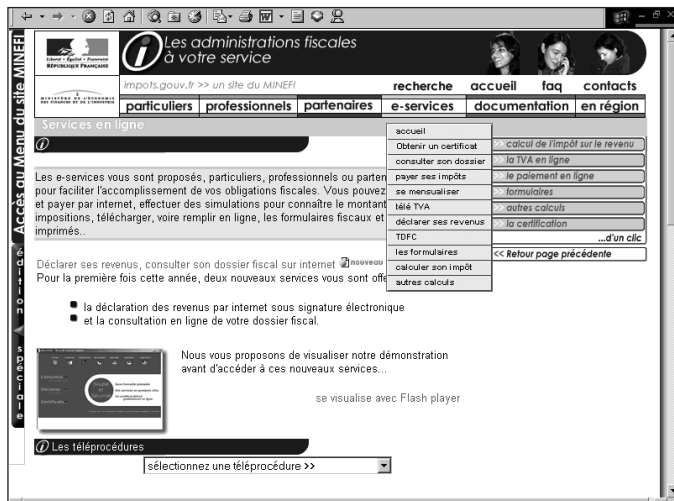
- Belgium: Launched in February 2002, InterVat is a service that allows companies to declare their VAT online (Figure 1). As an application provided by the country's Ministry of Finance (www.minfin.fgov.be), InterVat ensures a secure exchange of information that is PKI-enabled. With this system, users can submit their declarations more quickly and in a way that reduces the need for expensive manual support—there is no need to reenter existing data because processes input and validate automatically. This means that manual administration is only necessary for exception handling.

Figure 1: InterVat Home Page



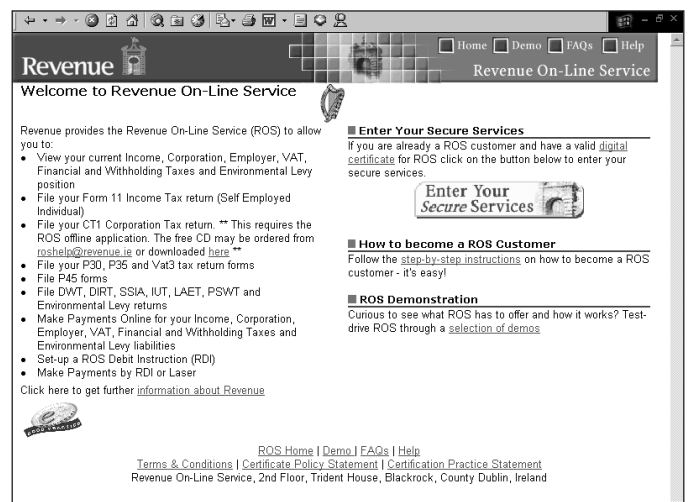
- France: Since July 15, 2001, businesses in France with an annual turnover of Euros 15 million have been mandated by law to file and pay their corporate taxes electronically (Figure 2). The original deadline for this requirement was the beginning of the second quarter of the same year, but the government faced a number of legal challenges because French law at that time stated companies were only required to pay a maximum of Euros 6 million in this way. The French tax authorities currently employ over 50,000 permanent staff, around 50 percent of whom operate as data-handling clerks, a job that electronic tax filing makes almost entirely irrelevant. The challenge for the French is how to reduce staff numbers, and reap the rewards of the cost savings this will lead to, without alienating trades unions and the general public.

Figure 2: Home Page for French Financial Services and Electronic Tax



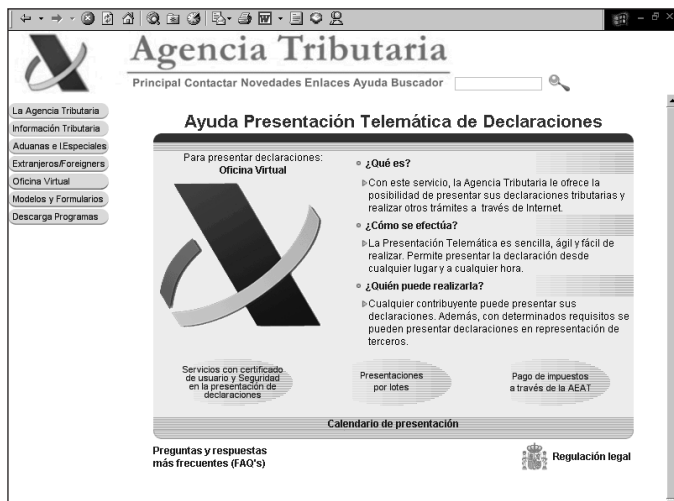
- Ireland: A country whose revenue authority was identified by Accenture as a leader in the field of online service delivery in the consultancy's April 2002 report eGovernment Leadership – Realizing the Vision. Ireland has required the e-filing of VAT and welfare contributions since the second quarter of 2001. In June 2001, Euros 877 million worth of taxes were processed using the Internet, a figure that represented 12 percent of the total tax intake. The Irish revenue department hopes that by automating the filing process a large proportion of the 10 percent to 40 percent of errors that currently occur as a result of the manual processing of tax claims will be substantially reduced. The Revenue Online Service (ROS – www.ros.ie) enables the filing and payment of taxes online, and also allows taxpayers to undertake enquiries on their current tax status and review their previous tax transactions (Figure 3). Customers that use this service are given digital certificates that allow them to digitally sign legally enforceable tax returns.

Figure 3: Ireland's Revenue On-Line Service



- Spain: Although the country has a below average rate of Internet usage, the Spanish government has been at the forefront of developing user-friendly and workable electronic tax systems. Particular attention has been paid to the security risks that revolve around handling tax transactions online. To this end, the Web site of La Agencia Tributaria (Figure 4), the government agency that is responsible for tax management, as well as customs and excise, allows taxpayers to make a tax return electronically using a unique digital signature (www.aeat.es). The work undertaken by the Spanish authorities was recognized by Accenture who, in their April 2002 Report, ranked Spain as the world's leading tax authority for online service delivery. Over 420,000 individuals now file online in the country, and the process is compulsory for all companies with an annual turnover of more than Euros 6 million

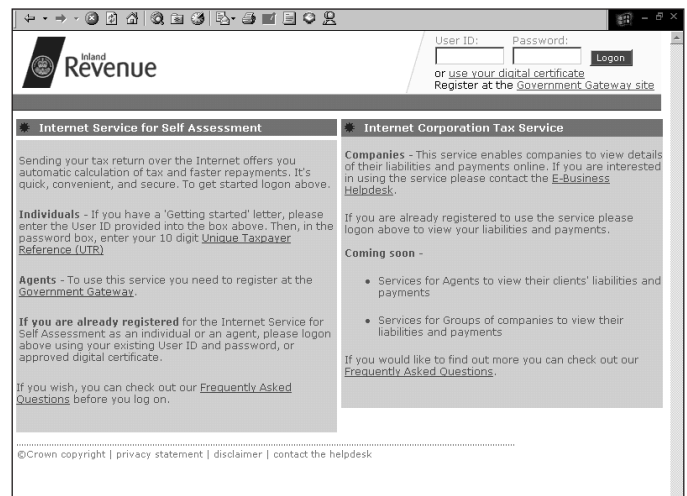
Figure 4: Spain's Online Tax Web Site



- United Kingdom: The Inland Revenue has set itself a series of ambitious targets. It wants 50 percent of all its services to be available electronically by the end of 2002 (the figure is currently 30 percent) and all services to be available electronically by December 31, 2005. It is also forecast that by the end of 2005 50 percent of all transactions with customers will take place through the Inland Revenue's electronic services (Figure 5). A report produced by the

National Audit Office in February 2002 looked at the progress the Inland Revenue had made towards the provision of online services to customers in the United Kingdom (www.nao.gov.uk/pn/01-02/0102492.htm). According to the Office, business interest in the Inland Revenue's electronic data interchange for Pay As You Earn (PAYE) tax has been strong. Around 5,000 businesses and other organisations now use the service to send tax data to the Revenue. This covers the returns relating to six million workers. However, the award-winning service that allows individual taxpayers to file their self-assessment tax forms through the Internet (www.inlandrevenue.gov.uk) has not been so successful. Concerns about security and the fact that taxpayers did not see a clear benefit in using the electronic service were major problems, as were persistent problems with the software. Four out of five completed submissions for 1999-2000 could not be sent first time, and although the first time completion figure rose to 44 percent between April and September of 2001, three out of ten submissions were still failing to get through first time between September and December of the same year. The National Audit Office Report concludes that the Inland Revenue is setting targets that are too ambitious. It points out that 39,000 people used the online self-assessment service between 1999 and 2001 against a projection of 300,000, and by January 2002 50,000 had used it, as opposed to the forecast number for 2001-02 of 200,000. However, the potential cost savings to the Inland Revenue are significant, amounting to Euros 4.5 per customer.

Figure 5: United Kingdom's Inland Revenue Web Site

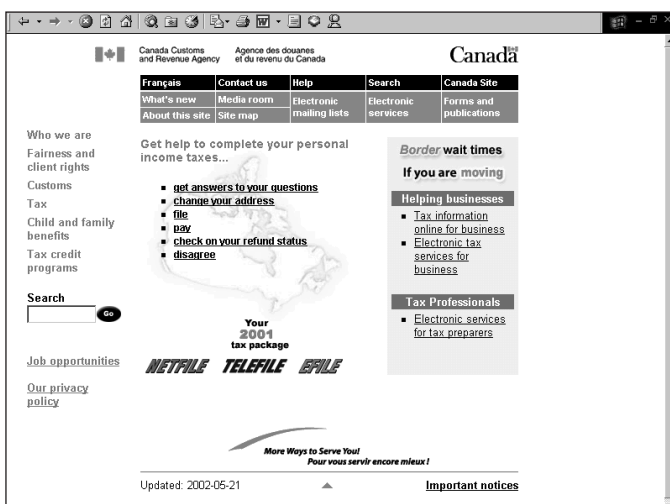


## Examples outside Europe

The benefits of reworking tax agencies and authorities to take onboard the possibilities afforded by electronic communication are being explored across the world. A number of countries are now offering services in this area. Some of the most prominent include:

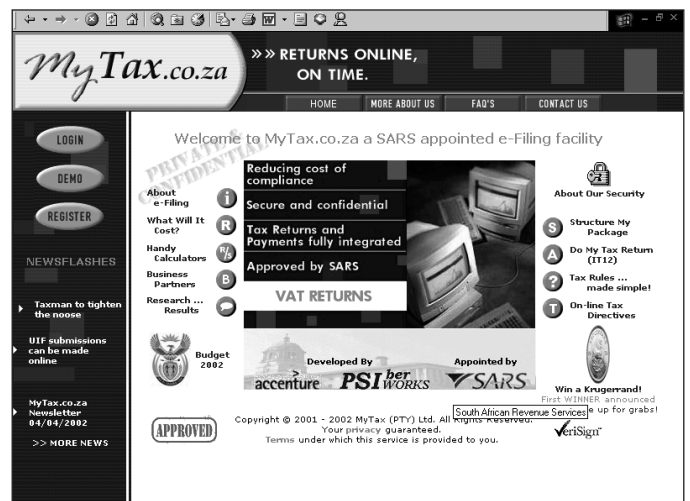
- Canada: Identified by Accenture as a leading-edge electronic revenue agency, the Canadian Customs and Revenue Agency ([www.ccr-aadrc.gc.ca](http://www.ccr-aadrc.gc.ca)) provides a range of online services to both corporate and individual taxpayers (Figure 6). For example, the recently launched NETFILE ([www.netfile.gc.ca](http://www.netfile.gc.ca)) allows users to file personal income tax and benefit returns directly to the CCRA through the Internet. Although there are some types of tax returns that are not yet available for electronic submission, NETFILE generally streamlines the tax filing process as it leads to greater accuracy and a quicker turnaround in communication between the CCRA and the taxpayer. One effect of this is that it takes an average of only two weeks for tax refunds to be paid out. Equally as important is that NETFILE operates as a secure and confidential medium. The CCRA also has a number of payment options available to corporate taxpayers who wish to pay business taxes electronically through their financial institution's telephone and banking services. To this end, the CCRA provides hyperlinks from its site to those of the institutions that participate in this scheme.

Figure 6: Canada's E-Service for Tax Payers



- South Africa: The South African Receiver of Revenue (SARS) is involved in a joint venture with the private sector that allows all businesses, provisional taxpayers, and accounting firms to submit tax returns to SARS through the Internet. My Tax ([www.mytax.co.za](http://www.mytax.co.za)) also enables the electronic payment of VAT, PAYE, and the Skills Development Levy and Provisional Tax (Figure 7). Through the ability to view all previous correspondence they have had with SARS, as well as to track their payment history and to receive electronic confirmation of all transactions, My Tax allows taxpayers to manage all aspects of their relationship with the Receiver of Revenue. In addition, when a taxpayer registers with the site, My Tax permits real-time payment of taxes to SARS by means of a secure Internet connection.

Figure 7: South Africa's My Tax Home Page



- United States (federal level): Approximately 40 million U.S. citizens filed their 2001 federal tax returns online either themselves or using an agent, according to the most recent statistics from the Internal Revenue Service (IRS). The predictions are that this number will rise to 45 million for 2002. Along with the Financial Management Service (FMS), the IRS now offers three electronic ways of filing taxes and getting refunds. The most established filing and payment mechanism is E-file, which was launched nationwide in 1990 and allows users not only to file their taxes but to make single, one-time settlement payments to the IRS. EFTPS-On-Line ([www.eftps.gov](http://www.eftps.gov)) enables individuals and businesses to pay federal taxes using Internet technology (Figure 8). This system builds on more established options by providing printable acknowledgements for documenting each transaction, the ability to schedule advance payments and by allowing users to access their payment histories. Finally, Direct Deposit automatically deposits tax refunds into taxpayers' bank accounts. It is an option that 34 million people chose during the 2001 filing season. One major problem in the United States has been concern over security with regards to electronic correspondence with the IRS. During the 2000 tax filing season, auditors from the General Accounting Office hacked into the IRS computer system and gained access to the tax records of more than 35 million citizens. As a result, the last two years have seen a major reworking of security, with a sweeping set of changes and upgrades being undertaken to ensure an extra level of protection. A 1998 restructuring law states that 80 percent of all tax and information returns should be filed electronically by 2007. It is a target that the IRS believes it will struggle to hit.

Figure 8: U.S. Federal EFTPS-OnLine Home Page



- United States (state level): The 49 states responding to a 2001 survey conducted by the Center for Digital Government, stated that they now offer online taxation forms that can be downloaded by businesses and individuals. In 48 of the states, taxpayers can file their returns online, while in 36 it is possible to pay taxes online as well. On top of all this, 42 states reported that they have developed electronic storage and retrieval systems for tax and revenue data. The results showed a significant year-by-year advance in online tax management at state level in the United States. In 2000, for example, only 25 states offered online tax forms. Analysts from the Center for Digital Government examined the Web sites and services offered by revenue authorities and ranked states accordingly (Table 1). The top two were Indiana and North Carolina. Officials from Indiana reported that the state's individual tax return was downloaded 500,000 times in the first three months of 2001, while the state has also significantly cut down on processing times for paper returns as a result of introducing an imaging system to store and retrieve documents. Meanwhile, a two-dimensional bar-coding system for paper returns means that a batch of 90 documents takes between 10 and 15 minutes to process, cutting out four and a half hours of data entry time previously required.

Table 1: Top 10 States Using Online Taxation and Revenue Services

2001 Digital State Survey —Top 10 states taxation/revenue		
State	Points	Rank
Indiana	100	1
N. Carolina	100	1
Illinois	98.8	3
Kansas	98.8	3
Wisconsin	98.8	3
New York	98.2	6
N. Dakota	97.1	7
Missouri	95.3	8
Delaware	94.1	9
Nebraska	94.1	9
Texas	94.1	9

(source: Center for Digital Government)



# Establishing a Workable System

**Although the potential benefits of operating an electronic, online revenue service are clear, the path to putting together a system that works and leads to the benefits identified above is a difficult one. There are a number of issues that governments and revenue authorities have to grapple with before they can actually put in place something that will work to the advantage of all.**

## **Making the most of the potential**

Most of today's electronic tax and electronic tax filing efforts by European governments have so far fallen short because they merely replicate the same old tax processes online. New technology and old processes have reached a stalemate. To maximise the potential in new technology, governments must set themselves new goals.

Simply put, this means looking at electronic tax filing as an integrated part of an entirely reengineered way of offering services to the general public, which in turn means the establishment of e-government networks that span different departments of state, technology enablers, private sector providers and tax-paying corporations.

According to the IBM Institute for Business Value, although the challenge is a huge one, it is worthwhile:

“Sharing data and streamlining services among government departments and levels enables customers to comply with tax obligations more efficiently. One technique for simplifying taxpayer services requires government standardization and integration across local, regional, central and international jurisdictions. Breaking down traditional department silos will require strong, active executive leadership. Departments must also use common rules, technology standards, integrated service channels and pervasive information sharing processes. Integrated government teams, that draw resources from different functional areas, respond to all customer needs. The Streamlined Sales Tax Project (SSTP) in the United States is one example of successful cross-jurisdiction coordination. This voluntary 38-state effort to unify filing procedures for sales and use taxes aims to ease the administrative burden on U.S. business taxpayers. On an international level, the U.S. government has successfully negotiated agreements with the government of the Cayman Islands and other countries to phase out tax havens, which will facilitate collection for the United States Internal Revenue Service.” (page 8, Revenue and fiscal management, IBM Institute for Business Value, March 2002)

To produce the significant compliance and operational processing efficiencies government integration can bring, revenue departments must understand how interoperable their processes, organizations, and architectures are with other departments:

“Do business and technical resources jointly develop and implement strategic plans? Does an intranet or common drive exist to share information across government departments? Are common performance measures established? Do standard data definitions, rules, templates, and terms exist across departments? Are common citizen and business data stored in a central location?” (page 9, Revenue and fiscal management, IBM Institute for Business Value, March 2002)

It is only by adopting this all-encompassing vision that governments and revenue authorities will get the customer buy-in that is so necessary for any electronic filing and electronic tax scheme to function effectively.

#### **Customer buy-in**

Ultimately, a system will only work if those at whom it is aimed—individuals and corporate taxpayers, as well as those who file on their behalf—find it an attractive option. The evidence is that, so far, this is often not the case.

A survey conducted for Forrester Inc’s eFiling Kick-Starts eGovernment Report found that European companies with a turnover of more than Euros 1 billion a year were unenthusiastic about various governments’ electronic tax initiatives. Of those companies interviewed, 80 percent expressed satisfaction with the

current way their in-house tax and finance departments take care of filing and paying corporate taxes, 43 percent of respondents would be reluctant to pay taxes online, and 20 percent felt that electronic tax filing would have little or no impact on their costs as it would not decrease the 80 percent of costs that are accounted for by the labour involved in tax preparation. What’s more, 50 percent had security concerns and worried about the potential loss of control electronic tax filing could involve.

In the United States, the Electronic Tax Administration Advisory Committee reported a survey conducted by the Council for Electronic Revenue Communication Advancement (CERCA) in its 2001 submission to Congress. According to the survey, 60 percent of practitioners that currently prepare business returns on behalf of clients would not file electronically, including 49 percent who were not at all likely to do it.

In its submission, the ETAAC identified three types of practitioner—mass market, high-volume regional, and national income tax preparation firms; small accounting and tax firms; and large accounting tax firms—and then looked at the benefits and barriers to electronic tax filing for each (Tables 2a and 2b).



**Table 2a: Benefits of e-Filing for Various Sized Users**

Benefits of E-filing	Mass Market	Small Accounting Firms	Large Accounting Firms
Acknowledgement of filing and extensions to confirm receipt by IRS and prevent possible late filing penalties	X	X	X
Error-check increases accuracy for IRS and practitioner	X	X	X
Clients who owe IRS can pay electronically to prevent late payment penalties	X	X	X
Approximately 97% of all returns can be e-filed	X	X	
Competitive advantage for EROs over non-EROs	X	X	
Reduction in postage and paper	X	X	
Advertising and marketing collateral provided by IRS to promote program	X	X	
Taxpayer perception that CPA is current with technology		X	X
Financial savings in material and labor costs	X		
Faster refunds for customers	X		
Facilitates other products and services, such as bank products	X		

**Table 2b: Barriers to e-Filing for Various Sized Users**

Barriers to E-Filing	Mass Market	Small Accounting Firms	Large Accounting Firms	Solutions to Overcome Barriers
Self-select PIN program execution is difficult	X	X		Modify/simplify the self-select PIN program
Still rely on antiquated IRS systems for accurate debt indicator, fraud detection and revenue protection	X	X		Provide an indicator of revenue protected tax returns with acknowledgement, much like the debt indicator
Erroneous client notices regarding processing issues	X	X	X	Adopt appropriate acceptance standards for e-filed returns, comparable to paper acceptance standards
Inability of the e-filing process to accept all forms and "white paper" schedules		X	X	Expand e-filing compatibility to include more "white paper" schedules, especially for disclosure purposes
Lack of software to file the mandated returns (e.g. 1065 experience)			X	Do not use a legislative mandate to require the filing of all returns electronically
Requirements for multiple EFIN's for multiple office locations	X	X	X	Have single "firm-wide" EFIN's
Inability to include foreign offices in e-filing process due to "Foreign ERO" problems			X	Work with the International offices of the large firms and the local IRS to bring in the overseas offices into the e-filing net
Concern with transmission and information security breaches	X	X	X	Overcome taxpayer ambivalence with increased education and marketing to taxpayers promoting e-filing as the "cutting edge"
Taxpayers are ambivalent about technology (ease, security)	X	X	X	
Lack of perceived value		X	X	
Erroneous notices to taxpayers on balance due returns	X	X	X	Provide additional customer service support for EROs
Difficulty in reaching IRS e-file coordinators by telephone	X	X	X	
The ERO application and screening process may discourage some practitioners	X	X	X	Require all practitioners to register and meet the same standards imposed on EROs
ETA regulations imposed on EROs are cumbersome with harsh penalties	X	X	X	
Initial additional data keypunch requirements	X	X	X	
Additional requirement for "date of birth" for electronic extensions		X	X	
Technology costs related to transmitting returns	X	X	X	
Additional cost to firm for some software service providers	X	X	X	
Dual procedures for providing returns to clients	X	X	X	
Incompatibility of firms return review procedures with e-filing (preparer/manager/partner review of returns)		X	X	Recommended incentives – see Section 6.0 (G) of the report
Inability to pass additional costs onto clients		X	X	
Inability to file piggyback with all states	X	X	X	

The issue for revenue authorities and for governments is to decide how they can increase usage. One way, of course, is to make the process compulsory. This is what has happened in France and Spain, for example, where companies that exceed a specified annual turnover are compelled to submit their tax returns online. However, this is not a universally favoured approach. In the United States, the ETAAC has expressly come out against compelling businesses to file electronically even though the acceptance of online services in the United States has so far been disappointing. In its 2001 Report to Congress the ETAAC stated that: "E-filing success should be based on ease of use and convenience, not on government mandates." To this end, the ETAAC identifies three areas in which work should be concentrated to persuade more practitioners to use online filing services:

- Work with the small-business organizations. The largest volume of business returns is from small-business filers. Small businesses have different needs and challenges. Congressional mandates impose undue burdens on the small-business community. WE recommend that the ETA and the Small Business/Self-Employed Division work closely with the small-business organizations and conduct market research in developing services to insure the programs developed are of benefit and will be used voluntarily by the small-business community.
- Work with other stakeholders. Bringing together a task force of stakeholders to identify and solve the barriers of business electronic tax filing is an efficient process resulting in cooperation, acceptance, and ownership. Electronic filing will flourish.
- Marketing, education and security measures. Target marketing of business electronic tax filing services critical in informing business of the electronic tax filing opportunities and respective benefits. As the business community becomes more informed and educated, the concerns of security will lessen and electronic filing will become the accepted means of filing tax returns.

The ETAAC is also exploring ways to encourage self-preparers (those who do their own tax returns instead of employing an agent to do them) to submit their individual filings electronically. So far, less than 20 percent of self-preparers make use of online electronic filing facilities offered by the IRS. To this end, the ETAAC produced a range of options open to the authorities to encourage an increased buy-in (Table 3):

Table 3: Incentives for Increased Individual Electronic Tax Filing

Incentives for Self-Preparers	PRO	CON
Free electronic preparation & transmission software	Reduces cost & improves accuracy of IRS processes. Provides taxpayer with free federal software.	The cost of providing the software free of charge by the IRS.
Free electronic preparation & transmission software, to include state software	Reduces cost & improves accuracy of IRS processes. Provides taxpayer with free federal and state software.	The cost of providing the software free of charge by the IRS. Additional cost of coordinating and packaging specific state software.
Extend filing due dates 7 - 15 days (Caroline has extended due date to May 1st for internet filers)	Allows the taxpayer additional time to prepare their return.	Legislation on the Federal and state level would be required to relax this requirement.
Set up temporary e-file sites	The IRS could set up temporary e-file sites in malls, libraries, community centers, banks, and other locations to make e-filing easier and more convenient for the taxpayer.	Cost associated with multi-site equipment, space rental, staff, etc.
Discount for E-Filers & EFT Taxpayers	The IRS could provide taxpayers with a rebate for e-filing and for making an EFT payment early. For example, a 1% rebate if filed at least 30 days early, and a 1.25% rebate if filed 31 to 45 days early.	Loss of revenues from offering rebate.
\$50 to \$100 AGI reduction	Taxpayers who file electronically would be eligible for an AGI reduction. Taxpayers would be rewarded for e-filing.	Loss of revenues from offering reduction.
\$10 Tax Credit for taxpayers who file their return electronically, tax credit doubled for first time e-filers	The \$10 tax credit was proposed by ETAC in their 2000 Annual Report to Congress. This incentive would also provide a \$20 tax credit for first-time e-filers, to get them into the program.	Would reduce total revenues collected by the IRS.
Toll-free telephone "help-line" for e-filing support	1997 Survey of tax practitioners indicated that 43% of practitioners would be "Highly Motivated" and 52% would be "Moderately Motivated" to participate in e-filing with this incentive.	The cost of the toll-free line and staffing the "help-line".
Taxpayer's signature not required for each filing	1997 Survey of tax practitioners indicated that 36% of practitioners would be "Highly Motivated" and 51% would be "Moderately Motivated" to participate in e-filing with this incentive. The tax practitioner would not have to obtain their clients signature each and every time that they submitted a return for them, thus speeding up the process and reducing costs.	Legislation on the Federal and state level would be required to relax this requirement. Legal liability may also be an issue. If a taxpayer denies his/her return, then he/she is probably a non-filer.

In Europe, Forrester believes that a number of issues must be addressed in order to convince business to use electronic taxation process:

- Offer new, richer services that really matter to businesses. Governments should take a page from Finland, which offers businesses prepopulated tax forms and a process to update their tax information on an ongoing basis—significantly reducing the tax preparation burden. Like the United Kingdom's Inland Revenue, European governments must use business focus groups to explore true business needs and challenge Net technology vendors to provide innovative solutions.
- Transcend security concerns. Public administrations should not only aim to alleviate the justified and psychological security concerns of their constituents, they must also propose new, superior services like nonrepudiation through digital signatures, integrity through hashing, and confidentiality through encryption.
- Rope accounting firms into electronic tax filing. In France alone, accounting firms provide 500,000 SMEs with tax-filing services. To get these SMEs excited about electronic tax filing, European governments should involve accounting firms in the electronic taxation process. For example, they should create a role for accountants in digital certification – similar to how the French government partnered with three banks to digitally certify VAT tax filings. (pages 10 and 11, eFiling Kick-Starts Government, Forrester Research Inc., April 2001)



## Politics

Europe is a continent of democratic countries. Ultimately, therefore, the key strategic issues concerning the implementation of electronic tax policies will be taken by elected politicians. Because politicians often work to a timetable defined by general elections that take place every four or five years, this presents those designing new systems with an interesting set of problems.

While a long-term plan for reworking a revenue authority and integrating its function with other government departments is probably the only way in which the full benefits of electronic tax collections and administration can be realized, such a time span is not necessarily appealing to politicians.

Approving the substantial expenditure necessary for the technical and administrative revolution electronic tax projects will lead to, as well as the marketing and publicity costs necessary, means that the politician is taking a risk. First, governments have a finite set of resources. In devoting resources to electronic tax, the politician is potentially moving resources away from other more politically popular projects. In addition, the time it will take for the new system to come fully into operation means that it could well be another politician—from another party—who reaps the benefits. What's more, governments may need to find parliamentary time to introduce supporting legislation to ensure that changes are backed-up by the force of law. Again, this may mean dropping other more politically attractive measures as a result.

The majority of electronic tax projects in Europe have so far failed to deliver substantial rewards to customers or governments because there has been a reluctance on behalf of governments to venture forth and authorize the entire reengineering of all back-office and front-office functions associated with the collection of taxes and their interaction with the rest of government. Until this changes, the full potential inherent in electronic tax and electronic tax filing will remain untapped.

The challenge for administrators is to stand firm. Both the Inland Revenue in the United Kingdom and the IRS in the United States have been given ambitious targets in electronic tax, and both have admitted that it is unlikely these targets will be hit (see above). It is hard to avoid the conclusion that the explanation for the initial enthusiasm in accepting these challenges was that the dramatic results promised were politically appealing, and thus gave administrators greater leverage when dealing with elected politicians. The problem with failing to hit targets, however, is that this gives politicians the chance to question the entire project as something which is expensive and fails to deliver the promised results.

A related issue revolves around the potential that exists for conflict with workforces, trades unions, and public opinion when the job-cutting possibilities of electronic tax administration are understood. As Forrester Research points out in its August 2001 report *eFiling Kick-Starts Government*, although electronic tax filing means that around 25,000 of France's revenue workers are no longer necessary, the introduction of the system has not led to the announcement of major redundancies. Likewise, in Germany legal commitments to the employment of civil servants will make large-scale job cuts very difficult. The solutions, says Forrester, is to recast the role of the civil servants affected:

“Governments should retrain the staff members made redundant by electronic tax filing into the equivalent of networked customer services representatives. Armed with an integrated view of a corporation's records held by the tax authority, these new administrative clerks should be able to swiftly answer questions and handle exceptions—for example, by conversing with users in real time through secure instant messaging from Reuter's.” (page 10, *eFiling Kick-Starts Government*, Forrester Research Inc., April 2001)

# Summary

- The single market within the EU means that countries across Europe are facing increasing tax competition between tax authorities. The introduction of the euro in most EU countries has further exacerbated this process, as has the growing importance of e-commerce.
- Electronic tax offers a number of exciting possibilities to both customers and governments. For customers, it has the potential to simplify the filing and payment process, and allow greater interaction with revenue authorities and greater access to information. For governments, the user-friendly nature of the Internet means the development of better relationships with customers. In addition, the introduction of electronic tax offers the chance to significantly cut the costs associated with tax administration and collection and, further into the future, will play a vital role in the reengineering of the government function that the Internet will almost inevitably lead to.
- Countries across Europe have begun to introduce some forms of electronic tax. Amongst the most noteworthy projects are those in France, Spain, the United Kingdom, and Ireland. The United States, too, has invested significant amounts in setting up an electronic tax system.
- In most cases, however, public perceptions and use of the Internet as a means of working with revenue authorities lags. The public has yet to be convinced of the benefits of electronic tax and worries about issues such as security and loss of control. Governments need to address these issues as a matter of urgency.
- Governments still have a great deal of work to do before the full potential of the Internet can be reaped. Too often, the Internet is merely replicating existing manual systems. New ways of looking at problems need to be introduced. For this to happen strong political leadership will be necessary, as will commitment to long-term development and expenditure.

Series Editor Simon Willis

Internet Business Solutions Group EMEA

Cisco Systems

Enquiries [swillis@cisco.com](mailto:swillis@cisco.com)







**Corporate Headquarters**  
Cisco Systems, Inc.  
170 West Tasman Drive  
San Jose, CA 95134-1706  
USA  
www.cisco.com  
Tel: 408 526-4000  
800 553-NETS (6387)  
Fax: 408 526-4100

**European Headquarters**  
Cisco Systems International BV  
Haarlerbergpark  
Haarlerbergweg 13-19  
1101 CH Amsterdam  
The Netherlands  
www-europe.cisco.com  
Tel: 31 0 20 357 1000  
Fax: 31 0 20 357 1100

**Americas Headquarters**  
Cisco Systems, Inc.  
170 West Tasman Drive  
San Jose, CA 95134-1706  
USA  
www.cisco.com  
Tel: 408 526-7660  
Fax: 408 527-0883

**Asia Pacific Headquarters**  
Cisco Systems, Inc.  
Capital Tower  
168 Robinson Road  
#22-01 to #29-01  
Singapore 068912  
www.cisco.com  
Tel: +65 317 7777  
Fax: +65 317 7799

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