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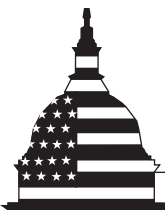
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TAX ADMINISTRATION

Preliminary Information on Selected Foreign Practices That May Provide Useful Insights

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G A O

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Why GAO Did This Study

The Internal Revenue Service (IRS) and foreign tax administrators face similar issues regardless of the particular provisions of their laws. These issues include, for example, helping taxpayers prepare and file returns, and assuring tax compliance.

GAO was asked to describe (1) how foreign tax administrators have approached issues that are similar to those in the U.S. tax system and (2) whether and how the IRS identifies and adopts tax administration practices used elsewhere.

To do this, GAO reviewed documents and interviewed six foreign tax administrators as well as tax experts, tax practitioners, taxpayers, and trade group representatives. GAO also examined documents and met with IRS officials. This preliminary information is based on GAO's ongoing work for the Committee to be completed at a later date.

What GAO Recommends

GAO makes no recommendations in this testimony. Understanding how other tax administrators have used certain practices to address common issues can provide insights to help inform deliberations about tax reform and about possible administrative changes in the U.S. existing system to improve compliance, better serve taxpayers, reduce burdens, and increase efficiencies.

View [GAO-11-540T](#) or key components. For more information, contact Michael Brostek at (202) 512-9110 or brostekm@gao.gov.

TAX ADMINISTRATION

Preliminary Information on Selected Foreign Practices That May Provide Useful Insights

What GAO Found

Foreign and U.S. tax administrators use many of the same practices such as information reporting, tax withholding, providing web-based services, and finding new approaches for tax compliance. These practices, although common to each system, have important differences. This testimony describes the following six foreign tax administration practices that address common issues in tax administration.

Selected Foreign Tax Administration Practices

Foreign administrators	Practice
New Zealand	Does integrated evaluations of tax expenditures and discretionary spending programs to analyze their impacts and improve program delivery
Finland	Uses the internet to calculate individual tax withholding rates and revise pre prepared tax returns to improve service at lower costs
European Union	Uses multilateral treaty information exchange on interest payments to member nations' citizens to spur compliance by individual taxpayers
United Kingdom	Uses information reporting and withholding so most wage earners do not need to file a tax return
Australia	Uses a compliance program for high net wealth individuals that focuses on their full set of business interests to improve compliance
Hong Kong	Uses semiannual payments instead of periodic withholding for the Salaries Tax

Source: GAO analysis

Although differences in laws, culture, or other factors likely would affect the transferability of foreign tax practices to the U.S., these practices may provide useful insights for policymakers and the IRS. For example, New Zealand integrates evaluations of its tax and discretionary spending programs. The evaluation of its Working For Families tax benefits and discretionary spending, which together financially assist low- and middle-income families to promote employment, found that its programs aided the transition to employment but that it still had an underserved population; these findings likely would not have emerged from separate evaluations. GAO previously has reported that the U.S. lacks clarity on evaluating tax expenditures and related discretionary spending programs and does not generally undertake integrated evaluations. In Finland, electronic tax administration is part of a government policy to use electronic services to lower the cost of government and encourage private-sector growth. Overall, according to Finnish officials, electronic services have helped to reduce Tax Administration staff by over 11 percent from 2003 to 2009 while improving taxpayer service.

IRS officials learn about these practices based on interactions with other tax administrators and participation in international organizations, such as the Organisation for Economic Co-operation and Development. In turn, IRS may adopt new practices based on the needs of the U.S. tax system. For example, in 2009, IRS formed the Global High Wealth Industry program. IRS consulted with Australia about its approach and operational practices.

Chairman Baucus, Ranking Member Hatch, and Members of the Committee:

I appreciate this opportunity to discuss how some foreign tax administrators have focused on issues similar to those faced by the United States (U.S.). All tax administrators strive to address similar issues regardless of the specific provisions of their laws. Understanding how other tax administrators have used certain practices to address these common issues can provide insights to help inform deliberations about tax reform and about possible administrative changes in our existing system to improve compliance, better serve taxpayers, reduce burden, and increase efficiencies.

My statement today will draw from our ongoing work for the committee to describe (1) how foreign tax administrators have approached issues that are similar to those in the U.S. tax system and (2) whether and how the Internal Revenue Service (IRS) identifies and adopts tax administration practices used elsewhere. Our work includes selected practices of New Zealand, Finland, European Union (EU), United Kingdom (UK), Australia, and Hong Kong.¹ Our report, to be issued in May 2011, will provide our detailed descriptions of those tax administration practices and their differences from U.S. practices.

We based our selection of these practices on several factors, including whether the tax administrators had advanced economies and tax systems, tax information was available in English, and the foreign tax administrator's approach differed from how the U.S. approaches similar issues. We reviewed documents and interviewed officials from 6 foreign tax administrations. We primarily used documentation from each government's reports that are publicly available. When possible, we confirmed additional information provided to us by officials and held meetings with experts, public interest groups, and trade groups to identify their views about these systems. To describe whether and how the IRS identifies and adopts tax administration practices used elsewhere, we reviewed related documents and interviewed IRS officials. We discussed the information in this statement with officials of IRS and six foreign tax administrators and incorporated their comments as appropriate.

¹ The Hong Kong Special Administrative Region is part of the People's Republic of China. Throughout this statement we will use Hong Kong as the abbreviation for this region.

We conducted our work from October 2009 to March 2011 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis conducted, provide a reasonable basis for any findings and conclusions in this statement.

Although the descriptive information presented in this testimony may provide useful insights for Congress and others on alternatives to current U.S. tax policies and practices, comparisons across tax administration systems or even within systems must include a separate analytic step to identify the factors that might affect the transferability of the practices, such as differences in law, to the U.S. Based on such an analysis, countries determine whether others' practices could be adopted. For example, nations have differing cultures. Generally, attitudes toward government can affect voluntary tax compliance. When taxpayers are more willing to accurately comply with tax rules, less enforcement action by the administrators is needed. Measurements of taxpayers' attitudes are not well defined or uniform; nor are measurements of voluntary compliance.

Examples of Selected Tax Administration Practices to Address Known Tax Administration Issues

The following examples illustrate how New Zealand, Finland, EU, UK, Australia, and Hong Kong have addressed well known tax administration issues.

New Zealand Does Joint Evaluations of Tax Expenditures and Discretionary Spending Programs to Analyze Their Effects and Improve Program Delivery

New Zealand, like the U.S., addresses various national objectives through a combination of tax expenditures and discretionary spending programs. Tax expenditures are the amount of revenue that a government forgoes to provide some type of tax relief for taxpayers in special circumstances, such as the Earned Income Tax Credit in the United States.² In New Zealand tax expenditures are known as tax credits.

New Zealand has overcome obstacles to evaluating these related programs at the same time to better judge whether they are working effectively. Rather than separately evaluating certain government services, New Zealand completes integrated evaluations of tax expenditures and discretionary spending programs to analyze their combined effects. Using this approach, New Zealand can determine, in part, whether tax expenditures and discretionary spending programs work together to accomplish government goals.

One example is the Working For Families (WFF) Tax Credits program, which is an entitlement for families with dependent children to promote employment. Prior to the introduction of WFF in 2004, New Zealand's Parliament discovered that many low-income families were not better off from holding a low-paying job, and those who needed to pay for childcare to work were generally worse off in low-paid work compared to receiving government benefits absent having a job. This prompted Parliament to change its in-work incentives and financial support including tax expenditures.

The Working for Families Tax Credits program differs from tax credit programs in the United States in that it is an umbrella program that spans certain tax credits administered by the Inland Revenue Department (IRD) as well as discretionary spending programs administered by the Ministry of Social Development (MSD). IRD collects most of the revenue and administers the tax expenditures for the government. Being responsible for collecting sensitive taxpayer information, IRD must maintain tax privacy and protect the integrity of the New Zealand tax system. MSD administers the WFF's program funds and is responsible for collecting data that includes monthly income received by its beneficiaries. This

²The Earned Income Tax Credit (EITC) is a refundable credit to reduce individual income tax for certain people who work and have less than \$48,362 of earned income for tax year 2010. The amount of the credit varies depending on the filing status and number of qualifying children.

required that IRD and MSD keep separate datasets, making it difficult to assess the cumulative effect of the WFF program.

To understand the cumulative effect of changes made to the WFF program and ensure that eligible participants were using it, New Zealand created a joint research program between IRD and MSD from October 2004 to April 2010. The joint research program created linked datasets between IRD and MSD. Access to sensitive taxpayer information was restricted to IRD employees on the joint research program and to authorized MSD employees only after they were sworn in as IRD employees.

The research provided information on key outcomes that could only be tracked through the linked datasets. The research found that the WFF program aided the transition from relying on government benefits to employment, as intended. It also found that a disproportionate number of those not participating in the program were from an indigenous population, which faced barriers to taking advantage of the WFF. Barriers included the perceived stigma from receiving government aid, the transaction costs of too many rules and regulations, and the small amounts of aid for some participants. Changes made by Parliament to WFF based on these findings provided an additional NZ\$1.6 billion (US\$1.2 billion) per year in increased financial entitlements and in-work support to low- to middle-income families.³

While economic differences exist between the New Zealand and U.S. tax systems, both systems use tax expenditures (i.e., tax credits in New Zealand). Unlike the United States, New Zealand has developed a method to evaluate the effectiveness of tax expenditures and discretionary spending programs through joint research that created interagency linked datasets. New Zealand did so while protecting confidential tax data from unauthorized disclosure.

In 2005, we reported that the U.S. had substantial tax expenditures but lacked clarity on the roles of the Office of Management and Budget (OMB), Department of the Treasury, IRS, and federal agencies with discretionary spending programs responsibilities to evaluate the tax

³ To adjust foreign currencies to U.S. dollars, we used the Federal Reserve Board's database on foreign exchange rates. New Zealand dollars converted to U.S. dollars as of December 31, 2004.

expenditures.⁴ Consequently, the U.S. lacked information on how effective tax expenditures were in achieving their intended objectives, how cost-effective benefits were achieved, and whether tax expenditures or discretionary spending programs worked well together to accomplish federal objectives.⁵ At that time, OMB disagreed with our recommendations to incorporate tax expenditures into federal performance management and budget review processes, citing methodological and conceptual issues. However, in its fiscal year 2012 budget guidance, OMB instructed agencies, where appropriate, to analyze how to better integrate tax and spending policies that have similar objectives and goals.

Finland Uses the Internet to Enable Taxpayers to Adjust Individual Tax Withholding Rates and Revise Pre Prepared Tax Returns to Improve Service at Lower Costs

Finland better ensures accurate withholding of taxes from taxpayers' income, lowers its costs, and reduces taxpayers' filing burdens through Internet-based electronic services. In 2006, Finland established a system, called the Tax Card, to help taxpayers estimate a withholding rate for the individual income tax. The Tax Card, based in the Internet, covers Finland's national tax, municipality tax, social security tax, and church tax.⁶ The Tax Card is accessed through secured systems in the taxpayer's Web bank or an access card issued by Finland's government. The Tax Card system enables taxpayers to update their withholding rate as many times as needed throughout the year, adjusting for events that increase or decrease their income tax liability. When completed, the employer is notified of the changed withholding tax rate through the mail or by the employee providing a copy to the employer. According to the Tax Administration, about a third of all taxpayers using the Tax Card, about 1.4 to 1.6 million people, change their withholding percentages at least annually. Finland generally refunds a small amount of the withheld funds to taxpayers (e.g., it refunded about 8 percent of the withheld money in 2007).

⁴GAO, *Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue*, GAO-11-318SP (Washington, D.C.: Mar. 1, 2011).

⁵GAO, *Government Performance And Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined*, GAO-05-690 (Washington, D.C.: Sept. 23, 2005).

⁶Individuals who are members of the Evangelical-Lutheran Church or the Orthodox Church pay a flat-rate church tax. Local church communities determine the tax rate, which varies between 1 and 2 percent of taxable income. Individuals who are not members of either church do not pay the tax.

Finland also has been preparing income tax returns for individuals over the last 5 years. The Tax Administration prepares the return for the tax year ending on December 31st based on third-party information returns, such as reporting by employers on wages paid or by banks on interest paid to taxpayers. During April, the Tax Administration mails the pre-prepared return for the taxpayer's review. Taxpayers can revise the paper form and return it to the Tax Administration in the mail or revise the return electronically online. According to Tax Administration officials, about 3.5 million people do not ask to change their tax return and about 1.5 million will request a tax change.

Electronic tax administration is part of a government-wide policy to use electronic services to lower the cost of government and encourage growth in the private sector. According to Tax Administration staff, increasing electronic services to taxpayers helps to lower costs. Overall, the growth of electronic services, according to Finnish officials, has helped to reduce Tax Administration staff by over 11 percent from 2003 to 2009 while improving taxpayer service.

According to officials of the Finnish government as well as public interest and trade groups, the Tax Card and pre-prepared return systems were established under a strong culture of national cooperation. For the pre-prepared return system to work properly, Finland's business and other organizations who prepare information returns had to accept the burden to comply in filing accurate returns promptly following the end of the tax year.

Finland's tax system is positively viewed by taxpayers and industry groups according to our discussions with several industry and taxpayer groups. They stated that Finland has a simple, stable tax system which makes compliance easier to achieve. As a result, few individuals use a tax advisor to help prepare and file their annual income tax return.

In contrast to Finland's self-described "simple and stable" system, the U.S. tax system is complex and constantly changing. Regarding withholding estimation, Finland's Tax Card system provides taxpayers an online return system for regularly updating the tax amount withheld. For employees in the U.S., the IRS's Website offers a withholding calculator to help employees determine whether to contact their employer about revising their tax withholding. Finland's system prepares a notice to the employer which can be sent through the mail or delivered in person, whereas in the U.S. the taxpayer must file a form with the employer on the amount to be withheld based on the estimation system's results.

In the U.S., individual income tax returns are completed by taxpayers—not the IRS—using information returns mailed to their homes and their own records.⁷ Taxpayers are to accurately prepare and file an income tax return by its due date. In Finland, very few taxpayers use a tax advisor to prepare their annual individual income tax return. Unlike in Finland, U.S. individual taxpayers heavily rely on tax advisors and tax software to prepare their annual return. In the U.S. about 90 percent of individual income tax returns are prepared by paid preparers or by the taxpayer using commercial software.

The EU's Multilateral Treaty Information Exchange on Interest Payments Is Envisioned to Spur Compliance

The European Union seeks to improve tax compliance through a multilateral agreement on the exchange of information on interest earned by each nation's individual taxpayers. This agreement addresses common issues with the accuracy and usefulness of information exchanged among nations that have differing technical, language, and formatting approaches for recording and transmitting such information. Under the directive, adopted in June 2003, the 27 EU members and 10 other participants agreed to share information about income from interest payments made to individuals who are citizens in another member nation. With this information, the tax authorities are able to verify whether their citizens properly reported and paid tax on the interest income. The directive provides the basic framework for the information exchange, defining essential terms and establishing automatic information exchange among members.⁸

As part of the directive, 3 EU member nations as well as the 5 European nonmember nations agreed to apply equivalent measures (i.e., withholding tax with revenue sharing described below) during a transition period through 2011, rather than automatically exchanging information.⁹ Under this provision, a 15 percent withholding tax gradually increases to 35

⁷If the taxpayer fails to file a return and enough information returns reporting income have been filed, the IRS can create a return, based on that information and mails it to the taxpayer for acceptance or adjustment. IRS prepares these returns under a compliance program and the taxpayer may be assessed penalties.

⁸Under automatic information exchange, countries agree to routinely provide information about tax-related transactions.

⁹These nations are the Swiss Confederation, the Principality of Liechtenstein, the Republic of San Marino, the Principality of Monaco, and the Principality of Andorra. The information upon request exchange generally requires a specific justification for the information needed by the requesting tax authority.

percent by July 1, 2011. The withholding provision included a revenue-sharing provision, which authorizes the withholding nation to retain 25 percent of the tax collected and transfer the other 75 percent to the nation of the account owner. The directive also requires the account owner's home nation to ensure that withholding does not result in double taxation by granting a tax credit equal to the amount of tax paid to the nation in which the account is located.

A September 2008 report to the EU Council described the status of the directive's implementation. During the first 18 months of information exchange and withholding, data limitations such as incomplete information on the data exchanged and tax withheld created major difficulties for evaluating the directive's effectiveness. Further, no benchmark was available to measure the effect of the changes.

According to EU officials, the most common administrative issues, especially during the first years of implementation of the directive, have been the identification of the owner reported in the computerized format. It is generally recognized that a Taxpayer Identification Number (TIN) provides the best means of identifying the owner. However, the current directive does not require paying agents to record a TIN. Using names has caused problems when other EU member states tried to access the data. For example, a name that is misspelled cannot be matched. In addition, how some member states format their mailing address may have led to data-access problems. EU officials told us that the monitoring role by the EU Commission, the data-corrections process, and frequent contacts to resolve specific issues have contributed to effective use of the data received by EU member states.

Other problems with implementing the directive include identifying whether investors moved their assets into categories not covered by the directive (e.g., shifting to equity investments), and concerns that tax withholding provisions may not be effective because withholding rates were low until 2011 when the rate became 35 percent. The EU also identified problems with the definition of terms, making uniform application of the directive difficult. Generally these terms identify which payments are covered by the directive, who must report under the directive, and who owns the interest for tax purposes.

Nevertheless, EU officials stated that the quality of data has improved over the years. The EU officials have worked with EU member nations to resolve specific data issues which have contributed to the effective use of the information exchanged under the directive.

Comparing the EU and U.S. practices on exchanging tax information with other countries, the U.S. agreements and the directive both allow for automatic information exchange.¹⁰ The U.S. is part of the Convention on Multilateral Administrative Assistance in Tax Matters, which includes exchange of information agreement provisions and has been ratified by 15 nations and the U.S.¹¹ However, the U.S. is prevented by IRC 6105 from releasing data about the extent of information exchanged with treaty partners or the type of information exchange used.

The UK Uses Information Reporting and Withholding So Most Wage Earners Do Not Need To File a Tax Return

The UK promotes accurate tax withholding and reduces taxpayers' filing burdens by calculating withholding rates for taxpayers and requiring that payers of certain types of income withhold taxes at standard rates. The UK uses information reporting and withholding to simplify tax reporting and tax payments for individual tax returns. Both the individual taxpayer and Her Majesty's Revenue and Customs (HMRC)—the tax administrator—are to receive information returns from third parties who make payments to a taxpayer such as for bank account interest. A key element of this system is the UK's Pay As You Earn (PAYE) system. Under the PAYE system HMRC calculates an amount of withholding from wages to meet a taxpayer's liability for the current tax year.

According to HMRC officials, the individual tax system in the UK is simple for most taxpayers who are subject to PAYE. PAYE makes it unnecessary for wage earners to file a yearly tax return, unless special circumstances apply. For example, wage earners do not need to file a return unless income from interest, dividends, or capital gains exceeds certain thresholds or if deductions need to be reported. Therefore, a tax return may not be required because most individuals do not earn enough of these income types to trigger self-reporting. For example, the first £10,100 (US\$16,239) of capital gains income is exempt from being reported on tax returns.¹² Even so, payers of interest or dividend income withhold tax before payments are made.

¹⁰ U.S. agreements include tax treaties, tax information exchange agreements, mutual legal assistance treaties, and mutual legal assistance agreements.

¹¹ The Convention is in force among Azerbaijan, Belgium, Denmark, Finland, France, Iceland, Italy, the Netherlands, Norway, Poland, Slovenia, Spain, Sweden, Ukraine, and the United Kingdom.

¹² We used rates that matched the time period cited for the foreign amount. The currency conversion for the capital gains amount is as of February 25, 2011.

PAYE also facilitates the payment of tax liabilities by periodic withholding at source for wages under the PAYE system. The withheld amount may be adjusted by HMRC to collect any unpaid taxes from previous years or refund overpayments. HMRC annually notifies the taxpayer and employer of the amount to withhold.

Taxpayers can provide HMRC with additional information that can be used to adjust their withholding. If taxpayers provide the information on their other income such as self-employment earnings, rental income, or investment income, HMRC can adjust the PAYE withholding. Individuals not under the PAYE system are required to file a tax return after the end of the tax year based on their records.

In addition, HMRC uses information reporting and tax withholding as part of its two step process to assess the compliance risks on filed returns. In the first step, individual tax returns are reviewed for inherent compliance risks because of the taxpayers' income level and complexity of the tax return. For example, wealthy taxpayers with complex business income are considered to have a higher compliance risk than a wage earner. In the second step, information compiled from various sources—including information returns and public sources—is analyzed to identify returns with a high compliance risk. According to HMRC officials, these assessments have allowed HMRC to look at national and regional trends. HMRC is also attempting to uncover emerging compliance problems by combining and analyzing data from the above sources as well as others.

The UK and U.S. both have individual income tax returns and use information reporting and tax withholding to help ensure the correct tax is reported and paid. However, differences exist between the countries' systems.

- The U.S. has six tax rates that differ among five filing statuses for individuals (i.e., single, married, married filing separately, surviving spouse, or head of household) and covering all types of taxable income. In general, the UK system has three tax rates, one tax status (individuals), and a different tax return depending on the taxable income (e.g., self-employed or employed individuals).
- U.S. income tax withholding applies to wages paid but not interest and dividend income as it does in the UK.
- U.S. wage earners, rather than the IRS, are responsible for informing employers of how much income tax to withhold, if any, and must annually self assess and file their tax returns unlike most UK wage earners.

Another major difference is that the U.S. automatically matches data from information returns and the withholding system to data from the income tax return to identify individuals who underreported income or failed to file required returns. Matching is done using a unique identifier TIN. HMRC officials told us that they have no automated document-matching process and the UK does not use TINs as a universal identifier, which is needed for wide-scale document matching. HMRC officials said that they may do limited manual document matching in risk assessments and compliance checks. For example, HMRC manually matches some taxpayer data—such as name, address, date of birth—from bank records to corresponding data on tax returns. The closest form of unique identifier that HMRC uses with some limitations is the national insurance number. HMRC officials said they are barred from using the national insurance number for widespread document matching, which leaves HMRC with some unmatchable information returns.

Australia Uses a Compliance Program for High Net Wealth Individuals That Focuses On Their Full Set of Business Interests to Improve Compliance

High wealth individuals often have complex business relationships involving many entities they may directly control or indirectly influence and these relationships may be used to reduce taxes illegally or in a manner that policymakers may not have intended. Australia has developed a compliance program that requires these taxpayers to provide information on these relationships and that provides such taxpayers additional guidance on proper tax reporting. The Australian High Net Wealth Individuals (HNWI) program focuses on the characteristics of wealthy taxpayers that affect their tax compliance. According to the Australian Tax Office (ATO), in the mid-1990s, ATO was perceived as enforcing strict sanctions on the average taxpayers but not the wealthy. By 2008, ATO found that high-wealth taxpayers, those with a net worth of more than A\$30 million (US\$20.9 million), had substantial income from complex arrangements, which made it difficult for ATO to identify and assure compliance. ATO concluded that the wealthy required a different tax administration approach.

ATO set up a special task force to improve its understanding of wealthy taxpayers, identify their tax planning techniques, and improve voluntary compliance. Due to some wealthy taxpayers' aggressive tax planning, which ATO defines as investment schemes and legal structures that do not comply with the law, ATO quickly realized that it could not reach its goals for voluntary compliance for this group by examining taxpayers as individual entities. To tackle the problem, ATO began to view wealthy taxpayers as part of a group of related business and other entities. Focusing on control over related entities rather than on just individual tax

obligations provided a better understanding of wealthy individuals' compliance issues.¹³

The HNWI approach followed ATO's general compliance model. The model's premise is that tax administrators can influence tax compliance behavior through their responses and interventions. For compliant wealthy taxpayers, ATO developed a detailed questionnaire and expanded the information on business relationships that these taxpayers must report on their tax return. For noncompliant wealthy taxpayers, ATO is to assess the tax risk and then determine the intensity of ATO's compliance interventions.¹⁴

According to FY 2008 ATO data, the HNWI program has produced financial benefits. Since the establishment of the program in 1996, ATO has collected A\$1.9 billion (US\$1.67 billion) in additional revenue and reduced revenue losses by A\$1.75 billion (US\$1.5 billion) through compliance activities focused on highly wealthy individuals and their associated entities.¹⁵ ATO's program focus on high wealth individuals and their related entities has been adopted by other tax administrators. By 2009, nine other countries, including the U.S., had formed groups to focus resources on high wealth individuals.

Like the ATO, the IRS is taking a close look at high income and high wealth individuals and their related entities. As announced by the Commissioner of Internal Revenue in 2009, the IRS formed the Global High Wealth (GHW) industry to take a holistic approach to high-wealth individuals. The IRS consulted with the ATO as GHW got up and running to discuss the ATO's approach to the high wealth population, as well as its operational best practices. As of February 2011, GHW field groups had a number of high wealth individuals and several of their related entities under examination.

One difference is that Australia has a separate income tax return for high-wealth taxpayers to report information on assets owned or controlled by HNWIs. In contrast, the U.S. has no separate tax return for high-wealth

¹³ Australian dollars converted to U.S. dollars as of December 31, 2008.

¹⁴ For more information on IRS's related entities program see GAO, *IRS Can Improve Efforts to Address Tax Evasion by Networks of Businesses and Related Entities*, GAO-10-968, (Washington, D.C.: September 24, 2010).

¹⁵ Australian dollars converted to U.S. dollars as of December 31, 2007.

individuals and generally does not seek asset information from individuals. According to IRS officials, the IRS traditionally scores the risk of individual tax returns based on individual reporting characteristics rather than a network of related entities.¹⁶ However, the IRS has been examining how to do risk assessments of networks through its GHW program since 2009. Another difference is that the ATO requires HNWI to report their business networks and the IRS currently does not.

Hong Kong Uses Semiannual Payments Instead of Periodic Employer Withholding for the Salaries Tax

Although withholding of taxes by payers of income is a common practice to ensure high levels of taxpayer compliance, Hong Kong's Salaries Tax does not require withholding by employers and tax administrators and taxpayers appear to find a semiannual payment approach effective. Hong Kong's Salaries Tax is a tax on wages and salaries with a small number of deductions (e.g., charitable donations and mortgage interest). The Salaries Tax is paid by about 40 percent of the estimated 3.4 million wage earners in Hong Kong, while the other 60 percent are exempt from Salaries Tax.

To collect the Salaries Tax, Hong Kong does not use periodic (e.g., biweekly or monthly) tax withholding by employers. Rather, Hong Kong collects it through two payments by taxpayers for a tax year. Since the tax year runs for April 1st through March 31st, a substantial portion of income for the tax year is earned by January (i.e., income for April to December), the taxpayer is to pay 75 percent of the tax for that tax year in January (as well as pay any unpaid tax from the previous year). The remaining 25 percent of the estimated tax is to be paid 3 months later in April.

By early May, Inland Revenue Department (IRD)—the tax administrator—annually prepares individual tax returns for taxpayers based on information returns filed by employers. Taxpayers review the prepared return and make any revisions such as including deductions (e.g., charitable contributions), and file with IRD. IRD then will review the returns and determine if any additional tax is due. If the final Salaries Tax assessment turns out to be higher than the estimated tax previously assessed, IRD is to notify the taxpayer who is to pay the additional tax concurrently with the January payment of estimated tax for the next tax year.

¹⁶GAO, *IRS Can Improve Efforts to Address Tax Evasion by Networks of Businesses and Related Entities*, GAO-10-968 (Washington, D.C.: Sept. 24, 2010).

Hong Kong's tax system is positively viewed by tax experts, practitioners, and a public opinion expert based on our discussions with these groups. They generally believe that low tax rates, a simple system, and cultural values contribute to Hong Kong's collection of the Salaries Tax through the two payments rather than periodic withholding. Tax rates are fairly low, starting at 2 percent of the adjusted salary earned and not exceeding 15 percent. Further, tax experts told us that the Salaries Tax system is simple. Few taxpayers use a tax preparer because the tax form is very straightforward and the tax system is described as "stable." Further, an expert on public opinion in Hong Kong told us that taxpayers fear a loss of face if recognized as not complying with tax law. This cultural attitude helps promote compliance.

Unlike Hong Kong's twice a year payments for the Salaries Tax, the U.S. income tax on wages relies on periodic tax withholding in which tax is paid as income is earned. IRS provides guidance (e.g., Publication 15) on how and when employers should withhold income tax (e.g., every other week) and deposit the withheld income taxes (e.g., monthly). Further, the U.S. individual tax rates are higher and the system is more complex. These tax rates begin at 10 percent and progress to 35 percent. Further, the U.S. taxes many forms of income beyond salary income on the individual tax return.

IRS Considers Foreign Tax Practices That Might Merit Adoption

IRS officials learn about foreign tax practices by participating in international organizations of tax administrators. By doing so, IRS officials say they regularly exchange ideas and learn about other practices. As the IRS learns of these practices, it may adopt the practice based on the needs of the U.S. tax system.

IRS is actively involved in two international tax organizations and one jointly run program that addresses common tax administration issues. First, the IRS participates with the Center for Inter-American Tax Administration (CIAT), a forum made up of 38 member countries and associate members, which exchange experiences with the aim of improving tax administration. CIAT, formed in 1967, is to promote integrity and transparency of tax administrators, promote compliance, and fight tax fraud. The IRS participates with CIAT in designing and developing tax administration products and with CIAT's International Tax Planning Control committee.¹⁷ Second, the IRS participates with the

¹⁷ Center for Inter-American Tax Administration, <http://www.ciat.org>.

Organisation for Economic Co-operation and Development (OECD) Forum on Tax Administration (FTA), which is chaired by the IRS Commissioner during 2011. The FTA was created in July 2002 to promote dialogue between tax administrations and identify good tax administration practices. Since 2002, the forum has issued over 50 comparative analyses on tax administration issues to assist member and selected nonmember countries.

IRS and OECD officials exchange tax administration knowledge. For example, the IRS is participating in the OECD's first peer review of information exchanged under tax treaties and tax information exchange agreements. Under the peer-review process, senior tax officials from several OECD countries examine each selected member's legal and regulatory framework and evaluate members' implementation of OECD tax standards. The peer-review report on IRS information exchange practices is expected to be published in mid 2011.

As for the jointly run program, the Joint International Tax Shelter Information Centre (JITSIC) attempts to supplement ongoing work in each country to identify and curb abusive tax schemes by exchanging information on these schemes. JITSIC was formed in 2004 and now includes Australia, Canada, China, Japan, South Korea, United Kingdom and the U.S. tax agencies. According to the IRS, JITSIC members have identified and challenged the following highly artificial arrangements:

- a cross-border scheme involving millions of dollars in improper deductions and unreported income on tax returns from retirement account withdrawals;
- highly structured financing transactions created by financial institutions that taxpayers used to generate inappropriate foreign tax credit benefits;¹⁸ and
- made-to-order losses on futures and options transactions for individuals in other JITSIC jurisdictions, leading to more than \$100 million in evaded taxes.

To date, the IRS has implemented one foreign tax administration practice. As presented earlier, Australia's HNWI program examines sophisticated

¹⁸When JITSIC uncovered transactions used by large corporations to generate inappropriate foreign tax credit benefits, the information was shared among members. The IRS made the generator a compliance concern for large corporations and has been pursuing these cases.

legal structures that wealthy taxpayers may use to mask aggressive tax strategies. In 2009, the OECD issued a report on the tax compliance problems of wealthy individuals and concluded that “high net worth individuals pose significant challenges to tax administrations” due to their complex business dealings across different business entities, higher tax rates, and higher likelihood of using aggressive tax planning or tax evasion.¹⁹ According to an IRS official, during IRS’s participation in the OECD High Wealth Project in 2008, IRS staff began to realize the value of this program to the U.S. tax system. As we stated, the IRS now has a program focused on wealthy individuals and their networks.

Chairman Baucus, Ranking Member Hatch, and Members of the Committee, this concludes my statement. I would be happy to answer any questions you may have at this time.

Contacts and Acknowledgments

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¹⁹OECD, *Engaging with High Net Wealth Individuals on Tax Compliance*, 2008

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