



RIKSREVISIONEN

*Summary:*

Business compliance controls – selection,  
volume development and monitoring

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RiR 2012:13

# Summary

## Business compliance controls – selection, volume development and monitoring RiR 2012:13

During the 2000's, the Swedish Tax Agency underwent a major organisational change at the same time as the overall objectives for tax collection were modified. Having previously focused on measures that retrospectively ensured the correct tax liability, the Swedish Tax Agency has since 2006 changed strategy and now focuses more on preventive measures to ensure that tax liability is calculated right from the start. Much of the changed strategy aims to reduce the proportion of the tax gap arising from the corporate sector.<sup>1</sup>

The formula and outcome of compliance control are of importance both to the public finances and national economy. Even if the direct fiscal outcome of the control activities carried out by the Swedish Tax Agency does not amount to a large proportion of the total tax collection, the control itself and its effectiveness are of significance as it affects the willingness to comply. This willingness to comply is, in turn, of great importance to the size of the tax gap. Another important aspect of the control is that it enables companies to compete on equal terms.

## Audit background

The tax gap is largest in areas where the Swedish Tax Agency has to rely on the submission of tax returns from taxpayers themselves such as the taxation of corporate revenue. The tax gap is smaller in areas with developed system support and extensive third-party information such as personal income tax. The Swedish Tax Agency estimates that the corporate sector accounts for almost 80 percent of the overall tax gap.

The result of a prestudy to the audit report showed the difficulty in attaining a comprehensive overview of the development of business compliance control volumes. In addition, there were indications that the accuracy of the selection of business controls had not improved in general. Should control volumes decrease in parallel with the selection of business controls remaining unchanged, the result would be a decline in the quality of business controls.

In 2010, the Swedish Tax Agency introduced a new work method called *Choice of measure* that allows the staff to choose which control measure should be applied in each individual case. The results of this change and how the Swedish Tax Agency handles follow-up information arising from the compliance control are important issues for the audit.

In view of the above, the Swedish National Audit Office (the Swedish NAO) has audited the effectiveness of the Swedish Tax Agency's handling of business controls and the availability of adequate follow-up information. In addition, the audit has also entailed evaluating the follow-up information available to the Government on the Swedish Tax Agency's development of business compliance controls.

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<sup>1</sup> A tax gap constitutes the difference between the tax that would have been determined if everyone had reported their activities and transactions correctly, and the tax that is determined in practice.

## The Swedish Tax Agency's business compliance controls

The strategy of the Swedish Tax Agency is to prioritise measures that result in taxpayers reporting their tax liabilities right from the start. This aims to minimise the ongoing case management and so-called '*basic controls*' (checking of obvious errors that can be found without an investigation) and is also meant to provide more time for more advanced controls, hereinafter referred to as '*extended controls*'.

Extended controls primarily apply to two areas. The first area is called '*Tax evasion*', where an extended control is carried out on companies strongly suspected by the Swedish Tax Agency of trying to evade paying tax. In order to do this, the Swedish Tax Agency makes use of a number of sources in order to select companies for a control such as tips, communications with other authorities, etc. The second area is called '*Other companies*' and focuses on the remaining risk areas. In this area the Swedish Tax Agency makes use of its own databases to select companies for a compliance control, hereinafter referred to as '*automatic control selections*'. In 2011, the Swedish Tax Agency allocated the same amount of resources to each of these two areas.

Controls are organised within the framework of projects coordinated on a national level. The projects themselves determine what is to be controlled within a specified business group. The audit of the Swedish NAO has focused on four major control projects, i.e. corporate income tax, VAT declaration, employers' contributions and cash trading.

### Audit results

The overall conclusion of this audit is that the Swedish Tax Agency is largely lacking adequate follow-up information regarding the development of volume and accuracy of business compliance controls. In addition, certain work methods could be used more efficiently. The grounds for these assessments are presented below.

### Control accuracy is difficult to measure

The Swedish NAO notes a number of difficulties in measuring and evaluating the accuracy of controls, i.e. the extent at which controls are aimed at companies submitting incorrect tax returns. However, there are indications to suggest that the Swedish Tax Agency has not succeeded in its endeavour to improve the accuracy of its selection of controls. The accuracy of tax audits has improved. On the other hand the use of such tax audits as a control tool is becoming less and less frequent.

In the case of tax audits, the Swedish Tax Agency is able to measure the exact proportion of investigations resulting in a change in tax liability. However, the most common type of control is to make inquiries over the telephone or in writing, the concept of which is generally referred to as *desktop controls*. The Swedish Tax Agency is not able to measure the proportion of desktop controls that result in a change in tax liability. Nonetheless, there is a target that specifies that 60 percent of desktop controls should result in a change in tax liability. In order to assess whether or not the target has been met, the Swedish Tax Agency makes an approximate calculation based on the number of decisions resulting in a change in tax liability, which in 2011 resulted in a figure of 61 percent. However, there is a great risk for overestimation when using this method. Therefore, the Swedish National Audit Office has together with the head office of the Swedish

Tax Agency come to the conclusion that it would be more correct to base the calculation on the *number of controlled companies*. This generates a substantially lower figure.

The accuracy can also be analysed by measuring the proportion of control hits (business selected for control) that leads to measures (for example desktop control and tax audit) and changes. However, this type of analysis is only feasible for the Swedish Tax Agency's automatic control selection. Moreover, the audit has found that such proportional values are often overestimated when a control leads to changes in tax liability over multiple time periods (and thus, multiple decisions being made). Since there is no regular monitoring of the number of decisions made for each control hit, the Swedish Tax Agency has no knowledge as to the extent of this problem. Another problem is that it is not possible to measure whether the control hits listed as not acted upon are due to a shortage of time or that there is no reason to investigate.

## **Difficult to monitor the development of control volumes**

The Swedish NAO notes the difficulty in presenting the volume development of controls over time as none of the separate measurements available to the Swedish Tax Agency can provide a full overview. Accordingly, this audit presents a number of less complete ways in which to measure control volumes where the overall picture shows a decline in volumes. An analysis of the reason for this decline in volumes is further complicated by the fact that the Swedish Tax Agency is not separating control volumes for the two principal control areas, i.e. *Tax evasion* and *Other companies*. In addition they have not been able to separate between *basic controls* and *extended controls* during a few years. Possible explanations for the decline in volumes are that more effort has gone into preventative work and that controls have become more complicated, although there is no follow-up information to confirm this. If business control volumes were to decline without the Swedish Tax Agency simultaneously increasing the accuracy of its control selection or the efficiency in other of its operations, the objectives of the Swedish Tax Agency to minimise the tax gap may become jeopardized.

The Swedish Tax Agency promotes follow-up controls as an important tool to ensure that control measures taken has led to a change in the behaviour of previously controlled companies. However, there is no information on the number of follow-up controls carried out in 2011 and in the years leading up to 2008 and hence, the audit could not draw any conclusions as to the volume development of follow-up controls.

It has not, during the period evaluated by the audit, been possible for the Swedish Tax Agency to calculate meaningful productivity measures as control volumes could only be allocated to tax categories but not to the control areas, i.e. *Tax evasion* and *Other companies*. However, as for staff timesheets, these could not be allocated to any tax categories. It also became clear in the course of the audit that time spent is not a good measurement of the volume of controls carried out.

## **An overview of the need for follow-up information is missing**

Within the control projects audited by the Swedish NAO criticism has been voiced of the effectiveness of the follow-up tools used by the Swedish Tax Agency to monitor control projects. In some cases, the Swedish Tax Agency has been unable to monitor if the projects has achieved the objectives intended. As a consequence, the objectives appear to have failed to serve as policy

instruments. In addition, the Swedish NAO notes that there are deficiencies in the tools used for follow-up of automatic control hits, which limits the ability to learn from selection results. However, the management of the key project Prius, responsible for developing the automatic control selections, is already aware of those deficiencies. As to remaining selections (primarily used in the area *Tax evasion*) there is no coherent follow-up information, which is an even a greater deficiency.

A train of thought running through the control strategies of the Swedish Tax Agency is that its measures are meant to prevent faults and the recurrence of faults. However, it is difficult to verify to which extent this end is met. There is no comprehensive overview to identify preventive measures, an issue which the Swedish Tax Agency has recognised internally. As a consequence, it is not possible to monitor to which extent control projects contribute to achieving the objective of more preventive work.

### **The handling of automatic control selections can be made more effective**

Control selections within the area of *Other Companies* are managed by the Prius project using an automatic database selection. The Prius project is also in charge of improving the accuracy of automatic control selections. The Prius project management acknowledges that there is a lack of understanding for why the staff does not act on a large proportion of companies selected for compliance controls. To act on a selected business means in this case that the staff carries out a control or provides the business with specific information.

A control project is led by a national coordinator, who among other things commissions Prius to perform an automatic control selection. The audit has noticed that the confidence in the quality of control hits (i.e. the proportion of hits in a control selection worth acting on) varies from one control project to another. As a result, the coordinator sometimes orders a greater number of control hits than what is possible to deal with in the project. Another factor that may result in not all control hits being acted upon is if the time allocated to the control project during planning is not made fully available or a high employee turnover means that the staff carrying out the controls is lacking in experience.

To determine whether a control hit will lead to a measure, the staff performs a pre-control of the selected business. This can be seen as a second selection where the staff picks out relevant control hits from the control selection provided by Prius. Even if a single pre-control is not a lengthy process, a large number of pre-controls on the other hand will lead to valuable time being spent on deselecting irrelevant control hits rather than on carrying out controls. From a follow-up and analysis point of view, it ought to be more efficient if the Prius project was to manage all deselections rather than it being dealt with by the control projects.

It becomes more of a problem when the control hits must be deselected due to a shortage of time. If control hits are deselected without a pre-control then no time is lost that could have been spent on carrying out controls but there is a substantially higher risk of relevant control hits being discarded.

The Swedish NAO has established that regardless of whether a large volume of control hits are deselected due to a shortage of time or following a pre-control, it is an inefficient use of the control selection. Rather than spending a lot of time on pre-controls that leads to deselected control hits, that time could be used to correct incorrect tax returns. Also, when the staff deselect control hits due to a shortage of time, it is impossible to know if it is the least relevant hits that are deselected.

## **Work method 'Choice of measure' subject to improvement**

In 2010, the Swedish Tax Agency introduced a new work method called 'Choice of measure' as a way in which to make business controls more effective. The motive behind this was the belief that local staff and not staff at the head office of the Swedish Tax Agency are best suited to choose what measures should be taken in individual cases. The Swedish NAO notes however that there is no central directive on how to implement this new work method and as a result, there are now regional inconsistencies. The Swedish Tax Agency does not know if the new work method 'Choice of measure' has led to improved efficiency. In addition, the Swedish NAO has found that audit resources are not always available when a tax audit is considered to be the most effective measure.

## **The Government's control of the Swedish Tax Agency's business controls**

As regards the corporate compliance controls, the Ministry of Finance relies on an informal control, which seems to be working well, according to the Ministry. The Ministry of Finance has expressed confidence in the Swedish Tax Agency not failing to inform the Ministry of any problems during its regular verbal reconciliations. However, the audit has revealed deficiencies in the Swedish Tax Agency's data used for measuring volume development and selection accuracy as well as the consistency between different regions with regard to the design of business controls. Thus, there is basis for the Government to ensure that the reporting of the Swedish Tax Agency's activities relating to the development of business controls is improved.

## **Recommendations of the Swedish National Audit Office**

Based on the findings of the audit, the Swedish National Audit Office makes the following recommendations to the Swedish Tax Agency:

- The Swedish Tax Agency should examine the need for appropriate follow-up information and based on that improve the follow-up of the development of control volumes and the accuracy of control selections.
- The Swedish Tax Agency ought to examine how to best practise the work method 'Choice of measure' and ensure that current tutorials in investigative methods are adequately supplemented. In addition, the Swedish Tax Agency should develop routines for the coordination of demands for and availability of tax audit resources.
- The Swedish Tax Agency ought to examine the cause of the high proportion of control hits being deselected and take appropriate measures.

Furthermore, the Swedish National Audit Office makes the following recommendations to the Government:

- The Government should ensure that the Swedish Tax Agency provides adequate information on the development of business controls.