

Summary

Tax supervision – a matter of trust in
public administration (RiR 2013:12)



Tax supervision – a matter of trust in public administration

Government agencies and municipalities are major tax payers. Just as private companies, they have to deal with extensive and sometimes complicated tax regulations. It is important for several reasons that government agencies and municipalities handle their tax accounting correctly. On an overall level this can affect the general public's trust in public actors. A more specific example in the VAT field is that incorrect processing of VAT can skew competition between the private and public sectors.

Assessment background

Reasons: In its vision, formulated as “full trust in public administration”, the National Audit Office emphasises the importance of the general public trusting government agencies. Meanwhile, there has lately been information surfacing about government agencies and municipalities committing various errors in their tax accounting. Considering the risk of competition skewing, as well as the loss of trust arising from how these government agencies have handled their taxes, the National Audit Office has chosen to assess this matter.

Aim: The aim of the assessment is to investigate the risk of errors in the tax accounting of public actors, and what effects this may have. The assessment also aims to investigate if the control systems that surround the tax accounting of public actors are effective and well-measured. However, the aim has not been to quantify the extent of the errors made or to measure the impact that errors in public actors' tax accounting has on the general public's trust.

Implementation: The National Audit Office has conducted document studies and interviews with a number of actors. In-depth interviews have been conducted with five government agencies, focusing on their handling of VAT matters. The results of the in-depth interviews have been used as the basis for a survey sent to 150 government agencies, focusing on how they handle VAT. The National Audit Office has also analysed all audits of public actors conducted by the Swedish Tax Agency between 2010 and 2012. The assessment has also made use of statistics from the Swedish Tax Agency regarding control and information to public actors.

Assessment results

The assessment shows that there are a number of risks related to the tax accounting of public actors. In the assessment we have also been able to conclude that there are several weaknesses in the control system that surrounds the tax accounting of public actors. Based on the trust risks



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related to errors in public actors' tax accounting, the National Audit Office wishes to emphasise the importance of government agencies and municipalities ensuring that their tax accounting is correct. There are also reasons for other parts of the control system, such as the Swedish Tax Agency as well as the state and municipal audit, to reinforce their initiatives in this field.

Many problems with government agencies' VAT-accounting

The government agencies' tax accounting is often viewed simply as money being circulated within the State. However, the assessment shows that an incorrect handling of VAT can have a number of negative effects. As the Swedish Tax Agency lacks the authority to audit government agencies' compensation for input VAT and the Swedish National Financial Management Authority does not have an auditing role, this is in practice an area without any form of control. At the same time, the Swedish Tax Agency's conducted audits show that there are often errors made in the municipalities' VAT-accounting. The National Audit Office has therefore conducted its own assessment of VAT handling among government agencies. The assessment has resulted in the following findings and conclusions.

Rules regarding taxation of withdrawal of assets are not applied among government agencies

Lease and sale of real property is generally not subject to VAT. Therefore, the owner of real property normally cannot deduct input VAT on procured services for the management of their real property. This means that in these cases the input VAT becomes an operational cost, making it cheaper to carry out the services in-house. To make it cost neutral to conduct real property management with one's own staff compared to hiring labour, there are rules regarding the taxation of withdrawal of assets. The regulations mean that owners of real property are to pay VAT for real property services conducted with their own staff.

The assessment shows that government agencies do not apply these taxation rules for their own real property services carried out by their own staff despite there being no exemption for government bodies in the existing legislation. Such an exemption has existed, but was removed in 1995. Government agencies are not entitled to compensation for input VAT for work on permanent residences, which is why in the absence of asset withdrawal taxation rules it is cheaper to use one's own staff for this management. As government agencies are not applying these withdrawal regulations for real property services, the National Audit Office notes that there is a skewing of competition between the public and private sectors.

In the National Audit Office's survey aimed at government agencies, almost one third of the answering agencies state that they have premises intended to be permanent homes. Of these, 38 per cent stated that they have their own staff conducting technical maintenance of these homes. While it is likely that many government agencies only have a small number of permanent homes, there are examples of agencies with a large number of premises intended to be permanent homes. For



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these agencies the amount of money that is not being taxed according to the rules of withdrawal taxation might be substantial.

The National Audit Office finds it remarkable that the problem persists despite the exemptions being removed almost 20 years ago. However, it is hard to criticise individual agencies for their handling when neither the Swedish Tax Agency nor the Swedish National Financial Management Authority have any information about how asset withdrawal taxation is to be handled by the State. The fact that this problem has not been highlighted previously indicates a lack of follow-up regarding tax regulations. It is therefore important that functioning follow-up procedures are in place.

Reverse tax liability for construction services are applied incorrectly

To counteract tax fraud in the construction industry, the main rule is for the buyer rather than the seller to account for the VAT, known as reverse taxation. However, the rules do not apply when a government agency purchases construction services for operations only attributable to the agency's exercise of authority. According to the Swedish Tax Agency, business owners unsure if they are to charge VAT or not when selling construction services should ask the authority buying the service what the purpose of the purchase is. Our assessment shows that errors are often made with regard to this, and that many government agencies have trouble determining if the purchase is made for the agency's professional operations or for their exercise of authority.

The fact that the government agency is unable to decide on the purpose of the purchase of construction services causes a number of problems. A construction company which applies reverse taxation incorrectly risks having to pay VAT plus a tax surcharge and interest to the Swedish Tax Agency. However, a government agency may, by being exempt from control, in practice also be compensated for incorrectly charged VAT. To avoid risk-taking, a construction company may therefore choose to never apply reverse taxation. The problem with this method is that it risks undermining the regulations for reverse taxation in the construction industry.

Few government agencies apply for repayment of VAT paid abroad

A government agency that has to pay VAT abroad may apply for repayment of the VAT from the Tax Agency in the country where the VAT has been charged. Despite as many as 75 per cent of government agencies in the survey stating that they have expenses relating to foreign VAT, only a quarter of them apply for repayment of foreign VAT. The main reason for this is that the agencies feel that it is not worth the trouble.

VAT paid abroad for which repayment is not sought constitutes an actual cost for the State. Today no one knows how much VAT Swedish government agencies pay abroad. The agencies' own estimates in the survey indicate that the figures are in the millions. The fact that individual government agencies with small expenses relating to foreign VAT do not apply for repayment is hard to question. The work that the agency has to put into an application process is often not proportional to what it can expect to receive in return. However, the fact that many government



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agencies (including ones with major expenses) do not apply for repayment of VAT means that there is currently a non-negligible outflow of state funds. It could therefore be justified to have a joint function for government agencies to apply for repayment of foreign VAT.

Rules for entertainment are seen as complicated

There are limitations to government agencies' right to VAT compensation when it comes to VAT related to entertainment. After taking samples from five government agencies' entertainment invoices, it is noted that errors could be found at all five agencies in question.

The number of investigated government agencies is too small for it to be possible to draw conclusions about government agencies in general. However, the fact that the government agencies have trouble with the accounting of entertainment is confirmed by the Swedish National Financial Management Authority, which states that the rules surrounding entertainment are complex and that there is a risk of government agencies making errors.

Based on the significant attention that surrounds hospitality and entertainment issues lately, the National Audit Office finds it remarkable that so many government agencies still lack the requisite knowledge about how entertainment should be accounted for.

The Swedish Tax Agency's control requires more resources

In its 2008 risk assessment, the Swedish Tax Agency states that the risk of errors and cheating among public actors is low compared to several other areas of risk. However, the Swedish Tax Agency still highlights VAT, excise tax, and other benefits as areas of risk for public actors. The risk is believed to be higher among municipalities and their companies than among government agencies. The National Audit Office does not question the Swedish Tax Agency's risk assessment but notes that the analysis is incomplete.

The National Audit Office can conclude that the Swedish Tax Agency has assigned relatively few resources to the control of public actors in the past few years, dedicating at most six full-time equivalents per year on tax auditing. During this period, only a handful of audits of government agencies have been conducted. There have been slightly more audits of municipalities and municipal companies, but significant limitations have been needed to take on large municipalities. The National Audit Office believes that the low number of audits and the occasionally limited scope means that new types of errors and problems may be overlooked. The low number of audits in recent years means that it is questionable whether there currently exists sufficient data for conducting a new full-coverage risk analysis for public actors.

The Swedish Tax Agency was planning to increase the resources for the fiscal year 2013, but these reinforcements are still not fully in place. The National Audit Office believes that there have been insufficient resources allocated to the work related to public actors in recent years and that it is important that these extra resources are allocated as soon as possible.



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Information and support for government agencies can be improved

Normally, government agencies are referred to the Swedish Tax Agency for questions relating to tax regulations. However, the Swedish National Financial Management Authority is responsible for guidance and support regarding VAT compensation. Among other things, the Swedish National Financial Management Authority's website has a VAT guide. Despite this, the Swedish National Financial Management Authority states that in complicated matters they often have to refer to the Swedish Tax Agency as the regulations relate to the Value-Added Tax Act.

Many of the government agencies interviewed in the assessment find it hard to know how VAT regulations are to be interpreted. One example is where to draw the line between professional operations and exercise of authority. Both the Swedish National Financial Management Authority and Swedish Tax Agency consider that it is difficult to draw a clear line. The National Audit Office believes that there is room for improved collaboration between the Swedish Tax Agency and the Swedish National Financial Management Authority when it comes to advising government agencies about how input VAT and related matters should be handled.

Taxes seldom subject to municipal and state auditing

State and municipal auditing has, for natural reasons, significantly more insight into the public actors than the Swedish Tax Agency has. What is audited is determined by an assessment of risk and materiality for various types of errors. It has been noted in the assessment that taxes are seldom the subject of state and municipal audits. Given the risks related to public actors' tax accounting, the National Audit Office believes it to be necessary for state and municipal audits to give greater consideration to the trust issues associated with incorrect tax administration in their risk and materiality assessments.

Government agencies and municipalities are ultimately responsible

Ultimately, municipalities and government agencies are responsible for taxes being handled correctly. There are rules for internal control in support of this. However, the regulations for government agencies are far more extensive than those for municipalities. The Swedish Tax Agency states that they often see examples of poorly functioning internal control in the municipalities.

The overall impression we got from our contacts with government agencies is that there is a general desire to act correctly when it comes to taxes, but that things sometimes still go wrong. We have also seen examples of government agencies who take tax issues a little too lightly.

The Swedish National Audit Office's recommendations

The Swedish National Audit Office wants to emphasise the importance of taxes being handled correctly in the public sector. The requirements placed on private companies are high and it is important that the public sector leads by example. How taxes are handled by the public sector is also important for the general public and companies' trust in the State's operations.



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Based on the assessment's findings and conclusions, the Swedish National Audit Office submits the following recommendations:

To the Government

- Urgently revise the regulations for taxation of withdrawal of assets in Government agencies.
- Consider commissioning the Swedish Tax Agency to audit government agencies' compensation for input VAT.
- Consider asking the Riksdag to commission the Swedish Tax Agency to issue tax surcharges, or a corresponding charge, when encountering errors in municipal applications for VAT compensation.
- Consider creating a joint function for government agencies to apply for repayment of foreign VAT.

To the Swedish Tax Agency

- Ensure that resources for the control of public actors are sufficient to provide a full-coverage risk assessment.

To the Swedish National Financial Management Authority and the Swedish Tax Agency

- Improve the collaboration regarding VAT information and clarify the guidelines regarding construction VAT and entertainment

