



ROMANIA

TECHNICAL ASSISTANCE REPORT—ENABLING THE LARGE TAXPAYER OFFICE TO REDUCE THE TAX GAP

August 2016

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Romania

Enabling the Large Taxpayer Office to Reduce the Tax Gap

Allan Jensen, Norman Gillanders, and Keith Cartwright



Technical Assistance Report

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GLOSSARY

| | |
|------|---|
| CRM | Compliance risk management |
| EUR | Euro (currency of the eurozone) |
| FAD | Fiscal Affairs Department |
| HWI | High wealth individual |
| HQ | Headquarters |
| IT | Information technology |
| LTO | Large Taxpayer Office |
| NAFA | National Agency for Fiscal Administration |
| OECD | Organization for Economic Cooperation and Development |
| RDF | Risk Differentiation Framework |
| RAMP | Revenue Administration Modernization Project—World Bank |
| RMU | Risk Management Unit |
| RON | Romanian Leu (Currency) |
| SOE | State-owned enterprise |
| TA | Technical assistance |
| VAT | Value-added tax |
| WB | World Bank |

PREFACE

Requested by Mr. Eugen Orlando Teodorovici, Minister of Public Finance, a revenue administration mission from the Fiscal Affairs Department (FAD) of the IMF visited Bucharest, Romania from July 22–August 4, 2015 tasked with reviewing the performance of the Large Taxpayer Office under the National Agency for Fiscal Administration (NAFA).

The mission, which was led by Mr. Allan Jensen (FAD) and comprised Messrs. Norman Gillanders and Keith Cartwright (both external FAD experts), overlapped with a visit by Mr. John Buchanan (external FAD expert) who was in Bucharest to provide technical assistance (TA) on taxpayer compliance programs for high-wealth-individuals (HWI) and high income earners.

The mission met with Mr. Eugen Orlando Teodorovici, Minister of Public Finance; and from NAFA Mr. Gelu Stefan Diaconu, President; Mr. Mihai Gogancea-Vatasoiu, Vice President; Mr. Octavian Deaconu, Secretary General; and Mr. Adrian Cucu, Director of the Large Taxpayer Office (LTO). The mission also met with many other managers and staff in the Ministry of Public Finance and NAFA, including the LTO.

From the Romanian Court of Accounts, the mission met with Ms. Elena Doina Dascalu, Vice-President; Mr. Dan Firtescu, Counselor; and other officials of the Court. The mission also met with Mr. Ismail Radwan, Country Program Coordinator Central Europe and the Baltic States, World Bank. Finally, the mission met with representatives of major accounting firms in Bucharest.

The mission expresses its gratitude for the excellent cooperation it had with the authorities; in particular Ms. Delia Radoi and Ms. Luminita Rontescu (both NAFA) did an outstanding job in facilitating the logistics of the mission.

A draft report was provided to the authorities at the end of the mission and has been finalized in IMF headquarters. The report consists of an executive summary and seven sections: (i) Large Taxpayer Office Reform Context; (ii) Improving the Large Taxpayer Criteria; (iii) Improving Compliance Risk Assessment; (iv) Strengthening Audit Selection and Focus; (v) Improving Value-Added Tax Refund Procedures; (vi) Improving Tax Arrears Collection; and (vii) Other Large Taxpayer Office issues.

EXECUTIVE SUMMARY

This mission was tasked with reviewing the performance of the LTO of NAFA. The government envisages that NAFA—and in particular its LTO—will deliver improved taxpayer compliance to provide additional tax revenue for the government’s economic program. However, this will not happen without radical changes to the LTO’s mandate and operations. For many reasons, which are described in this report, its activities are not strongly focused on the major compliance risks that make up the bulk of the tax gap. This report recommends a comprehensive change plan. Strong government support, including to legislation changes, are required to enable the reform.

Main findings and recommendations

There is scope for reducing the tax gap. The value-added tax (VAT) collection gap at 44 percent is the highest in the EU, and at 18.8 percent of GDP in 2014, tax revenue collection is lower than in most EU member states. As compliance efforts are largely focusing on VAT, it is very likely that compliance is at a similarly low level across other taxes (e.g., corporate tax).

Presently, the LTO will not be able to reduce significantly the tax gap caused by large businesses. The following are the key reasons leading to this conclusion:

- No modern compliance risk management (CRM) approach is in place. Consequently, the taxpayer compliance picture has not been sufficiently analyzed, and there is no strategy in place to guide operational activities towards major compliance problems.
- About 46 percent of annual LTO audit resources are used on VAT refund issues with material results only in about 10 percent of audits. In advanced administrations, VAT refund audits occupy less than 5 percent of LTO resources.
- VAT refund audit concerning a large taxpayer takes half a year on average, due (largely) to the burdensome obligations placed on the administration, while in advanced administrations such audits typically take a day or less.
- The intense attention paid to the audit activities by the Court of Accounts—together with the situation that tax auditors can be made accountable personally for any tax shortfall not discovered during the audits—are key reasons for these lengthy audits.
- Around a third of total annual audit resources are used on satisfying audit requests coming from the Court of Accounts, other parts of NAFA, and other authorities. These audits often produce very small results.
- The remaining 20 percent of total annual audit resources is mainly focused on audit plans developed “bottom up” (although there is minor NAFA Headquarters (HQ) input). This is not a strategic approach and the outcome is meager as a result.
- There are also shortcomings in taxpayer services and collection enforcement.

- The assignment of taxpayers to the LTO is done incorrectly. The LTO struggles to manage 2,392 taxpayers who account for less than 50 percent of total tax revenue collected by NAFA. A better selection (built upon taxpayer turnover) would assign 1,200–1,400 taxpayers to the LTO who would account for up to 60 percent of total revenue.

In addition, there are shortcomings with respect to organization and legal framework that represent essential enablers, which need support at the highest levels for changes to be made. An example would be changes to the tax code and to tax procedures; without these reforms, any new approach will flounder. Additionally, deep organizational and cultural changes will be needed. The people in the LTO will need to embrace entirely new ways of working and there will also need to be a major training effort to equip them with the necessary skills. To succeed, the LTO will need a degree of autonomy similar to that enjoyed by regional offices. That means it must have the freedom to devise and implement appropriate and codified procedures to control its share of the tax base. It cannot continue to operate through the same procedures used to control small and medium enterprises.

The effective administration of large taxpayers is critical to the government's fiscal objectives and to reducing the tax gap. It is essential that NAFA has a very strong and effective LTO that consistently pursues a coherent and proven compliance strategy and is well equipped in both skilled people and material tools.

While the body of this report discusses the reform needs in much more detail and provides recommendations on each issue, these are the major recommendations:

Short term (6–12 months)

- Change the criteria for inclusion of taxpayers in the LTO so that it is primarily based on turnover (sales). The criteria should apply for taxpayers throughout Romania and should be the primary mechanism to establish whether a taxpayer is "in or out."
- Maintain or increase the current number of employees in the LTO, even though the new criteria may significantly reduce the LTO taxpayer population. Although, the population will reduce, its importance in terms of revenue that needs to be protected will increase.
- Commence upgrading the skills of LTO personnel through training, including through exchange programs with advanced tax administrations, and replace personnel as appropriate to upgrade the LTO (it is essential that LTO personnel are highly skilled so that they can match their counterparts in the accounting firms).
- Make a government decision to commence the implementation of the compliance risk management model outlined in this report.
- Change the Tax Procedure Code and relevant regulations and instructions so that sufficient mandate for NAFA is established to enable it to prioritize its compliance efforts to address the major revenue risks.
- Revise the procedures for VAT refund (risk assessment and audit) to cut down on the excessive use of audit resources.

- Remove from law and regulations: (1) NAFA's obligation to audit taxpayers for statute of limitation purposes only; (2) the personal liability for the revenue shortfall upon auditors and other officials; and (3) auditors' obligation to review all tax periods since the last audit.
- Reach a protocol with the Court of Accounts so that it can continue to carry out its important role, but in the context of a modern and quality-assured compliance-management framework (essentially, NAFA would be adopting the compliance risk model of the EU).
- Establish within the LTO a strong risk management unit to facilitate: high-level risk analysis to determine industry sector and other significant risks clusters; prioritizing risks for compliance treatment; coordinating the development of compliance strategies; and facilitating the selection of audit cases.

Medium term (12–36 months)

- Provide the LTO with appropriate accommodation (as already planned); sufficient transport means; and appropriate modern technical tools, including laptops and information technology (IT) software to undertake e-audit.
- Reorganize the LTO organization structure along the lines suggested in this report.
- Provide for industry competitive salaries to LTO managers and key personnel, in particular auditors and legal and IT experts, to attract and retain exceptionally skilled personnel.

These recommendations are in conformity with the overall objectives of the World Bank (WB) Revenue Administration Modernization Project (RAMP) for Romania.

I. LARGE TAXPAYER OFFICE REFORM CONTEXT

A. Fiscal Context

1. Modernizing NAFA, including the LTO, is an important component of the government's economic reform program. Despite recent strong fiscal adjustment efforts, various issues, including the external environment in Europe, will continue to pose a risk to macroeconomic consolidation. Given the limited fiscal headroom for new spending and for accommodating tax reductions recently adopted by parliament (see Paragraph 2), the authorities have a strong interest in improving the efficiency and effectiveness of revenue collection—including by the LTO. Table 1 shows tax revenue collections since 2009 in percent of GDP.

Table 1. Tax Revenue, 2009–15

(In percent of GDP)

| | 2009 | 2010 | 2011 | 2012 | 2013 | Prelim. 2014 | Proj. 2015 |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|-----------------|---------------|
| Taxes | 26.7 | 26.0 | 27.6 | 27.8 | 27.2 | 27.3 | 26.7 |
| Corporate income tax | 2.6 | 2.1 | 2.0 | 2.0 | 1.9 | 2.0 | 1.9 |
| Personal income tax | 3.6 | 3.4 | 3.4 | 3.5 | 3.6 | 3.5 | 3.7 |
| VAT | 6.7 | 7.4 | 8.5 | 8.5 | 8.1 | 7.6 | 7.9 |
| Excises | 3.1 | 3.2 | 3.4 | 3.4 | 3.3 | 3.6 | 3.6 |
| Customs duties | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Social security contributions | 9.4 | 8.6 | 9.0 | 8.7 | 8.5 | 8.6 | 7.8 |
| Other taxes | 1.2 | 1.3 | 1.2 | 1.6 | 1.7 | 1.8 | 1.7 |

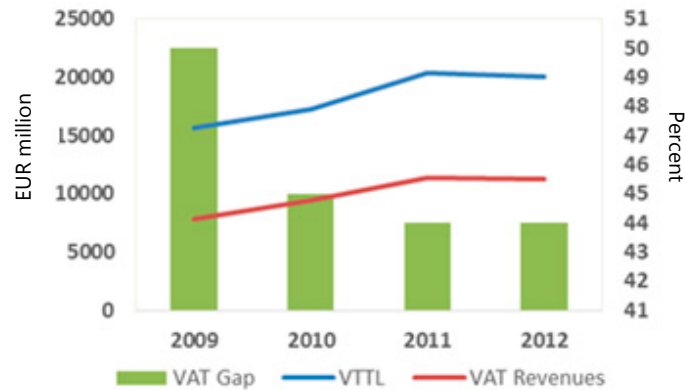
Sources: Authorities; and IMF staff compilations.

2. The government expects the fiscal impact of tax reductions to be partially offset through improved taxpayer compliance. Recently, the parliament adopted legislation that will lower (from 2016) the VAT rate, excises, and taxes on dividends as well as cancelling the tax on nonbuilding constructions. These changes will undermine the fiscal targets to reach and remain within the medium-term budgetary objective. However, the government envisages that the tax administration—and in particular the LTO—will deliver improved taxpayer compliance to reduce the tax gap and offset in part the fiscal impact of these policy changes.

3. There is plenty of scope for reducing the tax gap by improving taxpayer compliance. Although it is doubtful that taxpayer compliance can be improved substantially in the short term, there is plenty of room for improvements in the medium to long term. The VAT collection gap at 44 percent (Figure 1) is the highest in the EU, and at 18.8 percent of GDP in 2014 (excluding social contributions), tax revenue collection is lower than in most EU member states (Figure 2). As most of NAFA's compliance activities are focused on controlling the VAT, it is

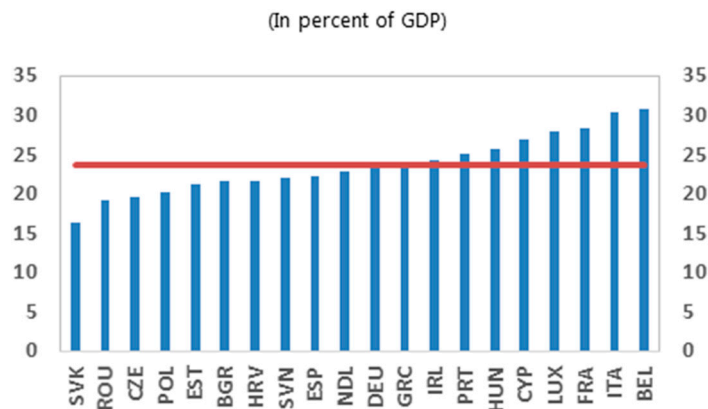
reasonable to assume that the tax compliance is similarly low with regard to other tax headings (i.e., corporate income tax, personal income tax, excises, and social security contributions). NAFA must develop capacity to reduce these tax gaps.¹

Figure 1. Value-Added Tax Receipts and Gap



Source: European Commission.

Figure 2. Government Taxes, 2014¹



Source: World Economic Outlook.

¹ The comparison in Figure 2 does not include social security contributions.

¹ Tax gap: Difference between actual and potential tax collections if all taxpayers were compliant.

B. The Large Taxpayer Office's Current Prospect of Reducing the Tax Gap

4. The effective administration of large taxpayers is critical for tax collection and the investment climate. Large businesses present special challenges for any tax administration. In Romania, as in other countries, most large taxpayers comply with their basic obligations to report and pay tax on time. However, some large businesses are likely to engage in sophisticated forms of noncompliance—involving international activities, related party transactions, and structured financial arrangements—which may have severe revenue implications and contribute considerably to the overall tax gap. Box 1 provides examples of compliance risks related to international activities. In addition, large businesses often deal with the most complex aspects of the tax laws. The way in which these laws are applied will have major implications for profitability and, consequently, the decisions of businesses to invest in Romania.

Box 1. Examples of Compliance Risks Related to International Activities

- Individuals concealing taxable assets or income using offshore accounts, offshore trusts or shell companies often located in tax havens or other countries that do not exchange information for tax purposes.
- Small or closely-held businesses using tax haven based shell companies to shift profits abroad, often using fictitious invoices or over (or under) charging for related party transactions.
- Large (often multinational) corporations engaging in any number of sophisticated transactions ranging from cross-border financial schemes that are profitable only due to embedded tax benefits, to the misuse of treaties, to the manipulation of transfer pricing to artificially shift income into low tax jurisdictions and expenses into high tax jurisdictions.
- Various forms of VAT “carousel fraud.”
- The development of business-to-consumer cross-border trade (e.g., through e-commerce based services).

5. Therefore, it is essential that NAFA possesses a very strong LTO—that should be (1) well equipped (in terms of sufficient and highly skilled resources, adequate accommodation, sufficient transport means, and technical tools); and (2) tasked and mandated (through legislation, regulations and instructions) to pay attention to large taxpayers in a way that addresses the major risks to the overall revenue collection in this segment.

6. Currently there is no certainty that the LTO's compliance efforts are addressing the major risks to revenue. The LTO uses a number of compliance methods (e.g., taxpayer services, audit, and collection enforcement) that need to be developed further to achieve optimal compliance impact (see Section II-VII). Even if these tools were well developed, there is no strategy in place to guide operational activities towards major compliance problems and ensure that the most effective and appropriate mix of service, audit, and enforcement interventions is utilized. Simply put, the taxpayer compliance picture has not been sufficiently analyzed and

existing efforts are not part of a coherent strategy. Therefore, there is no certainty that current efforts are focusing on the right issues and are taking into account compliance behaviors by different groups of taxpayers.

7. On the contrary, it is very likely that efforts are not having much impact on the tax gap, if any. For example, as described in more detail in Section IV:

- About 46 percent of annual LTO audit resources are used on VAT refund issues with material results only in about 10 percent of the conducted audits. In advanced administrations, VAT refund audits occupy a very small percentage of LTO resources (less than 5 percent). Risk analysis and prioritization should direct audit activities towards VAT refund claims posing major risks. The resources saved should be utilized to audit issues of more significance in terms of safeguarding major revenue streams.
- The time used for each audit is excessive compared to international standards. In Romania a VAT refund audit concerning a large taxpayer takes half a year on average, while in advanced administrations such audits typically take a day or less. The intense attention paid to NAFA audit activities by the Court of Accounts, together with the situation that auditors can be made accountable personally for any tax shortfall not discovered during the audits, are said to be the main reasons for these lengthy audits. The audit resources wasted on nonproductive audits are enormous.
- Around a third of total annual audit resources are used on satisfying audit requests coming from the Court of Accounts, other parts of NAFA, and other authorities. These audits often produce very small results. It is said that efforts are often focused on “finding the last leu.”
- The remaining 20 percent of total annual audit resources is mainly focused on audit plans developed “bottom up” (although there is minor NAFA HQ input). This is not a very strategic approach and the results are meager as a result.
- There are also shortcomings in taxpayer services and collection enforcement, which weakens the LTO’s ability to impact effectively on taxpayer compliance behaviors. For example, taxpayer services are not tailored to address areas of major risks, but are rather responses to enquiries from taxpayers and accounting firms.
- Finally, the assignment of large taxpayers to the LTO is not done in conformity with good international practices. Currently, the LTO struggles to manage about 2,392 taxpayers, who account for less than 50 percent of total tax revenue collected by NAFA. A more correct selection (using a different criterion) would assign 1,200–1,400 taxpayers to the LTO, who would account for up to 60 percent of total revenue. This means that currently the LTO taxpayer population includes taxpayers that should not have been included, while large taxpayers that should have been included have been left out and remain under supervision of regional or local offices.

C. International Approaches to Prioritizing Compliance Efforts

8. Advanced tax administrations see it as their key objective to reduce the tax gap—using the means that can best and most economically achieve this. Today, governments require tax administrations to produce measurable and improved compliance outcomes in return for the considerable budgetary means that are invested in them. The concern is no longer about the number of audits and the extra tax assessed; what counts is the tax administration's capability to deliver real outcomes in terms of significant improvements in taxpayer compliance and consequently tax gap reductions. Therefore, these administrations prioritize their resource allocations to ensure that input provides the desired outcome.

9. These administrations put considerable effort into determining the size of the tax gap and analyzing how it is composed—in terms of which risks make up the bulk of the tax gap. These could, for example, be certain taxpayer segments where the compliance is low; paragraphs in the law that are generally being misunderstood; tax avoidance schemes; transfer pricing issues; and weaknesses in tax administration, etc.

10. They develop and implement compliance plans. Advanced administrations prioritize identified risks and develop and implement integrated compliance plans utilizing all available compliance tools to ensure, for example, that a certain industry sector as a whole becomes more compliant within a two- or three-year timeframe. This approach generates much larger and more lasting additional revenue streams than a traditional approach without industry focus. These plans similarly address major risks clusters that may relate to a number of taxpayer segments (e.g., a VAT law paragraph that has been misunderstood by an accounting firm that has clients across a range of industry sectors). Only matters of significance are included in the plan.²

11. There are essential differences between these methods and NAFA's approach. These methods are highly strategic and integrated in terms of tax administration functions—and are a departure from the taxpayer-by-taxpayer approach that NAFA uses—to a focus on industry sectors and other major risk clusters. It also represents a change from auditing everything in a taxpayer's accounts to auditing only matters of significance (e.g., the component of the accounts

² The plan would direct the tax administration's operational efforts towards mitigating key compliance risks—those that make up the bulk of the tax gap—and would be the mechanism for communicating, aligning and sequencing a range of compliance activities to achieve a defined outcome in terms of compliance impact. The compliance plan development process would apply a market segmentation approach and sophisticated data analysis to identify the key industry sub-sectors and issues contributing to the tax gap. The compliance plan would promote the development of strategies (e.g., industry based) for the treatment of noncompliance, which aim for an optimal mix of responses (e.g., education, assistance, clarification of the tax laws, simplified procedures, audit, enforcement, and publicity) to achieve the widest possible impact on voluntary compliance across the entirety of the targeted taxpayer segment (e.g., an industry group).

or the issues that during the risk analysis were identified as constituting major risks³). Also taxpayers would not be audited just because of statute of limitation issues, but only if risk analysis suggests that there are major compliance risks.

12. International experience shows that this much more strategic approach delivers sustainable increases in tax revenue through increased taxpayer compliance. This experience has led to the development of the CRM model that is now endorsed by the IMF, the EU, and the Organization for Economic Co-Operation and Development (OECD).⁴ The model aims to influence taxpayer compliance behaviors using many of the same marketing techniques that are utilized by businesses to “encourage” customers into buying their products and services to achieve a higher market share. In a modern tax administration context, audit is just considered one of many tools to achieve improved taxpayer behavior across the entire taxpayer population in a taxpayer segment—including those taxpayers who are not being audited. This is because audit results are widely communicated within the taxpayer segment to influence overall taxpayer behavior.

D. The Way Forward

13. The LTO needs to be strengthened considerably to enable it to mitigate the tax gap and improve the business climate. There is no doubt that if the LTO continues to operate as at present, it will not be able to reduce significantly the tax gap caused by large businesses. It must implement modern compliance risk management methods; strengthen organization structures, up-skill personnel, and utilize modern IT tools. The government must support this development, including by making the necessary changes to legislation. It is also important that the Court of Accounts changes its current audit approach so that it can accommodate the way revenue administrations need to operate today. Section II–VII discusses in more detail how NAFA should operate in the future.

E. Technical Assistance

14. The Government is embarking on a major WB-financed reform project to enhance revenue administration capacity. In August 2013, NAFA began the implementation of a major and broad-based WB-financed modernization project (value: US\$92 million), which aims to increase effectiveness and efficiency in the collection of taxes and social contributions; increase tax compliance; and reduce the administrative burden on taxpayers to comply with their responsibilities under the tax laws. IT reform is a major component of the project, which incorporates the key recommendations made by previous FAD tax administration missions. With

³ Naturally, if during an audit it is evident that there may be major compliance problems in other areas as well, then the audit would be extended to include these areas.

⁴ The CRM model, as set out, for example, in the European Commission’s *Compliance Risk Management Guide for Tax Administrations* (2010) is a framework for the implementation of modern CRM principles. It is a systematic process in which a tax administration makes deliberate choices on which treatment instruments can be used to effectively stimulate compliance and prevent noncompliance, based on knowledge of all taxpayers and their behavior, and the tax administration’s available capacity.

the WB now taking the TA lead concerning the overall implementation of reform measures, FAD has continued to support (through expert visits) some specific TA needs related to taxpayer compliance management (e.g., HWI compliance projects).

15. The TA has facilitated reform progress, but more assistance is required. A meeting the mission had with WB representatives confirmed that considerable progress has been made in some areas. The same is the case in the area supported by FAD—the compliance programs for HWI and high-income-earners. However, an extremely challenging task lies ahead to ensure that the IT component of the project becomes a success. It is evident that there is a large gap between the current business processes and their organization, and the processes the revenue administration will need if it is to benefit fully from implementing a modern commercial off-the-shelf IT system. NAFA cannot afford to maintain outdated business processes and it is important that NAFA and the Government are flexible with regard to changing laws and business processes where required to ensure that reform efforts bring about a modern administration. With regard to the areas supported by FAD, NAFA would benefit from further assistance on the HWI and LTO components. Assistance in implementing fully a taxpayer self-assessment system would also be beneficial.

II. IMPROVING THE LARGE TAXPAYER CRITERIA

A. Current Situation

16. The criteria for selecting those enterprises that are administered by the LTO have been changed a number of times over the years. Initially NAFA selected cases using a turnover test, but later changed to more complex criteria. The current criteria are summarized in Box 2.

17. Changes in the criteria significantly increased the number of LTO taxpayers, but without significant impact on the LTO's share of the total NAFA collected revenue. Table 2 shows that the LTO population has nearly tripled since 2006; the increase in the LTO population has been broadly matched by increases in the number of LTO auditors; and that this has not significantly impacted on the LTO share of total NAFA collected revenue.

B. Issues

18. The current identification criteria are not optimal. The modest increase in the LTO share of total tax revenue in recent years—despite a significant increase in its taxpayer base and a commensurate increase in the number of auditors—indicates that the selection criteria are not appropriately focused.

19. Many tax administrations use a turnover criterion. There is broad international consensus that a turnover test is the most straightforward means of identifying the potential tax payable. If a criterion based on actual taxes paid is applied, as in NAFA, then large taxpayers who have taken steps to reduce tax liabilities, for example, as a result of aggressive tax planning,

transfer pricing, or loss off-setting, will not be brought into the base but will still present a major compliance risk.

Box 2. Large Taxpayer Selection Criteria

The basic criterion defining a large taxpayer is the result of aggregating two indicators selected in the following proportions:

- the volume of the tax liabilities declared by the taxpayer—50 percent; and
- the turnover reported in the financial statements as of December 31 of the year preceding the one in which the categorization is performed—50 percent.

Other criteria

- All banking, insurance, and financial institutions are included.
- New businesses which self-declare when established that they will invest Euro (EUR) 10 million or more.

The first 2500 legal entities that meet the criteria are selected for inclusion with the LTO.

Source: National Agency for Fiscal Administration.

Table 2. Large Taxpayer Office—Taxpayer Population, Auditors, and Revenue Share, 2006–15

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | June 2015 |
|--|------|------|-------|-------|-------|-------|-------|-------|-------|-----------|
| Taxpayer population ¹ | 874 | 998 | 1,309 | 1,892 | 1,978 | 3,034 | 2,000 | 1,937 | 2,500 | 2,392 |
| Number of auditors | 235 | 135 | 144 | 146 | 166 | ... | 261 | 290 | 341 | 332 |
| LTO share of NAFA revenue (in percent) | N/K | N/K | 37 | 38.8 | 41.9 | ... | 47.8 | 45.8 | 49.9 | 47.9 |

Source: National Agency for Fiscal Administration.

¹ For 2011, IMF report “Maintaining Reform Momentum,” Sept. 2011.

20. A turnover test will provide a better-focused taxpayer base for the LTO. Table 3 stratifies taxpayers in Romania by turnover. It shows that, for example, if a turnover criterion for the LTO were set at Romanian Leu (RON) 100 million and above, then the LTO population would be 1,241 taxpayers who pay 57.5 percent of all taxes. This turnover criterion would therefore halve the number of taxpayers and increase the LTO proportion of total tax revenues by nearly 10 percent. This shows clearly that the existing criteria are inadequate; many cases of low or no value are being administered by the LTO, while some significant cases must be outside its control. It is essential that the LTO administer all taxpayers who meet the LTO criteria.

Table 3. Stratification of Taxpayers by Turnover and Tax Paid

| Turnover | Number | % of Total | Turnover | | Tax Paid | | | |
|--------------------------|----------------|---------------|---------------------|---------------|--------------------|---------------|--------------------|---------------|
| | | | Amount (In RON) | % of Total | VAT | | All Tax Types | |
| | | | | | Amount (In RON) | % of Total | Amount (In RON) | % of Total |
| Above 20 billion | 0 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 10 billion to 20 billion | 4 | 0.00 | 63,032.62 | 5.78 | 4,110.90 | 7.22 | 15,422.18 | 11.98 |
| 1 billion to 10 billion | 98 | 0.03 | 231,191.89 | 21.20 | 12,094.88 | 21.23 | 32,420.75 | 25.19 |
| 900 million–1 billion | 11 | 0.00 | 10,340.51 | 0.95 | 338.56 | 0.59 | 646.38 | 0.50 |
| 800 million–900 million | 11 | 0.00 | 9,244.10 | 0.85 | 952.07 | 1.67 | 1,423.35 | 1.11 |
| 700 million–800 million | 22 | 0.01 | 16,333.18 | 1.50 | 758.28 | 1.33 | 1,873.36 | 1.46 |
| 600 million–700 million | 25 | 0.01 | 16,340.57 | 1.50 | 783.98 | 1.38 | 1,751.99 | 1.36 |
| 500 million–600 million | 51 | 0.01 | 27,971.65 | 2.57 | 1,297.28 | 2.28 | 2,477.20 | 1.92 |
| 400 million–500 million | 50 | 0.01 | 22,332.26 | 2.05 | 1,072.33 | 1.88 | 2,097.58 | 1.63 |
| 300 million–400 million | 93 | 0.03 | 31,250.84 | 2.87 | 1,568.03 | 2.75 | 3,099.65 | 2.41 |
| 200 million–300 million | 204 | 0.06 | 49,509.97 | 4.54 | 2,527.11 | 4.44 | 4,390.38 | 3.41 |
| 150 million–200 million | 210 | 0.06 | 36,230.82 | 3.32 | 1,883.60 | 3.31 | 3,254.91 | 2.53 |
| 100 million–150 million | 462 | 0.13 | 55,871.31 | 5.12 | 2,779.77 | 4.88 | 5,231.24 | 4.06 |
| 75 million–100 million | 417 | 0.12 | 35,646.10 | 3.27 | 1,826.33 | 3.21 | 3,761.53 | 2.92 |
| 50 million–75 million | 916 | 0.26 | 56,032.94 | 5.14 | 2,984.52 | 5.24 | 5,488.06 | 4.26 |
| 20 million–50 million | 3,682 | 1.04 | 113,495.36 | 10.41 | 6,137.70 | 10.77 | 11,408.53 | 8.86 |
| 5 million–20 million | 15,314 | 4.31 | 145,868.53 | 13.38 | 7,184.50 | 12.61 | 14,427.50 | 11.21 |
| 1 million–5 million | 51,396 | 14.47 | 111,850.81 | 10.26 | 5,366.71 | 9.42 | 11,613.09 | 9.02 |
| 150 thousand–1 million | 120,295 | 33.87 | 51,113.72 | 4.69 | 2,579.09 | 4.53 | 6,611.36 | 5.14 |
| 0–150 thousand | 161,882 | 45.58 | 6,746.36 | 0.62 | 727.64 | 1.28 | 1,310.15 | 1.02 |
| Total | 355,142 | 100.00 | 1,090,405.54 | 100.00 | 56,973.28 | 100.00 | 128,709.19 | 100.00 |

Source: National Agency for Fiscal Administration.

21. The additional criteria used by NAFA for LTO selection appear appropriate. The inclusion of all financial enterprises in the LTO accords with international good practice. Also, the inclusion of new businesses, which self-declare that they will invest a minimum of EUR 10 million in Romania, ensures early LTO supervision of significant start-ups.

22. Treatment of related entities. It is international good practice to include in the LTO all entities that are related to the large taxpayer. This avoids the risk that the LTO will exclude large corporate groups and their members when one or more of its members does not meet the selection criteria, even though the group as a whole does. It also allows the group to be administered as a single entity, giving a better oversight of related party transactions. Entity relationship occurs when enterprises are connected through defined levels of ownership creating common control. A workable definition is any economic entity that owns more than a prescribed percentage (by value or number) of the shares or voting rights of another entity; or those economic entities under direct or indirect control of a third party. Because related entities are

subject to common control, the turnover selection criterion should be applied to the controlled group to determine whether together they constitute a large taxpayer.

23. It is essential that the LTO selection criteria are clearly specified in operational instructions across NAFA and are applied without exception. Transparency is a must; everyone should be clear on the definitions and how they are calculated so that they are applied consistently and all appropriate cases are brought within the LTO.

24. When the new criteria are applied, some cases currently in the LTO will be moved to NAFA regions, while cases in the regions that meet the new criteria are moved into LTO. Taxpayers currently in the LTO, who will not meet the new criteria, must be appropriately handled when moved to NAFA regional offices. Although not meeting the new turnover test, many of the cases leaving the LTO will nonetheless be significant contributors to the economy. It is essential that handover arrangements are put in place to minimize the disruption to these taxpayers, and that the receiving regional NAFA office is equipped to appropriately monitor and manage any tax risks that these taxpayers pose. This means that handover protocols must be established, which may include the appointment of LTO liaison officers at regional offices; procedural guidelines or instructions to regional offices; allocation of cases to regional staff that possess appropriate experience and skills; and training and mentoring of staff where required. NAFA could also consider instructing regional offices to audit those transferred taxpayers that have not recently (within the last two–three years) been audited by the LTO. This would ensure that regional offices get an early chance to become familiarized with their new taxpayers and their compliance risks.

25. Once the new LTO population is established, the question arises of how long a taxpayer should be retained in the LTO after its circumstances change so that it no longer meets the criteria. Removing the taxpayer from LTO as soon as it fails the criteria is not in line with international good practice; it is not helpful to either the taxpayer or tax administration to have a constant carousel for enterprises that are hovering around the turnover test level. A majority of European countries' LTOs have adopted two or three years as the period to retain a taxpayer in these circumstances.

C. Recommendations

26. These are the recommendations for improving the LTO taxpayer population criteria:

- Replace the existing LTO basic criteria with a turnover criterion set at RON 100 million.
- Apply the turnover test to grouped companies to determine if in aggregate they qualify as a large taxpayer.
- Retain the existing additional criteria of all financial entities and new businesses which self-declare a minimum EUR 10 million investment in Romania.
- Apply the new criteria consistently and without exception.

- Put in place arrangements to ensure that taxpayers leaving the LTO are properly managed in the NAFA regions.
- Apart from the taxpayers removed because of the new criteria, retain any taxpayer who no longer meets the criteria, within the LTO for at least two years.

III. IMPROVING COMPLIANCE RISK ASSESSMENT

A. The Large Taxpayer Office's Current Risk Assessment Framework

27. The LTO is required to plan its risk assessment—and consequently its audit work—within guidelines and priorities set by the NAFA HQ. These guidelines set out high-level requirements in annual and quarterly notes, and monthly notes set out priorities in much greater detail. The top priority is always VAT refund audits. If auditing VAT refund claims identified as high risk takes all of the LTO resource in a month, then no other kind of audit work will be commenced. The second priority will be audits nominated or requested from other parts of NAFA or other governmental bodies. The third priority will be cases risk assessed and nominated by the LTO, if it has any remaining capacity.

28. The emphasis on VAT refunds assurance and the levels of audits nominated by external bodies distorts both risk identification and the audit program. All VAT refund claims are screened by a team within the LTO HQ. Around 90 percent of VAT refunds are assessed as low risk and are not audited. But where a VAT refund is assessed as high risk, a full—and time-consuming—audit is undertaken. VAT refund risk assessment and audit are covered in more detail in Section V. The emphasis on VAT refunds and the level of audits nominated by external bodies leaves little scope for auditing the other main taxes. The LTO judges that currently only 20 percent of its audit resource is spent on high risk (non-VAT refund) cases. By any standard this is unacceptably low.

29. The risk assessment approach in the LTO has significant weaknesses when compared with international good practice. Risk assessment of VAT refunds is covered in Section V. Risk assessment in the LTO to identify high risk cases is carried out by LTO auditors. They may be assisted by some limited data from the small NAFA Risk Team, which issues the guidelines described in paragraph 27. Additionally, multi-national enterprises are reviewed by transfer pricing specialists in LTO HQ, and data sent to LTO auditors to use when they have sufficient capacity. But beyond this, the risk selection made by LTO auditors is based on VAT cross-matching, checking on specific issues from prior audits, stand-alone databases, and an assessment of the type of business operation. These “bottom-up” selections are formed into a monthly audit list which has to be approved by NAFA HQ. There is no high-level assessment of sectoral or tax code risks, no cross-LTO prioritization of risk, and no differentiation of taxpayers by their behaviors or capacity to manage their own tax risks.

30. The LTO audit results are consequently lower than would be expected from an LTO with a more developed approach. As Table 4 shows, this is particularly the case when considering the additional taxes actually collected.

Table 4. Large Taxpayer Office—Audit Results

(Amounts are in millions of RON)

| Activity | 2012 | 2013 | 2014 |
|-----------------------------|------|-------|-------|
| Number of audits completed | 245 | 241 | 343 |
| Additional taxes identified | 944 | 2,559 | 2,630 |
| Additional taxes collected | ... | 879 | 865 |
| Penalties | 0.2 | 0.27 | 0.23 |
| Number of auditors deployed | 210 | 225 | 317 |

Source: National Agency for Fiscal Administration.

B. Moving Toward International Good Practices in Risk Assessment

31. The compliance models of leading tax agencies usually start with the CRM model and a differentiation framework. International good practice evaluates and seeks to mitigate tax compliance risks from three perspectives, ideally drawing upon tax gap analyses:

- **the tax perspective**, by identifying the most material risks to each major tax (irrespective of market segment or industry);
- **the market and industry perspective**, by identifying major risks that are prevalent in different taxpayer segments (typically, large, medium, and small business) and in major industries within those segments; and
- **the taxpayer-level perspective**, by evaluating the risk posture of individual enterprises using a risk differentiation framework.

32. One of the key benefits of conducting a tax gap analysis is that it can lead to a better understanding of the underlying causes of the gap. This permits the tax administration to develop appropriate counter-strategies and also directs resource allocation. It is understood that some high-level analysis has been undertaken in NAFA HQ but that the work is not yet sufficiently advanced to provide the kind of operational or policy insights on which to base counter-action. This leaves NAFA and the LTO short of an important tool from which to feed analysis into the three perspectives, which are described in more detail below.

The tax perspective

33. It is important to extend the LTO's risk management system to identify risks involving a particular tax, or part of the tax code that cut across multiple industries, and to bring these risks under active management. The LTO should appoint senior and experienced

individuals to act as “risk owners” who will be responsible for developing nationally coordinated strategies for identifying the most material risks to each major tax or part of the tax code and for developing national compliance strategies to bring these risks under control. This will include:

- risk filters to identify the risks in specific tax returns;
- legislative changes;
- process or procedural changes;
- enhanced guidance to taxpayers;
- new taxpayer services and audit techniques to deal with the risk; and
- periodic reporting by the risk owners to LTO leadership on the actions taken and progress that is being made in mitigating the risks.

The market and industry perspective

34. The risk management system can be further refined by developing industry-based approaches. Many tax administrations have developed risk parameters and filters to detect the risk of certain forms of noncompliance in enterprises operating in particular industries. Based on this analysis, industry-based compliance strategies are developed to bring these risks under active management. The strategies are underpinned by a national plan that sets targets for the number and types of treatments that are to be applied to large businesses in key industries. In some countries, a senior individual is appointed to serve as the “industry leader” for a specific industry. The industry leader is responsible for overseeing the design and national implementation of the strategy including:

- developing industry-specific risk parameters and filters;
- setting targets for the types and numbers of treatments to be implemented by compliance teams in different locations; and
- reporting to the LTO leadership the results of the strategy to determine whether progress is being made in bringing the industry-specific risks under control.

35. The LTO needs to develop industry-based approaches, including a structure largely based on industry-focused units. This is a common feature of LTOs in leading tax agencies and provides an opportunity to apply an industry-wide lens to the identification and evaluation of industry risks. This facilitates the development of industry-wide compliance plans based on an understanding of the causes of the tax risks within those industries. Box 3 illustrates the high-risk industry project approach.

Box 3. High Risk Industry Project Approach

Where an industry or trade is identified as high risk, the revenue agency should:

- engage with the relevant industry or business associations to explain why it is seen as high risk and to ensure that the revenue agency has an accurate understanding of how the industry operates;
- publicize the revenue agency's intention to conduct a verification program of the industry and seek the support of the associations in informing their members;
- identify tax practitioners who have a significant client base in the targeted industry, alert them to the issues and request that they inform their clients of the intention to conduct a verification program;
- conduct a sample audit program to confirm the most serious areas of noncompliance and to quantify the amount of tax at risk across the industry;
- engage with the industry association and the tax practitioners to prepare advice to industry participants on the areas of noncompliance identified through the sample audit program;
- send letters to taxpayers in the industry and/or communicate with taxpayers through the industry association and practitioners advising them of the specific areas of noncompliance and requesting that they review their returns and make any necessary self-corrections;
- *highlight that voluntary disclosures will attract lenient penalties*, and that further audits are planned under which taxpayers who have not self-corrected will be subject to full penalties;
- offer free seminars and advisory visits for taxpayers who are unsure of their obligations (these seminars should ideally be conducted jointly with the industry association);
- ensure that the revenue agency's enquiry staff is aware of the compliance improvement program and has scripted answers for enquiries received from taxpayers about the program, including how to make a voluntary disclosure, attend a seminar or request an advisory visit;
- ensure that the collection enforcement staff is aware of the program and applies the reduced penalties and more flexible payment arrangements to taxpayers who voluntarily self-correct;
- conduct a follow-up audit program of the industry with wider coverage and targeting taxpayers who have failed to self-correct and are assessed as high risk; and prosecute the worst offenders;
- publicize results of audits and prosecutions highlighting how data matching and other new approaches facilitated detection of high risk taxpayers, and using representative case studies to show how delinquent taxpayers were identified and dealt with; and
- measure the effectiveness of the project e.g., by tracking the number of voluntary disclosures received and the overall change in tax paid by taxpayers in the target industry, and surveying the industry and practitioners to test for changes in observed compliance behavior.

36. Currently, the LTO has only adopted an industry-based approach for the banking, finance and insurance sectors. Based on a sector analysis of current LTO taxpayers provided by NAFA (Appendix 2), additional industry groupings could be based on mineral exploitation; wholesale and retail trades; energy production and distribution; and manufacturing. With the introduction of a new petroleum tax regime from the start of 2016, an oil and gas industry sector will also be essential.

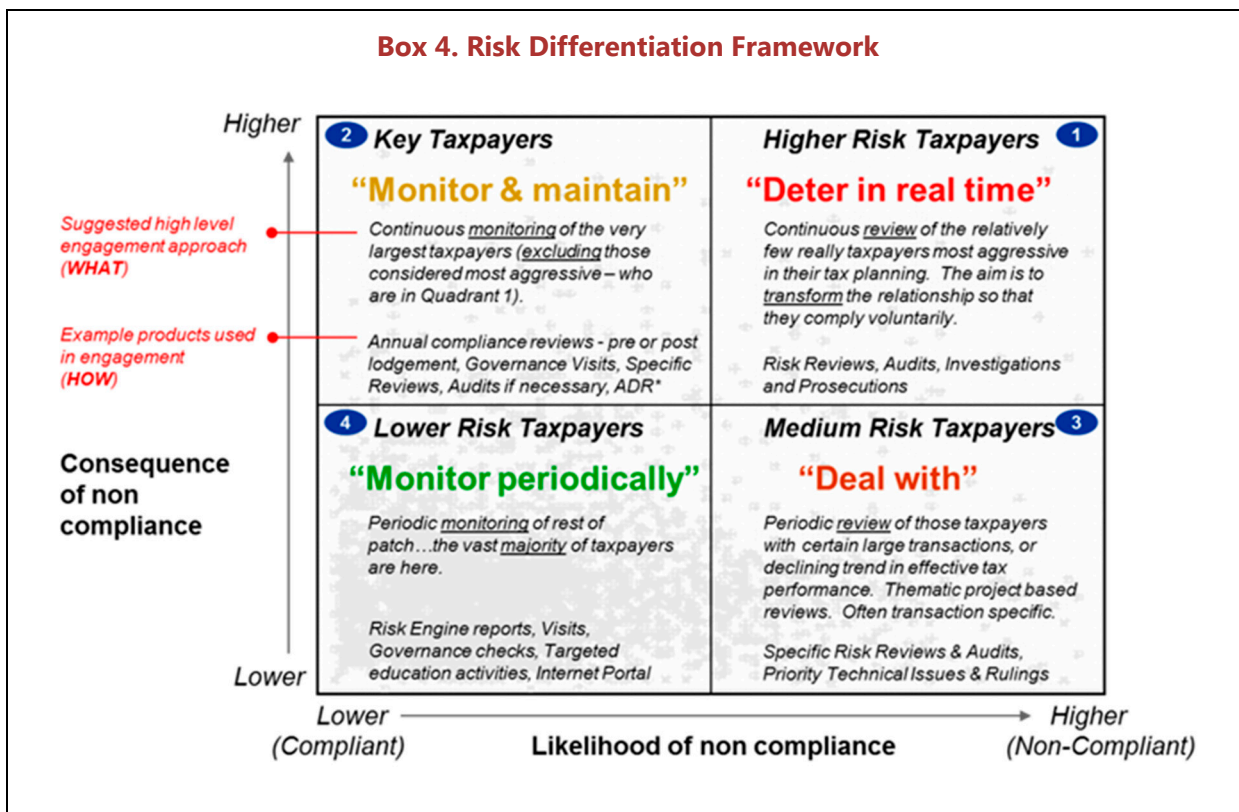
The taxpayer-level perspective

37. Risk assessment by the LTO is currently focused at the taxpayer level and there is considerable scope for improvement. Using available data, the LTO auditor assesses if a taxpayer poses a tax risk and should be included in the LTO monthly audit plan. As described in more detail in Section IV, if a taxpayer is selected then a full audit is conducted, not restricted to the issue or issues initially identified as posing a potential risk. There is no comprehensive assessment of the overall risk the taxpayer poses or of where the taxpayer sits on the compliance spectrum. Nor is there any differentiation of the type of audit that will be appropriate.

38. International good practice at the taxpayer level begins by making a thorough assessment of where the individual large taxpayer sits on the compliance spectrum. This assessment determines the risk management approach that the LTO will adopt to treat any tax risks posed by the taxpayer. A range of risk filters are used to profile the taxpayer and place in a risk category:

- size, structure, and complexity;
- past compliance behavior, including cooperation with the tax administration;
- the way in which the taxpayer manages tax risks and the appropriateness of the governance that surrounds the way it makes decisions about its tax risks.
- business performance over time compared with the taxpayer's own tax outcomes and with that of its peers;
- issues identified by risk assessment, specialist areas, and intelligence gathering, particularly for significant transactions that allow scope for opportunistic tax planning, such as merger, acquisition, or disposal;
- intelligence from the LTO industry sector on industry performance and on where the taxpayer sits in relation to industry tax risks including patterns and trends in tax performance;
- intelligence from overseas tax administrations;
- intelligence from other government agencies and publically available information;
- risks arising out of the implementation of new tax law;
- level of international dealings and the tax outcomes over time, and compared to the functions performed, assets used and risks accepted; and
- the adequacy of internal controls and systems.

39. Using the framework in Box 4, taxpayers are placed in one of four broad risk categories.



40. This risk framework is used to make decisions about which large taxpayers will be risk assessed, based on a full understanding of all relevant facts and circumstances. This risk rating does not influence the outcome of a possible review, but it does influence the likelihood of a review and the approach that will be used to tackle any risks that need to be addressed. It focuses compliance activity, including audit, in the most efficient way to tackle risks and in practice also acts as a tool to allocate LTO audit resource to where it will be most effective in closing the tax gap. It links directly to the different types of audit described in Section IV. As already described, the LTO in Romania does not comprehensively assess where the taxpayer sits on the compliance 'spectrum' nor does it differentiate the type of audit that will be most appropriate.

41. In refining the risk management system, it is essential to bear in mind that risk management and risk differentiation are not about auditing every case. The whole point of risk differentiation is to allow for proportional and appropriate responses by the tax administration that addresses the causes of the risks. This means that for higher risk groups, audit may be appropriate, whereas for lower risk groups a lighter touch would minimize for them unnecessary compliance costs. Where, for example, the risks stem from a lack of legal clarity, such risks may be best addressed through technical guidance, public rulings, or legislative amendment. Appendix III is an Australian Taxation Office publication, which describes the Large Taxpayer Risk Differentiation Framework in more detail.

C. Establishing a Risk Management Unit

42. The LTO in Romania will need to significantly enhance its risk assessment capability to fully support the risk approach described above. Best practice is to establish a risk management unit (RMU) dedicated to the large taxpayer segment, either as part of a broader risk management division, which supports the whole tax administration, or as a distinct and discrete unit which is part of the LTO. The latter approach is preferable if a well-developed and broadly based risk management division does not already exist. This appears to be the case in NAFA, and an LTO-specific RMU is recommended at this stage. The LTO RMU staff will require training in new techniques and approaches. The change in LTO culture and the amount of training needed to successfully adopt the new risk assessment approach are considerable. The functions of an RMU include:

- identifying emerging compliance risks and developing risk mitigation strategies;
- preparing the annual audit plan;
- developing risk analysis methods and case selection techniques;
- introducing new audit techniques;
- conducting quality assurance and review;
- evaluating outcomes and feeding into future plans, strategies and techniques; and
- establishing and maintaining a working relationship with the NAFA High Wealth Individual Unit

D. Recommendations

43. These are the recommendations for improving the LTO's compliance risk assessment:

- Carry out tax gap analyses to enable a better understanding of the underlying causes of the gap, and thus permitting the LTO to develop appropriate counter-strategies and appropriately allocate resources.
- Extend the LTO risk management system to identify risks involving a particular tax (or part of the tax code) that cut across multiple industries and bring these risks under active management.
- Refine the LTO risk management system by developing industry-based approaches, including an LTO structure largely based on industry-focused units for both risk assessment and audit teams.
- Adopt a Risk Differentiation Framework to make decisions about which large taxpayers will be risk assessed, based on a full understanding of all relevant facts and circumstances.
- Enhance the LTO's capability to fully support the risk approach described above, including the establishment of a specific RMU.

- Work with the NAFA training unit to address the considerable up-skilling needs inherent in moving to the new approach to risk assessment.

IV. STRENGTHENING AUDIT SELECTION AND FOCUS

A. Current Situation and Issues

44. The audit program is incorrectly focused. As described in Section V the emphasis on VAT refunds assurance and the levels of audits nominated by external bodies distort both the LTO risk identification and the audit program. LTO management says that 32.5 percent of its audit resource is spent on checks required by other parts of NAFA and external bodies, and 46 percent is devoted to VAT refund audit. This leaves the LTO with just over 20 percent of its audit resources to devote to high risk non-VAT refund cases. By any standards this is unacceptably low; particularly as the work required by others and by VAT refund audit is relatively unproductive in terms of closing the tax gap. LTO management aspires to having the discretion to use 50 percent of its audit resources on high risk (non-VAT refund) work. By international standards even this is far too low. Impediments—including the code around VAT refund audits and the audit and checking requirements put upon LTO by others—have to be substantially reduced or removed entirely.

45. The LTO is not making effective use of its auditor resource. An outdated approach to compliance audit persists. An LTO auditor will evaluate if a taxpayer poses a tax risk and should be included in the LTO monthly audit plan. Criteria include the time since the last audit, and selection can be determined by the statute of limitations. A taxpayer selected is then subjected to a full audit, which is not restricted to the issue or issues initially identified as posing a potential risk. Verifications, checking and rechecking of documentation and transactions characterize much of the compliance management work. The mission met with private sector representatives who expressed strong concerns that audit methods are not evolving. Too much attention is being paid to lower risk items, and superficial concerns on the form of transactions, while substantive risks to revenue are overlooked.

46. LTO auditors are concerned to follow the audit guidelines to the letter and seek to establish and assess every last RON of tax. If in the course of an audit an auditor misses some elements, he or she may be held personally liable for any tax that was not assessed. Oversight and selective secondary audit is undertaken by the Court of Accounts, an independent body external to NAFA. The Court of Accounts' auditors are said to be concerned with the procedural propriety of taxpayers' affairs and to ensure that the LTO auditor has conducted the appropriate

cross-checks and reviewed supporting documents down to the last detail, rather than with whether major tax risks are identified or with the materiality⁵ of the issues pursued.⁶

47. The stipulation that LTO auditors (in fact all NAFA auditors) can be held personally liable for shortfalls negatively affects their approach. As a consequence, they will always carry out a full audit; follow the guidelines on all the cross-checks to be carried out whether appropriate and proportionate or not; they will carry on with their audit until the last RON has been established; and always follow interpretations that favor the tax authority. This means that more significant risks—of the type that will not be found by a ‘tick box’ approach—will go undetected. It means that audits will take significantly longer than they would if the auditor restricted enquiries to satisfying him or herself on the risks identified pre-audit. It also means that many more issues go to appeal because the auditors take a view that safeguards themselves. This means less revenue to the government and it significantly increases the burden on the taxpayer. The stipulation that auditors can be held personally responsible for potential shortfalls must be removed from the law or dis-applied in the suggested LTO/Court of Accounts protocol described in the next paragraph.

48. The Court of Accounts is open to changing its approach to monitoring LTO audit activity to match a new LTO approach to risk assessment and audit. The mission met with officials, including the Vice President of the Court of Accounts. The mission explained its thinking on how the LTO approach to risk assessment and audit should develop. In response, the Vice President indicated that there was scope for the Court of Accounts to develop its own approach to match, and that a protocol between the NAFA and the Court of Accounts was feasible. This is a very important development, potentially clearing a significant obstacle to implementing a new approach to auditing large taxpayers. NAFA senior management should speedily follow up with the Court of Accounts on this discussion in the context of the change in approach recommended in this report.

49. LTO audit work should be directly guided by the risk model described in Section III. The appropriate audit approach for the particular taxpayer and risk should be guided only by the Risk Differentiation Model and limited to the specific risks identified through the risk assessment process. This means that a proportionate and appropriate response is made by the LTO that addresses the causes of the risks and seeks to encourage voluntary compliance. Coupled with a more realistic and pragmatic attitude to materiality, it will ensure that audits are more targeted, less burdensome to taxpayers, shorter and achieve far more in terms of additional revenue yield

⁵ ‘Materiality’ is used in this report to mean the professional judgement that an auditor exercises in deciding that it is no longer cost effective to pursue a tax risk. It is not a reference to the accountancy concept of materiality.

⁶ The Court of Auditors cannot legislatively steer LTO operations. However, indirectly they have done this in that the LTO has adjusted its audit operations in a way that takes into account what the Court apparently wants to see (e.g., that an audit will continue until the last Ron has been “found”).

and tax gap closure. This approach will also free additional resource to tackle the most complex and challenging instances of noncompliance.

50. There are many different ways of fostering voluntary compliance, addressing tax risks and closing the large business tax gap, of which full audit is the most costly and most exceptional. As previously described, tax risks and tax gap issues may be addressed in a number of different ways, including education, guidance, process or procedural changes, revision to the law, projects, and leverage. Box 5 describes the range of typical risks treatments.

51. Audit must be viewed as just another way of closing the tax gap. Even when audit is the best way of addressing a risk, there are different and less costly audit approaches available to match the risk situation. Internationally, by far the most numerous audits are of the single issue and limited scope audits. Full audits, of the type commonly used by the LTO in Romania, are less common, more costly, and only used where the risks fully justify such an approach. Table 5 illustrates commonly used audit types.

52. These new approaches to tackling large business compliance risks will require a considerable up-skilling in the general level of the LTO compliance skills. The change in the LTO audit culture and the amount of training needed to adopt the new audit approach cannot be overstated. Section VII, 'Other Issues,' deals with these training needs in more detail.

53. An advanced case management system is needed to manage the workload for the audit function. A case management system helps to assign audit cases to tax inspectors and generate information on the length of the time spent on audits, the monetary value per auditor and per hour spent, the number of cases each auditor has finalized and not finalized, and other information that is essential to the proper management of a modern audit department.

54. Other audit support tools should be provided to auditors. Effective tax agencies provide auditors with laptops and special audit applications that (1) include data from the taxpayers' tax returns and related ratios; (2) contain all the reference material, procedural manuals, checklists and forms the auditor may need during an audit; and (3) provide guidance and support to auditors during each stage of the examination.

B. Recommendations

55. These are the recommendations for improving audit selection and focus:

- Substantially reduce or remove entirely the requirements around VAT refund audits, and the other audit and checking requirements put upon LTO by others.
- Follow up speedily on the mission's discussion with the Court of Accounts.
- Remove from the law the stipulation that auditors can be held personally responsible for potential shortfalls, or overrule in tax law or dis-apply in the suggested NAFA/Court of Accounts protocol.

Box 5. Typical Revenue Risks Treatments

| | |
|--|---|
| Legislation and policy | <ul style="list-style-type: none"> • Changes to existing laws • Proactive communication with taxpayers regarding changes to existing tax laws |
| Technology based self-service tools | <ul style="list-style-type: none"> • Self-service tools for taxpayers • Downloadable software • Internet online services • Electronic filing • On-line help • Taxpayer account access |
| Education-based treatments | <ul style="list-style-type: none"> • Advisory services groups • Seminars and presentations educational • Publications • Education for selected high risk • Downloadable/hardcopies of booklets and guides |
| Encouragement and support-based treatments | <ul style="list-style-type: none"> • Front line service • Contact centers • Help lines • Real time reviews of taxpayer records (to assist taxpayers comply) |
| Cooperative arrangement treatments | <ul style="list-style-type: none"> • Industry partnerships to improve example: compliance • Industry associations/taxpayer representative groups affairs • Tax accountants information • Other government agencies for <ul style="list-style-type: none"> - police - customs - internal • Other sources of third party |
| Pre-obligation reminders | <ul style="list-style-type: none"> • Reminders to submit and pay taxes due <ul style="list-style-type: none"> ✓ Telephone service ✓ Email ✓ Letter • Visits • Electronic short message |
| Audit | <ul style="list-style-type: none"> • Registration checks • Advisory audits • Record keeping audits • Desk audits • Single (or specific audits) • VAT refund audits • Audit projects (specific groups of taxpayers) • Comprehensive audits • Fraud investigations |
| Debt collection | <ul style="list-style-type: none"> • Contact center—outbound calling • Reminder letters • Offer of installment arrangements • Enforced collection |
| Media engagement | <ul style="list-style-type: none"> • Communicating areas of tax administration focus • Publishing Results of compliance campaigns • Publishing names of offenders |

Table 5. Illustration of Commonly Used Audit Types

| Type of audit | Explanation |
|----------------------|---|
| Full audits | The scope of a full audit is all encompassing. It typically entails a comprehensive examination of all information relevant to the calculation of a taxpayer's tax liability for a given period. The objective is to determine the correct tax liability for a tax return as a whole. In some countries full audits are carried out as part of random audit programs that are used to gather data on the extent, nature and specific features of tax compliance risks, for compliance research purposes and/or the development of computerized audit selection formulae. Given their broad scope, full audits are typically costly to undertake—a substantial program of full audits will require considerable resources and reduce the rate of coverage of taxpayers that could otherwise be achieved by a more varied mix of audit types. |
| Limited scope audits | Limited scope audits are confined to specific issues on the tax return and/or a particular tax scheme arrangement employed by the taxpayer. The objective is to examine key potential risk areas of noncompliance. These audits consume relatively fewer resources than full audits and allow for an increased coverage of the taxpayer population. |
| Single issue audits | Single issue audits are confined to one item of potential noncompliance that may be apparent from examination of a taxpayer's return. Given their narrow scope, single issue audits typically take less time to perform and can be used to review large numbers of taxpayers involved in similar schemes to conceal noncompliance. |

- Adopt the Risk Differentiation Model and only audit the specific risks identified through the risk assessment process.
- Introduce and use more realistic and pragmatic guidance concerning materiality.
- Discontinue the practice of conducting a 'full' audit even where a minor initial risk was identified.
- Avoid auditing taxpayers solely for statute of limitation reasons, but only if the risk assessment identifies major compliance risks.
- Adopt a range of different ways of fostering voluntary compliance, of which full audit will be the most exceptional.
- Provide an enhanced case management system to manage the workload for the audit function.
- Provide other audit support tools to auditors.

V. IMPROVING VALUE-ADDED TAX REFUNDS PROCEDURES

A. Current Situation and Issues

56. The VAT refund processes distorts the LTO's capacity to close the tax gap. The emphasis on VAT refunds assurance (together with the levels of audits nominated by external bodies) distorts both risk identification and the audit program in the LTO. As mentioned earlier, the LTO is left with only 20 percent of its resources to spend on auditing high risk non-VAT refund cases.

57. The LTO work on VAT refunds is bound by NAFA HQ guidelines. These guidelines set the top priority as VAT refund audits. All VAT refund claims are risk assessed by a team within LTO HQ and around 90 percent are assessed as low risk and are passed to NAFA HQ for repayment, without audit. Where a VAT refund is assessed as high risk, a full, time-consuming and costly audit is undertaken. Auditors review more widely than any specific risk identified, partly in order to protect themselves from later criticism. Additionally, the law requires the audit to cover the entire period back to the last VAT audit, and risk selection can also be determined by the statute of limitations. Audits typically take six months to complete.

58. The 'strike rate' from the risk identification methodology is low. LTO senior managers said that:

- 70 percent of VAT refund audits produced no change to the amount claimed;
- 20 percent resulted in minor adjustments of less than 10 percent; and
- 10 percent produced adjustments of more than 10 percent.

59. Other tax administrations have developed computer-based risk analysis tools that automatically verify a high proportion of refund claims. In addition, the risk rules identify specific risks for the remainder, which auditors are typically able to audit in a day or less. These risk rules are regularly tested, revised and improved. The mission assumes that the WB project will work closely with NAFA, including the LTO, to develop a refined risk analysis tool closely aligned with international good practice.

60. The LTO senior management has said that the law will not currently allow any streamlining of the VAT refund audit approach or shortening of the audit. The law needs to be changed to permit refund verification audits only on the issues that are material to the refund claim and avoiding the examination of other issues and periods. Other tax administrations do some of the verifications by letters or over the telephone.

61. Timely payment of refunds is essential for creating a positive investment climate. As can be seen in Table 6, late payment of refunds was experienced throughout 2014. Late payment of refunds can be damaging to a country's business climate, as it often creates serious

cash flow problems for enterprises, with attendant economic and tax risks. To avoid this situation, the government needs to provide sufficient resources to pay refunds and the tax administration needs to ensure that refund claims are processed expeditiously.

Table 6. Value-Added Tax Refunds, 2014

(In millions of Lei)

| 2014 | Claimed | Approved | Offset Amounts | Repaid Amounts | Refund overdue |
|-----------|---------|----------|----------------|----------------|----------------|
| January | 769 | 594 | 399 | 433 | 1,702 |
| February | 766 | 660 | 286 | 259 | 1,951 |
| March | 830 | 780 | 355 | 266 | 2,142 |
| April | 782 | 836 | 395 | 492 | 2,009 |
| May | 749 | 971 | 373 | 171 | 2,202 |
| June | 795 | 831 | 322 | 384 | 2,286 |
| July | 889 | 856 | 506 | 271 | 2,346 |
| August | 728 | 768 | 428 | 346 | 2,309 |
| September | 639 | 687 | 315 | 243 | 2,775 |
| October | 828 | 568 | 474 | 355 | 2,393 |
| November | 776 | 915 | 375 | 417 | 2,352 |
| December | 725 | 447 | 597 | 953 | 1,506 |

Source: National Agency for Fiscal Administration.

B. Recommendations

62. These are the recommendations to improve VAT refund procedures:

- Change the risk planning assumption that VAT refund audits is the primary priority for the LTO, which is currently detrimental to other work which will contribute more to tax gap closure.
- Enhance the VAT refund risk identification rules to reduce the proportion assessed as high risk, reducing significantly the number of pre-refund audits and markedly improving the proportion of audits that result in a significant adjustment to the claim.
- Amend laws and instructions to remove requirements that an audit and shall cover the entire period back to the last audit.
- Perform refund verification audits only on the issues that are material to the refund claim, avoid the examination of other issues and taxes and streamline and shorten the audits so that they are broadly in line with international good practice.

VI. IMPROVING TAX ARREARS COLLECTION

A. Current Situation

63. The LTO performs better than the rest of NAFA in this area. At the end of June 2015, the accumulated stock of tax arrears owed by large taxpayers stood at RON 5,905.2 million, including social contributions. This represents 12.8 percent of the LTO's total collections for the period or 6.1 percent of national tax revenue. The comparable debt figure for all of NAFA shows a debt of RON 19,250 million or 20 percent of collections. More details are shown in Table 7.

Table 7. Number of Large Taxpayer Office Tax Debtors and Amounts Owed

(In millions of RON)

| | 2013 | 2014 | 2015 (June 30) |
|--------------------------------------|------------------|------------------|-----------------|
| All taxes and contributions | | | |
| Revenue total | 173,533.5 | 182,546.1 | 96,069.3 |
| Total debt as percent | 8.6 | 9.3 | 20 |
| LTO debt as percent of revenue total | 2.1 | 2.9 | 6.1 |
| LTO total collections | 79,459.3 | 91,090.6 | 46,168.4 |
| LTO as percent of own collections | 4.7 | 5.7 | 12.8 |
| Total debt | 14,941.8 | 16,988.3 | 19,250.1 |
| LTO | 3,719.1 | 5,203.5 | 5,905.2 |
| LTO share (percent) | 24.9 | 30.6 | 30.7 |
| Excluding social security | | | |
| All NAFA tax debt | 10,620.2 | 12,878.8 | 14,682.6 |
| LTO debt | 2,725.3 | 4,295.4 | 4,871.1 |
| LTO share (percent) | 25.7 | 33.4 | 33.2 |

Source: National Agency for Fiscal Administration.

64. It is too soon to say if the increased total debt level of 20 percent (and the LTO's 6.1 percent) is a cause for alarm. Both tax payments and debt management responses have an annual cycle and 20 percent is a mid-year figure. Tax arrears in OECD countries commonly range from about 5–15 percent of annual tax collections.

65. State-owned enterprises owe large sums. It should also be borne in mind that, with debts of RON 3,563 million, state-owned enterprises (SOEs) managed by the LTO owe about 60 percent of its debt, or 18.5 percent of national tax debt.

66. The methods used by the NAFA debt management and collection teams are typical of EU member states. A range of enforcement options is used and is improved from time to time. Increased use of seizure and sale of assets was mentioned to the mission as an example, although, this tool became less useful in the aftermath of the economic crisis.

67. Not enough use is made of installment payments. Normally in Romania, bank guarantees are required before an installment plan is agreed. However, guarantees are expensive and can be hard to get for the purpose of paying taxes. LTO managers said that the competition directorate of the European Commission had mentioned legal difficulties with any relaxation of the guarantee requirement. However, clear rules always exist for reaching consistent decisions on the duration and scope of installments. These rules can be automated, meaning that well-structured, on-line installment schemes can be applied for in many cases (depending on the amount of debt). Therefore, no competitive advantage arises where limited and rational schemes are open to all taxpayers who need them and who qualify. Most EU countries use unguaranteed installment plans as a key element in their debt work and Romania should do so too, using appropriate protocols.

68. Although, the LTO's debt to collection ratio is lower than the national average, it is increasing faster than the national trend. National tax debt rose by some 29 percent from end 2013 to mid 2015, while the debt related to LTO taxpayers increased almost 59 percent. It appears that this increase is partially due to the transfer of a significant number of loss-making SOEs to the LTO; these seem to have little or no tax contribution but substantial tax debts (Table 8).

Table 8. The State-Owned Enterprise Content of Large Taxpayer Office Debt

| (In millions of RON) | | | | |
|----------------------------------|------------------------------|---------|----------------|-----------------------------------|
| Debts of SOEs managed by the LTO | Amount owed at end of period | | | Percentage Increase Since 2013 |
| | 2013 | 2014 | 2015 (June 30) | |
| SOE debt | 1,988.1 | 2,218.6 | 3,563.8 | 79 |
| Percent of LTO total debt | 53 | 43 | 60 | |

Source: National Agency for Fiscal Administration.

69. Much of NAFA's arrears workload is due to an outdated tax assessment system. While advanced tax administrations have implemented a full taxpayer self-assessment system, NAFA still sifts through all tax returns and assesses administratively the tax for those taxpayers where there is doubt about the correctness of the return. This system is further compounded by "accessories" (interest and penalties). VAT arrears at end 2013 consisted of RON 2,239 million, split evenly between taxpayer self-declarations and administrative assessments and "accessories". Unsurprisingly, some RON 1,200 million was under appeal. This cycle is repeated year after year across all taxes. By creating a large sum of disputed arrears both NAFA and businesses are burdened with extra costs and delays arising from unrealistic assessments that produce blanket appeals.

70. NAFA needs to move to a full self-assessment system. This should be done as a component of implementing the WB project. Failure to do so will perpetuate inefficient and

ineffective debt management approaches and slow down progress towards risk-based working. NAFA, in the meantime, is operating with increased costs and reduced revenues

B. Recommendations

71. These are the recommendations for arrears collection:

- Implement a comprehensive installment system for tax debts on modern lines with bank guarantees only required in exceptionally risky cases.
- Develop decision-making rules and detailed protocols to manage installment plans fairly and consistently.
- Use as little resources as possible on highly indebted SOE's as their situation requires a political solution.
- Move towards a full self-assessment system that produces realistic and undisputed tax liabilities for quick collection.

VII. OTHER LARGE TAXPAYER OFFICE ISSUES

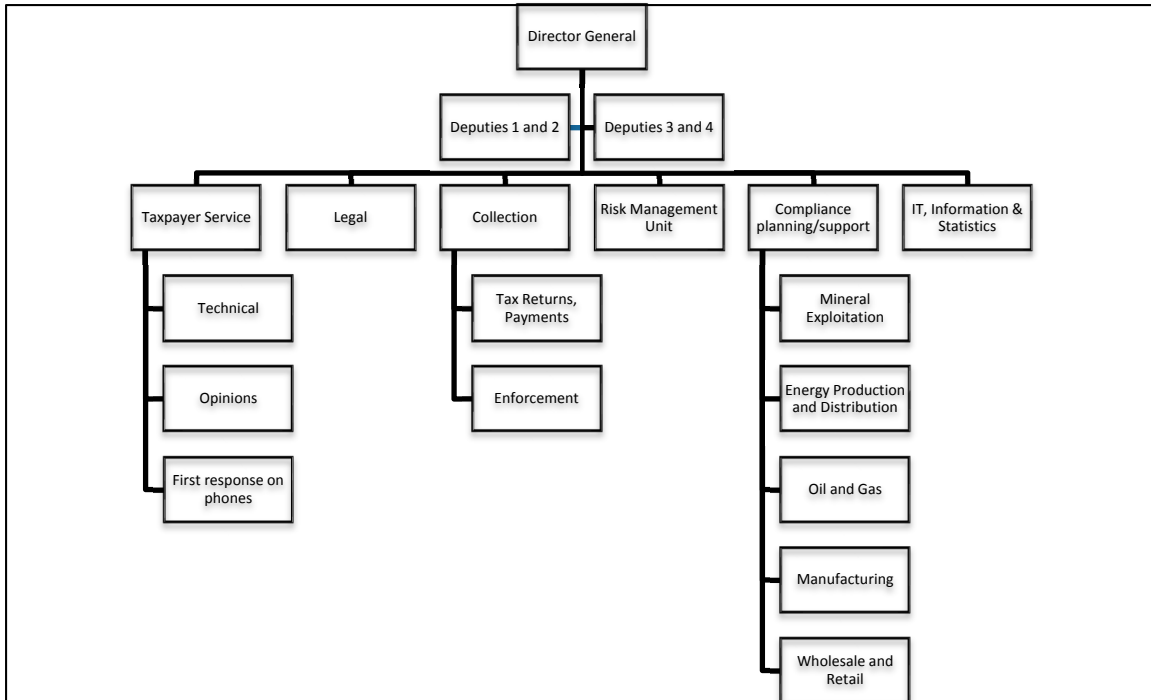
A. Improving the Organization Structure

72. The LTO's performance is being impeded by several deficiencies in its organizational structure. First, the LTO does not offer the full range and depth of taxpayer services that is the norm in large taxpayer offices elsewhere. The absence of a robust taxpayer services section has resulted in a situation where large taxpayers receive insufficient assistance and support in complying with their tax obligations. As a consequence, opportunities to help taxpayers make better tax decisions are being lost and the role of taxpayer services in reducing the tax gap is diluted. Second, the LTO's compliance operations lack an appropriate division of responsibilities between, on the one hand, those staff who select taxpayers for audit and, on the other hand, those who conduct the audits. The audit section is also hindered by the absence of a specialist unit to provide auditors with support in such technical areas as international tax issues or anti-avoidance. Third, the LTO's organizational structure does not provide for any industry specialization, which impedes the development of knowledge and skills on how the tax laws should be applied to key industries. LTO compliance issues are dealt with more fully in previous Sections.

73. A new structure is needed to overcome the LTO's organizational weaknesses. The organizational structure depicted in Figure 3 reflects both good international practice and local conditions. It provides for three main changes over the current structure that would strengthen tax administration. First, a stronger taxpayer services section would be created to provide taxpayers with high-quality support and assistance in an active and taxpayer-centered manner. Second, creating a strong RMU would improve risk focus and would also separate the responsibilities for selecting taxpayers for audit and for conducting the audits. Third, a technical support unit would provide advice and assistance to auditors in international tax matters and

other complex tax issues. An in-house legal section could support these new services staff and would also advise auditors dealing with more difficult cases and legal queries. Finally, the compliance sections would be re-organized fully on industry sector-specific lines that would support the development of specialized compliance programs to administer key industries.⁷ Taken together, these changes would put in place the organizational foundations needed to support better compliance and revenue collection from large taxpayers.

Figure 3. Organization Structure Proposal for the Large Taxpayer Office



B. Creating an Account Manager Function

74. An important initiative adopted by many large taxpayer administrations is the creation of a new job category entitled “account manager.” Building on the concept of the LTO’s “one-stop tax service inspectors,” the new taxpayer services section would over time include key account managers who would be organized in industry specific units and assigned a group of taxpayers to whom they provide a “single point of contact” into the LTO. Staff members carrying out this role are expected to provide a broad range of services to their clients in a more proactive and service-oriented manner with greater knowledge of how the tax laws apply to a particular industry.

⁷ Only two sectoral compliance sections exist at the moment—insurance and banking and finance.

75. Their duties would involve (a) ensuring that all requests and queries by a large taxpayer (involving legislation, interpretations, tax refunds, etc.) are addressed within a stipulated period of time; (b) proactively updating taxpayers on changes in tax laws and other matters affecting their tax affairs; (c) making initial contact with delinquent taxpayers to ascertain why returns or payments have not been submitted on time; (d) accompanying auditors on an introductory meeting before an audit commences; and (e) providing the proposed Risk Management Unit with information on taxpayers' activities. The creation of these posts could be phased in once the basic structure shown in Figure 3 was in place.

76. Relationships with industry groups, practitioners, and financial advisors can be used to influence tax compliance. Many tax agencies actively develop relationships with external stakeholder groups such as taxpayer associations, industry groups, and accounting societies. To this end, the LTO managers and the taxpayer services section could usefully hold regular meetings with such bodies to better understand their specific business environments and gain insights into their perspectives on key tax issues.

C. Up-Skilling Large Taxpayer Office Personnel

77. The skills needed for audit and control of large taxpayers are not fully in place. Auditors enter the LTO with either an economics or legal degree. In either case, their knowledge of taxation is likely to be based on principles rather than practice.⁸ Drawing connections between the records of a business, its books of account and the reliability of its tax declarations therefore needs to be taught to new entrants in most tax administrations. Basic training should be delivered before any person attempts his or her first audit, covering the basics of each tax and the simpler audit techniques. Training on intermediate and advanced topics would follow, including international taxation and anti-avoidance. This can be done in-house, or by partnership with a relevant professional institute or a combination of both methods.

78. NAFA has a training tradition that could be adapted to develop at least some of the skills needed. In-house training has been provided in the past in basic taxation and such training sessions normally included an examination. After induction, auditors can normally expect to move through three levels of responsibility over a period of about nine years with attendant pay increases. Career progression could be linked to attendance at suitable training modules and passing the examinations. Although the Human Resources Department would have to put effort and funds into developing the right curriculum, there would likely be a high return on this investment.

⁸ The LTO has some skill in risk analysis, transfer pricing and computer audit techniques, but not enough. There is no structured modular training that would lead to expertise in tax-technical areas or in depth analysis of business records and accounts.

D. Taking Advantage of Information Technology

79. Improved IT support would allow a better-trained staff to do higher quality work across a range of tasks. Areas where IT produces a big payback include taxpayer accounting, record keeping, debt analysis and collection, refund management and audit. The mission observed that many of the basic processes are heavily reliant on clerical staff and that running the LTO produces a mountain of paper. IT generally helps manage high volume low value work. Freeing staff from these tasks through electronic case working would release resources for compliance work. Regarding compliance, only 12 licenses exist in the LTO for the Access Control List computer package that greatly speeds up routine audits, particularly for VAT. That is not a sufficiently high rate of usage to create a sustainable community of users in this key area.

80. The LTO must specify its operational and functional IT needs in the context of the development of the new IT system. Re-development of the IT system will begin soon under the WB RAMP project. It would be possible to create the structure shown in Figure 3 gradually using existing IT systems. The operation of the structure would be improved as the WB project is implemented; but the WB project must have continual input from the LTO to get the maximum value from new systems. It would be good if the LTO would have a small IT unit consisting of systems and business analyst to enable it to articulate its IT business needs to systems developers. It is essential to clearly specify the functional requirements for the new IT system. With some IT skills in-house, the LTO could play its proper role in influencing the detailed design of its new IT system to ensure that it fully supports contemporary large taxpayer administration.

E. Providing More Autonomy to the Large Taxpayer Office

81. The LTO needs more autonomy. Despite its importance, the LTO is “methodologically subordinated” to NAFA’s normal procedures. It is a principle of modern tax administration that the tax treatment of different groups of taxpayers is tailored to their significance, their trustworthiness, and their operating environment. In all these respects, large companies are very different from smaller businesses and it is normal for LTOs to have the competences to develop their own methodologies in specialist areas. Thus, providing the LTO with an organizational autonomy that is similar to regional offices, and combining this with competences to develop methodologies that match the need for the effective and efficient administration of large taxpayers, likely would lead to a higher level of tax compliance within this segment over time.

F. Recommendations

82. These are the recommendations for selected LTO issues:

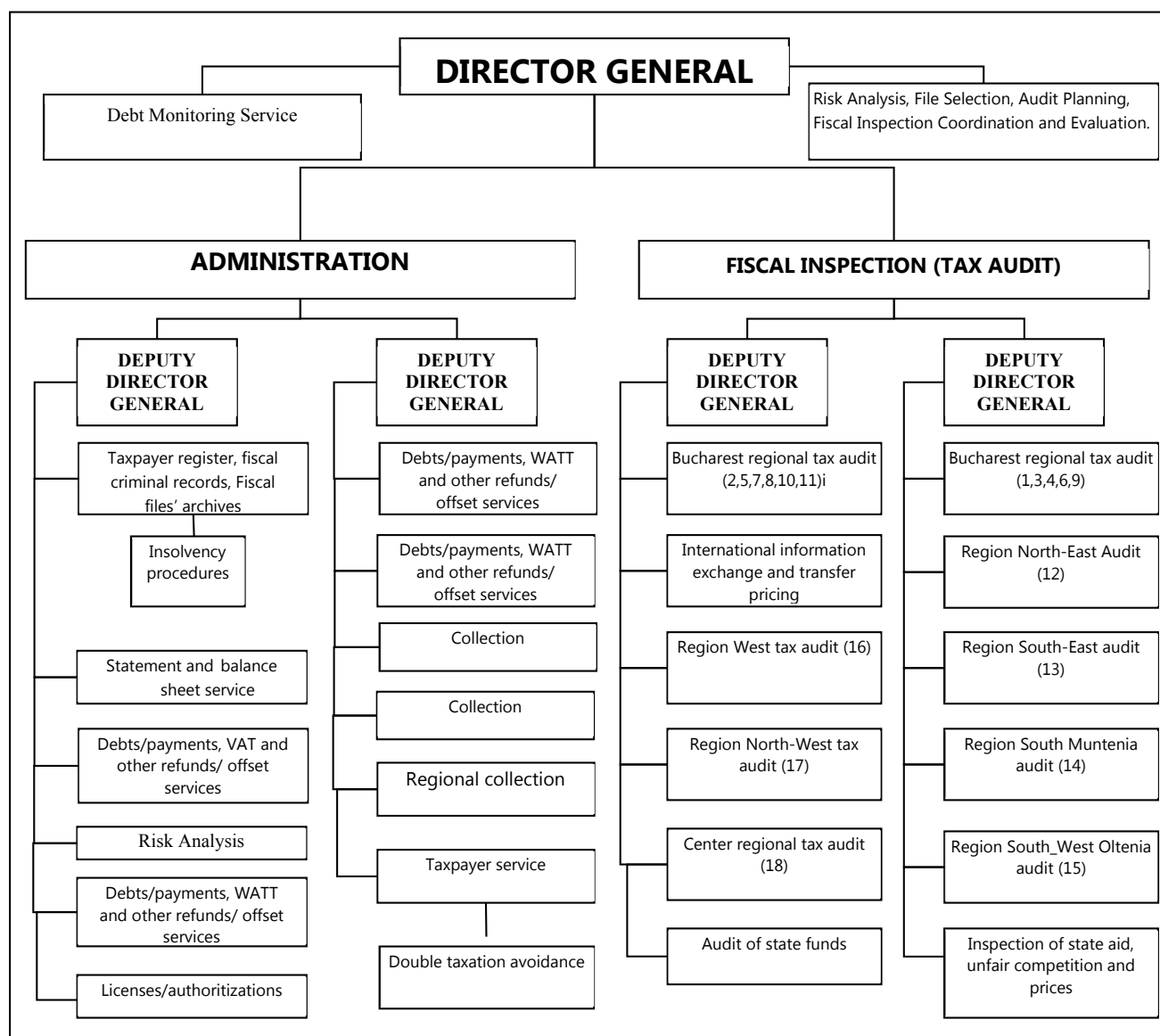
- Adjust the LTO structure over time to an industry-sectoral basis.
- Add legal expertise to the LTO headquarters.
- Improve auditor training using a combination of in-house and external trainers to include training in risk assessment techniques through structured, modular programs covering taxes and risk management processes, including basic and advanced audit skills.

- Ensure that LTO top managers and the Training Department in NAFA work together to build risk assessment training into relevant programs by specifying levels of need for specific duties, and the content and timing of training.
- Train more audit staff in the use of e-audit techniques and software and increase the number of licenses to match.
- Strengthen taxpayer services, including phasing in the use of account managers.
- Set up a management group in the LTO to identify, specify, and implement the best possible IT architecture for the LTO under the RAMP program.
- Add in-house IT expertise to the LTO headquarters.
- Develop permanent, structured forums for exchanging views with taxpayer representative bodies and industry associations.
- Provide the LTO with an organizational autonomy similar to NAFA regional offices and relax its “methodological subordination” to standard NAFA practices to allow it to develop service and compliance approaches suitable for large taxpayer management.

Appendix I. Overview of Large Taxpayer Office Organization and Other Issues

The LTO manages just under 50 percent of NAFA's tax revenues and accounts for some 30 percent of tax arrears. In monetary terms, it collected RON 91,091 million in 2014 out of a total NAFA collection of RON 182,546 million. Its share of arrears was RON 5,204 million from a total of RON 16,988 million. Its organization is shown in the table below:

Current Organization of the Large Taxpayer Office



Its staffing level is modest. With 598 officers in place from an authorized establishment of 641, it uses about 2.5 percent of NAFA's personnel. There are 332 tax inspectors in the LTO, with staff assigned to management, administrative and support functions filling the remaining 266 positions.

The LTO currently manages 2,392 large businesses. These taxpayers share of total taxes collected by NAFA is under 50 percent. The tax share managed by the LTO could be increased by using better selection rules while at the same time reducing the total of businesses under control (see Section II).

Organizationally, the guiding principle is that of geography. Nine audit units handle eighteen audit teams. Of these, sixteen are based on territorial boundaries and only two (insurance and banking) are organized by economic sector. Eleven audit teams are based in Bucharest (including the insurance and banking teams) with the remaining seven based in the regions but under direct LTO control.

As well as audit management, a substantial LTO HQ in Bucharest handles administrative and support functions including elements of risk analysis. These administrative functions include registration, file maintenance, taxpayer service, debt management and enforcement.

There is support for the LTO in the business community. A well-attended meeting with 'Big 4' accountancy firms showed that there is strong support for continuing the development of the LTO along modern lines. The higher level of skill and confidence displayed by its auditors was seen as a strong positive factor for business and its support in terms of offering opinions on technical issues was welcomed as something to be built upon.

Appendix II. Overview of Large Taxpayer Office Business by Sector and Revenue

| Business Sector ¹ | Taxpayers | | Revenue 2014 | |
|---|-------------------------|--------------------------------|-----------------------|------------------|
| | Number of LTO Taxpayers | Percent of Total LTO Taxpayers | Amount (Billions Leu) | Percent of Total |
| A Agriculture, forestry, and fishing | 60 | 2.39 | 0.74 | 0.82 |
| B Mining and quarrying | 28 | 1.11 | 13.26 | 14.62 |
| C Manufacturing | 721 | 28.69 | 19.63 | 21.64 |
| D Electricity, gas, steam, and air conditioning supply | 89 | 3.54 | 6.07 | 6.69 |
| E Water supply; sewerage; waste management, and remediation activities | 67 | 2.67 | 1.09 | 1.21 |
| F Construction | 175 | 6.96 | 2.18 | 2.40 |
| G Wholesale and retail trade; repair of motor vehicles and motorcycles | 787 | 31.32 | 30.22 | 33.32 |
| H Transporting and storage | 133 | 5.29 | 4.11 | 4.53 |
| I Accommodation and food service activities | 13 | 0.52 | 0.29 | 0.32 |
| J Information and communication | 79 | 3.14 | 4.21 | 4.64 |
| K Financial and insurance activities | 124 | 4.93 | 4.22 | 4.65 |
| L Real estate activities | 17 | 0.68 | 0.28 | 0.31 |
| M Professional, scientific, and technical activities | 93 | 3.70 | 2.20 | 2.42 |
| N Administrative and support service activities | 53 | 2.11 | 1.11 | 1.23 |
| O Public administration and defense; compulsory social security | 1 | 0.04 | 0.42 | 0.46 |
| P Education | 1 | 0.04 | 0.01 | 0.01 |
| Q Human health and social work activities | 9 | 0.36 | 0.15 | 0.16 |
| R Arts, entertainment, and recreation | 21 | 0.84 | 0.43 | 0.48 |
| S Other services activities | 1 | .004 | 0.00 | 0.00 |
| T Activities of households as employers; undifferentiated goods—and services—producing activities of households for own use | | | | |
| U Activities of extraterritorial organizations and bodies | | | | |
| Total | 2,472 | 98.37 | 90.62 | 99.91 |

Source: National Agency for Fiscal Administration.

¹ For example, as classified by Nomenclature statistique des Activités économiques dans la Communauté Européenne (EU economic codes), established by EP/Council Regulation No 1893/2006 or other classifications in use in Romania.

The risk differentiation framework

To help us assess your tax compliance risk and determine how we engage with you

HOW DO WE MANAGE TAX RISK?

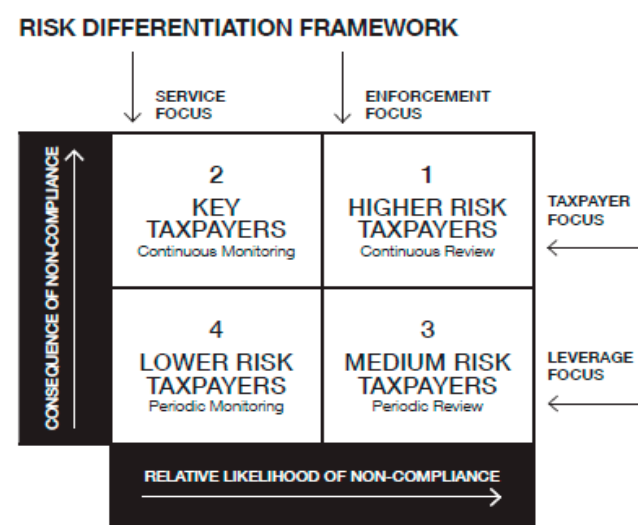
We use the Risk Differentiation Framework (RDF) approach to help us assess your tax risk and determine the intensity of our response in a coherent, consistent and considered way. It complements the compliance model which suggests an appropriate choice of remedy.

The RDF is based on the premise that our risk management approach will be different based on our perception of both your estimated:

- likelihood of non-compliance (that is, having a tax outcome we don't agree with)
- consequences (dollars, relativities, reputation, precedent of that non-compliance).

Using the framework, we place you into one of four broad risk categories (higher risk, medium risk, key taxpayer and lower risk) for each tax type (income tax, GST and excise).

Our risk rating does not in any way influence the outcome of a possible risk review, but it does influence the likelihood of a review and the formality and intensity of it.



Quadrant 1 – higher risk taxpayers

For our higher risk taxpayers the framework suggests a real time/continuous risk review stance to enable us to identify and assess risks as they arise.

There will always be a small number of taxpayers who we see as having a higher relative risk because of, for example, their relative size, the nature of the transactions they undertake, their apparent effective tax rate or their compliance history.

The Commissioner notes:

Certainty for these taxpayers is not in relation to their tax position but rather a certainty that they will be reviewed by us. Such an experience will be fair and professional but may also be quite formal and intense.

(Speech by Michael D'Ascenzo, Commissioner of Taxation, 22nd Australasian Tax Teachers Association Conference, Sydney, 22 January 2010)

We will assign sufficient resources to enable us to identify and understand any significant transactions that have the potential for tax planning, so that we can quickly form a view on their appropriate tax treatment.

While we take all relevant facts and circumstances of a case into account, for higher risk taxpayers we are more likely to use our formal powers of information gathering.

Quadrant 2 – key taxpayers

For our key taxpayers the framework suggests a continuous monitoring stance.

Most of Australia's largest businesses fall into this category and they have significant influence on the tax system.

If you are a key taxpayer, what you do matters a great deal to the overall health of the tax system. Hence we have

a particularly keen interest in your risk management and governance frameworks to mitigate tax compliance risks.

As a key taxpayer you are more likely to have approached us for a ruling in regard to a controversial or contentious tax matter and we aim to service your requests promptly to provide certainty



Australian Government
Australian Taxation Office

THE RISK DIFFERENTIATION FRAMEWORK

We are less likely to use our formal powers of access and questioning and our choice of remedy for non-compliance is more likely to involve alternative dispute resolution approaches where this is appropriate.

Annual compliance arrangements (ACAs) provide key taxpayers with certainty and reduced compliance costs.

Quadrant 3 – medium risk taxpayers

If you are a medium risk taxpayer, the framework suggests a more periodic review stance.

We may involve you in specific risk reviews, where we follow-up matters of concern relating to specific issues. These are generally issues identified in our compliance program.

These reviews are likely to be part of a compliance project involving other businesses with similar issues. This approach helps us to consistently address the issue across the market and reduce compliance costs for you.

Quadrant 4 – lower risk taxpayers

The majority of large businesses have a lower risk rating.

If you are a lower risk taxpayer, the framework suggests a periodic monitoring stance. This can involve activities such as:

- targeted information about specific issues we have identified in the market
- visiting you
- our normal internal risk review process of monitoring your tax activities.

If we consider you are in this risk category, you are unlikely to be contacted for additional information and less likely to have significant matters of concern requiring follow up.

HOW IS THE FRAMEWORK APPLIED?

We use the framework to make our decisions about who we will risk review and why. In doing this, we understand that relevant facts and circumstances need to be taken into account.

If we have a concern about your risk rating, we will discuss it with you. As your rating is reviewed at least annually, you may shift across risk categories over time as the information we have to form a view of your relative risk changes.

HOW DO WE RISK ASSESS LARGE BUSINESSES?

The value, volume and complexity of transactions undertaken by large businesses have inherent risks for tax compliance.

We apply a level of risk analysis to all large businesses.

Our overall approach is to closely examine significant transactions and business results that show inconsistencies between tax and the economic outcomes.

Specific compliance risks we are focusing on include:

- profit shifting through transfer pricing, thin capitalization and debt generation
- material transactions such as mergers, acquisitions and business restructures that allow for opportunistic tax planning.



For information about issues we are focusing on, visit our website at www.ato.gov.au/complianceprogram

Using a range of risk filters, listed below, we profile your business twice a year against your previous results and data from other businesses (both domestic and international). This will place you into one of the four risk categories.

We look at:

- your past compliance behavior
- your tax task management governance
- your business performance over time compared to your tax outcomes and that of your peers
- issues identified by our specialist areas and intelligence gathering, particularly for significant transactions that allow for opportunistic tax planning, such as a material merger, acquisition or disposal
- intelligence from our industry segments on industry performance and its relationship to tax risks including patterns and trends in tax performance
- intelligence from overseas tax administrations and from Joint International Tax Shelter Information Centre (JITSIC)
- Intelligence from other government agencies such as the Australian Securities and Investments Commission (ASIC) and publicly available information
- Risks arising out of the implementation of new tax law
- Your level of international dealings and the tax outcomes derived from such dealings over time and compared to the functions performed, assets used and risks accepted

We also undertake special research programs to improve our understanding of issues impacting on your compliance and better identify high risk cases.



This information is from the *Large business and tax compliance booklet*. For a copy of the booklet, visit www.ato.gov.au/lbtc

OUR COMMITMENT TO YOU

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